



SWP



**13th Annual Conference on
“The Taiwan Issue in China-Europe Relations”**

Shanghai, China

October 9 – 11, 2016

A workshop jointly organised by the German Institute for International and Security Affairs / Stiftung Wissenschaft und Politik (SWP), Berlin and the Shanghai Institutes for International Studies (SIIS), Shanghai. With friendly support of the Friedrich-Ebert-Stiftung (Shanghai Office).

Discussion Paper

Do not cite or quote without author's permission

**A Trade Diplomacy Triangle?
Cross-Strait Relations and EU-China / EU-Taiwan Relations
in the Past Year**

Maaïke Okano-Heijmans
Clingendael Institute
The Hague

A Trade Diplomacy Triangle? Cross-Strait Relations and EU-China / EU-Taiwan Relations in the Past Year

Maaïke Okano-Heijmans

This paper addresses recent developments in EU-China-Taiwan relations in the field of trade diplomacy.¹ It assesses the consequences of change in cross-Strait relations and of the proliferating trade diplomacy in East Asia for EU-China and EU-Taiwan economic cooperation. Particular focus goes out to developments since the launch of the EU's new trade strategy in October 2015 and the rise to power of the Tsai Ing-wen government in Taiwan in 2016. Negotiations on a Comprehensive Agreement on Investment (CAI) between the EU and China have been underway since 2014. While reiterating its commitment to the 'one China' policy, the EU in 2015 declared itself open to similar talks with Taiwan. How do cross-Strait relations influence these two processes and what are the EU's main aims and considerations in these talks? And what are the prospects of these agreements successfully being completed in the foreseeable future, with what consequences for each of the three sides?

Better understanding of these issues is of importance as cross-Strait relations are going through a period of uncertainty, and as the EU is reconsidering its foreign and security policies — including towards Asia. China and the EU are increasingly intertwined through trade and investment, and the Chinese government is reshaping global trade and investment patterns as well as global economic governance. China is investing heavily in EU — roughly 20 billion euros in total in 2015, or half of what the EU invested in China that same year. Both sides thus have much to gain from positive engagement, and choices on how one side wishes to govern the domestic economy, bilateral relations and the international order also impact the other.

European companies and institutions at both the EU and at member state level are (and want to continue to be) positive engagers of China, as well as of Taiwan. More so than some others — including the United States and Japan — they are welcoming a greater role of China in the global economy and in global economic governance. This is evident, for example, from participation in the Asian Infrastructure Investment Bank (AIIB); multi-level engagement on China's flagship One Belt One Road (OBOR) strategy; the relatively open stance to Chinese investment in Europe; EU-China negotiations in the CAI; consultations on Connectivity; and openness to China's participation in the Trade in Services

¹ This paper builds on the Clingendael Report by Maaïke Okano-Heijmans, Sander Wit and Frans-Paul van der Putten, *Cross-Strait Relations and Trade Diplomacy in East Asia — Towards Greater EU-Taiwan Economic Cooperation?*, The Hague: Clingendael Institute, March 2015. Available [online](#).

Agreement (TiSA). Recently, however, European players (both at EU and Member State level) feel challenged to maintain their open stance towards China. The Chinese domestic environment is becoming increasingly more difficult for European companies to operate in, generally providing less security — due to new, arbitrary laws — and weak protection through the rule of law. European governments are concerned by the reversing trend of reform in China on certain fronts and the fact that standards are increasingly up for debate. These developments are making it more difficult for European companies to invest. Such sentiments play into the EU's stance on trade diplomacy, which is becoming more politicized as a whole — including towards mainland China and Taiwan.

Cross-Strait Developments and Trade Diplomacy

In recent years the strengthening of cross-Strait economic relations created new opportunities for Taiwan's intra- and interregional trade diplomacy. In particular, the Economic Cooperation Framework Agreement (ECFA, 2010) and subsequent economic agreements between mainland China and Taiwan facilitated negotiations on preferential trade liberalization of Taiwan with third parties. Economic deals were concluded with Singapore and New Zealand (both in 2013), Japan (2011-2013) and several Latin American countries (2004-2008). One important motivation for the Taiwanese government to invest in such trade diplomacy is that Taiwan is losing out economically as bilateral and (inter)regional negotiations on trade and investment agreements proliferate in East Asia and beyond, largely without Taipei being part of them.

This favourable political climate deteriorated, however, with the staggering defeat of the then-ruling KMT — first in Taiwan's local elections (November 2014) and then in the island's general election in January 2016. The inauguration in May of the DPP government led by Tsai Ing-wen has put a big question mark over the future of cross-Strait relations and Taiwan's trade diplomacy. In June 2016 China unilaterally announced a freeze of bilateral relations until Tsai acknowledges the so-called 1992 Consensus.² Clearly, Beijing is not afraid of using its political clout to influence Taiwan and willing to return to its tactics of slowing or blocking economic agreements, as it did before the deepening of cross-Strait economic relations under the previous KMT-government. This narrower window of opportunity for Taiwanese trade diplomacy is of consequence in

² The '1992 Consensus' acknowledges there is only 'one China' while allowing the two sides to describe what this means in their own way. While stating that she wants to maintain the status quo in Cross-strait relations, Tsai has not accepted this formula — neither during her campaign, nor in her acceptance speech in May 2016. Although Tsai now appears to eschew the phrasing of this understanding while embracing its substance, it is highly questionable that this will satisfy Beijing.

particular to the opening — as well as closing — of any economic talks, including possible EU-Taiwan negotiations. After all, these public and formal instances are politically most sensitive.

As the new Tsai administration is yet to provide more clarity on how it wishes to govern Cross-strait ties, Beijing is expressing its displeasure and repeating previous warnings that it will not tolerate any move by Taiwan toward independence. The chill in relations across the Strait is reportedly also having an impact on third countries that maintain formal diplomatic ties with China and simultaneous friendly relations with Taiwan. For example, Beijing is now more likely to protest against states that exchange high-level representatives with the island.

Even before the chill in cross-Strait relations, Taiwan was forced to look more actively to other trade partners. Decreasing demand from mainland China for Taiwan's exports due to slowing Chinese growth and the development of its own supply sources, which replace some of the demand for imports from the island, pushed the Taiwanese in this direction. The government is thus attempting to gain formal consent from China to join regional cooperative efforts in East Asia and potentially also to link with countries and regions elsewhere. First and foremost, the new administration is hoping to join the US-led Trans-Pacific Partnership (TPP). Taiwan is eager to become a member in the second round — after the initial 12 countries ratify the agreement — seeing this as a way to integrate its economy even more closely in the global supply chain. The changing trade patterns across the strait have also contributed to Tsai Ing-Wen's co-called 'New South-bound' policy — that pushes Taiwanese businessmen to Southeast Asian nations — as well as to attempts to bolster Taiwanese exports to Japan, India and in due time even Iran. Better access to the world's biggest single market, the EU, has also been high on the Taiwanese government's wish list for several years already.

Only recently, efforts by Members of the European Parliament and the Taiwanese government to move towards opening of negotiations on an EU-Taiwan economic agreement are paying off. Last October, the EU committed itself to exploring launching negotiations with Taiwan, building on talks with China. This is coming after years in which the EU has been — as it continues to be — preoccupied with other negotiations, notably the Transatlantic Trade and Investment Partnership (TTIP) and the EU-Japan agreement. Complementing staffing constraints at DG Trade, (real and perceived) Chinese sensitivity about Taiwan's international manoeuvring have been reasons why even informal talks on an EU-Taiwan economic agreement did not start.

Political context aside, economic rationale is the key determinant of which partners the EU negotiates with. That is to say, from the EU-perspective, the launch of negotiations on investment with Taiwan hinges on the ability of the

Taiwanese government to overcome domestic opposition, particularly from the agricultural lobby. European stakeholders have repeatedly expressed concern about specific market barriers. And they are not the only ones: Taiwan ranks 65th for ease of cross-border trade — compared to 96th place for mainland China³ — which should be distressing for an island that largely depends on trade for its prosperity.

The EU Strategizing?

For decades a guardian of trade multilateralism under the flag of the World Trade Organization (WTO), the EU has in recent years joined the bandwagon of bilateral and regional trade negotiations. The stalemate in the multilateral WTO Doha Development Round negotiations in particular brought home the fact that trade is not just about trade (or economic calculations more broadly) — not least in relations with Asia-Pacific countries. The EU has thus started to look for alternative ways to guarantee better access to third countries' markets. To this end, it embarked on a variety of bilateral and regional talks with priority countries. In addition, the EU plays an active part in plurilateral initiatives on sector-specific trade liberalization, including the Trade in Services Agreement (TiSA), the Environmental Goods Agreement (EGA); and the Agreement on Government Procurement (GPA). At the same time, trade negotiations have come to involve also political and normative issues of norm-setting, rivalry for influence, strengthening of partnerships, and resource allocation. A cursory overview of key policy-documents illustrates this shift in EU strategy.

Trade Strategy, China Strategy and Global Strategy

In its latest trade strategy of October 2015, the EU Commission (DG Trade) reinforces the role of trade policy as the main contributor to promoting growth, jobs and investment in the Union.⁴ Newer is the explication of international trade tools to promote its own values and policies and to expand its own regulatory practices to the rest of the world. Indeed, the 'promotion of European values' — including sustainable development, good governance, respect for the environment and human rights — is one of the three pillars of the new EU trade strategy. The EU also expresses its commitment to conclude ongoing talks on a Comprehensive Agreement on Investment (CAI) with China and, 'building on the investment

³ World Bank, *Doing Business*, 12 July 2016, p. 238, available [online](#). It should be noted that on the overall assessment of the ease of doing business, Taiwan ranks 11th and China 84th.

⁴ European Commission, *Trade for All: Towards a More Responsible Trade and Investment Policy*, Brussels: Directorate-General for Trade, October 2015, available [online](#). References from p. 5, 23 and 31, amongst others.

provisions under negotiation with China’, to explore launching negotiations on investment with Taiwan (as well as Hong Kong).

For its part, the EU’s new China strategy confirms the CAI as an immediate priority of the EU towards the objective of deepening and rebalancing its relationship with China, as well as its intention to exploring the launch of negotiations with Taiwan.⁵ The European External Action Service — which published this China strategy in June 2016 — confirms the EU’s commitment to its ‘one China’ policy and vows continued support for the constructive development of cross-Strait relations as part of keeping the Asia-Pacific region at peace. In addition, the EU declares itself committed to continuing to develop its relations with Taiwan and to supporting the shared values underpinning its systems of governance.

In its Global Strategy of June 2016, the EU emphasises the need for collective investment in a credible, responsive and joined-up Union:⁶ the EU ‘needs to be more joined up across [its] external policies, between Member States and EU institutions, and between the internal and external dimensions of [its] policies.’ While a joined-up approach is said to be particularly relevant to the implementation of the Sustainable Development Goals, migration and security, it is equally relevant to EU-China relations. Also here, the call for more coherent policies of the EU and its Member States is oft-heard. Relatedly, the Global Strategy vows to deepen economic diplomacy and to scale up the EU’s security role in Asia — engaging China based on respect for rule of law, both domestically and internationally.

A crucial point to be distilled from all three strategy documents is the fact that the EU is coming to terms with the fact that trade is no longer just about trade. This constitutes a fundamental shift from earlier times, when the EU was hardly willing to move beyond the separation of economics and politics/security — a stance that was still noticeable in the EU-China Summit Joint Statement (2015) and EU-China 2020 Strategic Agenda. Other than in the three above-mentioned recent strategies, the shift in EU policy is reflected in recent efforts to develop a European economic diplomacy as well as in the EU-China Connectivity Platform.

⁵ European Commission, *Elements for a new EU strategy on China*, Joint communication to the European Parliament and Council, Brussels: European External Action Service, 22 June 2016, available [online](#). References in the text from pages 4 and 6.

⁶ European Commission, *Shared Vision, Common Action: A Stronger Europe*, A Global Strategy for the European Union’s Foreign and Security Policy, Brussels: European External Action Service, June 2016, available [online](#). References in the text from pages 10-11.

The China-EU-Taiwan Triangle

Europe is thus strengthening efforts to develop a coordinated, long-term perspective on trade and economic diplomacy. Its main objectives are to ensure a level-playing field for European companies; to ensure reciprocity in economic relations; and to uphold standards and values that developed based on its own lessons learned. Asian countries play an important part in the EU's trade and economic diplomacy, as illustrated by the fact that seven out the EU's 20 biggest trade partners are from this region (see also table 1 below — which excludes Hong Kong and Singapore). It is thus hardly surprising that the EU inked its first free-trade agreement in Asia with South Korea, back in 2011. This agreement is often referred to as the first 'new generation FTA, going far beyond tariff cuts and trade in goods. In addition, the EU concluded a deal with Vietnam in late 2015, while negotiations continue with other countries in the region, including Japan, India, Malaysia, and of course, China.

While expected economic benefits are key in determining what partners to negotiate with, political considerations are increasingly considered as well. Important in the East Asian context, is the EU's stake in the region's stability — as shown by official statements in recent years, in which the EU expressed concern regarding rising tensions in East Asia's maritime areas, in which both China and Taiwan are stakeholders. More specifically, various EU statements since 2010 welcomed concrete and positive steps in cross-Strait relations.

Table 1: The EU's trade in goods with some of its main Asian partners in 2015 (in billions of Euros)

	China	Japan	South Korea	India	Taiwan
Export from EU	170.4	56.5	47.9	38.1	18.4
Import to EU	350.4	59.7	42.3	39.4	25.5
Trade volume	430.8	116.2	90.2	77.5	43.9
Balance	-180.0	-3.2	5.5	-1.3	-7.1
Rank*	(2) 14.9%	(7) 3.4%	(8) 2.6%	(10) 2.2%	(18) 1.2%

* The rank and accompanying percentages concern trade with external, non-EU markets in 2015.
Source: [Eurostat](#) / [DG Trade](#), 2016

Key economic issues in the EU's relationship with China involve impediments on the Chinese market — notably with regard to joint venture requirements, the investment catalogue, and new (security) legislation. Illustrative of the challenges facing European companies, is the fact that the EU's trade is deficit widening — including in the service sector, where there are great opportunities for European

countries in China, at least in theory. Also of concern to EU policymakers are elements of Chinese activities in Europe and neighbouring third countries, especially concerning government procurement, financial support from government, labour rights, transparency, and sustainable development.

The investment agreement that the EU and China have been negotiating since 2014 will replace the existing bilateral agreements that most EU Member States have with China. The EU's aim is for a comprehensive agreement, including not only investment protection but also liberalization. As difficulties of doing business on the Chinese market grow on certain fronts, an increasing number of policymakers and other stakeholders voices the opinion that the EU should be more confident in its negotiations with China, including in its bilateral CAI negotiations. The EU should demand reciprocity from China — that is, be brave enough to set demands in negotiations, for example. While China may have little to gain from an investment agreement with the EU under current market conditions — which are very forthcoming to third countries, including China — Beijing should be wary of the possibility that the EU market may be less welcoming of foreign investment, especially from state-owned enterprises.

With EU-China investment negotiations firmly underway, the road has been cleared to also initiate talks with Taiwan — at least in theory. As stated earlier, the EU has now formally committed itself to exploring the launch of EU-Taiwan negotiations. As stated in new Trade Strategy, talks with Taiwan will move on a par with EU-China talks — meaning that initially, they would involve investment talks, while talks on a more comprehensive deal could follow later. The intensification of EU-Taiwan consultations in recent years — firmly within the constraints of the 'one China' policy — further contributes to the positive momentum.

Most recently, at the annual Mid Term Review held in Taipei in June this year, the two sides assessed progress in their cooperation — including on investment. These regular meetings did not yet constitute a formal move towards the opening of negotiations on an EU-Taiwan investment agreement, however. As some EU officials comment: 'We are not there yet'. Amongst other things, this has to do with Taiwan's reportedly 'low level of ambition': the EU continues to ask for greater market access — especially on sanitary and phytosanitary measures (SPS) and on agriculture is an issue — but the Taiwanese government appears not ready to give in. Another factor is the EU negotiators' aim for coherence between the CAI with China and investment agreements with Taiwan and Hong Kong — suggesting that more clarity on the outcomes of EU-China talks is needed.

While considerate of the 'red lines' imposed by the 'one China' policy, the EU thus appears to have come to terms with the fact that economic relations with Taiwan should not be too much of a political issue. Indeed, the successful conclusion of economic deals between Taiwan and several other countries

suggests that talks with the island may be initiated without angering mainland China, provided that certain conditions are met. These conditions relate to timing — especially in relation to the EU-Taiwan-China triangular relations. The deepening of economic talks between China and Taiwan through the 2010 Economic Framework Agreement (ECFA) and subsequent cross-Strait agreements creates greater space for manoeuvre for Taiwan in its economic relations with other countries. The fact that the EU and China are negotiating a CAI thus constitutes a second crucial enabler, as third parties that wish to negotiate economic agreements with Taiwan should have similar trade agreements and good relations with China.

The potential gains for the EU of an investment agreement with Taiwan are sought first and foremost in the EU-Taiwan economic relationship. While the jury is still out on the exact economic benefits of an accord — including the existing barriers to trade that it is supposed to undo and the possibilities for European companies to use Taiwan as a hub — there is little doubt that both sides stand to gain from such an agreement. This includes elevating existing levels of trade and investment between the EU and Taiwan, delivering growth and jobs in the Union. Furthermore, European consumers stand to gain from enhanced competition between Taiwan and South Korea for the European market. Finally, European investors in Taiwan can reap the opportunities not just from being close to Taiwan's domestic market, but also from Taiwan's industrial landscape and its proximity to mainland China.

Supplementing economic motivations, closer EU-Taiwan economic cooperation may serve political and normative objectives. This conforms with the recent trend in EU trade policy more generally, which is increasingly used also to promote the EU's values and policies and to expand its regulatory practices. In EU-Taiwan relations, one such reason is to help restore the level playing field. After all, Taiwan is losing out on the EU market to competitors — in particular from South Korea and soon from Japan as well — that do have an agreement with the EU in place. An economic accord to help Taiwan would also create a positive environment for increased Taiwanese investment in Europe, which is desirable to spur growth and jobs. Separately, one strategic reason for the EU to initiate talks with Taiwan now that negotiations with China are under way is the prospect of gaining more concessions from both parties, which could bring both accords to a higher level. Third, the EU and its Member States have an interest in furthering regional cooperation and maintaining regional stability — that is to say, to maintain the status quo in cross-Strait relations. Finally, there is value for the EU and its Member States in recognizing the symbolically important role of Taiwan as an open, rules-based economic and democratic system. This means rewarding Taiwan for the significant process throughout recent decades with regard to its political system, the rule of law and human rights.

Final Reflections and Policy Recommendations

Third parties with an interest in stability and prosperity in the East Asian region have reason to see to it that the precarious status quo in cross-Strait relations is maintained. The EU and its Member States may contribute to this goal by supporting an open, sustainable and inclusive economy in China and by promoting economic prosperity and openness in Taiwan, which is also in the interest of mainland China. As China's biggest trade partner and Taiwan's fourth largest trade partner — after China, the United States and Japan — the EU is clearly a relevant player.

In devising its policies, there is value for the EU and its Member States in recognizing the difficult structural transition that China is going through, while continuing to emphasize the need for reciprocal benefit in both economic and political terms. In addition, it is worth levelling the playing field for Taiwanese companies that (wish to) do business in Europe — in an attempt also to attract more Taiwanese investment in the continent — and calling attention to the symbolically important role of Taiwan as a transparent and rules-based economic and democratic system. While confirming its 'one China' policy, the EU may contribute to the stability of cross-Strait negotiations by being a partner in China's reform, by negotiating in parallel EU-China and EU-Taiwan investment agreements, and by supporting Taiwan's participation in international frameworks.