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EU trade diplomacy and the cold peace in cross-Strait relations

Today's uncertainty in cross-Strait relations is not without consequence for third parties that maintain ties with both China and Taiwan. To what extent does (and should) the situation also impact on EU's trade diplomacy with both sides? This Policy Brief argues that under today's circumstances, the cold peace in cross-Strait relations is reason to tread carefully – and to stay on course. While confirming its 'one China' policy, the EU may contribute to the stability of cross-Strait relations by being a partner in China's economic reform and by negotiating EU-China and EU-Taiwan investment agreements in parallel.*

The May 2016 inauguration of the Taiwanese government led by Democratic Progressive Party (DPP) leader Tsai Ing-wen placed a big question mark over the future of cross-Strait relations. Within weeks, Beijing had unilaterally imposed a freeze on (semi-)official talks until the new Taiwanese President acknowledges the so-called 1992 Consensus.¹ Tsai so far appears to be eschewing the phrasing of this formula while

embracing its substance, but it is highly questionable whether this will satisfy Beijing. 'Cold peace' has become the short cut for describing relations across the Taiwan Strait.

Proper understanding of this new uncertainty in cross-Strait relations is important as the European Union (EU) is reconsidering its trade, foreign and security policies – including towards Asia. Choices for how the EU, China and Taiwan wish to govern their respective domestic economies, bilateral relations and the international order also impact upon the other sides, and all parties have much to gain from positive engagement.

Negotiations on a Comprehensive Agreement on Investment (CAI) between the EU and China have been under way since 2014. While reiterating its commitment to the 'one China' policy, the EU in 2015 declared itself open to similar talks with Taiwan. This Clingendael Policy Brief assesses how recent developments in cross-Strait relations influence these two processes, and how EU trade policy may contribute to stability and prosperity in East Asia.

* This Policy Brief builds on a March 2015 [Clingendael Report](#) and on discussions during the 13th Symposium on 'Sino-EU Relations and the Taiwan Question', which was held in Shanghai from 9–11 October 2016 and in Taipei from 12–14 October 2016. These second-track dialogues were supported by the Friedrich Ebert Stiftung, the Shanghai Institute of International Studies and the Taiwanese Ministry of Foreign Affairs.

¹ The '1992 Consensus' acknowledges that 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, President Tsai has not accepted this formula – neither during her campaign, nor in her acceptance speech in May 2016.

Challenges to Positive Engagement

European companies and institutions at both the EU and at member state levels have been positive engagers of China, as well as of Taiwan. More so than some other nations – particularly the United States and Japan – they welcome a greater role by China in the global economy and in global economic governance. This is evident, for example, from EU member states' participation in the Asian Infrastructure Investment Bank (AIIB); multi-level engagement on China's flagship 'One Belt, One Road' (OBOR) strategy; the open stance to Chinese investment in Europe; EU-China negotiations on investment and consultations on connectivity; and openness to China's participation in the Trade in Services Agreement (TiSA).

Recently, however, European players (at both the EU and member state levels) feel challenged about maintaining their open stance towards China. The Chinese domestic environment is becoming increasingly more difficult for European companies to operate in, generally providing less security – because of 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

The strengthening of cross-Strait economic relations in recent years created new opportunities for Taiwan's intra- and interregional trade diplomacy. Specifically, the 2010 Economic Cooperation Framework Agreement (ECFA) and subsequent economic agreements between mainland China and Taiwan facilitated negotiations on the preferential economic liberalization of Taiwan with third parties. 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 Kuomintang (KMT) – first in Taiwan's local elections (in November 2014) and then in the island's general election in January 2016. The inauguration in May 2016 of the DPP government led by Tsai Ing-wen has created uncertainty 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.

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 towards independence. Clearly, Beijing is not afraid of using its political and economic clout to influence Taiwan. 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.

The EU's New (Trade) Policies

A guardian of trade multilateralism under the flag of the World Trade Organization (WTO) for decades, the EU has in recent years joined the bandwagon of bilateral and regional trade negotiations. The stalemate in the multilateral WTO Doha Development Round of 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, regional and plurilateral talks with priority countries. At the same time, trade negotiations have also come to involve political and normative issues of norm-setting, rivalry for influence, the strengthening of partnerships and resource allocation. A cursory review of key policy documents – in particular their references to economic relations with China and Taiwan – illustrates this shift in EU strategy.

Trade Strategy, China Strategy and Global Strategy

In its latest trade strategy of October 2015, the EU (Directorate-General (DG) for Trade) reinforced the role of trade policy as the main contributor to promoting growth, jobs and investment in the Union.² More recent is the clarification 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 expressed its commitment to conclude ongoing talks on a CAI with China and, 'building on the investment 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 of exploring the launch of negotiations with Taiwan.³ The European External Action Service

(EEAS) – 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 emphasizes the need for collective investment in a credible, responsive and cohesive Union:⁴ 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 from the EU and its member states is often heard. Seen in this context, it is unsurprising that 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 the rule of law, both domestically and internationally.

A crucial point to be distilled from all three strategy documents is 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 the EU-China 2020 Strategic Agenda. Other than in the three recent strategies mentioned above, 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.

2 European Commission, *Trade for All: Towards a More Responsible Trade and Investment Policy*, Brussels: Directorate-General for Trade, October 2015, available [online](#). The references are from pp. 5, 23 and 31, among others.

3 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 are from pp. 4 and 6.

4 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 are from pp. 10 and 11.

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
Exports from the EU	170.4	56.5	47.9	38.1	18.4
Imports to the 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.

It should be emphasized that all three EU documents were published before the recent chill in cross-Strait relations – which is not without consequence for third parties' relations with China and Taiwan. While the EU and its member states would do well to tread carefully and follow developments closely, the consequences for the diplomatic space granted by China to Taiwan in the economic field appear limited so far.

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; to safeguard the European social and regulatory model at home; and to promote standards and values in the fields of government, sustainable development, human rights, fair and ethical trade, and the fight against corruption. Asian countries play an important part in the EU's trade and economic diplomacy, as illustrated by the fact that seven of the EU's twenty 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 (FTA) 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 the expected economic benefits are vital in determining which 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. This has been shown by official statements in recent years, in which the EU expressed concern regarding rising tensions in East Asia's maritime areas, where both China and Taiwan are stakeholders. More specifically, various EU statements since 2010 have welcomed concrete and positive steps in cross-Strait relations. Most recently, following the elections in Taiwan, the EU (and some of its member states) in January 2016 reiterated support for the continued peaceful development of cross-Strait relations.

The EU and China have been negotiating a CAI since 2014. This agreement is to replace the existing bilateral agreements that most EU member states have with China. The EU's aim, however, is for a comprehensive agreement that includes not only investment protection, but also liberalization. As the difficulties of doing business in the Chinese market grow on certain fronts, an increasing number of policy-makers and other stakeholders are voicing 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 the demands in negotiations, for example. China may have little to gain from an investment agreement with the EU under current market conditions – which are very accommodating to third countries, including China. However, the EU market could become less welcoming

of foreign investments from state-owned enterprises, which now make up 70 per cent of all Chinese investment in Europe. The German government's approval in October 2016 of the takeover of German robotics giant Kuka by Chinese appliance-maker Midea is illustrative of Europe's continued openness to foreign investment. Notably, however, it is also Berlin that has been most vocal in recent calls for stricter EU regulatory mechanisms that could block takeovers when acquirers are linked to a foreign state.

Key economic issues in the EU's relationship with China involve impediments to the Chinese market – notably with regard to joint venture requirements, equity caps, forced technology transfer, licensing restrictions and new (security) legislation. Illustrative of the challenges facing European companies is the fact that the EU's trade deficit is 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 policy-makers are elements of Chinese activities in Europe and in neighbouring third countries, especially concerning government procurement, financial support from the Chinese government to Chinese companies, labour rights, transparency and sustainable development.

Closing the Triangle?

With the ECFA in place and EU-China investment negotiations firmly under way, the road was also cleared to initiate similar talks with Taiwan. The formal commitment in October 2015 to explore the launch of negotiations with Taiwan – as per the EU's new Trade Strategy – came after years of preoccupation with other negotiations, notably the Transatlantic Trade and Investment Partnership (TTIP) and the EU-Japan agreement (both still ongoing). Complementing this, staffing constraints at DG Trade and (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.

As stated in the Trade Strategy, talks with Taiwan will move on a par with EU-China talks – meaning that they will initially 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.

At the annual Mid-Term Review, which was held in Taipei in June 2016, the two sides assessed progress in their cooperation – including on investment. Challenges remain, however, as talks move towards a formal EU-Taiwan investment agreement. Among 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 – but the Taiwanese side remains unwilling to concede. Another factor is the EU negotiators' aim for coherence between the CAI with China and the investment agreements with Taiwan and Hong Kong, suggesting that more clarity is needed on the outcomes of EU-China talks.

While considerate of the 'red lines' that are imposed by the 'one China' policy, the EU has thus 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. The fact that the EU and China are negotiating a CAI constitutes a second crucial enabler. Notwithstanding the cold peace in cross-Strait relations, indications from the Chinese side are that Beijing will not limit Taiwan's international space, even if it may do so, for example, on visa matters.

Political contexts aside, economic rationale is the key determinant in choosing with which partners the EU negotiates. In other words, the potential gains for the EU of an investment agreement with Taiwan are sought first and foremost in the EU-Taiwan

economic relationship. 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 only from being close to Taiwan's domestic market, but also from Taiwan's industrial landscape and its proximity to mainland China. From the European perspective, a key determinant in proceeding with Taiwan now 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. Moreover, they are not the only ones: Taiwan ranks 65th for ease of cross-border trade – compared to 96th place for mainland China⁵ – which should be distressing for an island that largely depends on trade for its prosperity.

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 objective is to help restore the level playing field. After all, Taiwanese companies are losing out on the EU market to competitors – in particular from South Korea and soon from Japan as well – that do already have an agreement in place with the EU. An economic accord 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 bringing 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 its significant progress throughout recent decades with regard to its political system, the rule of law and human rights.

Maintaining Stability

Third parties with an interest in stability and prosperity in the East Asian region have reason to ensure that peaceful relations are maintained across the Taiwan Strait. 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 experiencing, 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 European 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 relations by being a partner in China's reform and by negotiating EU–China and EU–Taiwan investment agreements in parallel. Under today's circumstances, the cold peace in cross-Strait relations is reason to tread carefully – and to stay on course.

5 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.

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