

SPECIAL ISSUE

CHINA AND BREXIT: WHAT'S IN IT FOR US?

ABOUT

The Chinese have long been obsessed with strategic culture, power balances and geopolitical shifts. Academic institutions, think-tanks, journals and web-based debates are growing in number and quality, giving China's foreign policy breadth and depth.

China Analysis, which is published in both French and English, introduces European audiences to these debates inside China's expert and think-tank world and helps the European policy community understand how China's leadership thinks about domestic and foreign policy issues. While freedom of expression and information remain restricted in China's media, these published sources and debates provide an important way of understanding emerging trends within China.

Each issue of *China Analysis* focuses on a specific theme and draws mainly on Chinese mainland sources. However, it also monitors content in Chinese-language publications from Hong Kong and Taiwan, which occasionally include news and analysis that is not published in the mainland and reflects the diversity of Chinese thinking.

Introduction

by François Godement

Trust today's Chinese international affairs experts to look at issues through the prism of Chinese interest first. This special issue of *China Analysis* looks at the first comments published in China in the wake of the Brexit shock. The authors suggest that most of the losses from Brexit will hit the European Union or the United Kingdom, or both, while China will get most of the gains. This "optimistic" view represents a marked contrast with Japan's gloomy assessments of the Brexit impact. Part of the difference, of course, is down to the fact that China has a very different relationship with the UK than does Japan. Not only has Japan experienced more than a century of friendship and even some kinship with the UK, but its companies have committed to major greenfield investments in the UK. The pound's immediate decline is a blow to their balance sheets, because of higher procurement costs for the UK subsidiaries. Meanwhile, China's investments have been mostly financial (or in real estate), and so Chinese companies could conceivably move out of the UK with less damage. China's love-hate relationship with its former colonial master still endures – and it is striking that the extraordinarily favourable policy of David Cameron and George Osborne gets almost no recognition, aside from the acknowledgement that China will have to find another supporter among EU member states. While Japan has been pleading for a "soft" Brexit – for which read, as little Brexit as can humanly be managed – Chinese commentators seem to be speculating much more directly about the chance of a windfall from a post-Brexit situation. They consider the

division and weakening of the EU, strong free trade deals with the UK (which China's Ministry of Commerce has officially declared to be a possibility), and even a separate deal on Market Economy Status.

Is this a pipe dream? With one insightful exception, our sources do not seem to have taken into account the disarray among British political forces, even within the camp of the winners. Strikingly, no one looks at the EU's possible strategy with regard to the Brexit decision – and yet this is perhaps the single most important factor in determining what is in store for Europe. The Chinese experts have a good excuse: the EU's reaction after Brexit has been disorganised, if not too visibly divided. While immediate speculation has mostly focused on the UK's Brexit shock, the perennial EU issue of “speaking with one voice” is reasserting itself – and that is something of which the Chinese are fully aware, given their own history of dealings with the EU. As we go to print, Jean-Claude Juncker has come out squarely against the possibility of an EU member state engaging in discussions about making its own trade deals outside of the EU.¹ How much the EU is able to stay in the driver's seat, or whether the UK manages to adopt a more nimble strategy, is something that China will need to consider.

¹ “EU chief opposes UK trade talks pre-Brexit”, AFP, 4 September 2016, available at <http://www.globaltimes.cn/content/1004674.shtml>.

Brexit: An opportunity for China?

Angela Stanzel

The United Kingdom's 23 June vote to leave the European Union came as a shock not only to fellow Europeans but also to many in China. For example, Jin Canrong, professor at the School of International Studies of Renmin University, was very surprised by the results; in his opinion, the UK's fate was decided by people's emotions rather than rationality. But not all Chinese observers were surprised, among them Chen Xin, director of the economic division at the Institute of European Studies at the Chinese Academy of Social Sciences, who supported the Leave campaign. He believed that the UK never truly belonged to the EU.² However, with Brexit decided, Chinese commentators, like those elsewhere, are considering the question of what happens next – and what it means for China.

The Chinese voices presented in this paper demonstrate the wide range of opinions in China about the present and the future of Europe, as well as the potential impact of Brexit (英国脱欧, *yingguo tuo ou*) on China. Both Wang Yiwei and Zhu Haibin are concerned that Brexit may have negative consequences for global financial markets and for the Chinese economy. Li Xiaopeng and Zhao Hongwei are more optimistic: they believe that China can benefit from the division of the EU. Feng Zhongping's opinion falls somewhere in between these hopes and fears. He calls on China to carry out a thorough assessment of the new developments and to strengthen its cooperation with the EU and the UK.

A negative economic impact on China

Wang Yiwei says that Brexit poses dangers both for Europe and for China.³ The EU's decline and inability to take care of itself (自顾不暇, *zi gu bu xia*) will have serious consequences for its ability to play a global role. Negotiations on the EU-China bilateral investment agreement and possible free trade agreement (FTA) could be compromised, as could cooperation on the new Silk Route initiative. China might lose the UK as its gateway for EU investment. And London could lose its role as the euro's main financial trading centre, which could cause problems for China: if, for instance, Brussels were to withdraw large amounts of its euros from London, China's euro financing channels in London would be affected, as would the eventual internationalisation of the renminbi.⁴

² Both Jin and Chen are among a group of researchers interviewed by the Chinese news site *Guancha* (观察者网, *guancha zhe wang*) on the Brexit vote. Su Di, Zhong Xiaowen, Li Chuyue, and Ling Mumu, "Nine researchers review Brexit: An historic event", *Guancha zhe wang*, 26 June 2016, available at <http://www.chinaelections.org/article/796/242770.html> (hereafter, Su et al., "Nine researchers review Brexit").

³ Su et al., "Nine researchers review Brexit". Wang Yiwei is a professor at the Institute of International Relations of Renmin University.

⁴ In March 2016, the UK became the biggest clearing centre for renminbi outside greater China. See "UK becomes second-largest offshore Rmb clearing centre", *Financial Times*, 28 April 2016, available at <http://www.ft.com/fastft/2016/04/28/uk-becomes-second->

The situation in Europe as a whole will be uncertain after Brexit, and Wang expects this uncertainty to have a negative impact on the global economy, as well as on China's own. He says that the Western European elite does not understand that the world has changed: emerging countries such as China and India now account for most of the UK's trade. If China and the UK sign a FTA, the UK will increase the attention it gives to China, and China's importance in the world will grow as well.

Like Wang, Zhu Haibin thinks that the UK's vote to leave the EU will have a significant impact on financial markets and the global economy.⁵ However, he says that in view of the complex and time-consuming negotiations that will take place, it may be several years before Britain's exit from the EU is complete, and Brexit's full impact will only gradually be felt.

Zhu warns that Brexit might disrupt China's capital flows, exchange rate, and monetary policies. One risk that could affect China is a capital outflow from emerging market economies. In recent years, China has been considering capital account liberalisation (资本账户开放, *ziben zhanghu kaifang*), but after the Brexit vote, Zhu thinks that Beijing might be cautious about introducing any liberalisation measures that could lead to capital outflows.

Even if Brexit has no direct effect right now on EU-China and UK-China relations, Zhu says that there could be indirect effects. For example, an economic downturn in the UK and the EU would inevitably have an effect on China's future trade with the two. At the same time, he expects the EU and the UK to compete for Chinese investment, which might balance out the indirect impact.

The UK's increased dependence on China

Li Xiaopeng says that Brexit could make the UK less important to Chinese firms – many Chinese companies have set up their European headquarters in the UK, and this may have to change after the exit from Europe.⁶ Moreover, Brexit could reduce the UK's financial influence, which would have negative consequences for the renminbi. But Li thinks that, in fact, these issues may be less important than they seem. Firstly, he trusts that the UK will remain a large economy even after Brexit, and so Chinese firms will still be able to operate from the UK. And he expects that the UK will depend on China after Brexit, which will cause the UK to promote renminbi internationalisation even more.

Li believes that a divided EU will also be more dependent on China, because without the UK, Brussels will have

[largest-offshore-rmb-clearing-centre/](http://www.chinaelections.org/article/910/242774.html).

⁵ Zhu Haibin, "The potential economic impact of Brexit on China and EU-China trade relations", *Aisixiang*, 3 July 2016, available at <http://www.aisixiang.com/data/100528.html>. Zhu is chief China Economist and head of Greater China Economic Research at J.P. Morgan.

⁶ Li Xiaopeng, "China is the biggest winner of the Brexit", *China Elections and Governance*, 24 June 2016, available at <http://www.chinaelections.org/article/910/242774.html>. Li Xiaopeng is an economist and columnist for the website *Chawang*.

fewer bargaining chips in negotiations with Beijing. In addition, Brexit weakens the EU's position on its own values, such as human rights, so Li thinks that Brexit might make Europeans more humble about these values in their dealings with China.

Zhao Hongwei says China has a major diplomatic opportunity to develop a special relationship with the UK after Brexit has taken place.⁷ Firstly, he believes that the UK will be the leading voice in granting China market economy status (MES). As a member of the World Trade Organization, the UK will be able to make an independent decision on granting MES once it has left the EU. Therefore, he urges Chinese diplomats immediately to start trying to make this a reality. However, Zhao does not mention that Brussels has to rule on MES by December 2016, at which point Brexit will not yet have taken place.⁸ It also remains to be seen whether the UK government will continue to advocate strongly for China's market economy in the future. But Zhao has a broader vision for deepened UK-China economic relations. He says that, to promote the British economy, the UK should negotiate a free trade zone with large markets such as China and India, and he notes that Brexit supporters have already put forward this idea.

For Feng Zhongping a more independent UK will be freer to push forward financial and trade deals with China.

Finally, Zhao hopes that Brexit will lead to the end of the EU's arms embargo (武器禁运, *wuqi jin yun*) against China. He notes the EU, has several times, debated lifting the embargo, which was imposed in 1989, but lack of unity among the 28 EU member states has meant the ban has stayed in place. Zhao sees the EU arms embargo as discrimination against China's policies, and he thinks that Brexit presents a great opportunity for China to break out of this political discrimination. If the UK and the EU were to lift the embargo, Zhao thinks it would boost China's relations with both the UK and the EU. However, Zhao seems overly optimistic that the UK will advocate lifting the arms embargo – and even if the UK were to end its ban, it seems unlikely that Brexit would result in the EU lifting its own embargo, since the issue is less about economics and more a matter of sensitive foreign and security policy.

Adjusting Chinese foreign policy

Europe expert Feng Zhongping provides a more balanced analysis of the impact of the Brexit vote on Europe and its implications for China.⁹ He is extremely pessimistic about

the domestic situation within the UK, in particular the weakness and division among the political establishment in a time of crisis. In addition, he writes that the UK is losing the EU as an important platform from which to exert influence on global economic affairs, which will necessarily weaken the UK's international standing. And he expects that the EU, too, will suffer from the loss of the UK in terms of Europe's foreign and security policy standing. Feng believes that through its status as a nuclear power and its seat on the United Nations Security Council, the UK has played an irreplaceable part in building the EU's influence on global foreign and security issues.

Feng then outlines what he sees as the most likely future scenario for UK-China and EU-China relations. Brexit will have disadvantages for the UK-China economic relationship – for example, Chinese firms will likely establish headquarters on the European continent rather than in the UK. But it will also present advantages, because a more independent UK will be freer to push forward financial and trade deals with China. This should result in closer economic and trade cooperation with China.

While UK-China and EU-China relations are generally viewed mainly from an economic perspective, Feng points out that the impact of Brexit on the geo-strategic environment of Europe and China should not be ignored. Feng sees the geopolitical map of Europe being rewritten, with a great power game (大国博弈, *daguo boyi*) taking place between Russia and the United States, and Europe somewhere in between. All this is bound to affect China's geo-strategic environment.

Feng says that China must react to the changes in Europe as a matter of urgency. Despite their major political and cultural differences, Europe and China have no outstanding geopolitical or strategic conflicts, and alongside their deeper economic relationship, Europe and China have also strengthened strategic cooperation on diplomacy and security. China, therefore, needs to fully comprehend the importance of UK-China and EU-China cooperation and to foster ties between the two, while at the same time making efforts to fully assess the impact of Brexit and to adjust its foreign and economic policies accordingly.

Feng seems optimistic that China, the EU, and the UK can deepen their relations even after Brexit, because they all share fundamental interests. Feng does not believe that the EU's economic development will slow significantly in the long term, and he thinks that having China as a partner could further boost the EU's economic growth. But Feng says that the EU is facing immediate social and political difficulties, which highlight even more the necessity and urgency of strengthening EU-China relations, and he calls on China to continue supporting Europe's integration and to make an effort to expand mutual economic cooperation. In particular, China should vigorously promote bilateral

deputy director of China Institutes of Contemporary International Relations (CICIR).

⁷ Su et al, "Nine researchers review Brexit". Zhao Hongwei is a professor at Hosei University in Japan.

⁸ On this issue, see Agatha Kratz, "Time's up: China's Coming Battle for Market Economy Status", *China Analysis Special Issue*, June 2016, and François Godement, "China's Market Economy Status and the European interest", *ECFR Policy Brief*, June 2016. Both are available at http://www.ecfr.eu/article/commentary_chinas_coming_battle_for_market_economy_status_7052.

⁹ Feng Zhongping, "Brexit and its impact on China", *Xiandai Guoji Guanxi*, Vol. 7, 25 July 2016, available at http://www.cicir.ac.cn/chinese/News_7466.html. Feng Zhongping is

investment agreements with the EU, and Feng notes that the EU mentions this explicitly in its recently published document on developing a new China strategy.¹⁰

Furthermore, China should continue to work with the EU on the “One Belt, One Road” initiative and the European Infrastructure Investment Plan (the so-called Juncker plan), and it should promote China’s MES as it does so. Feng says that the EU is reluctant to grant China MES because of trade protectionism, and he warns that the EU could become even more protectionist after Brexit. Therefore, he advises China to continue to work closely with EU member states and institutions on economic issues, and to monitor the EU’s internal debate on its future, taking account of anything that could affect China.

China should also strengthen economic cooperation with the UK, although Feng points out that the future EU-UK economic relationship needs to be determined first, for example with regard to the question of free trade agreements. Therefore, China needs to pay close attention to the future development of EU-UK relations and the impact it might have on China. Finally, Feng says that China needs to seek cooperation with the UK on mutual global interests, such as strengthened cooperation on global governance issues within the framework of the G20. Feng concludes that despite the political and economic challenges the EU and the UK face, China need not necessarily suffer along with them, so long as it adjusts to the changes and maintains positive relations with both the EU and the UK.

Feng Zhongping’s analysis and conclusions for Europe-China relations appear the most balanced among the different opinions presented in this paper, and contrary to most other experts, he does not see much benefit for China in a weakened Europe. Li Xiaopeng and Zhao Hongwei seem to exaggerate the positive outcome Brexit may have for China. But what is certain now is that China has already been affected by the vote for Brexit and the reshuffle in the British government. Just recently, the new government under Prime Minister Theresa May shifted its policies on Chinese investment – something neither these Chinese experts nor any others could have predicted. London delayed approval of the £18 billion Hinkley Point C nuclear power plant out of concerns about China’s 30 percent stake in the highly sensitive nuclear project. The move prompted the Chinese Ambassador to the UK to pronounce in a *Financial Times* article that “the China-UK relationship is at a crucial historical juncture”.¹¹ This might be an overstatement – but this major deal coming into question is nevertheless a huge blow for China, and a direct result of the Brexit referendum.

¹⁰ “Joint Communication to the European Parliament and the Council – Elements for a New EU Strategy on China”, High Representative of the European Union for Foreign Affairs and Security Policy, 22 June 2016, available at http://eeas.europa.eu/china/docs/joint_communication_to_the_european_parliament_and_the_council_-_elements_for_a_new_eu_strategy_on_china.pdf.

¹¹ “Full text of Chinese ambassador Liu Xiaoming article published by Financial Times”, China Daily, 9 August 2016, available at http://europe.chinadaily.com.cn/world/2016-08/09/content_26409320.htm.

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