



CHINA'S RULE AND STANDARD-SETTING AMBITIONS FOR GLOBAL TRADE

Implications for EU trade policy

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KEY FINDINGS

- **Trade policy is a central arena for global economic and geopolitical competition.** The Coronavirus has highlighted China's centrality in global trade and European supply chains. More than ever, European trade competitiveness and resilience require a clear understanding of the trajectory of China's trade policies.
- **Even though bilateral US-China and EU-China trade relations are mired in tensions, China's trade policy is on the march in other regions.** Amidst the US-China trade war and bogged down EU-China trade and investment discussions, China is pushing to invigorate its trade and investment partnerships with emerging market economies in Asia, Africa and Latin America. Much as it did after the 2008/09 global financial crisis, China claims that it can offer a lifeline for emerging market recovery from the economic crisis brought on by the Coronavirus.
- **China's interest and ability to shape global trade standards and rules are on the rise.** The capacity to set trade standards and rules underpins global economic competitiveness. The EU needs to understand these rising Chinese interests and abilities in order to effectively compete.
- **China influences trade rules and standards in three ways: "stalling," "competing" and "circumventing".** China's role in multilateral trade institutions like the WTO allows it to stall on trade standards with which it disagrees; China uses bilateral and regional Free Trade Agreements (FTAs) in the global competition to shape trade rules and standards and to reinforce China as a center of trade gravity; China uses unconventional tools like special economic zones, infrastructure packages, e-commerce initiatives and its own commercial dispute courts to circumvent trade obstacles in emerging market geographies.
- **China's domestic priorities condition its approach to global interdependence in general and to trade policy in particular.** Under Xi Jinping, China's increasingly ambitious trade policies have become a key pillar of support for state-led industrial strategies. As a result of the trade war with the US and the impact of the Corona crisis, China is becoming increasingly wary of the risks of trade and commercial interdependence. It is therefore redoubling efforts to structure trade patterns and trade standards and rules in line with its party-state-centered priorities.
- **This all means that the EU faces major challenges from China's integrated and ambitious trade strategy.** Beyond the current focus on WTO reform and bilateral relationships with China and the US, the EU will need to implement its own comprehensive, unified, and truly global trade agenda.

1. INTRODUCTION

Current EU trade policy vis-à-vis China is focused on stalled bilateral discussions on issues like the EU-China Comprehensive Agreement on Investment and market access. Meanwhile, **the EU-China trade relationship faces important new realities beyond this bilateral framework.** These include multilateral discussions about WTO reform, responding to the fallout of the US-China trade war, and dealing with the regional and global trade implications of the Coronavirus crisis.

The EU today faces a China that pursues an increasingly ambitious trade policy both in terms of geographies and rule- and standard-setting efforts. China's stated goals and actual trade policy reach far beyond traditional economic development interests and include broader geostrategic foreign policy aims as well. This includes efforts to expand its network of formal trade agreements (FTAs) as well as the pursuit of more informal arrangements such as the "Belt and Road initiative" with a strong focus on emerging markets from Southeast Asia to Africa and Latin America. In each of these regions, **China's trade practices will also shape environmental sustainability, labor and competition standards, rules for digital trade and e-commerce, as well as dispute settlement protocols.**

The Corona crisis and the US-China trade war have made China increasingly wary of how it manages international interdependence. How the EU strategically positions itself to compete and cooperate in this new environment of lower levels of interdependence and trade cooperation, one likely increasingly defined by different trade and economic blocs, will be crucial. Yet even against this background of pessimism about interdependence and globalization, China's role in global trade will continue to loom large.

Despite China's growing and assertive role in global trade and commerce, the EU brings impressive strengths to the table in its efforts to shape global trade for the 21st century. Effectively putting those strengths to competitive use will mean looking beyond seemingly intractable bilateral negotiations with China and also concentrating on how to best shape patterns of global and regional trade through the rules and standards that underpin it. This report sets out a framework for exactly such improved understanding of China's ambitions and what those mean for competitive EU responses.

- The report first looks at the domestic context of China's efforts to set global trade standards, including how China uses WTO membership to stall on OECD trade standards.
- Second, the report turns to China's approach to competing with regional and bilateral FTAs to set trade standards and bolster China's gravitational trade pull.

- Third, the report assesses China's unconventional approaches to setting trade standards in selected emerging market geographies in Latin America, Southeast Asia and Africa. Through such approaches, China seeks to circumvent obstacles to its trade and standard-setting ambitions.
- The report concludes with an outlook on how the EU can more effectively compete with China's trade policy and standard and rule-setting ambitions in a post-Corona world.

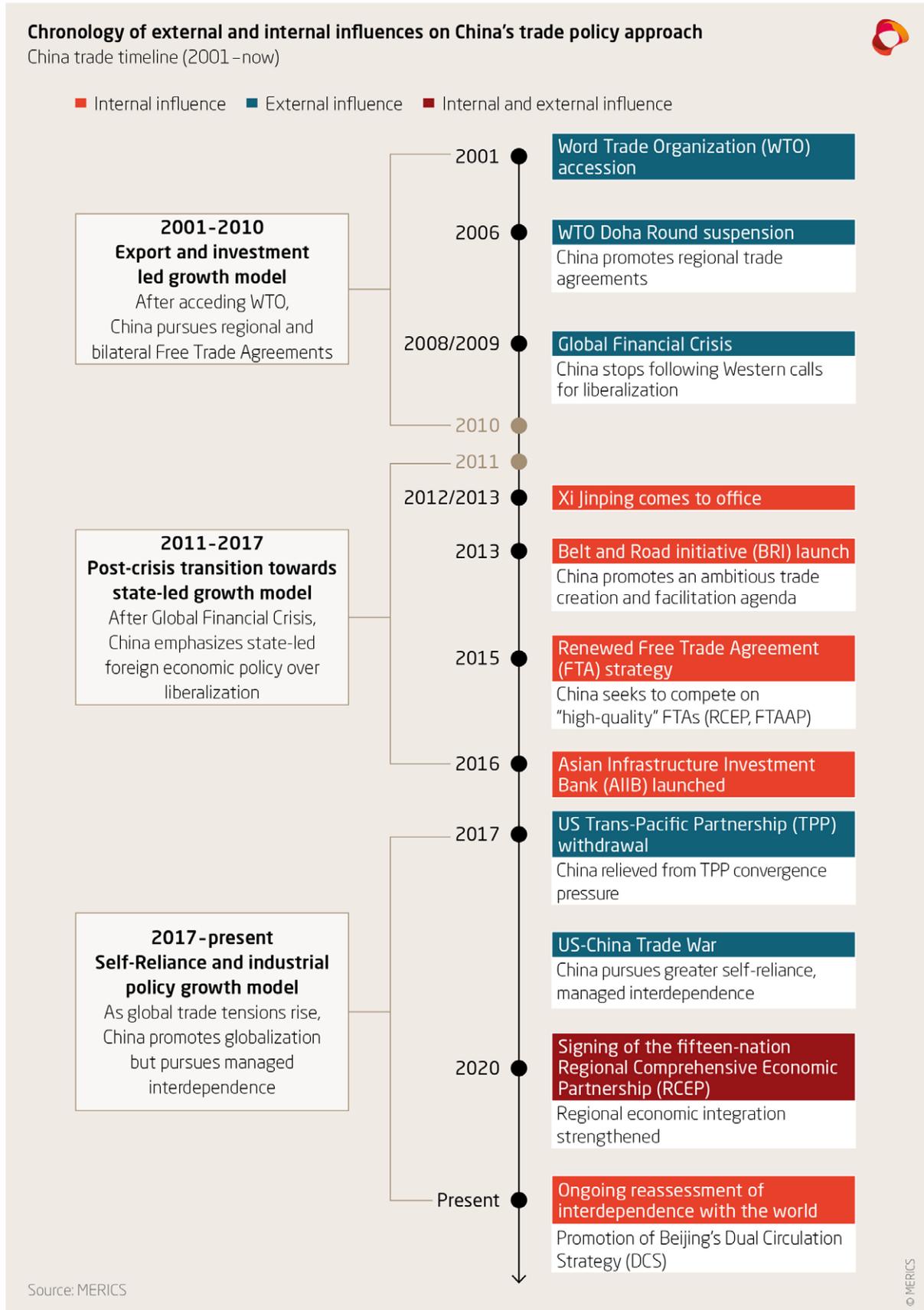
2. THE DOMESTIC CONTEXT: CHINA'S SHIFTING TRADE POLICY MOTIVATIONS AND PRIORITIES

China's domestic priorities condition the country's approach to global interdependence, including its trade policies. China's increased efforts to influence and determine global trade standards and rules are likewise a reflection of its changing domestic priorities. Specifically, **since joining the WTO in 2001, China has moved away from a relatively narrow focus on trade policy as a component of its domestic reform agenda towards using trade policy as part of broader and more ambitious foreign economic and geopolitical goals.** More recently, as a result of the trade war with the United States and the impact of the Coronavirus crisis, China has become increasingly skeptical of global commercial interdependence and is moving toward greater self-sufficiency and managed trade.¹ China has adopted three core components to achieve its evolving trade policy goals: multilateral, bilateral and non-conventional strategies and tools.

2.1 HOW DID WE GET HERE? CHINA'S GROWING TRADE AND RULE-SETTING AMBITIONS

Since joining the WTO China has moved from willingly binding itself to multi-lateral trade standards to setting its own standards (see exhibit 1). The Chinese leaders who negotiated China's WTO accession saw membership as a way to leverage China's own domestic reforms as well as to increase China's access to global markets. But even as its share of global trade grew rapidly in the early 2000s, China often dragged its feet on complying with its WTO commitments, including in areas such as intellectual property rights (IPR) and fair market access. **As China's commitment to multilateral trade standards stalled, it simultaneously began to push for its own bilateral FTAs, especially in its own Asian neighborhood.** Between 2001-2010, China therefore reaped the gains of membership in the multilateral WTO framework while at the same time setting a course to establish more China-centered trade networks.

Exhibit 1



The global financial crisis marked a turning point in China's approach to global economic interdependence, pushing it toward more state-led policies that continue to today. After 2010, China increasingly integrated its domestic and foreign industrial and trade strategies, including scaling up a range of unconventional strategies and tools to expand and control trade flows in key emerging market geographies. China's fiscal stimulus after the financial crisis increased the role and influence of its state-owned enterprises (SOEs), further elevating them as a key tool in China's international trade strategies.

Those strategies were increasingly linked to China's 2025 industrial policy as well as to its promotion of the Belt and Road Initiative (BRI), both state-led efforts to bridge China's domestic and foreign economic policies.² Building on this more integrated, state-led approach, in 2015 China introduced a new push to build competitive, "high standard" FTAs.

Today many leaders in China are more skeptical than ever about trade interdependence. Beijing is therefore likely to redouble its efforts to structure patterns and rules of global trade. Beginning in 2017, global trade tensions began to rise as US and European demands for reciprocity and a level playing field for trade with China grew more prominent. In response to US withdrawal from the TPP and its criticism of the WTO, Chinese leaders emphasized China's commitment to globalization and an open international trading system.³ At the same time, without the competitive pressure of a 21st century TPP trade agreement, China was able to pursue alternative, far less ambitious regional trade agreements like RCEP that did not place limits on state-owned enterprises or other standards averse to China's interests. When the United States pulled out of the TPP in 2017, the pressure on China to compete over higher trade standards in the Asia Pacific was greatly reduced, but growing trade tensions with the US also exposed China to vulnerable trade dependencies.

The Coronavirus crisis and the resulting trade disruptions have only increased Chinese concerns about interdependence and spurred talk of self-reliance and managed trade. In the meantime, China has continued to push its own new or updated FTAs as well as promoting an array of nonconventional approaches to increase and control trade flows. The result is that **China today increasingly seeks to structure global trade to limit dependencies while increasing its own leverage over the patterns and rules of trade.** Such efforts also mean that China is increasingly a competitor with the EU and other countries around the world that are seeking to diversify critical supply chains.

2.2 CHINA'S APPROACH TO TRADE RULES AND STANDARDS: STALLING, COMPETING AND CIRCUMVENTING

China has three broad approaches to trade: **multilateral stalling, bilateral competing and unconventional circumventing**. China is still an active participant and supporter of multilateral trade agreements like the WTO. Yet it has moved from using multilateral trade agreements to leverage liberal domestic reforms to using membership in multilateral trade institutions as cover for its own industrial and trade-promotion strategies. Many sticking points in China's accession talks to enter the WTO, such as market access and intellectual property rights (IPR), remain as controversial today as they were almost 20 years ago.

Continued delays in China's accession to the WTO's Agreement on Government Procurement (GPA) and China's continued use of industrial subsidies underscore how **China remains more comfortable with the WTO's status quo than truly invested in ensuring a level playing field**. Yet especially as the United States has pulled back or criticized multilateral trade institutions like the WTO, China has spied an opportunity to voice its support for an open, multilateral trading system while continuing to stall on many of the key issues that have led to European and American calls for greater "reciprocity" in trade and investment relations (see exhibit 2).

Exhibit 2



China's second approach to trade relies on an increasingly competitive expansion of regional and bilateral FTAs. China often engages in regional and sub-regional economic cooperation bodies to more efficiently bargain with a large number of smaller states and at the same time leverage China's relatively large market size. China, for example, is active in regional and sub-regional economic cooperation mechanisms such as ASEAN, APEC, the East Asia Summit, the Forum on China-Africa Cooperation, the China-CELAC Forum in Latin America and the Caribbean, to name just a few. While such forums offer platforms to discuss enhanced trade, it is China's network of regional and bilateral FTAs that has the potential to redraw global trade geography. **Despite China's claims about its "high quality" FTAs, China's competitive approach to FTA rule and standard setting continues to rest more on quantity than quality.**

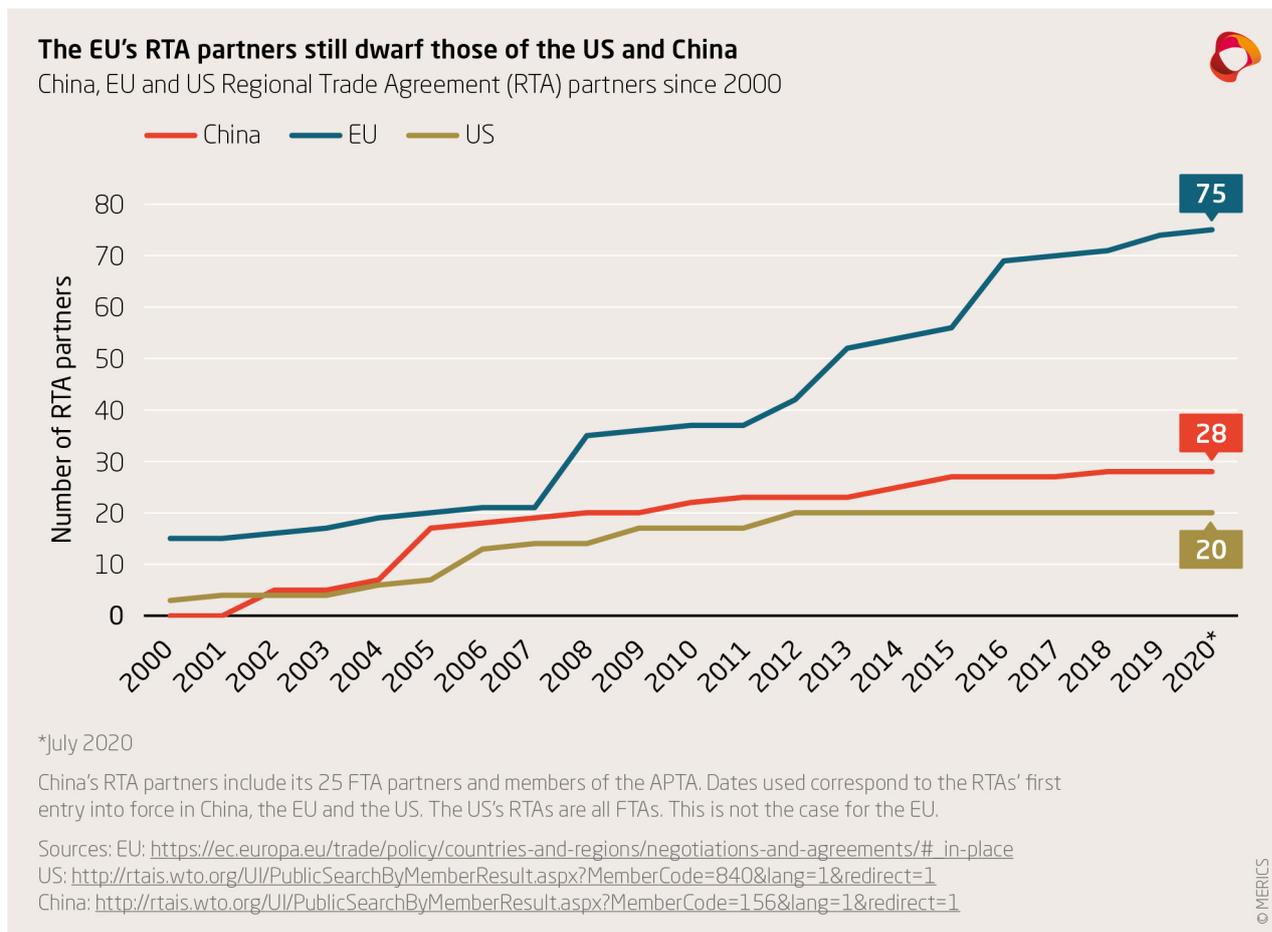
China also relies on a range of nonconventional approaches to promote Chinese trade standards and lock in China-centered trade flows in emerging market geographies. Such approaches are based on a range of Chinese strategies and policy tools that draw from China's own domestic policies and institutions and allow China to bypass established standards or create altogether new ones. China's increasingly expansive set of trade-facilitation strategies and tools includes loans-for-infrastructure packages, establishing overseas special economic zones (SEZs), promoting e-commerce platforms, as well as building China-linked dispute resolution bodies. These unconventional methods of establishing and promoting Chinese trade standards and China-centric trade flows are especially prominent in emerging market regions such as Southeast Asia, Africa and Latin America.

In formulating its own trade strategies and approach to trade standards and rules, the EU will need to account for all three of these Chinese approaches.

3. CHINA'S FTA TOOLBOX: TOWARDS COMPETITIVE "HIGH-STANDARDS" AGREEMENTS?

In the years since its WTO accession, China has become an increasingly keen promoter of FTAs. As with other elements of China's approach to trade, domestic considerations have driven this trend. China sees FTAs as a way to increase the supply and reduce the cost of critical energy and food commodity imports. China has also long used trade agreements to access critical markets and technologies, especially in strategic sectors such as high technology. At the same time, **as China has sought to support its firms' overseas expansion, it has seen FTAs as a tool to facilitate and increase the exports of Chinese goods and services.** To date, even though China's expanding network of FTAs is more notable for its quantity than quality, it remains a potent avenue for China to promote its own trade goals (see exhibit 3).

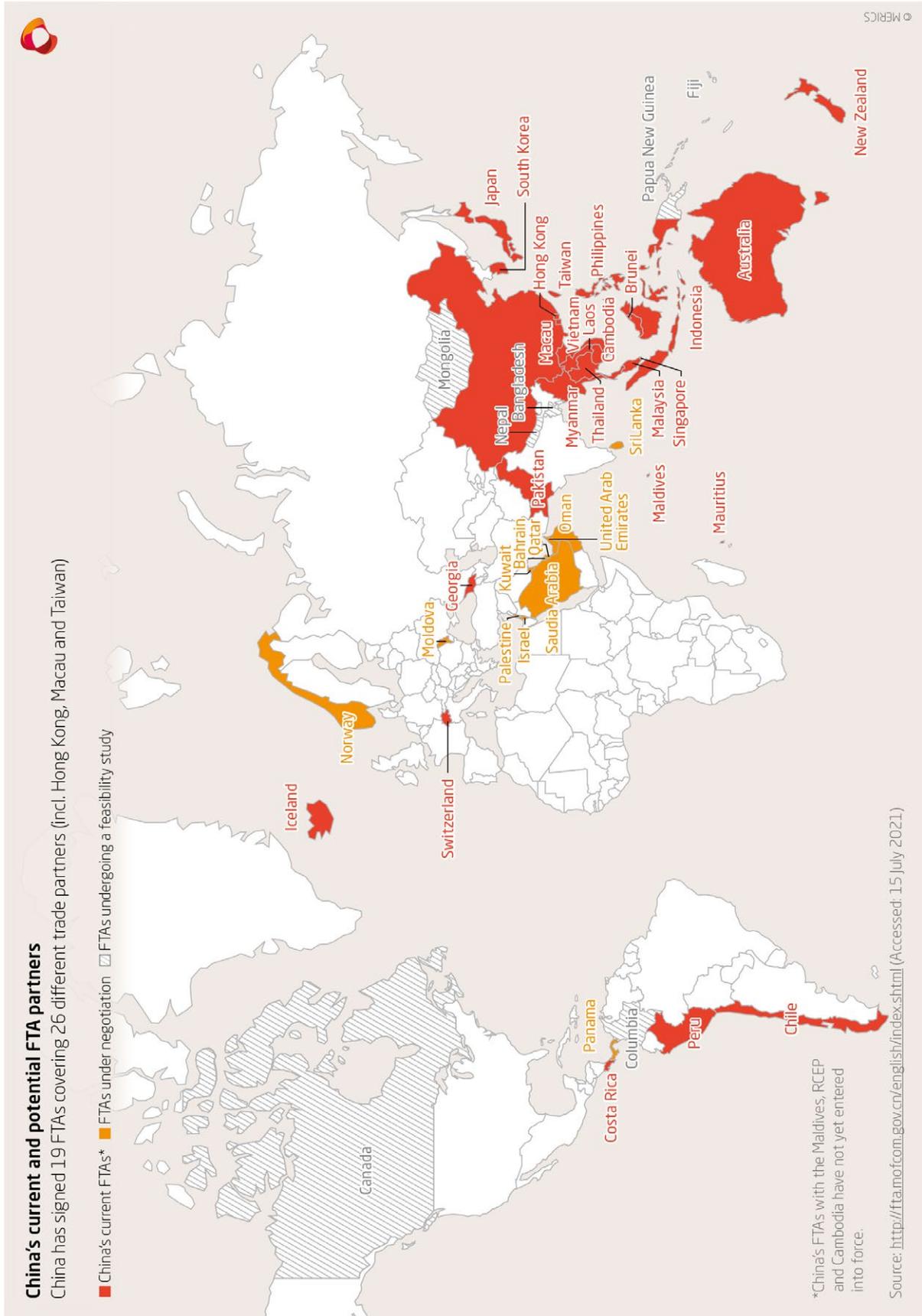
Exhibit 3



3.1 CHINA'S FTAS AS TOOLS OF A COMPETITIVE TRADE STRATEGY

China's FTA policies create leverage and promote China's strategic positioning in three ways: **1)** through sheer increases in quantity of FTAs, **2)** by developing geopolitical counterweight, especially in Asia, and **3)** through rule and standard setting. In terms of quantity, China had no FTAs or RTAs prior to 2001, while the EU already had 15. To date, China has signed 17 free trade agreements covering 25 different trade partners (including Hong Kong, Macau and Taiwan) across four continents.⁴ While the number of China's FTAs still pales in comparison with the EU, China has declared its intention to close this gap. Indeed, one of Beijing's official goals is to increase the "proportion of China's trade with FTA partners so that it reaches or exceeds the proportion found in most developed and emerging economies."⁵ With 10 new deals currently being negotiated, China's FTA partners are set to increase significantly in the coming years (see exhibit 4). Yet as detailed below, China's efforts to compete in quantity of FTAs has lagged behind its ability or desire to promote higher quality agreements.

Exhibit 4



China also sees FTAs as a way to compete geopolitically and reinforce Chinese trade centrality, especially in Asia. Given that China is the center of economic and trade activity in the region, it has used FTAs with regional partners to build and preserve leveraged interdependence. China's FTA with ASEAN was an early effort to reduce trade barriers in a region with historical and security tensions but also one full of economic dynamism.

More recently, with the demise of TPP, China sought not only to fill the vacuum but also to promote alternative bilateral and regional trade agreements (such as FTAAP or RCEP) that would align with China's regional interests in wider-Asia. Outside of Asia, geopolitical concerns about food and energy security also played a role in China's FTAs with countries like Peru and Chile, while gaining better access to Arctic shipping routes and potential energy resources played a role in China's FTA with Iceland.⁶

Exhibit 5

China's current FTA strategy

As laid out by the State Council in December 2015



Primary objective	To accelerate the formation of "a global network of high-standard" free trade agreements.
Preferred Partners	<ul style="list-style-type: none"> ■ First and foremost: Neighbouring countries and regions ■ Second: BRI signatories ■ Generally: "most emerging economies, large developing countries, major regional economic blocs and some developed countries"
Goals	<ul style="list-style-type: none"> ■ Form large markets with neighbouring countries, developing countries as well as BRI and BRICS partners ■ To allow "most of China's foreign trade and two-way investments to be liberalized and facilitated" ■ To increase "the proportion of China's trade with FTA partners so that it reaches or exceeds the proportion found in most developed and emerging economies" ■ "Actively participate in the setting of [new] international rules"
Towards high standards	<p>"Taking into account China's level of development and governance capacity as well as the prevailing international rules and their development trends, accelerate the negotiation of new issues [that meet our needs] such as":</p> <ul style="list-style-type: none"> ■ Intellectual property rights (IPR): "create a fairer IPR protection environment for Chinese enterprises to 'go out' ", improve IPR "protection and enforcement" as well as "enhance the awareness of businesses and the public vis-à-vis IPR protection" ■ The environment: "strengthen [China's] legislation and enforcement", "explore the feasibility of establishing an environmental impact assessment mechanism" ■ E-commerce: "promote cooperation between China and its free trade partners", "create mutually beneficial ... rules" and "strengthen the exchange of data" ■ Competition policy: "improve China's legal environment" ■ Government procurement: "when conditions are ripe, [allow] negotiations with FTA partners on the opening up of one another's government procurement markets" ■ Rules of origin (RoO): "strengthen" related rules ■ People: "facilitate the movement of natural persons" ■ Trade and investment: Promote the use of a "negative list" rather than a "positive list" approach
Potential testing ground	The PRC's Free Trade Zones and Ports should become a "testing ground for China to actively adapt to new economic development trends and new changes to global trade rules".

Source: http://www.gov.cn/zhengce/content/2015-12/17/content_10424.htm

China's steady expansion of FTAs is also part of a competitive approach to expanding China's trade standards and rules. Especially through the rollout of its 2015 "high standards" FTA strategy (see exhibit 5), **China has explicitly aimed to competitively position its own trade standards relative to other 21st century, high quality FTAs from the EU, the US and other OECD countries.** With an eye toward the TPP, China's 2015 strategy aimed to pre-emptively offer a set of standards better aligned with Chinese interests than those embodied in the TPP. In setting out a set of rules and standards issues in its 2015 trade strategy, China emphasized a range of topics for which it has regularly received criticism from OECD countries.

By putting a Chinese spin on such standards areas as environmental protection, IPR, competition and procurement policy, **China seeks to establish trade standards with Chinese characteristics.** For example, on IPR and competition policy, the 2015 trade strategy emphasized that it was Chinese firms that needed to be protected from intellectual property infringement or from unfair competition rules. On environmental protocols, the 2015 strategy stressed China's new emphasis on climate-change cooperation and green trade and investment rules and enforcement mechanisms.

3.2 CHINESE VS EU FTAS: COMPETING OVER QUALITY

While Chinese FTA standards have been rising, this does not mean alignment with EU or broader OECD standards. Instead, because China uses FTAs as a tool of competition, **China-promoted standards are meant to align with Chinese interests and values.** As a result, China's supposedly "high-quality" FTAs tend to fall short in comparison with EU FTAs. In general, while the comprehensiveness and quality of Chinese standards have improved from a low base, they still lack the depth and breadth of EU-designed FTAs (see exhibit 6).

A systematic comparison of Chinese and EU FTAs highlights these disparities across a range of trade standards:

- On environmental standards, Chinese FTAs have weaker commitments than EU FTAs, including inconsistent or nonexistent prohibitions against weakening environmental laws for trade or investment reasons. Moreover, China's environment-related FTA sections tend not to provide for consultations with the public whereas the EU's generally do.
- On labor standards, Chinese FTAs include very few labor-related clauses or completely leave out labor standards and rules. Even where such labor provisions are included in Chinese FTAs, they lack depth and enforceability. For example, in the 2013 China-Switzerland FTA both countries pledged to uphold their International Labor Organization commitments, yet China has still only ratified four out of eight of the ILO's fundamental conventions. Labor-related disputes are therefore largely left to more informal consultation and cooperation.

- Competition-related standards and rules appear more frequently in EU than in Chinese FTAs. And while competition-related stipulations have increased markedly in China's FTAs, it is well known that in practice these do not ensure a level playing field for its FTA partners when doing business in mainland China.
- On intellectual property rights standards and rules, Chinese FTAs also lag behind their EU counterparts. IPR-related clauses have increased significantly in China's FTAs, yet enforcement is focused on protecting Chinese firms' interests over those of FTA partners or third parties.
- On e-commerce provisions, very few of China's FTAs include the kinds of stipulations that exist in most EU FTAs. Yet this is set to change and China is active in promoting its own e-commerce trade and standards through more unconventional methods, including through its Digital Silk Road.
- On dispute settlement provisions, Chinese and EU FTAs include similar clauses, but this does not mean that they are equally stringent or as wide-ranging. Moreover, as with e-commerce, China is seeking to circumvent OECD standards by introducing its own dispute settlement bodies as part of its unconventional approach to trade standards and rules.

A look at China's interest in the upcoming Regional Comprehensive Economic Partnership (RCEP) reveals how **China's grandiose talk of "high standards" is largely part of its broader effort to compete geopolitically and to reinforce China as the center of trade gravity in Asia.** If completed, RCEP would be the world's largest FTA and in principle it aims to achieve "a modern, comprehensive, high-quality and mutually beneficial economic partnership agreement among the ASEAN Member States and ASEAN's FTA Partners".⁷ The end result looks set to be quite different and RCEP is expected to be a wide-ranging but shallow agreement. It may cover areas such as IPR, competition, government procurement, and e-commerce but for the most part will not go beyond existing WTO commitments. It is also likely to be devoid of any chapters focusing on labor rules, the environment and SOEs.⁸ With low standards and India now out of the agreement RCEP will further increase China's gravitational pull over Asian trade and commerce.

For these reasons, the EU's FTA with Vietnam (EVFTA) deserves a greater profile as a centerpiece of the EU's de facto FTA competition with China. Whereas the RCEP is not likely to go beyond the WTO on key trade standards, the European Commission has described the EVFTA as the most ambitious free trade deal the EU has ever signed with a developing country.⁹ It not only eliminates 99 percent of tariff and non-tariff barriers (compared to RCEPs 90-93 percent tariff reductions), EU companies will have access to Vietnam's public procurement market while ambitious disciplines on SOEs and state subsidies will come into force. Moreover, compared to lax or non-existent RCEP aims for environment and labor provisions, the EVFTA includes strong, legally binding commitment to labor rights and environmental protection. EU trade officials should point to the large quality gap between the EVFTA and RCEP to highlight what occupying the FTA standards high ground really looks like.

Exhibit 6



Comparing China's FTAs with the CPTPP and the EU-Vietnam FTA¹⁰

China's FTAs still lack the breadth and depth of recent EU- and US-designed FTAs

■ No (Element not included in the FTA) ■ Yes (Element included in the FTA)

FTA element (sub-element)	ASEAN 2004	Chile 2005	Pakistan 2006	New Zealand 2008	Singapore 2008	Peru 2009	Costa Rica 2010	Iceland 2013	Switzerland 2013	South Korea 2015	Australia 2015	Georgia 2017	Mauritius 2021	CPTPP 2018	EU-Vietnam 2020
1. Services	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
1.1 Negative list	No	No	No	No	No	No	No	No	No	No	No	No	No	Yes	No
2. Investment	Yes	No	Yes	Yes	Yes	Yes	No	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes
2.1 National Treatment (entry of investment)	Yes	No	No	Yes	No	No	No	No	No	No	No	No	Yes	Yes	Yes
2.2 Investment protection	Yes	No	Yes	Yes	Yes	Yes	No	No	No	Yes	Yes	No	Yes	Yes	No
2.3 Investor-to-State Dispute Settlement (SDS)	Yes	No	Yes	Yes	Yes	Yes	No	No	No	No	Yes	No	Yes	Yes	No
3. Subsidies - Goods	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	No	No	No	No	No	Yes	Yes
3.1 Prohibition of agricultural export subsidies	No	Yes	No	Yes	Yes	Yes	Yes	Yes	No	No	No	No	No	Yes	Yes
4. Subsidies - Services	Yes	No	No	Yes	No	No	No	Yes	Yes	Yes	Yes	No	No	Yes	Yes
5. Government Procurement	No	Yes	No	No	No	No	No	Yes	Yes	Yes	Yes	No	No	Yes	Yes
6. Intellectual Property Rights	Yes	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
6.1 Reaffirms or incorporates TRIPS Agreement	No	No	No	Yes	No	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
6.2 Trademarks	No	Yes	No	Yes	No	No	No	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes
6.3 Copyrights & neighbouring rights	No	Yes	No	Yes	No	No	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes
6.4 Patent	No	No	No	Yes	No	No	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes
6.5 Geographical Indications (Gis)	No	Yes	No	Yes	No	Yes	Yes	No	Yes	No	No	Yes	No	Yes	Yes
6.6 Traditional knowledge	No	No	No	Yes	No	Yes	Yes	No	Yes	Yes	Yes	Yes	No	Yes	No
6.7 Industrial Designs	No	No	No	Yes	No	No	No	No	Yes	Yes	Yes	No	No	Yes	Yes
6.8 Layout-Designs of integrated circuits	No	No	No	Yes	No	No	No	No	No	No	No	No	No	Yes	Yes
6.9 Enforcement	No	No	No	Yes	No	Yes	Yes	No	Yes	Yes	Yes	Yes	No	Yes	Yes
7. Competition	No	Yes	No	No	No	No	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
7.1 Adopts or maintains competition law	No	Yes	No	No	No	No	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
8. Environment	Yes	Yes	No	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes
8.1 No relaxation of environmental laws	No	Yes	No	Yes	No	No	No	No	Yes	Yes	Yes	Yes	No	Yes	Yes
8.2 Public participation / consultation provisions	No	No	No	Yes	No	No	No	Yes	Yes	Yes	Yes	Yes	No	Yes	No
9. Labor	No	Yes	No	Yes	No	Yes	No	Yes	Yes	No	No	No	No	Yes	Yes
9.1 No relaxation of labor laws	No	No	No	Yes	No	No	No	No	No	No	No	No	No	Yes	Yes
10. E-commerce	No	Yes	No	No	No	No	No	No	No	Yes	Yes	Yes	Yes	Yes	Yes
10.1 Customs duty exemptions for Digital Products	No	No	No	No	No	No	No	No	No	No	Yes	Yes	Yes	Yes	Yes
Total of "Yes"	9	14	5	23	7	13	11	14	18	20	20	15	11	29	24

Source: <http://rais.wto.org/UI/PublicMaintainRTAHome.aspx> (Accessed: 15 July 2021)

4. BEYOND FTA'S: CHINA'S UNCONVENTIONAL APPROACH TO TRADE STANDARDS IN KEY GEOGRAPHIES

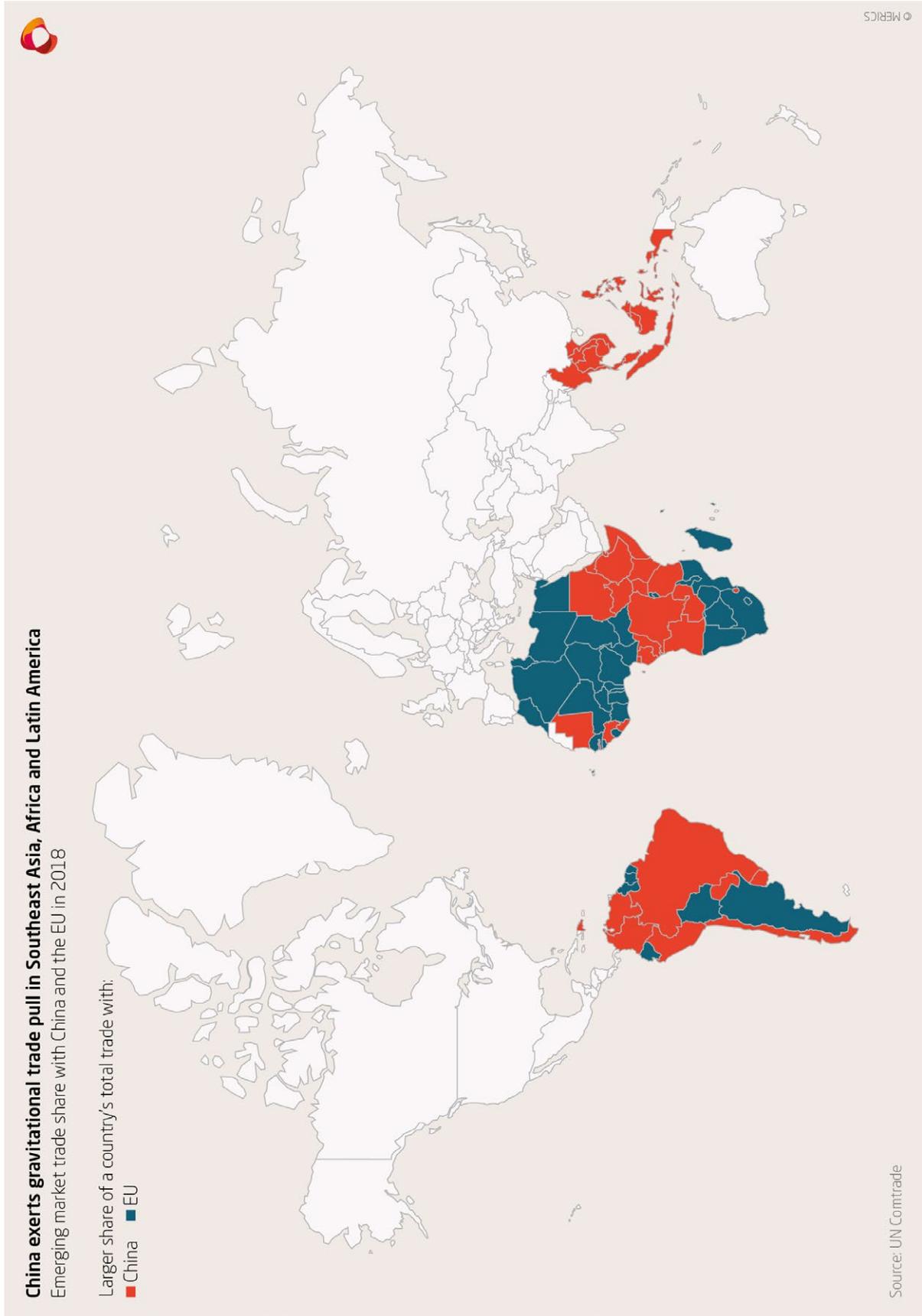
In addition to its competitive FTA strategy, China has positioned itself as a key trade and geoeconomic partner with emerging market countries in Latin America, Africa and Southeast Asia. It has done so by tapping into market forces as well as pursuing a range of comprehensive, unconventional strategies to circumvent trade barriers and lock in China-centered trade and trade standards. Both the market and unconventional, state-led components of China's emerging market trade strategy present a potent competitive challenge for EU trade policy.

4.1 BEIJING'S TRADE POLICIES EXPAND CHINA'S GRAVITATIONAL PULL IN KEY EMERGING MARKET GEOGRAPHIES

China became a leading trade partner with emerging market countries in South America, Africa and Southeast Asia in the wake of the China-led "commodity super-cycle" of the early 2000s. Since then, booming trade ties with China have also been bolstered by China's state-backed investment and finance in these regions as well as by lesser-known, unconventional trade and standard-setting approaches discussed below. Moreover, **China's trade ties to Africa, Latin America and Southeast Asia constitute a crucial component of its "developing country diplomacy," which aims to simultaneously strengthen China's comprehensive commercial and geopolitical ties to these regions** (see exhibit 7).

China's varying competitive advantages in emerging market regions like South America, Africa and Southeast Asia make China a formidable trade competitor for the EU. China's clearest competitive trade strengths are in Southeast Asia where its gravitational pull is the strongest. In Africa, China has become an important trade partner for the region, especially in Sub-Saharan Africa, but the EU retains a clear competitive advantage in its trade ties with the region. In Latin America, the picture is more mixed since many South American commodity exporters have become increasingly reliant on the Chinese market whereas the EU retains strong trade ties to the region, including through new FTAs.

Exhibit 7

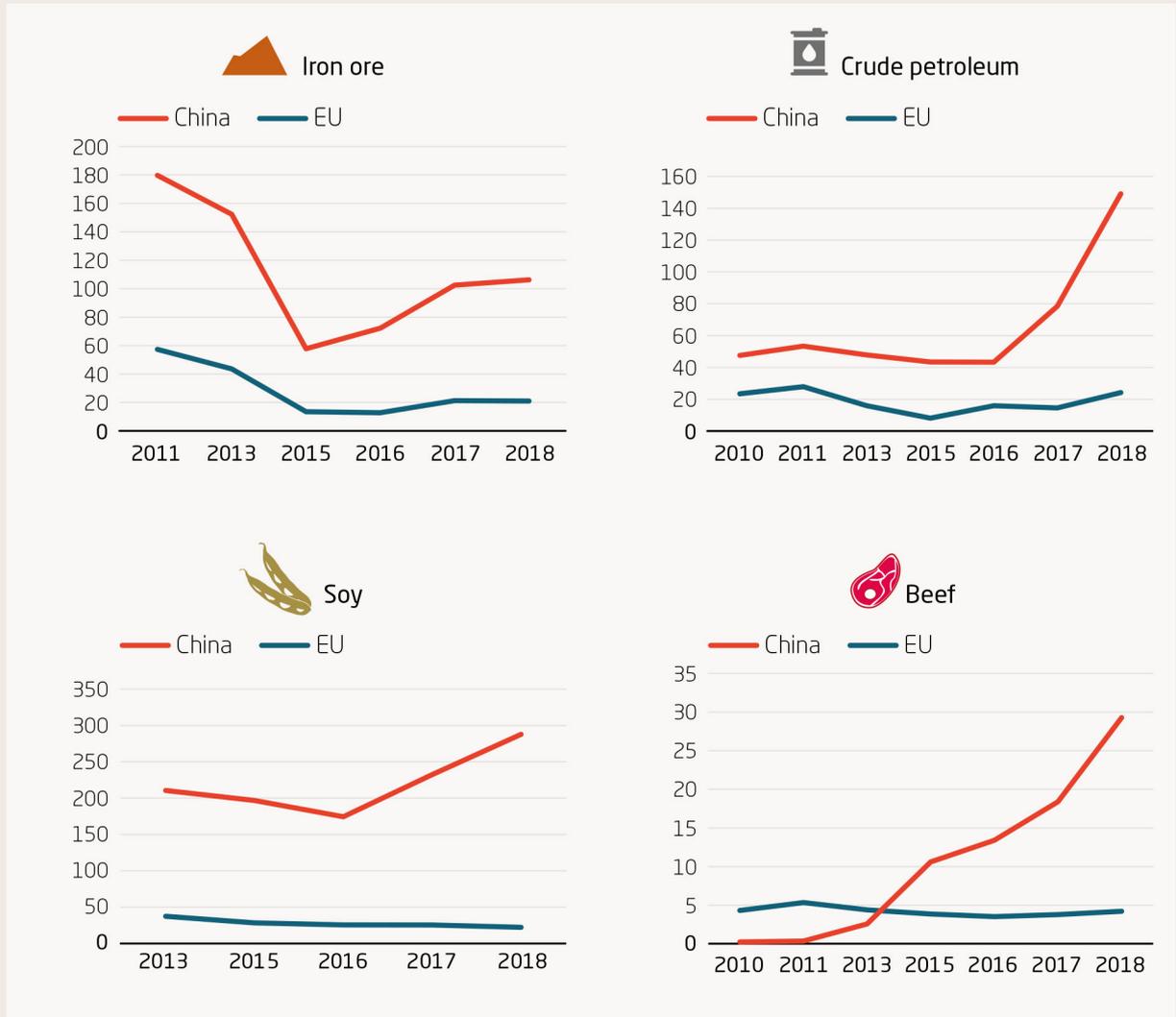


- **China's trade ties with Southeast Asia are broader and deeper than in either Africa or Latin America** and in the first part of 2020 ASEAN passed both the EU and the US to become China's number one trade partner. While this outcome is certainly tied to the Coronavirus crisis as well as longer-term trade tensions between China and the US, ASEAN-China trade links are set to grow even stronger. The structure of China's trade with Southeast Asia is also more diverse than with Africa or Latin America, with ASEAN countries less dependent on commodity exports to China and more integrated into regional Asian supply chains. The EU retains a competitive trade position in Southeast Asia, coming in as the region's third largest trade partner after China and the US. Despite progress with bilateral EU trade deals in the region, most recently the EU-Vietnam FTA, China will continue to deploy its entire arsenal of trade promotion and standard-setting tools to enhance its own competitive position in the region.
- China's trade relationship with Africa has received a strong boost from China's growing appetite for raw materials. Despite the lack of FTAs with the region, China-Africa trade has boomed in the last two decades, especially in the Sub-Saharan region. But Europe's close geographic and economic ties to Africa mean that the EU retains an important competitive advantage relative to China. The EU continues to be Africa's largest trade partner, with almost double China's share of total trade with the region in 2018. **Yet even more than in Latin America, China actively pursues a wide range of state-led investment and financing strategies in Africa.** These include unconventional trade tools, such as SEZs and package infrastructure deals, aimed at circumventing barriers to even greater China-linked trade flows. Therefore, while the EU retains key competitive strengths in its trade ties with Africa, it should expect China to continue the promotion of its own trade standards and rules in the region.
- In South America, commodity exports to China increased rapidly starting in the early 2000s. This has propelled China to become the number one or two export partner for many of the region's commodity-rich countries, including Brazil. **Even in the absence of an FTA with Mercosur, China's continuing demand for South American soy, beef, petroleum and iron ore all mean that China remains a key source of demand for the Mercosur bloc's abundant raw materials** (see exhibit 8).¹¹

Exhibit 8

South American soy and beef exports to China add to deforestation concerns

Mercosur commodity exports to China and the EU, value of exports, USD hundreds of millions



Source: UN Comtrade

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The Mercosur region's ecology has been deeply impacted by the expansion of land for soy production, including deforestation of the Amazon, to meet booming Chinese demand.¹² Trade tensions with the US have given a further boost to South American soy and beef exports to China since 2018, further exacerbating these environmental impacts. **In the absence of China's own environmental sustainability standards to govern its commodity trade with Mercosur countries, the EU-Mercosur FTA sustainability chapter offers a clear path for the EU to fill this gap in environmental standards for trade with the South American bloc.**

4.2 EXPORTING THE “CHINA MODEL” TO BUILD CHINA-CENTRIC TRADE STANDARDS AND CIRCUMVENT RULES

In each of these emerging market regions, China builds on its own market leverage to also pursue a range of comprehensive, unconventional strategies to lock in Chinese-centric trade and trade practices. Such unconventional strategies to lock in Chinese-centric trade and trade practices are most often deployed in China’s trade ties with emerging market economies in Latin America, Africa and Southeast Asia. They include **1)** infrastructure and infrastructure standards, often through package loans deals, **2)** overseas special economic zones (SEZs) and industrial parks, and **3)** e-commerce through the “Digital Silk Road”. Through each of these approaches, some of which China packages under the name of “industrial capacity cooperation”, **China seeks to export components of its own domestic development model in a way that reinforces Chinese trade standards and rules as well China-centric trade flows.** Notably, leading experts in China describe China’s flagship trade creation initiative, the Belt and Road Initiative (BRI), as an explicit alternative to the OECD for non-advanced economies.¹³

The first approach, package loans-for-infrastructure deals, sits at the heart of China’s BRI and serves the dual purpose of locking in China-based trade and expand opportunities for standards promotion. Even before the BRI, China had already begun to finance and build infrastructure in developing and emerging markets in Southeast and Central Asia, Africa, and Latin America and the Caribbean. China frequently offers bundled loans-for-infrastructure packages in which China’s state-owned policy banks provide the majority of financing as long as construction and labor contracts went to Chinese state-owned firms. In the so-called “Angola Model”,¹⁴ loan repayments have often been guaranteed by long-term export contracts for strategic commodities like oil. **Through these packages, China also seeks to guarantee greater exports of Chinese construction services as well as sales of over-capacity industrial products like steel and cement.**

When building railways or dams, such package deals have allowed China to establish specific construction or engineering standards and protocols. For example, the East Africa railway project linking the port of Mombasa in Kenya with Burundi, Rwanda, South Sudan and Uganda was hailed by Chinese authorities as a successful example of China’s ability to expand Chinese railway standards to Africa.¹⁵ Other Chinese package deals, including for the Kamchay hydroelectric dam in Cambodia, have built-in clauses allowing for Chinese environmental impact assessment protocols and services in lieu of local government reviews. **Such arrangements build in long-term demand for Chinese goods and services while embedding Chinese engineering or environmental practices more firmly.**

With the second approach, **Chinese-backed special economic zones (SEZs) and industrial parks, Chinese actors, along with local governments, create entire geographic and legal carve-outs in some emerging market countries** (see exhibit 9). Similar to China’s own domestic SEZs, such zones are set up with an eye toward reducing bureaucratic barriers that might inhibit investment in manufacturing and exports as well as

services and by providing tax incentives to attract local and Chinese firms and capital. They also can serve as export processing zones that allow Chinese and local producers to potentially circumvent customs and tax rules in both host countries and third markets.

Chinese overseas SEZ not only create exclusive Chinese trade opportunities, but they also can circumvent local and international trade rules. Originally called “trade and economic cooperation zones”, China’s export of SEZ has been especially pronounced in Africa and Southeast Asia. Ethiopia’s Eastern Industrial Zone (EIZ) is often held up a model of such Chinese-backed SEZ, yet even some Ethiopian officials in charge of collaboration with their Chinese counterparts admit that the EIZ is an exception.

Other Chinese-backed SEZ in Africa have become the focus of criticism either because they represent Chinese manufacturing interests or because they have become the site for subverting trade and customs rules. Egypt’s Suez SEZ has come under recent fire for exactly such subversion of EU trade rules.¹⁶ Chinese-backed SEZs in Southeast Asia, like Cambodia’s Sihanoukville have also come under criticism for basically become havens of illicit activity that attract Chinese and other criminal elements.

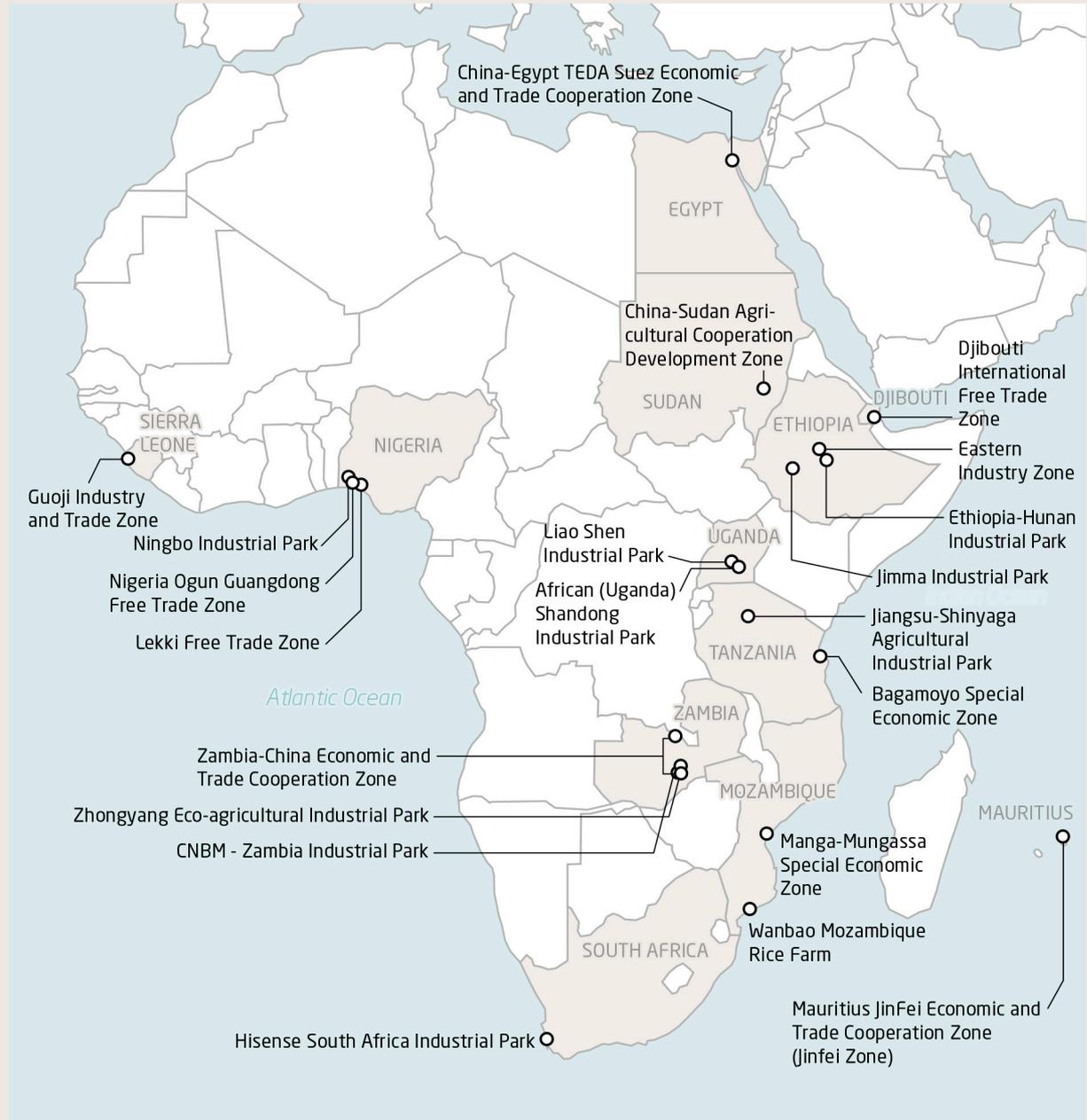
A third example of how China has been expanding elements of its domestic economic model in order to expand its exports and establish its own trade standards and rules is through e-commerce and digital infrastructure. Much of this is happening under the framework of the “Digital Silk Road” (DSR).¹⁷ Promoted as part of the BRI, the DSR builds on Chinese firms’ already strong position in telecommunications and other tech sectors in developing and emerging markets. Chinese firms like Huawei and ZTE have, for instance, have long-established strong footholds in both telecommunications infrastructure as well as retail sales in Africa, Latin America and parts of Asia.

In Latin America, Huawei is currently in negotiations with Chile to build the first trans-Pacific fiber optic cable, a move that would give the firm a digital infrastructure foothold in South America at a time when its rich world partners are systematically excluding it from their markets. Supplementing such state-led efforts, **China’s Jack Ma has also been keen to promote his Electronic World Trade Platform (eWTP) to implement the Alibaba founder’s vision for digital trade logistics and standards through initial “e-hubs” in Africa, Southeast Asia and Europe.**¹⁸

Exhibit 9

Chinese overseas SEZs create exclusive trade channels & circumvent trade barriers

Chinese-backed special economic zones (SEZs) in Africa



Source: <http://www.fdi.gov.cn/CorpSvc/Temp/T3/Product.aspx?idInfo=10000042&idCorp=1200000103> (Accessed: 1 July 2020)

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In response to the Coronavirus, China has built on its already existing promotion of e-commerce in emerging markets by increasingly offering technological solutions to virus diagnosis and tracking. Such efforts allow China to promote the digital components of its “Health Silk Road” spinoff of the DSR. It is also clear that China’s hopes to embed its own

technology and cyber standards in developing and emerging market settings, including through the rollout of facial recognition and police surveillance technologies, including in partnership with other non-democratic countries. For example, Venezuela has been a focus of China's all-in-one digital solutions, including for its facial recognition, digital ID, and health software. As China's technology Cold War with the US heats up, countries in Latin America and the Caribbean, in Africa and Southeast Asia are certain to feature as battlefields where China will seek to build on the e-commerce and digital platforms and standards that it is rolling out today.

China's use of unconventional strategies and tools to promote trade standards and rules comes with efforts to promote its own institutions to adjudicate overseas trade and investment disputes. **By creating Chinese trade and overseas commercial dispute resolution bodies, China aims to promote its own trade dispute standards and to be in a position to judge those same standards.** For example, through its newly created China International Commercial Court (CICC), China is promoting Chinese legal standards that can serve as an alternative to other, longer-standing Western standards and institutions in places like London and New York.

Created in 2018 and with branches in Shenzhen and Xi'an, the CICC aims to serve as a "one stop" solution to help resolve trade and investment disputes in emerging market BRI countries.¹⁹ The CICC explicitly offers services to Chinese firms and financial institutions but also to fill a regulatory and legal enforcement gap in some BRI countries in Southeast and Central Asia, Africa and the Middle East.

China aspires to expand the scope of the CICC to also include an International Commercial Dispute Prevention and Settlement Organization (CCPIT) that could have mediation-focused branches outside of the PRC. **Such dispute resolution bodies expand China's ability to circumvent existing international rules and legal settlement institutions while creating its own alternatives.**

5. OUTLOOK: ENGAGING CHINA'S TRADE POLICY IN A POST-CORONA WORLD

5.1 REPORT FINDINGS AND LESSONS FOR THE EU

In the wake of the Corona crisis and ongoing trade tensions with the US, China is likely to double down on its strategic trade agenda, including its ambitious efforts to promote trade standards and rules. As China seeks to assess its own trade dependencies, vulnerabilities and opportunities, it will increasingly divide countries into friends and adversaries. The world's developed democracies in Europe, North America and Asia will continue to be important for China's trade policy both because of their consumer markets and their advanced technology and manufacturing abilities. Yet as China's trade policy becomes ever more embedded in its geostrategic aims, **China's trade policy is likely to increasingly**

emphasize ties to emerging market economies where China's trade gravity and ability to set and influence trade standards and rules is likely to have more traction.

China's unconventional strategies outlined here are therefore likely to play an increasingly large role in its broader approach to trade and standard setting. China will continue to promote its multilateral WTO engagement as well as to push for more FTAs, but it will do so as part of a broader effort to build trade relationships where it has a market or standard-setting advantage. This means that the EU needs to account for China's multi-faceted approach to trade and standard setting. The EU will need a specific approach for China's stalling behavior with the WTO, its competitive FTA policies, and its unconventional methods for circumventing obstacles in the way of its trade and geopolitical ambitions.

Since China's trade policies and standard-setting priorities are part of the country's broader and more comprehensive domestic and foreign economic agenda and strategies, this will require an equally comprehensive and strategic policy response from the EU. It means that EU responses to China's industrial policies and ambitions should include understanding China's trade policies in both OECD and emerging market regions in its calculations.

In terms of China's competitive FTA agenda and strategies, China's continued push to build bilateral and regional FTAs since its 2001 WTO entry presents the EU with a number of geographic and substantive considerations. First, and similar to its broader economic diplomacy efforts, China sought FTA agreements with emerging markets and has increasingly expanded its FTA scope to include OECD partners. China has different trade and economic aspirations in FTAs with partner countries of different levels of economic development, with some emerging markets in Latin America and Africa, for example, being sources of raw materials important for Chinese energy or food security as opposed to European or North America markets with more manufactured and higher technology manufactures or services.

Despite its gradual push toward "high standards" agreements, China's FTAs consistently fall well short of EU FTAs on a range of important standards, from environment to labor to procurement issues. For the EU, its own standard-setting capacity through current, ongoing and future FTAs still has significant weight in what China and many of China's trade partners consider "high quality". Yet China's FTAs display a wide range standard-setting outcomes and China retains a potential advantage given its flexibility not just to adapt a wide range of FTA provisions given its partners' preferences, but also because in practice China is often unwilling or unable to effectively enforce any of the higher standards adapted in its FTAs. The EU thus has to be aware of China's ability to fill holes or vacuums where the EU has been unable to sign or complete its own FTAs or where broader multilateral trade deals such as the former TPP have been abandoned for less ambitious targets.

Beyond formal FTAs, China's more unconventional approaches to promoting Sino-centric trade standards also presents challenges and opportunities for the EU. Just as China's trade ambitions and policies are part of a broader domestic and foreign policy agenda,

China's approach to setting trade standards goes well beyond FTAs to include its BRI initiative. Under the BRI framework, China has promoted loans-for-infrastructure packages, special economic zones, e-commerce along the Digital Silk Road and dispute resolution centers, all of which have the potential increase China's trade in goods and services with BRI partners to the detriment of EU firms.

If China can lock in infrastructure projects where the majority of contracts go to Chinese firms and that facilitate even more goods and service trade, or if it can help establish SEZs that allow Chinese firms otherwise unavailable platforms for exports into the EU, or if Chinese-administered arbitration and dispute resolution centers have the final say on questions of Chinese-backed trade standards, the EU may be missing a large piece of China's trade-related activities that nevertheless have a major impact EU trade interests.

On the other hand, major concerns about the environmental, debt, labor and community impact of China's trade and other commercial ties to regions from Southeast Asia to Latin America to Africa all highlight that the strengths and quality of EU standards in each of these areas is a potential competitive EU advantage.

5.2 TOWARDS ENHANCED EU TRADE COMPETITIVITY WITH CHINA

For the EU, trade policy is one of its most potent geopolitical tools to influence global economic and global governance. Even though the EU prioritizes multilateral engagement through institutions such as the WTO, this report has reinforced the reality that China's own WTO engagement is often a stalling tactic for its own strategic trade agenda. Therefore, even though the EU and China both have retained public commitments of support for the WTO while recognizing the need for important reforms, fruitful cooperation will remain elusive. Any EU cooperation with China on WTO reform should be part of a broader strategy in which cooperation is only offered as part of a broader agenda of strategic competition with China's broader trade agenda.

On the EU preferential trade agreement strategy, China is more of a competitor or rival than a partner. The EU continues to be the standard-bearer in high-quality, progressive, 21st century FTAs, all the more so given the demise of US support for cutting-edge agreements like the TPP. Yet China is, and will continue to be, a dynamic player in promoting ever more of its own FTAs. **China continues to lag behind the EU in the quality of standards included in its FTAs, but because China strategically includes standards that align with its own interests it will be a competitor and rival to the EU in spreading its own trade standards.** In a post-COVID environment, the likelihood that such rivalry will lead to ever-greater managed trade means the EU will need to pay keen attention to China's comprehensive trade-creation and facilitation strategies, including those that go beyond traditional trade instruments like FTAs.

In fact, **China's unconventional strategies for promoting its own trade standards and rules, especially those that seek to expand elements of China's own domestic economic model in emerging markets, will present arguably China's biggest challenge to EU trade policy.** By financing and building infrastructure, by promoting SEZs, and

through supporting its own e-commerce firms and digital standards in regions like South-east Asia, Africa and Latin America, China seeks to circumvent obstacles to Sino-centric trade. Such unconventional tools limit opportunities for European firms and have the long-term potential to create ever more exclusive trading blocs with China at their core. As China builds its own international commercial dispute resolution bodies to cater to expanding international trade and investment interests, it will increasingly gain the ability to adjudicate its own trade standards and rules. EU trade policy needs to redouble efforts to not only promote the merits of its own formal trade standards, but also to compete with China's expanding set of unconventional strategies to set trade standards.

One instrument is the languishing Europe-Asia Connectivity strategy, which not only sets out a comprehensive agenda to promote sustainable connectivity standards, but also offers a vision for competitive EU trade and commercial policies in such emerging market regions. In light of discussions about creating more resilient supply chains, **the connectivity strategy could also provide a platform for tools that focus on how Africa or Southeast Asia could be part of more robust European supply chains.**

As the EU seeks to better balance engagement with China and ensure the EU's own interests, including resilience and enhancing "solidarity" and "sovereignty",²⁰ trade policy will play a key role. Especially in the wake of the Coronavirus crisis, the discussion at the EU level on the recalibration of its bilateral trade and commercial relationship with China will continue and intensify. This will influence ongoing bilateral negotiations such as the continuing talks on a Comprehensive Agreement on Investment (CAI), but also lead to debates about the EU's unilateral trade instruments. Yet outside of the bilateral relationship, third countries especially in emerging market regions like Africa, Eurasia and Latin America will play an increasingly important role in EU trade competitiveness.

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