

# EMBARGO UNTIL DELIVERED

- This is my first speech as a private citizen for five years. In a nice piece of symmetry, it just so happens that the last speech I gave as a private citizen was in 2004 and it was also on the subject of Europe and China.
- My appointment as EU Trade Commissioner had been delayed by a few weeks because of hearings in the European Parliament. And the speech I had intended to give in a formal capacity turned out to be a bit less formal than planned...
- Anyhow, it also was no accident that I had planned to make my first speech as Trade Commissioner on European relations with China. I felt - and I still feel - that this was the biggest issue in European trade policy and economic diplomacy.
- For cultural affinity reasons the EU at that point was still very oriented towards the Atlantic world, towards the US and Latin America. Although we recognised the pace of change in China and wider Asia, that recognition had yet to make a real impact on policy.

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- Looking back now I'm struck by the fact that import control agreements like the Multi-Fibre Arrangement that was to cause me so much grief and the special safeguards in China's 2001 WTO accession protocol were almost a subconscious European attempt to block out the economic and political implications of China's growing economic strength. A sort of tariff quota of the mind.
- They stood for a mentality that said: we will have so much of China, as much as suits us – but no more. But the point was that, even then, that was both naïve and misjudged.

### **Globalisation on other terms**

- Europeans and Americans had got very used to having globalization on their own terms. It was dominated by Western capital, western priorities.
- Although the implications for domestic producers in the West became increasingly apparent in greater cost competition, it also inaugurated what can only be described as a golden age for Western consumers, with goods almost impossibly cheap by historical standards.

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- But of course what was happening was far more fundamental than that. And it is symbolized by this city as well as anything. Export driven growth was transforming China.
- In just the four years that I was EU Trade Commissioner China overtook first the US, then Germany, to become the world's biggest exporter. It overtook Japan to become the world biggest holder – by far – of forex reserves. And it became the world's biggest emitter of carbon.
- The symbolism of China injecting several billion euros into joint ventures in the troubled Greek economy is not lost on anybody.
- This change is transforming the world to the point where China's own terms started to be an unavoidable part of multilateral diplomacy. Where China's choices about engagement and disengagement had implications for all of us. I used to say in Brussels: nobody has the luxury of ignoring China anymore.
- I'd like to think that one of my more valuable legacies as EU Trade Commissioner was a concerted effort to fill that policy gap. We reframed

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the strategic relationship with Beijing. I spent a huge amount of time here and developed a huge amount of respect for China and for the scale of the challenge of managing China's transformation.

### **Crossing the G20 rubicon**

- And what I would argue today is that in the last year or two we have crossed a rubicon in this process of realignment in the economic world.
- The creation of the G20 has formalized what everybody implicitly understood, which is that the era of the G8 is over.
- This cannot have been lost on anyone who had negotiated at the WTO where economic weight translates into negotiating power much more explicitly, and in which the status of China, India and Brazil has risen accordingly.
- In part this has happened by accident rather than design – it was forced on us by the banking crisis and the need to coordinate policy for tackling the collapse in global demand. Although I suspect it would have happened anyway.

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- How we handle this change could not be more important. And the fact that the initial portents are not entirely positive should worry us a little. Many Europeans and Americans interpreted China's strategy at the Copenhagen Climate Change Summit as deliberately aggressive, even obstructive.
- US rhetoric on Chinese currency policy has been equally blunt. Over the last year exchanges on Tibet, Google and shoe tariffs have often had a very tense quality.
- And in this respect the fact that the G20 model has been forced on us by expediency and crisis does not help, precisely because our understandings of that crisis are conditioning how we think about this new world. And this is the key thing I want to talk about today.
- In particular I think there is a sense among some in China that the banking crisis revealed serious flaws in the western economic model. A model that China is often exhorted to follow, and which it now quite understandably regards with suspicion.

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- On both sides there is a germ of justification in these positions. There is also substantial misconception. Indeed misconceptions so big that they could undermine the new order right from the start. This is what I want to pick apart a bit today.

### **A failed model?**

- There is no question that the banking crisis has dented the confidence of the US and the EU in some aspects of their banking systems. But we need to be very careful before we leap from a specific criticism of financial markets to a sweeping dismissal of the Western model as a whole.
- There are some – and not just in China – who argue that the banking crisis somehow discredits the case for the economic openness that has characterized the last twenty years.
- That the big stimulus packages that have been deployed here and around the world are ushering back in an age of demand management and state capitalism.

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- This view look at markets with distrust, and it looks to the economic power of the state for confidence.
- Again, these assumptions are not entirely crazy. The model of global economic integration, especially the integration of capital markets, has certainly run ahead of our ability to govern it effectively.
- Many parts of the Western mortgage and investment banking industries suffered what can only be described as a crisis of professional and regulatory competence. British and American households carried too much debt.
- And of course the assumption that something as fundamental to the economy as the wholesale capital market could not be subject to something as human and irrational as panic was proved to be very wrong.
- The UK, Europe and the US all have committed to addressing these regulatory failures. And banks themselves need to go through a process of professional renewal and self-scrutiny.

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- On the other side of the equation, the necessary intervention of governments to recapitalise the banking system and to provide a degree of fiscal counterbalance for collapsing private demand was a useful reminder of the basic role of government as the guarantor of the stability of the system.
- And I'd be lying if I didn't say that British and European officials sometimes looked at the speed with which the more centralized Chinese government was able to deploy its stimulus package with a certain bureaucratic envy.
- And there is certainly an important role for government alongside the market in enforcing standards of social protection and equipping people with skills and investing in infrastructure.
- But does any of this undermine the basic case for open economies in which resources are allocated in the main by markets rather than governments? Does it undermine the case that effective companies and industries – including banking – need the stimulus and discipline of market competition to drive innovation and growth? I don't think it comes close to doing either.



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- Obviously European and American governments now face a very substantial challenge of cutting the sovereign debt incurred in fighting off recession. This is part of a wider challenge of economic reform in Europe. And it is true that the democratic nature of our societies makes these debates public and painful. And if politicians do not act responsibly this can be an obstacle to necessary action.
- But if politicians are responsible it also forces us to build consensus, to allow society to take ownership of difficult change. And that is probably the only way to make this kind of painful process genuinely legitimate.
- So I also don't accept the argument that says that having to manage economic change in the full glare of public scrutiny and the discipline of democracy is a weakness. Perhaps we trade some efficiency for greater legitimacy. That seems a fair trade to me in the long run.
- And I think that there are considerable risks for China (or the West for that matter) in thinking that there is a 'Western model' that has somehow failed. Because China ultimately is as dependent on

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open trade, and open investment as anyone, and this should be a shared goal. That can't happen if it is pushed or perceived as a Western negotiating position.

- And the relatively greater reach of the state in the Chinese economy carries risks – and I actually believe Chinese policy makers and economists know this very well.
- They know that centrally directed investment has been useful in driving export-led industries but it has also overheated the construction and property sector and distorted the balance of domestic and external demand in the economy. State—led banking – now flush with a huge stimulus – is absorbing and weakened by a lot of bad debt.
- Liu Mingkang and Liao Min of the China Banking Regulatory Commission could not have been clearer about this in their annual report two weeks ago, which openly worried about inadequate risk controls and bad debt.
- A \$1.4trillion increase in loans outstanding in 2009 – a third of outstanding loans extended in the last year. 20% of outstanding bank credit extended to

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opaque vehicles set up by local government to fund projects.

- Understandably, the government has raised capital requirements and will force local governments to borrow more transparently on capital markets.
- I don't say this to score points. I just think that it is important to recognise that there are weaknesses and strengths in all our models. We all face challenges of reform. And we all need to manage this reform while assuring – as the Chinese say – harmonious development. We have to take our people with us.
- A free market model of banking has its weaknesses, especially at the international level. But state-directed banking, like state-directed economic development more generally, has its own vulnerabilities.
- At the end of the day, a model built on excessive consumer debt is no more sustainable than one built solely on supplying the goods those consumers buy.

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- As so often, we need to learn from the best and worst in both models. But I don't think there is any case at all for backing away from the essentially open and liberalizing journey that China started off on thirty years ago.

### **Power and perception**

- But having said all that, I do think that there is a bit of a lesson for Western governments and firms in the aftermath of the banking crisis. They need to be open about the extent to which business and regulatory models they had strongly advocated have been shown to be weak.
- And there is a wider point there about the underlying assumptions in some Western governments about how the global economic and political infrastructure is going to develop from here. It is not going to be solely on Western terms. It can't be.
- Western governments often complain that China is not ready to 'engage'. It wants economic power, but is not willing to exercise commensurate responsibility. In the WTO. Or at Copenhagen.

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- But I have some sympathy with the Chinese view that says that they are being asked to buy into and enforce a model of global governance that was not written with their interests in mind. That's not a malign conspiracy, its just a fact of life about the post-second world war world.
- So it is important to reform the IMF and the World Bank and the other international institutions to reflect Chinese weight and relevance. And it is important that both WTO and climate change negotiations are not open to the charge of the EU and the US setting out the rules for everyone else once they have secured their spot at the top of the pile. But I actually think these principles are pretty well accepted. And acted upon.
- Some of my Chinese friends say to me: you in Europe can't expect to lead in China's name. And that's of course true. But at the same time there is a strong sense that China is not yet really ready to lead in its own name.
- And yet without China there will be no global climate change settlement. No Asian security architecture. No sustainable rules for open trade and finance. And China needs these things as much as anyone. That's the reality.

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- But at the bottom of this tension is a problem of perception. And you cannot underestimate its importance. From the outside, China looks like 10% growth, barely slowed by global recession. It is a juggernaut, a tectonic shift in the global economic order. It has completely reshaped our markets in Europe and the US.
- But in my experience Chinese leaders see 10% growth as the bare minimum they need to create the jobs to meet the expectations of an urbanising and industrializing country with a very impatient taste for prosperity.
- They see it as the only way to manage a transition from a largely agricultural society to an entirely modern one in the space of two or three generations. And those generations are getting old very fast.
- We in the West see China as increasingly powerful and rich. China sees itself as still, in many respects, worryingly poor.
- Which is just to say that most Europeans and Americans simply cannot grasp the huge scale of

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the challenge of governing China at this critical period in its development. They see China as inward-looking because they simply don't grasp the scale of the challenge that preoccupies China's leaders.

- I think understanding this can help us condition expectations better on both sides. Instead of getting into a debate about who has the better model, or trading rhetorical blows on issues like the currency, we can get on with building one that preserves the openness that has brought such immense benefits to both sides, and which protects all our interests for the future.
- We can condition Western expectations with a bit of humility, and a bit of realism – but we also need to recognise that Chinese disengagement from the evolving landscape of multilateral governance at this important point is not in anyone's interests, including China.
- As I said at the beginning, nobody can dictate China's development, but nobody has the luxury of ignoring it either. Fundamentally we need to recognise that in a highly integrated world our collective success depends on our individual successes.

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- My five years of working with Chinese counterparts as a senior European and British official left me in little doubt of the difficulties we face. But it also left me with a very strong sense of how important getting this right is for all of us. And that, it seems to me, is a good message with which to end.

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