# Effects of the debt crisis on the EU-China relations

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*The economic (debt) crisis has become serious in the EU and in the Eurozone especially in the last few months. The European Financial Stability Facility (EFSF) was created as an instrument to handle this situation. But the financial contributions of the EU Member States seem not to be enough and China appears as a potential contributor. It is often cited that China offered Portugal and Spain in March 2011 to support their crisis management. However, recently, there are attempts from the side of the EU to convince China take part in the EFSF. Thus the question raised often in Europe is the following: Will China contribute to the EFSF? If yes, what conditions will the country raise? What are the arguments of the Chinese capital both in China and the EU? Consequently, our research is focusing on the impacts of the global financial and economic crisis on the new relations between the European Union and China.*

*China's enormous reserves enable the Asian financial assistance to European countries in crisis management but there are a number of questions related to this. The main findings of this study are that China can benefit from its European crisis management from many aspects, as the EU is the largest market for the Chinese products. Furthermore, reserve currency diversification and political considerations cannot be neglected, either. But the assistance may have serious risks for China: not only the expected return on investment is at a stake, but internal social and political tensions can emerge from helping the Europeans who still live in significantly higher wealth than most of the Chinese people.*

*Adopting Chinese capital raises questions for the European Union, as well. China may impose such terms by which the EU may become vulnerable and get into a dependent position, then presumably it will be difficult to solve the cooperation.*

**Keywords**: European Union, debt crisis, China, crisis management

## 1. Introduction

Recently, it is a well-known fact that capital doesn't flow from developed to developing economies but between rich countries. Lucas (1990) gives a few explanations for this phenomenon. However, since the early 2000s, capital has been flowing specifically from emerging economies (especially from China and oil-exporting Arabian countries) towards developed countries, primarily to the United States. It is a paradox situation that today China as a developing country finances the United States' debt. Because of the low savings rate of the US, China's enormous currency reserves help the Americans to be able to consume more than they produce (Morrison and Labonte, 2011). This leads to global imbalances between savings and investment, and these imbalances play an important role in the current crisis in most countries.

Owing to managing the financial crisis, budget deficits both in Europe and in the United States have become more significant recently because of the high social expenditures. By now the main issue for Europe is how to reserve its competitiveness. Although the Lisbon Strategy declared that the EU would be the world's most competitive economy by 2010, this aim has not been achieved, and the new long-term strategy (EU 2020) is about to raise the competitiveness (employment, innovation, energy, environment, poverty) while handling the negative effects of the crisis. In general, Europe has been facing serious challenges: achieving technological development, improving employment and reducing government deficits. Since the EU is an open integration in an economic sense, its position is strongly affected by global processes, too. It is clear that today while the renminbi is undervalued, the dollar is highly overvalued owing to its role as a “global currency”. A consequence of the crisis can be a massive appreciation of the euro against the dollar, which would continue to worsen the EU’s competitive prospects.

This paper concerns the process of the deepening of EU’s crisis and the possibility of cooperation between the EU and China to handle it. Our research objective is to determine the motives and risks of the cooperation from both sides. The basis of the analysis is that it is often cited that China’s foreign exchange-reserves (amounts to 3 197.5 billion USD in 2011 according to the SAFE (2012)) enable China to finance the Eurozone’s deficit. The first section deals briefly with the root of this entire question, and gives an overview about the European debt crisis and its deepening. Then we present the actions taken so far corresponding to the common Chinese-European crisis management. After it we examine the background of China's approach to Europe and the (economic and political) consequences that the EU needs to take into consideration, as well.

## 2. Europe’s deepening crisis

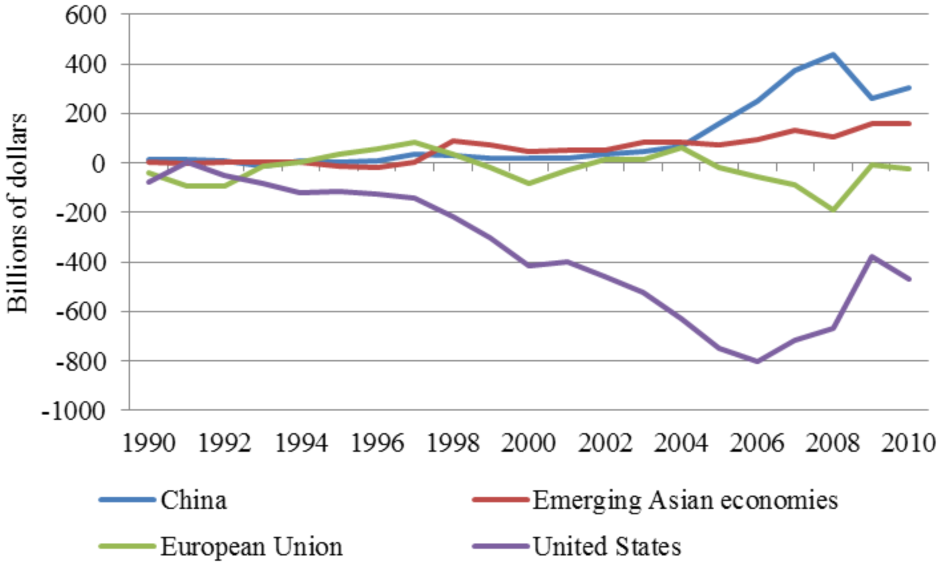
Europe and the United States live in dependence on each other, and as a result of it, the European Union is not able to avoid any economic failures, turmoil coming from the United States (Dallago and Guglielmetti, 2011; Wyplosz, 2010). This happened in the case of the 2007 crisis, as well. In this section, we give a short overview about the situation of the European Union during the crisis but avoid describing the crisis management of each country. We are trying to answer the following questions: who should finance the crisis management? Should the larger economies (such as Germany or France) take more responsibility for handling the crisis?

### 2.1. Global imbalances

Several factors contributed to the increase of global imbalances, like consumption-fueled growth in the US which resulted fiscal deficit and households’ indebtedness (thanks to low interest rates), that fostered a dramatic rise in the current account deficit (Botos, 2007; Dunaway, 2009). Meanwhile savings (denominated in USD) and current account surpluses of emerging economies have gradually increased, especially in China (Figure 1). China could hold this position owing to its enormous exports and China's policy of keeping its currency, the renminbi depreciated.

The role of the European Union in the global imbalances is different. The current account of the EU was reasonably balanced in the last two decades (aside from the year 2008), as shown in Figure 1. But the aggregated data may be misleading. The Eurozone’s data are similar to the EU’s, but if we examine the individual countries we can explore significant differences in the balance of payments. The worst performing EMU members (Spain, Italy, France, Greece and Portugal) were continuously increasing their deficits since the early 2000s but this was offset by Germany’s and the Netherland’s surplus (UNCTAD, 2012). All these imbalances are somewhat reasons for a global and European crisis.

**Figure 1: Balance of payments**

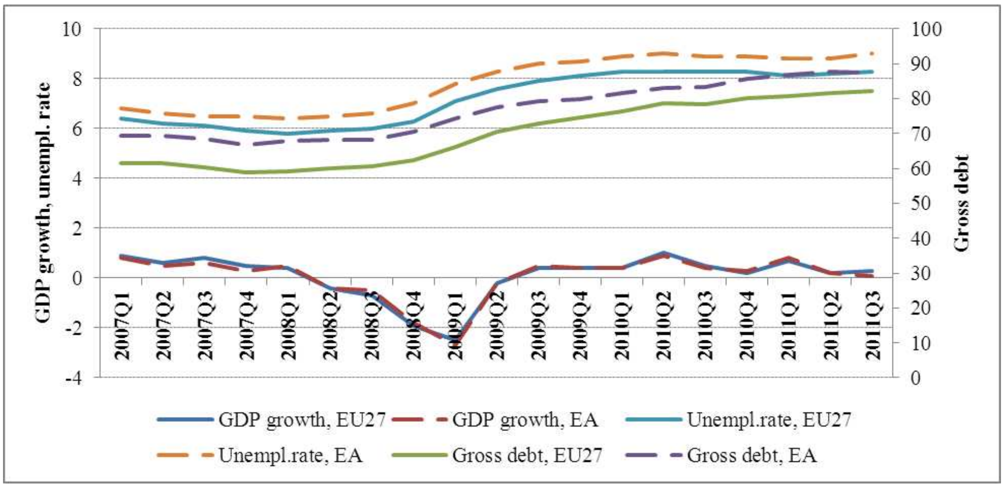



Source: UNCTAD (2012)

## 2.2. Crisis in the EU

The global financial (later economic) crisis stemming from the United States has had negative impacts in the European Union since 2008. Since then several economic problems have occurred in the European Union. The impacts of the crises can be seen on some selected economic indicators (Figure 2). The figure contains quarterly data of the European Union and the Eurozone as a whole. Regarding the GDP growth, the EU 27 and the Euro area presents the same trend: from the second quarter of 2008 the GDP started to decrease, and a year later, from the second quarter of 2009 started to increase again. However, there is a slight volatility: the peak was in the second quarter of 2010, then came again a small drop, but nowadays the GDP growth seems to be stagnant.

**Figure 2: GDP growth, unemployment rate (%) and gross debt (% of the GDP) in the European Union and in the Eurozone, quarterly, 2007-2011**



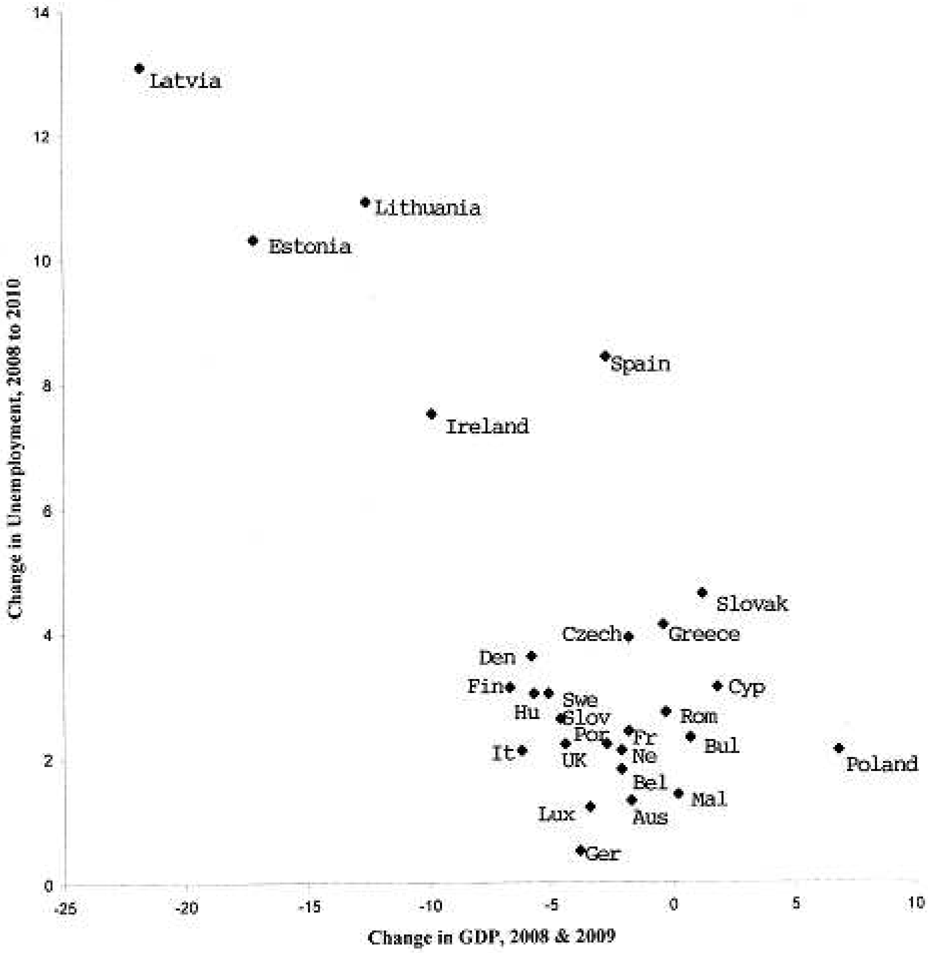

Legend: EA: Euro area

Source: own construction based on data of Eurostat (2012)

Regarding the unemployment rate, the Euro area suffers from higher unemployment: it has exceeded 9 per cent recently, while the whole EU stands at about 8 per cent. Note, that there are great differences among Member States: the largest unemployment rate can be seen in Spain (around 20 per cent according to Eurostat). Furthermore, the government gross debt has been increasing continuously: the Euro area nears 90 per cent of the GDP, while the whole EU stands near 80 per cent of the GDP. These aggregated data gives a short overview how the European Union experienced the crisis from 2008 onwards. The aggregated data cover the differences between the performances of the Member States, which may mislead.

Member States of the European Union reacted to the crisis in different ways (Figure 3). Some countries did not experience any recession or only a smaller one (Poland or Malta), while other states dropped into a great recession along with very high level of unemployment (for example, Spain or Ireland and the Baltic states). Altogether, the former cohesion countries have been the main losers of the crisis. The reason for this is that they suffered from several structural problems before the crisis appeared in Europe; it was the last "shot" for these countries. In the first years of the 2000's, a bubble appeared on the real estate market in several countries, such as Ireland or Spain. Both of them joined the Eurozone what resulted lower interest rates in the countries. As a result, rules of lending became looser, therefore the demand for properties increased heavily, raising their prices, as well. Before 2008, signs for a crisis appeared in these countries and the crisis arriving from the United States made these effects much stronger.

**Figure 3: Changes of unemployment and GDP growth in EU Member States**




Source: Cameron (2010, p. 26)

Kondor and Staehr (2011) investigated the impacts of the global financial crisis on the output performance of the EU-countries. Using regression models the authors found that financial deepening and high financial leverage (including variables such as current account deficits, private loans growth, net investment position), and large degree of trade openness negatively affected the output performance, while the level of financial depth did not have a negative effect. Furthermore, government deficits and government debts did not have an impact on output performance. All these refer to the fact that the larger the degree of financial and economic openness was, the larger losses the countries experienced in their output performance.

Managing the crisis has become a great challenge in many countries and the EU as a whole. The tools for this were almost the same in the Member States: offering guarantee for bank deposits, bailing banks out, or trying to handle the unemployment. Furthermore, the crisis affected several common policies of the EU: for example, new investment projects were accelerated, and as the cohesion policy ensures large financial resources, this policy cannot avoid the effects of the crisis (Radulescu and Ioan, 2009). Furthermore, the Eurozone fall into a deep crisis. This crisis is hard to manage since the countries face with different problems: sovereign debt crisis in Greece and Portugal, real-estate and banking crisis in Ireland and Spain or bank vulnerability in Germany and France (Hellwig, 2011). Since the Eurozone contains the largest economies of the European Union, the negative impacts cause difficulties in the whole integration. Nevertheless, the crisis in the Eurozone reflected that there are unsustainable structural components in the monetary union, and the gap between the periphery and the more resistant countries became wider as a consequence of the crisis (Dallago and Guglielmetti, 2011).

The need for financial resources is urgent. Instead of analyzing the potential reforms of the Eurozone (see, for instance, Hellwig, 2011), we are to investigate a potential lender of the financial assistance, and we pay great attention on how China may participate in the European Union’s crisis management and what kind of motivations may stand behind its assistance.

## 2.3. When does Europe survive/overcome the crisis?

In many countries it took several years to handle the crisis. A good measure for this is the real GDP growth and the years needed to reach the pre-crisis growth rate (Table 1). In 2009, almost every country experienced GDP decrease, except China with its more than 9 per cent growth. Regarding the years needed to come back to the pre-crisis level, it varies across countries: China needed no years, while the United States only one. Furthermore, there are great differences between the EU members: Germany and France are to reach their pre-crisis GDP level, other Eurozone members such as Greece, Ireland, Italy, Portugal and Spain are expected to be still under that level in 2012. However, Spain is nearer to that level than Greece or Ireland.

In a crisis situation, the protectionist trade measures are in the foreground, since countries are about to hinder deeper crisis and try to ensure market for the domestic producers to survive the difficult period. However, the European Union keeps using antidumping measures – and Vandenbussche and Viegelahn (2011) found that these measures target mainly China, meaning that the European Union – before, during and after the crisis – tries to protect its single market, especially from countries and industries which have similar product mix. Furthermore, the authors found that there is no significant difference between pre-crisis and during-crisis antidumping measures of the European Union. In general, the European Union was and still is a protectionist economy.

**Table 1: GDP growth (%), changes of GDP year to year and the number of years achieving pre-crisis level in the EU and in selected countries**

| Country / GDP growth | 2009 | 2010/2009 | 2011/2009 | 2012/2009 | Number of years |
|---|---|---|---|---|---|
| World | -0.5 | 104.5 | | | 1 |
| USA | -2.6 | 100.1 | | | 1 |
| China | 9.2 | | | | 0 |
| EU-27 | -4.1 | | | 101.5 | 3 |
| Eurozone | -4.1 | | | 100.9 | 3 |
| Germany | -4.7 | | 101.1 | | 2 |
| France | -2.5 | | 100.5 | | 2 |
| United K. | -4.9 | | | 100.2 | 3 |
| Greece | -2.0 | | | 91.8 | More |
| Ireland | -7.6 | | | 93.7 | More |
| Italy | -5.2 | | | 98.4 | More |
| Portugal | -2.5 | | | 96.9 | More |
| Spain | -3.7 | | | 98.5 | More |
| Hungary | -6.7 | | | 99.8 | Just |

Source: Inotai (2011, p. 363)

The aforementioned data in Table 1 reflect that there are economic problems in the Eurozone, mainly with the former cohesion countries (Ireland, Greece, Spain and Portugal). Therefore the question is raised: to avoid infection, is there any possibility to finance the bailout by common financial resources?

## 2.4. Who finances (should finance) crisis management in the European Union?

Managing the European crisis required a new kind of cooperation from the part of the EU and Eurozone members (Inotai, 2011). And the question is: who has to finance the crisis management? Since the EU budget is very narrow (equals to 1 per cent of the EU GNI), and it finances only common policies (including agriculture, cohesion, research and development policy), there is only a small policy space to act together in a crisis and to handle its consequences through common financial resources (Dabrowski, 2009). As a result, at first, the countries themselves were responsible for managing their own problems, resulting growing budget deficits. This situation is described by Inotai (2011, p. 368.) as “management of the costs of the crisis management”. But later more serious problems came up jeopardizing the Eurozone itself. The greatest challenge in the Eurozone is connected to Greece and handling the Greek debt crisis, and to avoid the infection to other peripheral countries such as Portugal or Spain.[1]

Gros and Mayer (2011) estimate that more than 2 trillion euros (exceeding 20 per cent of the Eurozone’s GDP) is needed for bailing out the whole periphery in the Eurozone (Greece, Italy, Ireland, Spain and Portugal) – and this should come from European sources. However, the EU-27’s contribution to the EU budget amounts only to 108 billion euros. Therefore the question is unambiguous: who should finance it? To rescue the Eurozone, the so-called European Financial Stability Facility (EFSF) was established in May 2010 to provide loans to countries with financial difficulties, to finance recapitalization of financial institutions, and to intervene in the debt primary and secondary markets (EFSF, 2012), However, Gros and Mayer (2010) emphasize that the fund of the EFSF is not large enough to stabilize markets.

[1] This paper is not about to describe the crisis management and the deepening crisis in several countries, therefore these issues are missed.

The financial crisis has impact on the EU budget. Inoescu and co-authors (2009) concluded that the financial crisis results a loosening budgetary discipline and an attempt is growing to find a solution not directly financing the EU Institutions from the Member States. Furthermore, in the European Union, the solidarity support does not mean a simple loan from the EU, but a loan from the Member States according to their share of the EU budget (Table 2). As a consequence, Germany – as the largest contributor to the EU budget – has to handle the EU crisis in the largest way (Türke, 2011). Furthermore, Greece is among the greatest beneficiaries. It can be accepted that Germany does not want to finance the problems of other countries.

**Table 2: The largest contributors to the EU budget (per cent)**

| Country | Average of 2007-2009 | 2010 |
|---|---|---|
| Germany | 19.3 | 19.5 |
| France | 16.6 | 16.7 |
| Italy | 13.5 | 13.3 |
| Great Britain | 10.4 | 10.9 |
| Spain | 9.5 | 9.3 |

Source: own construction based on Türke (2011, p. 22)

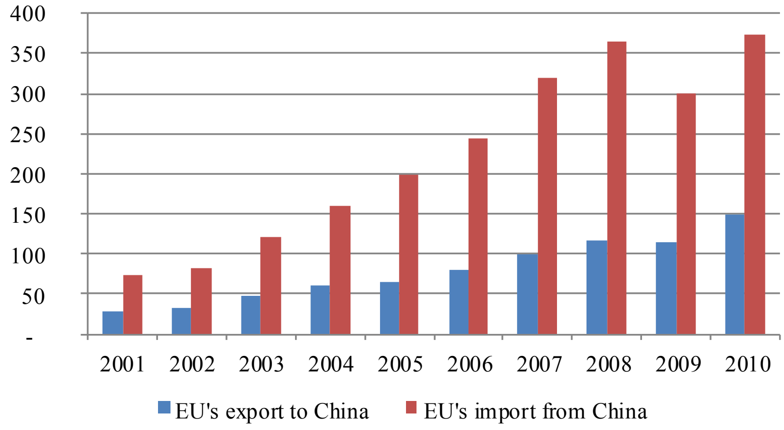
If there is a great debate about the share of costs and there are limitations in resources in the Member States (of the Eurozone), who could help stop a larger problem? If Germany (and the big Member States) does not want to help owing to their lower capacities, who could? As there are attempts both from the European and from the Chinese side for a potential Chinese financial contribution, we are to investigate this opportunity deeper.

## 3. China's approach to the EU

The collaboration between the European Union and China is not a new idea: the cooperation has evolved not only due to the crisis. There are several contracts between the two economies (including the bilateral agreements between China and the EU Member States) and since the early 2000s the two economies have considered each other as strategic partners (Szunomár, 2011) and negotiations started on a Partnership and Cooperation Agreement in January 2007 which would further improve the trade and investment relations between the EU and China (European Commission, 2006). This agreement is reasonable as China is the EU’s second trade partner, surpassed only by the USA, and the European Union is China’s biggest foreign trade partner (Zhimin and Armstrong, 2010). But the European trade with China is imbalanced: China runs a vast trade surplus with the EU, and the European import from China has been growing in a larger extent than the European export to China (Figure 4). This is the world’s biggest bilateral trade imbalance as since 2006 the EU’s trade deficit with China has been higher than the deficit with the US (Godement, 2011; UN Comtrade, 2012).

Nevertheless, the Chinese-European relations have not only economic but also political sense. Therefore, a series of annual EU-China summit started in 1998 as a stage for political dialogue (Zhimin and Armstrong, 2010). However, this strong relationship enables the pos-sibility of a sort of joint crisis management. Now we detail the main events of the Chinese-European cooperation in handling the EU’s depression.

**Figure 4: The EU-China trade relationship, 2001-2010 (billions of USD)**




Source: UN Comtrade (2012)

## 3.1. Chinese offer for Greece, Spain and Portugal

On the field of a potential common crisis management, the first steps were taken by China, but in this early period, these actions were severely bilateral. This means that at first China did not approach the Eurozone or the EU as a whole but only a few Member States, namely Greece, Spain and Portugal.[2] Common European turning to China happened only later, and parallel to this, former bilateral discussions continued and new ones started (primarily with Italy). Here we present China's movements to the three Eurozone countries for collaboration in reducing their general government gross debts.

- Wen Jiabao, Premier of the Chinese State Council declared already in May 2010 that China was ready to help Greece overcome its debt crisis (Reuters, 2010). This was not a special and direct offer from China; it meant only the Chinese support of the International Monetary Fund and the European Monetary Union (EMU) in aiding Greece. But it highly reflects on China's interest in not letting the Eurozone's crises deepen. Finally, in October 2010 China made a direct offer to buy Greek government bonds, and the two countries signed agreements on investment and trade (Daily Mail Online, 2010; Tandy 2010).
- At the end of the year 2010 China promised to buy Portuguese government debt of 5 billion euros (4 billion dollars) (Daily Mail Online, 2010). A year later, in December 2011 China Three Gorges Corp energy producer bought a 21 per cent share in Energias de Portugal for 2.7 billion euros (Financial Times, 2011). This transaction was a real success in the Portuguese privatization process.
- In January 2011 Chinese Vice Premier Li Keqiang visited to Spain and started to reconcile about signing corporate deals and buying Spanish public debt for approximately 6 billion euros (7.5 billion dollars, equal to the total sum of the Greek and Portuguese purchase) (Cala, 2011; Gleave and Lawson, 2011). In fact, the major part of the commercial contracts was realized in October 2010, when Chinese Sinopec bought 40 per cent of the Spanish Repsol's Brazilian subsidiary (for 7.1 billion dollars) (Dowsett and Aizhu, 2010). All these indicate that by now China has invested in oil assets not only in African but in Latin American emerging economies, as well in order to maintain its own economic growth. In the spring of 2011 China confirmed that the country would invest in Spain's financial sector, as well and continue to

[2] In this study we concern only with the Eurozone Member States, thus we do not deal with discussions between China and other EU Member States (for example Hungary).

finance the Spanish public debt (China Daily, 2011). By that time, China has already owned about 10 per cent of Spain's foreign debt (Cala, 2011).

Although the financial resources of China were important for these individual European countries, these bond acquisitions themselves were not enough to hinder the deep crisis in the European Monetary Union. This statement can be confirmed by the fact that in the fall of 2011the European Union itself turned towards China for more and other types of support.

## 3.2. The EU's request from China

In October 2011 the head of the European Financial Stability Facility, Klaus Regling travelled to Beijing to discuss the terms on which the Chinese government would inject money into the Eurozone economies (Groves, 2011). The plan was to leverage the 440 billion euro fund to more than 1 trillion euro by selling bonds and to structure a special purpose investment vehicle linked to the IMF (Jackson, 2011). As Regling had expected, the visit did not end with a concrete agreement but Beijing seems to agree to invest a greater amount of its enormous foreign exchange reserves in the European bailout fund (BBC News, 2011). What are the reasons of the country for investing in Europe? Why is it important for China to help the European countries overcome the crisis? In the following we investigate these issues.

# 4. Issues relating to the Chinese interference

The Chinese contribution in the European crisis management raises several questions on both sides. It can be assumed that China's approach to the Eurozone may not be altruistic, it has to have some self-interest in its helping hand for Europe. We have already mentioned the tight trade relationship between the two economies, but naturally there are other factors, too which influence the Chinese economic and supporting appearance. We are to present these factors in this section of the paper. Another question is raised from the European point of view: how important and how dangerous is the Chinese help for the EMU? The answer depends on several details out of which it is an important factor whether the Chinese investment in the EFSF (or other funds) will be provided in renminbi or in euro. We are to consider both cases.

## 4.1. China's interests in supporting the EU

In our approach, China has numerous reasons for decreasing the chance of deepening the Eurozone's sovereign debt crisis further. Beside the economic issues there are notable political motives too. Economic causes can be assorted in three major groups which are related to trade, investment positions as well as currency policy and foreign exchange reserves.

### 4.1.1 Trade

As we have argued before, trade relations between China and the EU have become very intense. China's number one merchandise export market is the EU. The 27 countries absorb approximately 20 per cent of Chinese commodity export (according to the WTO (2012), this rate was 19.7 per cent in 2010, amounting to nearly 311 billion dollar). In principle, the Eurozone's sovereign debt crisis may lead to decreasing demand for Chinese products, which obviously damages the Asian export-based economy.

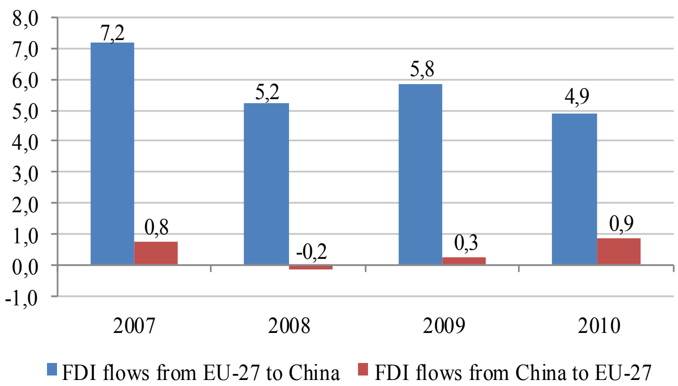
Notwithstanding, there are some researchers who do not agree with this statement. For example, Mei (2011) claims that the European demand for China's exports will not decline as long as the EU's big economies (Italy, Germany, France and Britain) do not collapse.[3] Furthermore, he highlights the fact that China has an enormous domestic market which is able to counteract the contraction of its export markets. Nevertheless, China as an export-oriented country having the EU as its large export-partner may suffer from the decreasing European demand, therefore the Asian country has great interest to help the European countries recover. In addition, the depreciation of the euro may aggravate the situation as it decreases the Chinese exporters' income. But alleviate this problem the fact that statistics show that 80 percent of China's foreign trade is settled in dollars, including its exports to the Eurozone (Mei, 2011). This means that the euro's depreciation against US dollar affects Chinese traders less seriously.

### 4.1.2 Investments

The value of the European direct investments in China is considerable and in recent years the EU's share in China's total FDI has increased (Ali and Guo, 2005; Zhimin and Armstrong, 2010). But the deepening EU crisis can generate a drop in European investments in China in the following years (Figure 5). Qingfen (2011) emphasizes that the EU's cut of investment in China by 378 million dollars in September 2011 is strictly connected to the debt crisis.

Indeed, Mei (2011) notes a "dual influence" of the Eurozone's crisis in this case. He believes that the European investments might decline in China because of the recession, yet other investors may turn towards China escaping from the contraction of their domestic markets. Leastways, total FDI inflow in China decreased from 2008 to 2009 and despite the fact that it increased later, it has not reached the 2008 level in 2010, yet (UNCTAD, 2012). This suggests that the EU still remains a very important FDI-donor for China.

**Figure 5: EU's FDI flows from and to China, 2007-2010 (billions of euros)**




Source: Eurostat (2012)

On the other hand, China has investments in Europe too. Although the volume of these investments are much smaller than the European FDI in China but they also have reached considerable amount, especially in recent years (Zhimin and Armstrong, 2010). China has trusted in Europe's economic prosperity and Chinese investments in the EU have been increasing continually since the crisis broke out (Figure 5). Hence the EU became the second biggest destination for Chinese outward FDI behind Hong Kong (Zhimin and Armstrong, 2010). China may have large losses if the euro depreciated resulting less worth of the Chinese investments. Therefore it serves as a very important reason why China needs to support the Eurozone and it to keep the value of the euro.

[3] Since the publishing of Mei's referred writing (Mei, 2011) Italy's situation has worsened, too.

### 4.1.3 Currency policy and reserves

Owing to its fast economic growth, China's share of the world's total GDP is approximately 9 per cent (UNCTAD, 2012), and it owns the largest amount of foreign reserves in the world, but the reserves consist mainly US dollars. With buying euro-denominated assets, China can realize a diversification in its currency reserves thus reducing the risk of keeping large amount of dollars. China's old desire to create a stable international financial system in which the dollar would be less dominant has been only strengthened due to the current economic crisis (Casarini, 2011).

In this context, Mihalakas (2011) draws attention to the so-called "Chinese Dilemma" about diversifying China's holdings of USD. It is true that the Chinese enormous dollar reserves increase the country's dependence on the USA and cause global financial imbalances. But the Chinese renminbi is pegged against the dollar at an undervalued rate in order to maintain the Asian economy's global competitiveness, and if China diminishes its US Treasury bonds' amount, it would lead to a significant strengthening of the renminbi against the dollar. This is obviously contrary to the Chinese interests and this is why Mihalakas (2011, p. 23.) claims that "Europe's leaders shouldn't expect anything more than symbolic Chinese support for the euro."

Godement (2011) mentions the possibility that China could lend Europe in renminbi. In this case the Asian country would transfer the exchange risk to the EU. Furthermore, this kind of agreement could internationalize the renminbi, which is expected to happen – sooner or later. The high reserves and the current crisis have highlighted for China that the internationalizing the renminbi is especially important. According to Gao and Yu (2009), China's potential benefits of internationalization of the renminbi are as follows:

1. The exchange rate risk for the Chinese companies would decrease.
2. The international competitiveness of the Chinese financial institutions would increase.
3. The cross-border transactions would boost.
4. Internationalized renminbi could offset the seigniorage that China has to pay to the US.
5. It could preserve the value of China's foreign exchange reserves.

With this knowledge it would not be surprising if China tried to take further steps in this direction.

### 4.1.4 Political impacts

Apart from economic issues, there are also political projections of China's potential financial assistance to the Eurozone. China can use its financial assistance to Europe as a bargaining power. It gives a large opportunity for China to achieve certain political objectives like the ac-ceptance of its market economy status or dropping the arms embargo by the EU. China might also force the EU to refrain from criticizing its human rights achievement. (We will concern these issues more detailed in section 4.2.)

Morris (2011) draws attention to a strange historic similarity: in October 1911, after China rose up in a revolution, European financiers lent money to the country. In contrast, in October 2011 Europe turned to China to borrow. According to Morris (2011), "it is one of the biggest turnarounds in history" and it illustrates well that China's global role has significantly changed during the past decades, not only in economic, but also in political sense.

Although Beijing has the potential to assist in the EMU's recovery from the debt crisis and has compelling reasons to do so, but the Chinese intervention may cause really important problems in the domestic society that the Chinese government cannot ignore. It is a sensitive point for Chinese people that though the Chinese economy grows in an amazing way, the level of living standards in the country stands at a low point, especially in the southern rural areas. Because of this, internal social and political tensions can emerge from helping the Europeans who still live in significantly higher wealth than most of the Chinese (Pierson and Lee, 2011). This is one reason for China not to be ”a lender of last resort” and Wen Jiabao has added that developed countries must be responsible for their fiscal and monetary policies and they have to cut the deficits in their country by their own instead of waiting for China to save them (Badkar, 2011).

## 4.2. What price should the EU pay for the Chinese assistance?

Having regard to its difficult situation, the EU has little choice in whose assistance it accepts during the process of the euro crisis management. Nevertheless, it is important to see what consequences the Chinese assistance may bring for the EU, because everyone is sure about that China may impose severe conditions in return for its help. There are both political and economic aspects of this question.

### 4.2.1 Economic consequences

It is evident that China does not want to waste its wealth and for this purpose the country will ask for guarantees on the European investments. Perhaps China will demand preferential trade terms (Groves, 2011), but we have not known these yet. But it is unambiguous that the EU will depend more on China.

We have already mentioned that if China decides to contribute to the EFSF, it can happen in euro or in renminbi. For the EU, both cases might have positive and negative effects.

- If China lend Europe in renminbi, it would transfer the exchange risk to the EU. This can mean a real danger if the internationalization of the Chinese currency starts and the overdue appreciation of renminbi begins. In this case the EU would have to pay back to China a multiple of the borrowed amount, and this can cause a much greater European debt crisis than the current one. Besides, this scenario might lead to a new situation in which neither the role of the euro would grow against the dollar, nor it would decrease compared to both the dollar and the renminbi in the global financial system.
- These kinds of risk would not occur if the EMU borrowed from China in euro. But the increased demand for euro could appreciate the common European currency against the USD and the renminbi, which would worsen the competitiveness of the European region (Botos, 2007).

These trains of thought should be subjects of detailed consideration among the European leaders.

### 4.2.2 Political effects

There is a very important Chinese request of political character with significant economic implications: Wen Jiabao expects the EU to recognize China’s market economy status as soon as possible in exchange for Beijing’s help (Casarini, 2011).[4] As a result of it, it will be more difficult for the EU to file anti-dumping cases against China in the World Trade Organization, while today the EU imposes strict restrictions on certain Chinese products.

[4] According to the rules of the WTO, all member countries have to recognize China's full market economy status by 2016 (Badkar, 2011).

In his article, Groves (2011) concerns with other possible political expectations of the Chinese regime in return for its contribution to the European bailout fund. He highlights the human rights issues as one of the most important questions. Experts agree that China is likely to ask for a cessation of EU's criticism on human rights abuses (Spiegel Online, 2011).

Another imaginable Chinese demand from the EU is to eliminate its arms embargo on China, which was imposed more than two decades ago, in response to the Tiananmen Crackdown in 1989 (Archick et al., 2005). Although the embargo is mainly symbolic (since China can purchase arms from Israel and Russia), Chinese are motivated in stopping these restrictions because they do not comply with the punishment that Burma or Zimbabwe obtained (Groves, 2011).

These requests discourage some Europeans to accept Beijing's contribution to the EMU's crisis management. Hans-Peter Keitel, president of the Federation of German Industry is one of those who say that the European Union has to be cautious and must not offer China a ”political trade-off” in return of financial resources (Spiegel Online, 2011). Moreover, if Europe yields to China in such political issues, it may cause problems between the US and the EU, considering that the States' interests do not meet China's further political headway.

## 5. Conclusions

The European Union, and especially the Eurozone, faced with a great challenge when it had to handle and manage the financial and economic crisis. In the first period, the countries' financial assistance and economic steps seemed to be enough for every country to survive the crisis. But several states – the former cohesion countries, and especially Greece – experienced serious problems. The Eurozone was – and is – in a crisis. The situation was not easy to overcome as the financial resources and the willingness of large economies to finance the costs were limited. As a solution, the external assistance appeared: both China and the European Union took steps to involve Chinese resources. At first, there were only bilateral attempts between China and some European countries, but later the official representative of the EU asked for negotiating the opportunities. In this study we investigated the motivations lying behind China's willingness: there are economic impacts and political reasons, as well. Trade and investment relations are important for China, while the country can diversify its currency reserves, or internationalize its currency by lending in renminbi, as well. Nevertheless, China risks social counteraction because of the social problems in the country: how dare the country lend money before solving the domestic problems?

Although China would gain on this “business”, several open questions remain in connection of its consequences on the European Union. If Europe now choses the easier way out of the debt crisis based on the Chinese capital in spite of domestic restrictions and strict fiscal policies, it risks both its economic and political independence, which may be disadvantageous in long term. Keep in mind, that the European Union imposes antidumping measures to protect the domestic producers, and the largest target of these measures is China. If the “lending deal” comes true, how much space remains for the EU to protect its market against Chinese competition? The question is, therefore, how to manage crisis and who finances the costs: do it alone or do it with somebody else?

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