

Britain and China: strong reserves of common ground

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At a turning point in both countries' development, Britain and China share strong reserves of common ground. In some important ways China and the UK are mirror images of each other. Over the past two centuries, both countries have displayed curiously juxtaposed patterns. Now, at a time of epochal international shifts, when the war in Ukraine has riven the world and America stands on the brink of a new and unpredictable Donald Trump presidency, it is worth examining how the two countries can combine forces in some key areas.

The Sino-British relationship is entering a new phase of relative warmth after a tense five years under successive Conservative administrations. Yet myriad potential sources of complication, conflict and confusion remain. As Kerry Brown of King's College London, a leading chronicler of British-Chinese relations, noted: 'The perennial search continues for a coherent policy framework by which to capture the complexity of working with China, acknowledging its importance, but also shielding against its less palatable and more problematic aspects.'¹

The landslide Labour election win in July 2024 provided the trigger for a change in course in the UK. A telephone call in August between President Xi Jinping and new Prime Minister Keir Starmer signalled a coming thaw.² This was followed by a bilateral conversation between the two leaders at the G20 summit in Brazil – astoundingly, the first personal meeting between Xi and a British prime minister for almost seven years.³ Progress is likely to become more evident with resumption in 2025 of a high-level economic dialogue between the two countries. Rachel Reeves, chancellor of the exchequer, is due to visit the country for the first such governmental exchange since 2019.

Many areas for co-operation despite strains

Despite the competitive strains and potential strategic conflicts accompanying China's spectacular 40-year economic ascent – and the more recent geopolitical inflections under Xi's rule – there are many propitious areas for co-operation. In reaction to full-frontal competition between the US and China in industry and manufacturing, China faces a major threat through heavy tariffs on American imports likely to be imposed in the early days of the Trump administration. A full-scale trade war in which China takes well-prepared retaliatory action would damage the world economy. Britain will not be able to sidestep these pressures. Indeed, it may be more exposed to strains than other countries in Europe.⁴

However, in financial services, somewhat removed from the main focus of US-China confrontation, Britain has some important comparative advantages. If applied in the right way, with due sensitivity over China's positioning vis-à-vis the US, Russia and the global South, these can bring benefits for both countries. The advantages may accrue also to non-British – especially American – financial entities in the City of London, which

may find a UK domicile provides a degree of additional assistance in Chinese transactions. China's prowess in manufacturing, technology and access to raw materials, both directly and through third countries, is now of unassailable importance. China continues to see the UK as an important repository of 'soft power' in areas such as education, media and communication, technical applications in key industries, and legal and business services.

Need for political surefootedness and strategic vision

Combining the two countries' strengths – at a time when the UK's relative position in the world will grow weaker, China's will become stronger – will require a combination of political surefootedness, strategic vision and implementation skills, which go well beyond anything either side has been capable of achieving hitherto.

Given the setbacks of the past five years, and the delicate position over issues such as human rights, Taiwan, Hong Kong and the Russo-Ukrainian war, no politician from either country would be rash enough to talk of restarting a 'golden age'. This was the headline term, selected with what now seems naïve over-enthusiasm, when David Cameron (aided by then-chancellor George Osborne) handled the relationship with China during his premiership from 2010 to 2016.

The British will treat some aspects of the relationship with circumspection for fear of damaging delicate arrangements with the US in defence, intelligence-sharing, military technology, advanced computing and artificial intelligence. Nothing can be taken for granted, but both countries should make a substantial effort to achieve mutual benefit – both for their own good and to help advance the interests of a wider international community.

Cycles of British and Chinese world power

Efforts to build on commonality must recognise that periods of British and Chinese world power have run in long cycles. For China, used to watching history through a long lens, this is of special significance. Ascendancy and decline have been broadly counter-synchronised. Britain's star has risen when China's shone less brightly, and vice versa. Before the age of globalisation started with Napoleon's defeat at the Battle of Waterloo, China was by a substantial margin the world's largest economy – even though, in view of its disconnection from the rest of the globe, it had little idea of how to use that power wisely or well.

As Britain gained scope, muscle and influence during the Victorian era and thereafter, China slid calamitously from its top position. The fall from grace at the hands of the UK and other European colonial powers still serves up disagreeable memories for the Chinese people and government.⁵ As Xi said in 2017, 'That page of Chinese history was one of humiliation and sorrow.'⁶

During the 20th century, it was Britain's turn to descend in the world rankings, gradually displaced, and then eclipsed, by the US as the number one industrial power. Now, following its dramatic rise, China is ensconced as the second most important economic power, although – in stark contrast to its 18th century position – interwoven into all parts of the world economy as the top trading nation. The year when China

eventually overtakes the US in terms of sheer gross domestic product, and the ensuing consequences, are open questions, but the direction of travel appears clear.

Britain at epicentre of struggle for superpower supremacy

In the struggle for supremacy between the superpowers, Britain may find itself more or less at the epicentre – a position from which it might suffer considerable discomfort as well as reap palpable rewards. Much is at stake. As economist Ricard Baldwin puts it, ‘The US is the world’s sole military superpower. It spends more on its military than the 10 next highest spending countries combined. China is now the world’s sole manufacturing superpower. Its production exceeds that of the nine next largest manufacturers combined.’⁷

Trump’s policies towards China – how ‘Trump the deal-maker’ will co-exist with ‘Trump the competitor’ – are bedevilled by uncertainty and unpredictability.⁸ The unsavoury reality for Europe is that both the US and China are likely to resort to similar ‘divide and rule’ tactics to separate individual European countries – including the UK – from the European mainstream.⁹ Trump in his policies towards Europe is likely to veer between supporting Europe’s frequently articulated but somewhat nebulous desire for ‘strategic autonomy’ – providing cover for weakening US ties – and applying pressure for individual countries to enact trade and military deals beneficial to America.¹⁰

Yet, in this interplay of forces, America should be aware of the risks to its own position from a further degradation of Europe’s position in the world. A further heightening of Europe’s vulnerability to the economic and political consequences of American isolationism and a strengthened Russian-Chinese relationship would leave America badly weakened.¹¹ If America under Trump overplays its protectionist hand, and becomes known as an unreliable business partner, this would further strengthen China’s desire to portray itself as a champion of globalisation and multilateralism.¹² This could drive a range of nations from the global South, and perhaps even Europe, into the Chinese fold, undermining America’s premier world role on which the country and its 47th president set so much store.¹³

Sobriety rather than exuberance: no talk of restarting ‘golden age’

This potential disturbance for the US may help strengthen Britain’s difficult-to-pull-off position as an equilibrating force between two economic behemoths. The last time the world leader in manufacturing was dispossessed was when the US surpassed the UK just before the first world war. It took the US decades to rise to the top, whereas the switch from American to Chinese leadership took only 15 or 20 years. It is too early to predict the long-term consequences of this dominance, but they are likely to be disquieting. The coming era will undoubtedly be marked by sobriety rather than exuberance.

However, the new UK government appears to espouse the view that Britain cannot afford, from both economic and geopolitical standpoints, to run adversarial relationships with both Russia and China at the same time.

This was one of the reasons why, in advance of the US presidential election on 5 November, Britain attempted to reset the relationship with Beijing. The Starmer government can argue that ministerial engagement with China had fallen well behind

the US pattern. The previous 18 months had seen a summit between Xi and Biden in San Francisco and headline visits to Beijing by three leading members of Biden's administration: Gina Raimondo, commerce secretary, Antony Blinken, secretary of state, and Janet Yellen, Treasury secretary. The scene-setting October 2024 visit to Beijing by David Lammy, the newly installed UK foreign secretary, in some senses represented a simple catch-up with the US.

American attitudes towards stronger Sino-British relationship

The Barack Obama administration in 2015 displayed initial hostility to Britain's membership of the Asian Infrastructure Investment Bank.¹⁴ The bank now has 110 shareholders (including prospective members), led by China, but pointedly without the US and Japan. It is firmly established as a smaller but permanent counterweight to the Bretton Woods institutions, the International Monetary Fund and World Bank, set up in 1944. It has though been careful to espouse the full gamut of western governance and operating standards. These include carrying out cofinancing with both the World Bank and the Asian Development Bank, adhering rigorously to US-led financial sanctions against Russia and its allies, and maintaining a central role for the dollar in financing and lending.

Despite this, American antipathy to AIIB and its actions could intensify under Trump. The British government and the AIIB leadership are considering a plan to establish a European funding hub in London in 2025, a move which would further increase its standing on international financial markets.

Jin Liqun, AIIB president since 2016, nearing the final year of his second five-year term, praised London's longer-term prowess as a financial centre, despite post-Brexit vicissitudes: 'The financial services sector represents UK's enduring competitiveness.' Despite Brexit, he said he sees 'no indication' of significant action by financial institutions to move out of London.¹⁵ 'We have followed the evolution of the international financial market, with more and more major cities getting increasingly assertive in developing their financial services capability. What we do not see is any sign of the possible waning of the UK's competitive advantage as a country of robust financial services.'

Like the AIIB, an institution sometimes regarded as its sister, the New Development Bank set up in Shanghai in 2015 and owned by the Brics countries (Brazil, Russia, India, China and South Africa) is a firmly dollar-based bank. America has long been wary of China-led efforts to dislodge the US from its pivotal position in world finance – sometimes known as efforts to set up a 'Beijing Woods' system. These sensitivities have increased since America-led sanctions efforts have led to a spate of countervailing moves to downgrade or circumvent the dollar's role in international trade and payments.

The Kazan meeting of Brics members in October, provocatively set to coincide with the annual meetings of the IMF and World Bank in Washington, was a diplomatic success for President Vladimir Putin. Yet it failed to take any significant new steps towards de-dollarisation. As China expert Herbert Poenisch pointed out in an OMFIF commentary, Brics is looking increasingly like a 'paper tiger' – the Kazan summit offered nothing new in economics and finance.¹⁶ 'A new cross-border payments system and even a common

Brics currency were on the table, with rumours of a petroyuan being established to replace the petrodollar. Russian government officials produced volumes of studies on many topics, ranging from agriculture, education, environment and energy to sports and counter-terrorism. However, the lack of adoption of any responsibilities by the participating countries and the failure to establish new institutions to manage the transition to a new world order showed a lack of political will to turn these proposals into a reality.'

Britain's financial deal-making capacity in bargaining with the US and China

Britain's opportunities for flexibility with China are subject to clear limits. But it can use its ability to strike public deals with the Chinese in the financial sphere and elsewhere as a component of bargaining in relations with both the US and China. There is a broad platform available for greater co-operation.

Fang Wenjian, chairman of the China Chamber of Commerce in the UK and general manager of Bank of China in London, said 92% of participating companies in a survey of the Chinese business community in the UK expect stable or increased revenue in the next two years. This was the most optimistic outlook since the survey's inception in 2020. Chinese businesses are playing a 'key role' promoting balanced UK development, Fang said, with 27% of respondents operating in regions outside the capital — a four-point increase from 2022.

The last session of the UK-China 'economic and financial dialogue' in June 2019 – at the end of the three-year premiership of Theresa May – finished with bold assertions about the future.¹⁷ The two countries proclaimed 'support for multilateralism and a shared goal of strong, sustainable and inclusive global growth'. And they promised to 'strengthen their economic co-operation, boost bilateral trade and investment, and deepen financial links'.

After a bout of large-scale political change – five prime ministers in five years – and the dislocation brought by the Covid-19 pandemic, Britain's departure from the European Union and the Russian invasion of Ukraine, the environment has shifted decisively. But it still seems likely that, if Reeves' visit to Beijing goes ahead, the next meetings will proclaim some equally far-reaching ambitions.

Neither the UK nor China has any interest in further fragmentation of the world trading system. At a more specific level, one big area will be in social security, in line with a new-found Chinese concern about its long-term weakness in safety-nets needed to protect retiree incomes.¹⁸ UK asset management and insurance companies can work with their Chinese counterparties to improve the running of the Chinese pension system to help overcome social and economic problems from the decline and ageing of the Chinese population.

Britain can provide advice on directing China's National Social Security Fund away from over reliance on cash and bond-like investments towards a greater proportion of equity assets, including holdings outside China, as well as investments in private as well as public markets. UK expertise may have special weight in view of probable political constraints on US asset management companies working directly and in a high-profile way with China during the early stages of the Trump administration. China will however need to spread its initiatives widely. In modelling its future pension system, it will need

also to consider countries such as Australia and Canada, which have very large capitalised public pension schemes, with heavy foreign investment, representing major forces on world financial markets.

Sustainable investment capabilities in transition finance

Forging sustainable investment capabilities, particularly in pooling expertise in the field of transition finance, is another important point of focus – furthering the work of the UK-China Green Finance Centre.¹⁹ Allied to this, co-operation in building resilient, transparent and reliable carbon markets would help realise China’s ambition to become an important international force in decarbonisation. There would be special value in marrying Chinese and British technological knowhow and financial expertise in low-carbon technologies, for example in developing the hydrogen economy where China is a world leader or in carbon capture and storage systems.²⁰

In banking and credit markets, Chinese banks might be able to play a greater role in North Sea wind energy and hydrogen projects. More generally, Chinese entities – including its largest banks as well as the China Investment Corporation, the sovereign fund and the NSSF – might act in support of the newly founded British National Wealth Fund²¹ to compensate for some of the investment lending lost as a result of Britain’s withdrawal from the European Investment Bank.²²

Depending on the overall political environment, developing energy from the North Sea in co-operation with China could be an area of combined European focus possibly linking the UK with other North Sea jurisdictions including Germany and the Baltic and Nordic countries.

Possible triangular relationship linking Germany

In view of the interlocking nature of trade and investment between Germany, the UK and China – and Germany’s extreme vulnerability to imports of high technology manufactured products in areas like electric vehicles – there is potential for Germany and the UK to work together over China. This could not only mitigate competitive problems but also bring mutual advantage in fields of finance and technology. Provided the political complications with Washington and Beijing are not too acute, this could grow into a triangular relationship between the three countries.

Britain is heavily dependent on Chinese capital investment in the UK and relies far more on financial services exports to the Chinese than on manufacturing. Germany by contrast is exposed because of its leading companies’ huge investment in Chinese manufacturing capacity. China’s industrial prowess and technological knowhow are now working through to enhanced Chinese exports targeted on Germany. These are undermining key elements of the German economy that were the mainstay of its 19th century rise to industrial power and its post-second world war revival.

This provides a highly unpleasant economic cocktail for Germany at an unstable time in the country’s politics ahead of the 23 February parliamentary election. It could provide the background for enhanced co-operation between the UK, Germany and China in finance and industry to underpin stable future patterns of trade and investment between the three countries.

Further work on internationalising the renminbi

Multilateral and European co-operation will be essential in further progress on internationalising the renminbi. The UK could repeat its performance in 2014 when, under the Cameron-Osborne administration, it became the first non-Chinese sovereign issuer in renminbi.²³ This could enhance a trend towards greater use of the Chinese currency in international borrowing aided by relatively low Chinese interest rates.²⁴

Further support could be given to sovereign borrowing by the Chinese government in London, as well other sovereign issuers, following the landmark China offering in 2016.²⁵ The UK Treasury would be keen to encourage China to issue 'green bonds' in London, in line with the UK's 'green gilts' programme.²⁶ In November, the China Construction Bank in London commemorated its 10th anniversary of renminbi clearing, with a cumulative total of Rmb100tn transacted during the decade, reinforcing UK progress as the leading non-Asian centre for renminbi trading.²⁷

Chinese and UK banks and government entities could work on providing facilities for foreign central banks to hold renminbi on deposits in London as well as in Hong Kong and mainland China – building on the roughly 80 central banks estimated to hold the Chinese currency in their reserves.²⁸ The renminbi's advance as a reserve currency has slowed since the Covid-19 pandemic, partly reflecting the yield differential between dollar and renminbi assets. Yet the currency's path towards greater international economic weight is a journey that the Chinese leadership is willing to measure in decades rather than years.

Outside crucial military and strategic fields, UK can act semi-independently

This list of financial projects underlines an essential reality of Sino-British co-operation. In existential matters of war and peace – whatever the possible hurdles thrown up by a new Trump administration – Britain will continue to rely heavily on the US as its principal international partner.

But outside crucial military and strategic fields, there are many areas where the UK can act semi-independently, including in partnership with other European countries. The UK like others has to be careful about erecting trade barriers with China in the supposed interest of protecting national security, when the fundamental reasons for such steps may lie far more in the realm of protectionism. Careful analysis is needed of risk and reward from such measures.

At a time of great uncertainty regarding the war in Ukraine, given the likelihood that some kind of peace deal will be engineered fairly early in the life of a new Trump administration, Britain's ability to provide diplomatic back channels and behind-the-scenes support may be of help in securing overall international recognition for whatever accord eventually emerges.

Joint mission on productivity in both countries

One of the major challenges for Britain, like other European economies, is weakness in productivity. Alongside the problems of an ageing society, overstretched public institutions and high public debt, low productivity growth will generate big future social, economic and political problems.

Unquestionably, China's helter-skelter expansion of the last 30 years is now giving way to a change of economic gear – a switch that could be accompanied by both domestic and external political strains. China will rely less on investment-fuelled exports – especially if trade wars with the US and barriers to its exports on other markets accelerate this shift – and more on internal consumption. This much-discussed transition was in evidence from 2009-18, but has stalled since that time, in line with the country's overall growth slowdown.

Nevertheless, the sheer size of the Chinese economy and its newfound prowess in many high-tech spheres mean that China adds a further portion of GDP each year equivalent to the size of a medium-ranking European country.

Despite the depredations of Covid-19 and the subsequent growth slowdown, China's GDP in current dollar terms has risen by \$3.6tn, according to the IMF. This is equivalent to the total size of the UK economy in 2024.²⁹ Whatever Trump 2.0 trials may lie ahead, this statistic needs to be borne in mind in considering future UK-China co-operation. Assembling the manufacturing, technology, trade and financial resources of the UK and China on a joint mission to build productivity in both countries would be a worthy task for the years ahead.

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