

BUSINESSEUROPE



# EU-CHINA RELATIONS 2015 AND BEYOND

March 2015



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## INTRODUCTION – WHY THIS REVIEW?

In 2011, BUSINESSEUROPE launched its report *Rising to the China Challenge*, an in-depth examination of China’s economic development and the state of the EU-China bilateral relationship. The report pointed to critical issues for China and the EU, highlighting key challenges and opportunities and gave concrete recommendations of how to address them in a constructive manner.

A SWOT analysis at that time, looking at strengths, weaknesses, opportunities and threats, gave the following result:

<p><b>Strengths of the EU</b></p> <ul style="list-style-type: none"> <li>• Technology / know-how</li> <li>• Strong presence in China</li> <li>• High quality of products &amp; services</li> <li>• International experience</li> <li>• European standards</li> </ul>	<p><b>Weaknesses of the EU</b></p> <ul style="list-style-type: none"> <li>• Strong currency</li> <li>• High risks for SMEs</li> <li>• Export power of China</li> <li>• Absence of level playing field with China on export promotion policies (2015)</li> <li>• Lack of EU diplomatic support</li> <li>• Dependency on raw materials</li> </ul>
<p><b>Opportunities in China</b></p> <ul style="list-style-type: none"> <li>• Huge and expanding market</li> <li>• High growth rates</li> <li>• Availability of raw materials (if access granted)</li> <li>• Availability of low-cost / skilled labour</li> <li>• Business partnerships possible</li> </ul>	<p><b>Threats in China</b></p> <ul style="list-style-type: none"> <li>• Technology transfer</li> <li>• Strong state influence</li> <li>• Discriminatory treatment</li> <li>• Weak IPR enforcement / counterfeiting</li> <li>• Retaliation</li> <li>• Subsidies</li> <li>• Differing domestic standards (2015)</li> <li>• Visa problems (2015)</li> </ul>

Now, three years later, it is time to take stock – which is the aim of this review. There are a number of very interesting new features, notably:

- today’s economic situation in the EU and in China;
- the reform agenda of the new Chinese leadership with President Xi Jinping and Prime Minister Li Keqiang;
- the future course of the new European Commission, together with the re-elected European Parliament and the European Council.

Additionally, both the European Union and China are involved either jointly or separately in very important trade and investment negotiations. Standing out for the EU are certainly the negotiations of Transatlantic Trade and Investment Partnership (TTIP). Individually, both China and the European Union have also stretched their fingers towards important Asian countries such as Japan and Korea but also fast developing economies in South-East Asia. At WTO level, the EU and China are part of



the revision of the Information Technology Agreement (ITA) and both parties are currently engaged in the plurilateral negotiations on an Environmental Goods Agreement (EGA). Last but not least, both sides have launched negotiations for an EU-China Bilateral Investment Agreement (BIA). And there are some external factors that might have an important impact, such as the Trans-Pacific Partnership (TPP).

This review is conducted against this background. It will look at the following subjects and should be read together with our 2011 report:

- What is China's economic position in the world today? Did Europe win or lose ground in a number of key sectors?
- How far did China further integrate into the global economy, did market economy reforms materialise? What can be expected from China's reform agenda?
- What is the future of EU-China relationship? Is the Bilateral Investment Agreement the right tool, or are different initiatives necessary?
- Has China made progress by working on the key recommendations that BUSINESSEUROPE made in 2011?

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## OVERVIEW OF PAST AND RECENT TRADE AND INVESTMENT TRENDS

China and the European Union remain major trading partners and their economies are strongly interlinked, with the EU respectively being China's top trading partner (€429 bn / 13.4% of total share), closely followed by the United States (€396 bn / 12.4%). For the European Union, the United States are the top trading partner (€484bn / 14.2%), and China being second (€428 bn / 12.5%). China's tariff levels have not changed substantially during the past three years. Compared to the figures used in our 2011 report, trade and investment have increased overall:

**Table: The EU-China Trade Relationship**

<p><b>Trade in goods</b></p> <ul style="list-style-type: none"> <li>• EU exports to China 2013: <b>€148.3 billion</b> (+80% compared to 2009)</li> <li>• EU imports from China 2013: <b>€280.1 billion</b> (+30% compared to 2009)</li> </ul> <p><b>Trade in services</b></p> <ul style="list-style-type: none"> <li>• EU services exports to China 2013: <b>€32.2 billion</b> (+71% compared to 2009)</li> <li>• EU services imports from China 2013: <b>€20.6 billion</b> (+47% compared to 2009)</li> </ul> <p><b>Foreign Direct Investment</b></p> <ul style="list-style-type: none"> <li>• EU outward investment to China 2013: <b>€3.2 billion</b> (+1% compared to 2009)</li> <li>• China inward investment to EU 2013: <b>€1.1 billion</b> (+1100% compared to 2009)</li> </ul> <p style="text-align: right;"><i>Source: DG Trade, European Commission</i></p>
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However, it is very interesting to have a closer look at the different years. For example, EU imports of goods increased significantly from 2009 to 2010 (+€68.6bn), but afterwards remained more or less stable. Following a peak in 2010 (-€170.5bn), in 2013 the EU's deficit in merchandised trade has a comparable level to the deficit in 2009 (-€132.9bn in 2009 / -€131.8bn in 2013). Main deficit areas are machinery products, textiles and clothing, and other manufacture products such as personal and household goods.

The situation is different in services trade, where the European Union continuously increased both its imports and exports. The positive EU trade balance in 2013 was about 2.5 times higher than four years before. Overall, export of commercial services to China now also take a bigger share in the EU's total value of services exported globally (4.8% in 2013 compared to 3.7% in 2009).

The figures on investment differ quite significantly year by year. Especially in the years 2011 (€20.1bn) and 2012 (€15.5bn), European companies significantly increased their investments in China. Similar changes, although at lower level, have been observed for China. Today's level of new EU investments in China is at a similar level as in 2009.

These figures are somehow mirroring the findings of the 2014 Business Confidence Survey<sup>1</sup>, conducted by the EU Chamber of Commerce in China (EUCCC). They report that two thirds of large companies stated that business in China has become more

<sup>1</sup> European Union Chamber of Commerce in China (EUCCC): Business Confidence Survey 2014



difficult, and half of European companies believe that the 'golden age' for multinational companies in China has ended. Naturally, this is also linked to the slowdown of the Chinese economy: the International Monetary Fund<sup>2</sup> predicts for the years to come decreasing growth rates: 7.7% in 2013, 7.4% in 2014 and 7.1% in 2015. As a result, European companies that have invested in China are setting more modest expectations. According to the EUCCC survey, only 57% plan to expand their current China operations, down from 86% in 2013.

An overview of key sectors, compared to the situation described in our 2011 report

## - **Chemicals**

Back in 2003, China's chemical sales were around €116bn, 8.7% of the global total. That was far behind the top trio of the EU, US and Japan. A decade later, China had become world leader in chemical output by a wide margin, with annual sales of €1047.3bn, a 33.2% share of the global total and far ahead of the EU's €527bn sales and 16.7% global market share. Today China is the EU's second-biggest chemicals trading partner, accounting for 9% of EU exports.

China has become the most important growth market for global chemical companies and a major investment location. While Chinese chemical companies are gradually increasing their focus on specialty chemicals, the country will remain a major importer of commodity chemicals for some time to come. Chinese expansion does not necessarily imply Europe loses out. Rather, there are wins for both and China offers many opportunities.

Fair market access is a priority for the sector, which believes that on-going talks about an investment agreement should ensure companies are treated equally irrespective of their nationality, ownership, type or size. China must honour the commitments it made when it joined the WTO in December 2001.

The sector regrets that active pharmaceutical ingredients (APIs) continue to face discriminatory entry-barriers, contrary to China's international commitments. The European chemical industry has also been regularly confronted with dumped imports originating from China. Though these are only a minute fraction of total chemical imports from China, anti-dumping measures restore a level playing field.

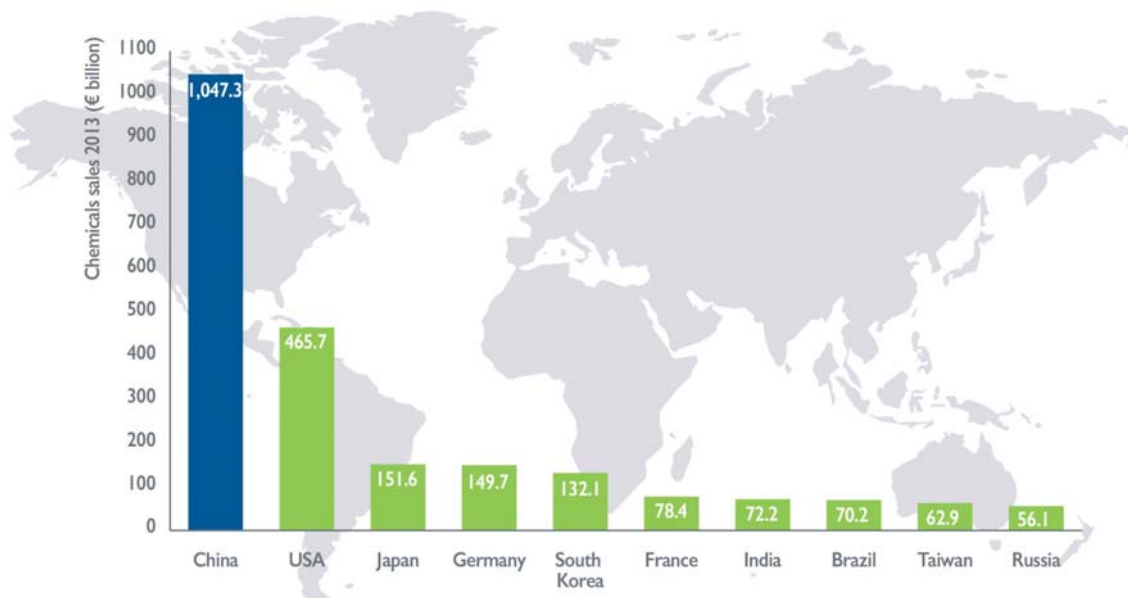
China would also facilitate the growth of its chemical industry and its trade with the EU if it accepted international standards for hazardous chemicals and addressed the practical difficulties that the industry experiences with the introduction of new substances on the Chinese market.

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<sup>2</sup> International Monetary Fund: World Economic Outlook (WEO) – Legacies, Clouds, Uncertainties (October 2014)



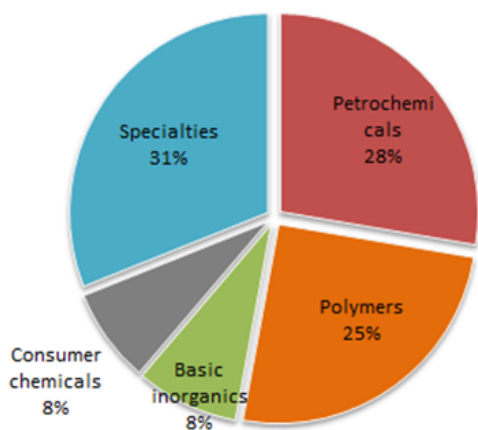
**China dominates chemicals world ranking**



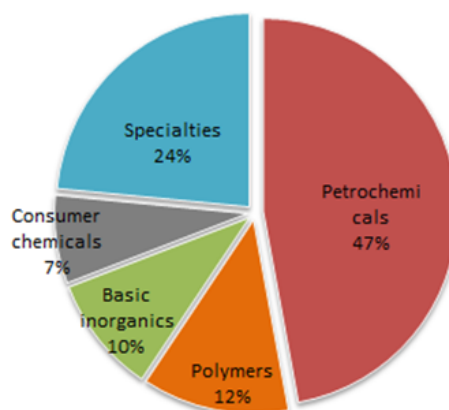
Source: Cefic, Chemdata International (2014)

**EU Chemicals Trade Flows with China by Sector (%)**

**EU Exports to China (2013, €10.6 billion)**



**EU Imports from China (2013, €9.3 billion)**

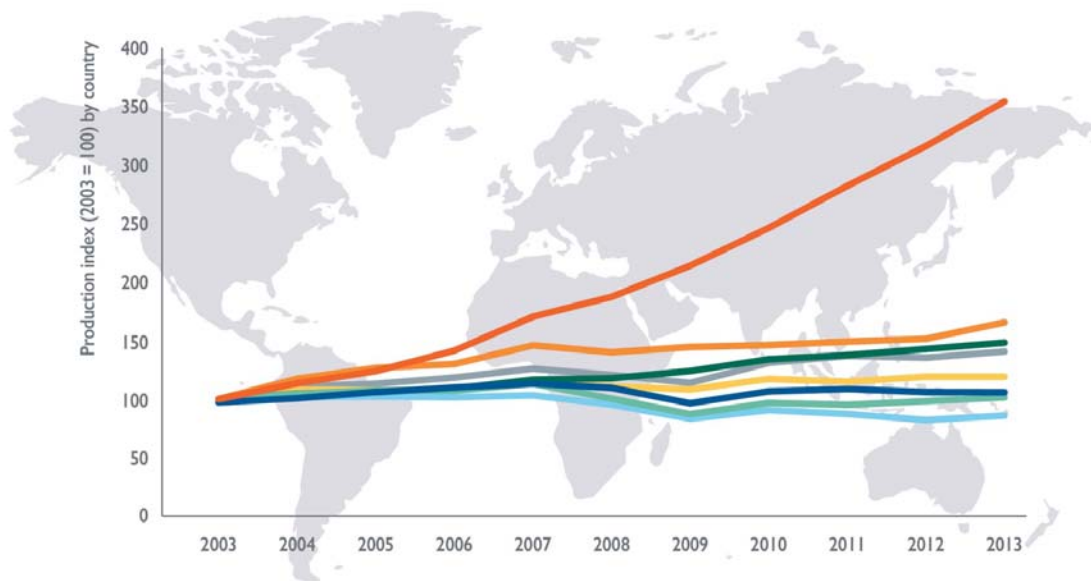


Source: Eurostat (Comext) and Cefic Analysis



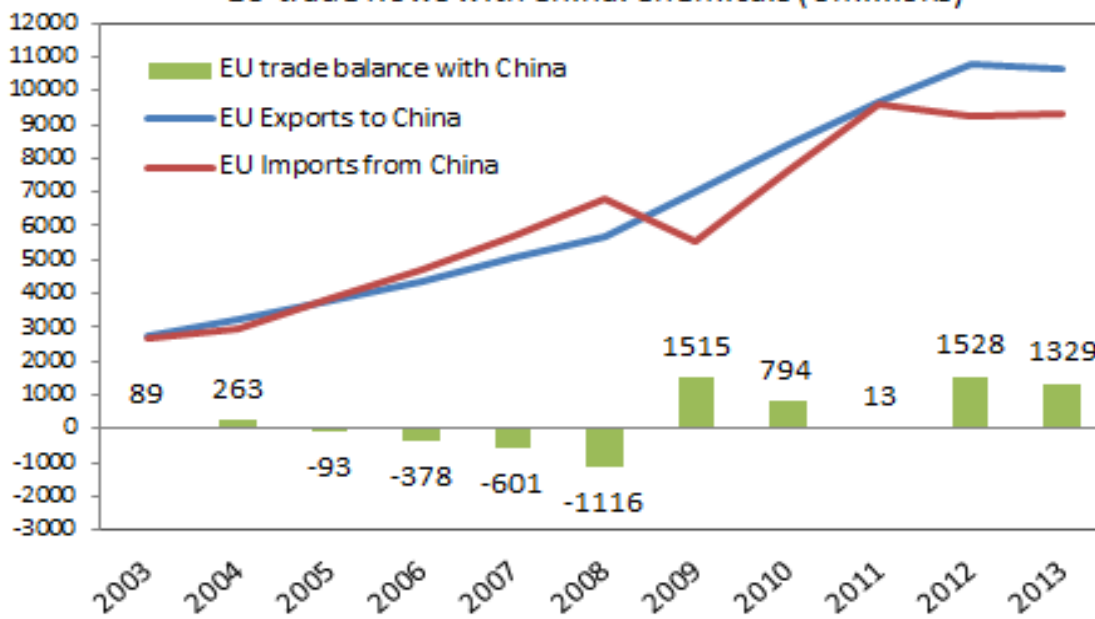
## Emerging economies outpace industrial countries in chemicals production

- China
- EU
- USA
- Japan
- South Korea
- Brazil
- Russia
- India



Source: Cefic Chemdata International (2014)

## EU trade flows with China: Chemicals (€ millions)



Source: Eurostat (Comext)



## - Automotive

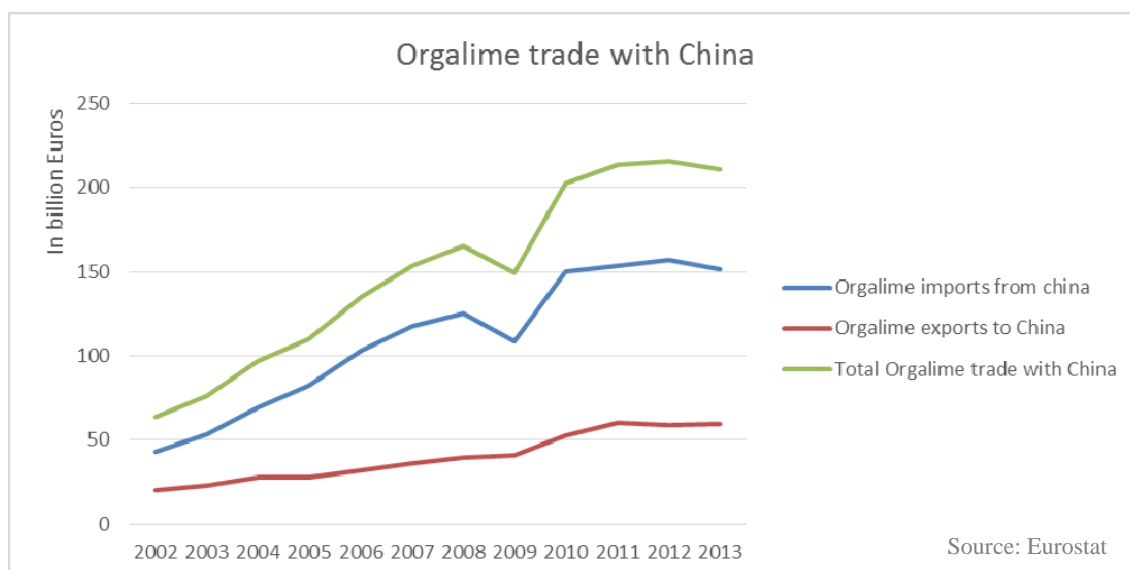
Increasing demand from domestic consumers has made China the biggest auto market in the world and the first manufacturer of passenger cars and commercial vehicles with 22,116,825 vehicles produced in 2013 (18,085,213 cars and 4,031,612 commercial vehicles). Chinese production now represents an impressive 25.3% of global automobile industry output, ahead of the European Union, Japan, the United States, South Korea, Brazil and India.

In 2013, the EU exported 559,033 vehicles to China, with a value of 20,031 million euro, and imported 169,569 vehicles from China.

The Chinese automobile market remains dominated by joint ventures with foreign partners (there is an obligation to create 50/50 Sino-foreign joint ventures in the automobile industry) governed by strict local content requirements. The aim is to allow local producers to build up a highly competitive car industry in the future.

## - Engineering industries (machinery and electrical)

During the past 12 years, the sector's total trade with China increased by almost four-fold from approximately €60 billion in 2002 to €210 billion. While both imports and exports have increased, the graph below shows that most of the growth in total trade came from imports into the EU from China. Between 2002 and 2013, the engineering industry's balance of trade deficit with China widened substantially from €23 billion in 2002 to €91 billion in 2013. Although imports have outpaced exports, the sector's trade with China as a percentage of total EU trade has remained stable over time: shifting from 50% in 2002 to 49% in 2013.





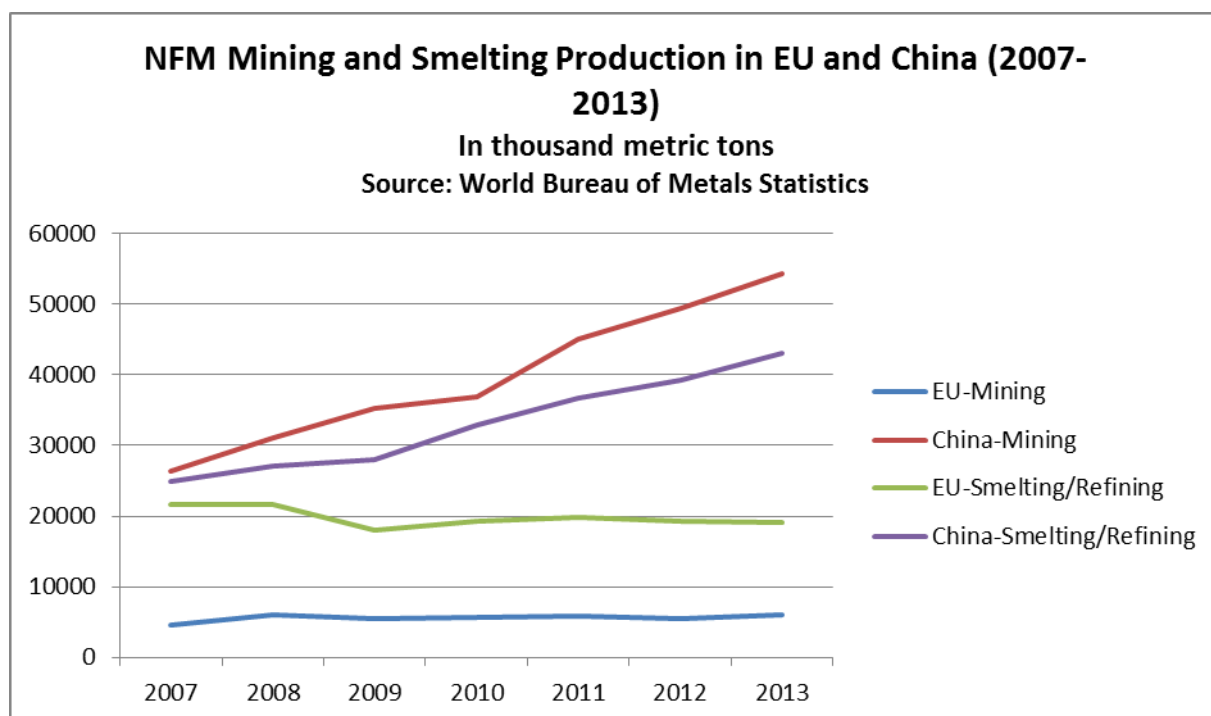


## - Metals

### *Non-Ferrous Metals*

1. Production Trends: As indicated in Chart No 1, China has significantly increased its mining capacity during the period 2007-2013, reaching a volume of more than 50 million tonnes in 2013, compared to a stagnant EU production of about 5 million tonnes. Smelting/Refining capacity follows the mining production trend with over 40 million tones of refineries' output in 2013 (almost 20 million for the EU)<sup>3</sup>.

**Chart 1: Non Ferrous Metals Mining and Smelting Production in EU28 and China (2007-2013)**

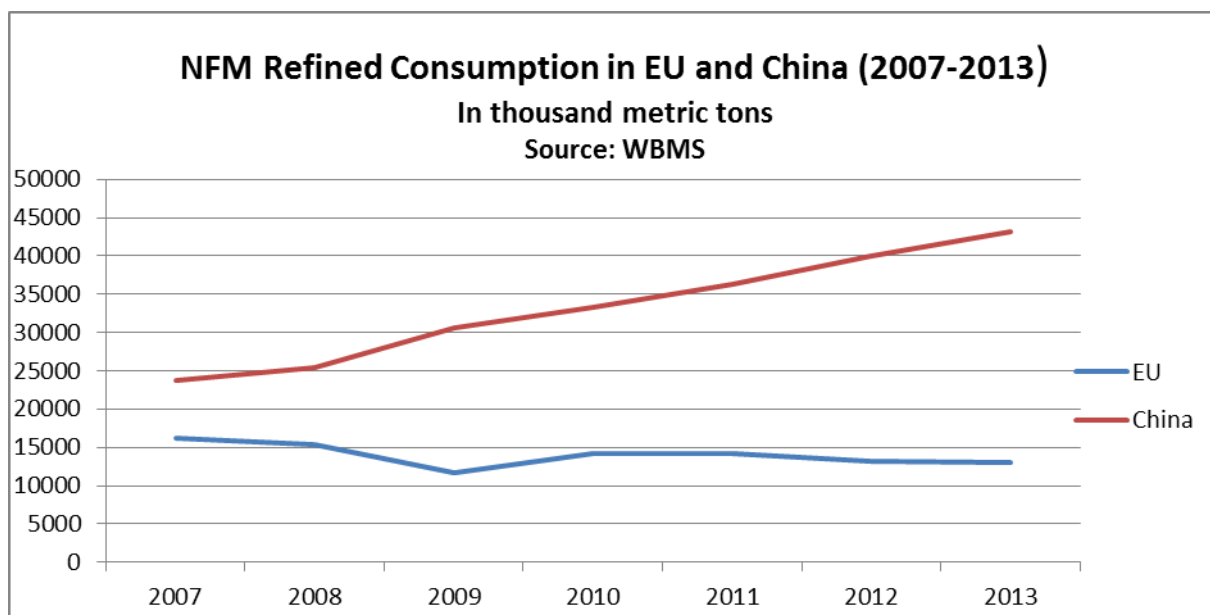


2. Consumption: Consumption trends in both EU and China follow the same pattern as production, with China consuming about 40 million tonnes of refined metal and the EU 13 million tonnes.

<sup>3</sup> Other countries that stand out in the NFM mining production are Australia (bauxite), Chile (copper).



Chart 2: Non Ferrous Metals Refined Consumption in EU28 and China (2007-2013)



Trade:

China’s increasing production and consumption of minerals and metals is mirrored in its trade with the EU, among other partners. EU has recorded an especially impressive increase of exports of ores and smelters’ output to China in the period 2007-2013, which can be explained by the increasing capacity of the Chinese economy to play a global role in processing and semi-fabrication and thus moving forward along the value chain.

For the Non-Ferrous Metals sector (NFM) the following data stand out: In 2013, China imported:

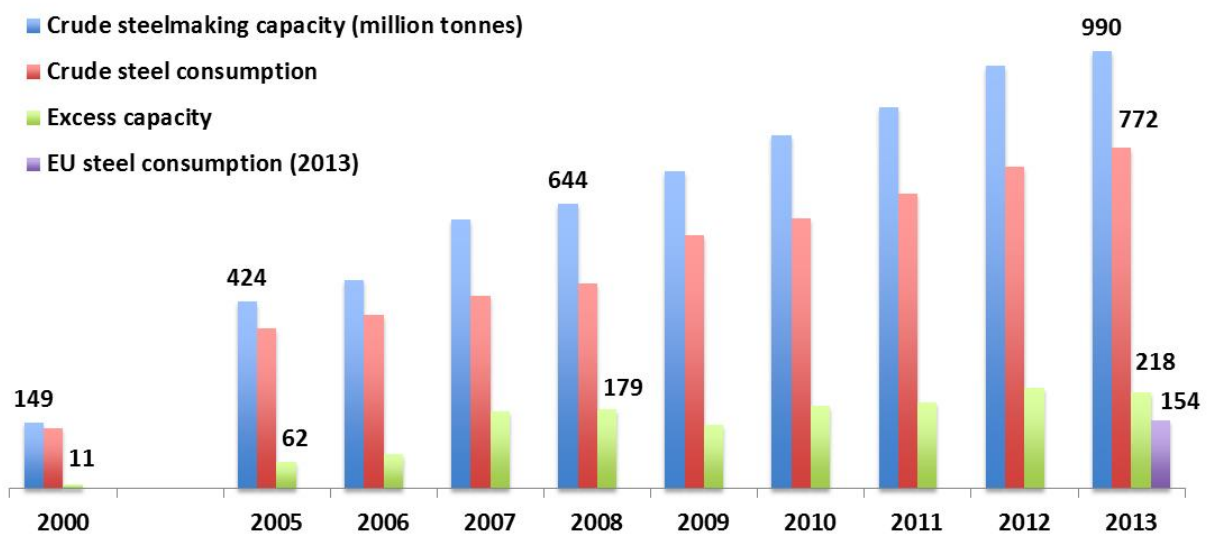
- 95% of ALL EU lead ore exports
- 80% of ALL EU copper waste and scrap exports
- 74% of ALL EU zinc waste and scrap exports
- 68% of ALL EU copper ore exports
- 54% of ALL EU nickel ore exports
- 53% of ALL EU copper smelter-refiners’ production
- 43% of ALL EU Aluminium waste exports

Regarding imports to the EU, China features as a basic importer of semi-fabricated products (of basic NFM, especially aluminium). 213,000 tonnes of semi fabricated metal products were imported from China to the EU in 2013, marking a 47% increase since 2007.

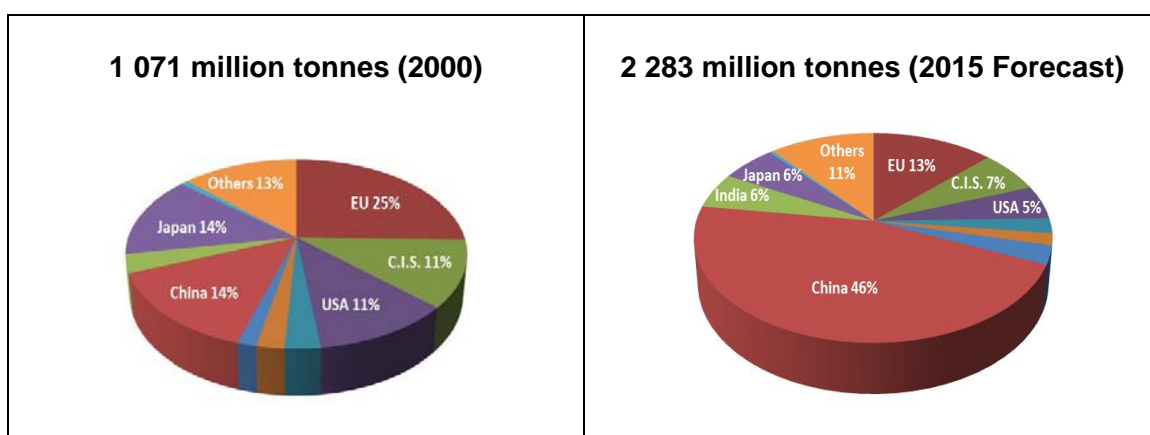


## - Steel

As the second biggest steel market in the world, the EU consumes 154 million tonnes of steel (2013) compared to 772 million tonnes in China. Chinese excess steel capacity is estimated at more than 200 million tonnes (2013) largely exceeds the total EU steel consumption (154 million tonnes):



In terms of world crude steel capacity, the following growth and changes in distribution have occurred:



In 2014, Chinese steel exports worldwide have reached the historic peak of 93 million tonnes (+60% year-on-year) compared with 15 million tonnes of steel imports. Weakening domestic demand in a context of persisting massive excess capacity is expected to continue the unprecedented steel export surges by China in 2015.

The Chinese steel sector is a pillar industry dominated by state-owned enterprises (SOE's) under a strict FDI prohibition.

## - Textiles

The analysis of the 2013 EU-28 trade with the world's major trading blocs confirms that China maintained its market share of textile and clothing products in the European Union at the high level of 36.7% but losing progressively, each year, more than one point compared to the years before (38.2% in 2012, 39.4% in 2011 and 40.8% in 2010). During 2013, in the EU-28, as a consequence of the moderate demand mainly of cheap textiles and clothing goods, China's market share of the EU's T&C imports in relative value has declined for a fourth consecutive year below its historical level of 2010. However, China remains (and by far) the top supplier of woven apparel to the EU-28, with a share of this market at 40.5% (42.9% in 2012).

In contrast, China is still not a significant market for EU exports despite the continuous positive trend in last years, especially for textiles. The share of EU-28 clothing goods exports to China also continues to grow slightly (4.2% in 2013 instead of 3.5% in 2012).

Table 1: EU-28 Trade balance with China

Reporting Countries Import Statistics (Partner Country: China)							
Commodity	Description	European Union Euros					
		2008	2009	2010	2011	2012	2013
TEX&CLO	50-63	31.734.674.910	31.297.059.880	36.373.185.380	38.721.550.280	35.835.328.350	34.678.015.300
TEXTILES	50-60+63	6.226.993.040	5.442.733.450	7.209.821.420	8.028.141.920	7.867.882.420	8.014.549.810
CLOTHING	61-62	25.507.681.870	25.854.326.430	29.163.363.960	30.693.408.360	27.967.445.930	26.663.465.490

Reporting Countries Export Statistics (Partner Country: China)							
Commodity	Description	European Union Euros					
		2008	2009	2010	2011	2012	2013
TEX&CLO	50-63	1.263.631.870	1.314.036.430	1.720.927.680	2.202.596.450	2.483.174.220	2.659.634.330
TEXTILES	50-60+63	1.022.572.470	1.034.012.680	1.351.399.790	1.634.502.880	1.718.486.040	1.741.933.010
CLOTHING	61-62	241.059.400	280.023.750	369.527.890	568.093.570	764.688.180	917.701.320

Reporting Countries Trade Balance Statistics (Partner Country: China)							
Commodity	Description	European Union Euros					
		2008	2009	2010	2011	2012	2013
TEX&CLO	50-63	-30.471.043.040	-29.983.023.450	-34.652.257.700	-36.518.953.830	-33.352.154.130	-32.018.380.970
TEXTILES	50-60+63	-5.204.420.570	-4.408.720.770	-5.858.421.630	-6.393.639.040	-6.149.396.380	-6.272.616.800
CLOTHING	61-62	-25.266.622.470	-25.574.302.680	-28.793.836.070	-30.125.314.790	-27.202.757.750	-25.745.764.170

Source: Euratex

Table 2: EU-28 Trade balance with Extra-EU28

Reporting Countries Import Statistics (Partner Country: EXTRA EU28)							
Commodity	Description	European Union Euros					
		2008	2009	2010	2011	2012	2013
TEX&CLO	50-63	81.430.745.040	75.872.751.950	87.064.503.650	96.386.163.530	92.221.091.080	92.577.202.700
TEXTILES	50-60+63	21.970.326.910	18.325.278.490	23.141.492.240	26.518.922.740	24.594.306.300	25.404.259.480
CLOTHING	61-62	59.460.418.130	57.547.473.460	63.923.011.410	69.867.240.790	67.626.784.780	67.172.943.220
Reporting Countries Export Statistics (Partner Country: EXTRA EU28)							
Commodity	Description	European Union Euros					
		2008	2009	2010	2011	2012	2013
TEX&CLO	50-63	36.319.821.060	30.624.274.260	34.346.103.500	38.957.977.990	41.526.778.890	42.320.329.310
TEXTILES	50-60+63	19.279.398.570	16.403.430.630	19.209.957.190	20.865.704.090	21.463.824.020	21.435.753.010
CLOTHING	61-62	17.040.422.490	14.220.843.630	15.136.146.310	18.092.273.900	20.062.954.870	20.884.576.300
Reporting Countries Trade Balance Statistics (Partner Country: EXTRA EU28)							
Commodity	Description	European Union Euros					
		2008	2009	2010	2011	2012	2013
TEX&CLO	50-63	-45.110.923.980	-45.248.477.690	-52.718.400.150	-57.428.185.540	-50.694.312.190	-50.256.873.390
TEXTILES	50-60+63	-2.690.928.340	-1.921.847.860	-3.931.535.050	-5.653.218.650	-3.130.482.280	-3.968.506.470
CLOTHING	61-62	-42.419.995.640	-43.326.629.830	-48.786.865.100	-51.774.966.890	-47.563.829.910	-46.288.366.920

Source: Euratex

#### - Construction

EU construction firms have a low presence on the Chinese market. This is mainly due to the difficulty for foreign firms to participate in the public procurement market in China. Legislative barriers and cheap prices offered by Chinese companies are two key factors that make it difficult for foreign firms to participate.

Contrarily, Chinese contractors are rapidly increasing their presence on the EU market. Amidst on-going budget cuts across the EU, Chinese contractors are able to offer cheap construction services that find particular traction in Eastern Europe. In Romania, the government invited Chinese contractors to build the country's transport infrastructure (highways, roads, high speed rail). A group of Chinese entrepreneurs was invited to discuss a list of projects that was released in late 2013. In Hungary it was announced in late 2013, early 2014 that freight and passenger rail lines would be constructed using Chinese funds, with the possibility that investors would also own and operate the lines. The presence of Chinese companies on the European construction market is in line with a broader presence of Chinese investment across sectors and across member states. The UK, Sweden and Greece, for example, have developed strategies for attracting Chinese investment.

#### - Pharmaceuticals – (new 2015)

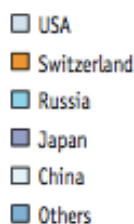
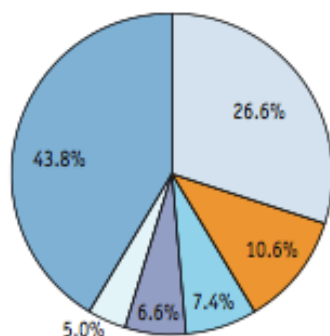
The Chinese market continues to represent one of the most relevant growing markets for pharmaceutical companies operating in Europe, with significant growth potential reliant on modernisation and reform. Over the past years, we have seen continued growth of bilateral trade between the EU and China, which is projected to be maintained during the coming years. In 2013, EU exports to China amounted to



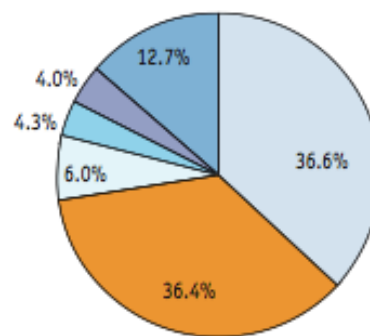
€148,269 million, with pharmaceuticals making up 3.8% of these exports, representing €5,635 million and registering a 9,3% increase when compared with 2012 figures<sup>4</sup>.

## THE EUROPEAN UNION'S TOP 5 PHARMACEUTICAL TRADING PARTNERS - 2013

### EU exports



### EU imports



Source: Eurostat, COMEXT database, April 2014

China has been going through significant healthcare reforms in the past few years and a good number of comprehensive reforms are planned in key policy areas relevant to pharmaceuticals in the near future or are already on-going, such as the revision of the Drug Administration Law, the Chinese Pharmacopoeia and the Pricing and Reimbursement system, amongst others.

These on-going reforms offer a critical opportunity to improve the business environment and address some of the issues that European pharmaceutical products face when entering the Chinese market, including lengthy and not always transparent clinical trial approval process; delayed government reimbursement decisions; lack of effective regulatory data protection and patent enforcement; and inconsistent patent examination guidelines, amongst others.

<sup>4</sup> [http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc\\_113366.pdf](http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113366.pdf)

## **MARKET ECONOMY STATUS**

During the last years, the European Union and China also had some high-profile trade disputes that raised attention even outside trade circles. The most prominent ones have been the cases brought up in the WTO by the EU against China on raw materials and rare earths, the disputes on Chinese solar panels, and the EU trade defence investigation into Chinese telecoms where both sides finally found an amicable solution.

However, these cases combined with the difficulty of modernising trade defence rules in the EU, show how highly sensitive this policy area is. This will naturally feed into the discussions of whether or not to grant Market Economy Status (MES) to China in 2016. China was categorised by most WTO members as a non-market economy in its protocol of accession to the WTO. BUSINESSEUROPE wishes to highlight that the decision on MES should be technical, and not politically motivated. In that respect, BUSINESSEUROPE wishes to re-underline the priority issues that should be addressed by China in its reform process:

- continued reform of the Chinese financial sector;
- effective enforcement of company law and international accounting standards;
- implementation of market economy principles;
- avoidance of governmental interference in the decision-making of companies;
- elimination of discrimination or unjustified restrictions, both for domestic and foreign operators;
- transparency of fiscal instruments and application of national treatment principle;
- enforcement of basic legal principles (notably on IPR, standardization or certification, services regulations);

European business continues to be very much interested in a real business to business dialogue that could facilitate and support the discussions on market reform.

## **CHINA'S REFORM AGENDA**

President Xi Jinping and Prime Minister Li Keqiang, the new Chinese leaders who came into office in 2012, have been confronted with a number of problems that need to be tackled without delay. The situation today has been described by many commentators as the *end of the golden era*.

The new Chinese leadership has understood that it must find solutions to its economic, societal and environmental problems. On 12 November 2013, delegates adopted a framework for reform – *Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform*; hereafter *The Decision*) – at the Third Plenary Session of the 18<sup>th</sup> Central Committee of the Communist Party of China.

*The Decision* provides a roadmap for reform, adapting China to today's economic environment, defining a modernised relationship between market forces and the state:

*“The underlying issue is how to strike a balance between the role of the government and that of the market, and let the market play the decisive role in allocating resources and let the government play its functions better”* (The Decision, Article 3)

*“We must put in place a modern market system in which enterprises enjoy independent management and fair competition, consumers have free choice and make autonomous consumption decisions, products and factors of production flow freely and are exchanged on an equal basis, strive to remove market barriers, and raise the efficiency and fairness of resource allocation.”* (The Decision, Title III)

*The Decision* offers some clear guidance and is comprehensive, including *inter alia* the relationship between the public and the non-public sector, the role of state-owned enterprises (SOEs), the development of urban and rural areas, innovation, transformation of government functions, the fiscal and taxation systems, trade and investment, the rule of law, and ecology.

To a large extent *The Decision* has been received positively, 45% of European companies surveyed for the 2014 EUCCC Business Confidence Survey stated that the reforms would present an opportunity and be good for their company. However, in many areas it remains to be seen how effectively the principles will be implemented in practice.



## **NEGOTIATIONS FOR A BILATERAL INVESTMENT AGREEMENT**

The official green light to start negotiations for a comprehensive EU-China investment agreement (BIA) was given at the 16<sup>th</sup> EU-China Summit, held in Beijing on 21 November 2013. One year before, in February 2012, both sides had already agreed in principle to launch such negotiations. The EU received the necessary negotiating mandate from EU member states in October 2012.

China is now negotiating investment agreements with its two biggest trading partners – the European Union and the United States. The objective is to reach ambitious deals, which include a broad definition of investment and cover pre- and post-establishment for all sectors of business.

In our 2011 report, BUSINESSEUROPE called for the launch of the negotiations as a priority issue. As the new Chinese leadership is shifting its focus from export-led growth to domestic demand and urban development, concluding a bilateral investment agreement has become even timelier. There are a number of very good reasons why this agreement can be beneficial for both China and the EU, as it will provide significant legal certainty for investors regarding the general rules of fair treatment for Chinese investments in Europe and European investments in China. This gives investors the certainty they need to make sustainable long term investments. It will clarify and remove to the maximum extent possible existing limitations to foreign investors. Also joint ventures will be facilitated by creating very clear rules for settling differences without government interference. Lastly, the BIA will provide important guarantees for investors against unjustified expropriations and for fair payment in case of justified expropriations. While this is rare in the EU and in China today, given the multitude of different governmental levels regulating business in the EU and in China, it is essential to have an over-arching framework of investment protection.

For BUSINESSEUROPE, this means concretely that the following issues must be part of the agreement:

- strong provisions to ensure market access for both goods and services on a non-discriminatory basis;
- removal of limitations to foreign investors – including joint-venture requirements;
- at least the equivalent of the highest level of investment protection that exists in the current individual Bilateral Investment Treaties between China and EU member states;
- inclusion of an effective investor-to-state dispute settlement – a standard request by the EU in all its trade negotiations – as an effective way to address potential cases of discrimination and expropriation;
- transfer of technology should take place on commercial terms only or by the voluntary decision of a company;
- elimination of local content and localisation requirements, as it should be up to the individual company to decide where, how and with whom they conduct their business operations;



- transparency of corporate governance, financial sources and transactions of foreign investors – a key issue, especially in light of increasing public attention given to large scale investments.

So far we have had four rounds of negotiation. Both sides have presented their text proposals and in 2015 we should enter in the hearth of the negotiations.

It is very clear that the investment negotiations are challenging, and both sides will need much staying power to conclude them successfully. It is worth noting in that respect that the US and China have been negotiating already since 2008. But it is also clear that this agreement will be very valuable to investors in the EU and in China, setting the ground to the creation of new jobs and growth by attracting new investments.

Occasionally, China has put forward the idea of launching negotiations for an EU-China free trade agreement. At the current stage the launch of FTA negotiations is premature as it is quite questionable that the conditions to successfully conclude an agreement exist. Hence BUSINESSEUROPE supports the approach to focus on the EU-China BIA negotiations.



## BUSINESSEUROPE'S SPECIFIC RECOMMENDATIONS – AN ASSESSMENT

**Issue:** China's preferential treatment for National Champions and SOEs

**2011 recommendation:** Apply strict competition rules in China and the EU

**Assessment:** BUSINESSEUROPE is highly concerned about the given direction: *“The basic economic system with public ownership playing a dominant role (...) is an important pillar of the socialist system with Chinese characteristics and is the foundation of the socialist market economy. (...) We must unswervingly consolidate and develop the public economy, persist in the dominant position public ownership, give full play to the leading role of the state-owned sector and continuously increase its vitality, controlling force and influence.”* (The Decision, Title II) Even though reforms are announced for state-owned enterprises (SOEs), they do not necessarily match with the objective of implementing market economy reforms. Increasingly foreign investors see SOEs as their main competitors. For instance, in the railway sector, the Chinese authorities encouraged the recent merger between the two largest Chinese rolling stock manufacturers. This merger will lead to the creation of a dominant operator with twice the size of its second largest competitor. This will significantly increase the prospect of a global player with significant impact in the competitive structure in the railway markets. This also questions the transparency of the domestic market in China.

**Issue:** Discriminatory procurement policies

**2011 recommendation:** Establish a level playing field through GPA accession

**Assessment:** China keeps on applying discriminatory procurement policies. The lack of transparency in procedures, the inconsistent implementation of certain legal provisions to foreign companies (far beyond the requirements imposed by the Chinese law) and discrimination policies against foreign products (“Buy Chinese” initiatives) seriously impede foreign companies to bid for public contracts. When China joined the WTO on 11 November 2001, it committed to negotiate its accession to the WTO Government Procurement Agreement “as soon as possible”. Today more than a decade later and after several offers, China is still not a GPA member. Although the 5<sup>th</sup> revised offer from December 2014 shows some improvement compared to the previous offer, it was considered by the GPA parties as insufficiently ambitious given that it covers only a small part of the Chinese public procurement market. It is far from the commitment (around 70%) and de facto coverage (approximately 85%) offered by the EU.<sup>5</sup>

<sup>5</sup> Statistics on the EU's official GPA commitment were drawn from discussions with officials from the European Commission. The maximum coverage offered by the EU through certain FTAs is 95% (Source: [http://trade.ec.europa.eu/doclib/docs/2012/march/tradoc\\_149243.pdf](http://trade.ec.europa.eu/doclib/docs/2012/march/tradoc_149243.pdf), p. 11).

**Issue:** Subsidies

**2011 recommendation:** Challenge Chinese subsidies at bilateral and multilateral level

**Assessment:** China continues to implement a large number of support programmes and provides specific subsidies to industries. Background to these – not always very transparent – initiatives is often the achievement of public policy goals. One such example is the Chinese steel industry. According to the China Iron and Steel Association, China's capacity utilization rate fell to 74% in 2013. The Chinese government should refrain from providing subsidies to steel companies which contribute to overcapacity in the market. However, public awareness and scrutiny over China's policy of subsidizing its industries has increased during the last years. The European Commission's trade defence investigations into Chinese telecoms were targeted to a substantial extent at supposed Chinese subsidies. Very remarkable as well is that it was an *ex-officio* investigation. At multilateral level there has not been any progress. The EU should push for this important issue to be taken up in the future WTO work plan.

**Issue:** Enhance legal certainty and improve business consultation

**2011 recommendation:** China should enhance transparency and predictability

**Assessment:** The Decision rightly sets out the need to “... *transform government functions, deepen the reform of the administrative system, exercise government administration in an innovative way, increase public trust in the government and improve its competence, and build a law-based and service-oriented government.*” (The Decision, Title IV) China must now live up to these objectives, as companies are still suffering from a lack of transparency, sometimes retroactive application of laws, insufficient consistency in the implementation of laws, administrative delays, fears of retaliation, and others. Conversely, progress on this issue appears to have slowed down following China's recent anti-corruption campaign. Decisions by government ministries and authorities are often postponed out of concern they might “backfire”. More progress is required on this issue so that doing business in China will be more reliable and future proof.



**Issue:** Foreign ownership restrictions

**2011 recommendation:** Allow restrictions only for national defence

**Assessment:** During the review period, China has continued its efforts to attract foreign investment. The Decision states that China “... will implement a unified market access system, and on the basis of making a negative list, all kinds of market players may enter areas not on the negative list on an equal basis and according to law.” (The Decision, Title III) Today’s situation is still characterised by many restrictions and/or joint venture requirements for foreign investors that are discriminatory and prevent healthy competition. The allocation of joint venture partners by the Chinese government is also no longer appropriate. Against this background, the position of Chinese SOEs has strengthened. The revised *Foreign Investment Catalogue*, the latest draft being published in November 2014, contains further and limited openings in some sectors, but also some tightening in others. China still retains a distinction between external and domestic investment, it actively guides foreign investments in areas of strategic interest, and has not yet moved towards the use of a negative list. Foreign investment should receive national treatment and minority share limits should be removed. It remains to be seen which changes the new laws on foreign investment will bring and what this means for European investors in China. For example, the Chinese Ministry of Commerce imposes a foreign ownership cap of 50% for joint ventures operating in strategic sectors such as power generation and transport, but also in sectors such as life insurance.

**Issue:** Transfer of technology and confidential information

**2011 recommendation:** Allow the protection of confidential information

**Assessment:** As a condition for granting market access, China continues to oblige European companies to transfer advanced technologies to Chinese entities. For the rail sector, experience has shown there is a requirement of 100% Chinese technology owned by a Chinese company or JV is the only way for EU businesses to access the market. Frequently this transfer of technology is linked to Chinese industrial policy goals. At EU level, BUSINESSEUROPE welcomes that the Commission has tabled a proposal for a directive on the protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisition, use and disclosure. The Chinese government should renounce the requirement for European companies to transfer technologies to Chinese entities in exchange for market access. Retaliation measures against foreign companies that do not consent to technology transfers should also be prevented.



**Issue:** Restrictions on services

**2011 recommendation:** Continue services market opening

**Assessment:** *“We will promote the orderly opening up of finance, education, culture, healthcare and other services sectors, lift limits on access for foreign investment in childcare, care for the elderly, architectural design, accounting and auditing, trade and logistics, electronic commerce and other such service sectors, and further liberalize general manufacturing.”* (The Decision, Article 24) Admittedly, China has made the development of a vibrant Chinese services market a priority, and this is positive. The China (Shanghai) Pilot Free Trade Zone should also be seen as a laboratory for reforms in some services sectors (esp. finance, health, and logistics), though the success of this pilot still remains to be seen. However, even if China recently adopted a negative list approach for investments, many sectors still remain closed or are under strong limitations to foreign investors. Furthermore the period for revising the negative list is too long: only once per three years. Worryingly, the Chinese government in 2014 adopted the “Guiding Opinions on the Application of Secure and Controllable information technology to Strengthen Banking Industry Network Security and Informatisation”, a regulation that would obstruct foreign ICT companies from fully participating in the Chinese banking IT market by requiring that banks procure “secure and controllable ICT goods and services” for up to 75% of their networks and systems by 2019. To qualify as “secure and controllable,” ICT products and services must – among other things – undergo intrusive security testing, contain indigenous Chinese intellectual property, implement local encryption algorithms, and comply with country-specific security standards. If fully implemented, these policies will undermine the ability of European firms active in China to participate in the country’s ICT market and could affect European banks operating in China. In addition, government proposals for the insurance sector dating from 2014 contain significant discriminatory measures against foreign reinsurers concerning higher risk loadings, the stand alone treatment of foreign branches, and the 5% additional risk factor of placing bank deposits in foreign banks.

**Issue:** Chinese Compulsory Certification and absence of international standards

**2011 recommendation:** Apply international standards

**Assessment:** The Chinese system of compulsory certification and the lack of recognised international standards still remains a major concern for European companies. Despite limited improvements, China still deviates from internationally recognised norms and standards in order to promote domestic technology. Moreover the standard setting process is opaque, often limiting or precluding foreign companies to participate. China should allow for greater participation of European enterprises in the consultation process for shaping China’s standardization system. European enterprises are familiar with international best practices and hence should be allowed more participation. Additionally, China uses its standard setting system as a means of industrial policy, forcing foreign investors to transfer technology.



**Issue:** Promotion of domestic innovation

**2011 recommendation:** Create an open climate for innovation – but not through the National Indigenous Innovation Programme

**Assessment:** In line with its continued transformation, China is moving up in the global value chain with innovation becoming increasingly important: *“We must accelerate the transformation of the growth model, and make China an innovative country.”* (The Decision, Article 2) However, innovation must be led by industry in order to be successful. China should focus on the creation of favourable framework conditions, instead of using its current top-down, centralistic and nationalistic approach which is often targeted to favour domestic companies and technologies. Thus, local content requirements related to indigenous innovation should no longer be linked to government procurement. A positive development in this regard is the suspension of the National Indigenous Innovation Programme on 1 July 2011 by the Chinese Ministry of Finance. The proposed National Indigenous Innovation Product Accreditation Catalogue has never been officially released. A negative development in this regard is the “Action Plan for the further implementation of the national strategy on intellectual property rights” (2014-2020) presented by the State Council at the beginning of this year. Budget figures for invention patents were raised again (4 patents per 10,000 people in 2013 to 14 in 2020).

**Issue:** Compulsory licensing

**2011 recommendation:** Refrain from compulsory licensing

**Assessment:** A number of ambiguities exist in the measures on compulsory licensing, and at least there should be more transparency and clarity about the requirements for granting a compulsory license, amongst other issues. Such uncertainties complicate business planning, which as a result can hamper innovation and long term investments. Some progress seems to have been made since the publication of the report. As of 1 January 2014, the new Regulatory Measure on National Standards Involving Patents (Interim) has been put into effect which, among other things, stipulates some basic rules on the disclosure of patent information and patent licences involving national standards.



**Issue:** Enforcement of IPR policies

**2011 recommendation:** Simplify and enhance IPR implementation and administrative procedures

**Assessment:** The Chinese government has shown willingness to address this issue: *“We will strengthen the application and protection of intellectual property rights (IPR), improve the technological innovation incentive mechanism, and explore ways to set up IPR courts.”* (The Decision, Article 13). Although China has comprehensive intellectual property laws that meet international standards, IPR violations and counterfeiting remain a very pressing concern. And while China is preparing to set up specialized IP courts in Shanghai, Beijing and Guangzhou, the execution of judicial rulings remain very difficult and costly. Protecting IPR is a growing concern for European companies as China attempts to shift from low-end manufacturing to an innovative economy. Further steps are required at all levels – on the administrative, the judicial, and on the legislative side. Cooperation with China on basic issues of patent policies should also be intensified, particularly in creating a level playing field and non-discrimination in the field of patent applications. This could involve actively training Chinese judges in IP matters and familiarising them with the way legal proceedings work in other countries. Based on Article 13 and China’s domestic IPR laws, we expect the Chinese government to support an international framework of IPR rules. The recognition and the enforcement of judgements (exequatur) which have been rendered in litigation cases between foreign and Chinese companies should be strengthened. BUSINESSEUROPE calls for a comprehensive application of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, which has been signed by China in 1987.

**Issue:** Macroeconomic imbalances

**2011 recommendation:** Support global adjustments to macroeconomic imbalances

**Assessment:** China’s exchange rate gradually appreciated, which is in line with BUSINESSEUROPE’s recommendation. However, it is difficult to assess whether or not this is due to Chinese domestic reforms or the repercussions of the global economic crisis. Overall, China does not allow the full floating of its exchange rate. For a further internationalization of the RMB, Chinese restrictions for inward foreign investment (including investment in the financial sector) need to be lifted.





**Issue:** Restrictions on access to raw materials

**2011 recommendation:** Reinforce existing WTO provisions and implement a strategic raw materials policy

**Assessment:** Overall, export restraints (taxes, quotas, bans) continue to be an important feature of Chinese trade policy. China's efforts to protect its domestic resources undermine the principles of free trade and inflate global prices of raw materials. In order to improve this situation, China has to implement the two WTO rulings on raw materials and rare earths by giving non-discriminatory access and ensuring that similar non-compliant cases will not occur again. Specific changes to GATT provisions could not be agreed upon by WTO members during the last years. The lifting of export restrictions on rare earths at the beginning of this year is a very positive signal in this regard. On the positive side, the EU has started to put in practice a more strategic and coherent raw materials policy.

**Issue:** Access to European procurement markets

**2011 recommendation:** Foster mutual openness in public procurement markets

**Assessment:** Particularly in Eastern Europe the presence of Chinese companies in public procurement markets is on the rise, which is also a direct consequence of China's policy objective to increase its foreign investments. There are on-going discussions at EU level about the best way to ensure mutual openness in procurement, especially with countries that manifestly exclude EU companies from their markets. The EU is pursuing the opening of procurement markets as a priority in its bilateral trade negotiations, and problems encountered regarding access to China's procurement should be addressed in the framework of the EU-China BIA – in addition to China's pressing GPA accession.

**Issue:** Unfair export promotion policies

**2011 recommendation:** Sign up to OECD rules on export credits and align the VAT system to international practice

**Assessment:** China continues to be an observer in the OECD, and still has not signed up to the OECD Arrangement on Export Credits. The harmonisation process of national rules with international standards such as OECD Arrangement on Export Credits should be actively promoted. China's welcome announcement to "*promote the reform of value-added tax, and simplify tax rate appropriately*" (The Decision, Article 18), together with other reforms and simplifications of China's taxation system, have to be followed up by concrete measures.

**Issue:** Development aid linked to strategic objectives

**2011 recommendation:** Link up development and commercial policies

**Assessment:** On 1 January 2014, the new EU GSP scheme entered into force. According to the new criteria, China is no longer a GSP beneficiary but for a limited group of products, namely: vegetable products (Section 2a), animal or vegetable oils, fats and waxes (Section 3), meat products (Section 4a), tobacco (Section 4c) and mineral products (Section 5). BUSINESSEUROPE views this as a positive development. As China is now an emerging economy, it needs to be a more active player in international development policies, not on the receiving end but as a donor.

**Issue:** Ethical behaviour

**2011 recommendation:** Apply OECD principles but refrain from unilateral rules

**Assessment:** China still has not adopted the OECD convention against bribery, nor does it adhere to the OECD guidelines for multinational companies. A positive step, however, has been the China-OECD Memorandum of Understanding signed on 24 October 2014, which mainly sets out a roadmap for the responsible business conduct of Chinese companies operating overseas. It is also worthy to note that the new Chinese leadership has announced that it would tackle the pressing problem of corruption in China: *“We will improve a system that combats and prevents corruption, promote political integrity, and see to it that officials are honest, the government is clean, and political integrity is upheld.”* (The Decision, Title X)

The holistic assessment is mixed of the progress achieved during the last years on the issues identified in the *Rising to the China challenge* report. The overall framework for broad and decisive reforms, set out in *The Decision*, is certainly promising. But effective implementation is still lagging behind in many areas, also when it comes to China’s commitment at international level. So a lot of work remains to be done on the issues raised in the BUSINESSEUROPE report. On the other hand, the Chinese authorities have recognised that they have to adapt to the new economic, social and ecologic environment in order to make the Chinese system sustainable and fit for the future.



## **THE WAY FORWARD FOR THE EUROPEAN UNION**

A strong and strategic relationship with China must also be a priority on the EU's policy agenda for the future. It is positive that during the first days of his mandate European Council President Donald Tusk already had contact with President Xi. The European Commission will continue the negotiations for a bilateral investment agreement. The European Parliament will also play an important role in the further evolution of the EU-China relationship.

Looking back, there have been up's and down's in the European Union's ability to be a united actor and have a single voice in its relationship with China. BUSINESSEUROPE assesses very positively the BIA negotiations, giving the opportunity to increase bilateral investments and address existing barriers in a structured and constructive way. However, on the other side of the coin is the continued absence of a common European voice towards China. This became particularly striking during sensitive anti-dumping case proceedings – like the solar panel case. The *three musketeer rule* – a BUSINESSEUROPE suggestion from 2011 – was not applied. This rule implies that all EU member states will react as one in case one EU member state itself or its major interest is threatened or retaliated against. Moreover, the potential of the High-Level Dialogue (HED) was not exploited sufficiently as a means to resolve problems in relation to market access, intellectual property rights, and others.

In 2015, the EU and China will celebrate their 40<sup>th</sup> anniversary of bilateral relations. This will provide an opportunity at the 2015 EU-China Political Summit to revise and revitalise the existing trade, economic, investment and political relations. In the run-up to this important bilateral Summit, the new European Commission should make a thorough assessment of the state of play and review where necessary the EU's trade policy in order to achieve the mature EU-China relationship that BUSINESSEUROPE called for in 2011. Such a mature relationship should be based on an open and constructive engagement from both sides, strict abidance to the rule of law and international agreements, non-discrimination and the existence of a level playing field.

### **How to revitalise the relationship with China – recommendations**

- Make a thorough assessment of the state of play and redraft the EU's China strategy where appropriate
- Prevent China to exert pressure on domestic affairs and speak up with a common voice on China matters
- Continue the negotiations for an ambitious Bilateral Investment Agreement as a matter of priority
- Use better the High Level Economic Dialogue to tackle barriers
- Use the Political Summits and other highest level meetings to advance key bilateral and multilateral negotiations, such as China's accession to the GPA
- Closely coordinate with major partners how to tackle common challenges in China
- Extend visa limits as a way to facilitate trade and investments

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# BUSINESSEUROPE



**BUSINESSEUROPE** is the leading advocate for growth and competitiveness at European level, standing up for companies across the continent and campaigning on the issues that most influence their performance. A recognised social partner, we speak for all-sized enterprises in 33 European countries whose national business federations are our direct members.



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