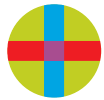

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EU-China: Bilateral Trade Relations and Business Cooperation

Enrique Fanjul

CEU Ediciones

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EU-China: Bilateral Trade Relations and Business Cooperation

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1. Introduction

The aim of this paper is to analyze trade and business cooperation between the EU and China, in order to make proposals for improving and expanding such trade and cooperation in the future. The paper mainly focuses on issues and questions that have achieved a particular prominence in recent times.

The paper is divided into three major parts.

In the first part we review the environment for trade and business relations. We address three issues that have gained special relevance:

- The uncertainties about the business climate for foreign companies, which have increased significantly in recent months, darkening the perception of the Chinese market among many European companies.

- The main irritants in bilateral trade. In this section we consider three issues: the EU trade deficit with China, EU protectionist measures against Chinese products, and the question of the exchange rate of the Chinese currency.

- Changes in the pattern of growth of the Chinese economy, which involve changes in business opportunities for European companies.

The second part is aimed at analyzing problems of access to the Chinese market. We discuss a number of issues: regulations, certifications, foreign investment restrictions, etc., with particular attention to restrictions that have recently emerged – such as the new policy favouring "indigenous innovation" in public procurement.

The third and last part contains some conclusions and identifies several windows of opportunity for the future in trade relations and business cooperation between the EU and China. We make some recommendations or suggestions to encourage greater use of these opportunities.

2. The environment for trade and business

2.1. Uncertainties on the business climate in China

In recent times many companies and business organisations have perceived a significant deterioration in the business climate in China for foreign companies. It is too early to make a precise assessment of the subject, but many foreign companies, including European companies, are concerned about what they perceive as worsening conditions for the conduct of their activities in the Chinese market.

What is new in comparison with former times is that, since 2009, companies have started to voice their discontent openly. In the past companies used to maintain a low profile in order to avoid angering Chinese authorities and suffering subsequent retaliation.

An important qualification is that complaints mainly affect technology-based, machinery and services companies, etc. Consumer goods companies face a much more favourable situation. For these companies, China has become a booming market. In the fields of luxury consumer goods, China is one of the world's most dynamic markets, and for many major international brands this has been a real lifeline in recent times of economic crisis.

Numerous reports in the press and from relevant institutions have pointed to this deterioration. James McGregor, former president of the American Chamber of Commerce in China, noted in the pages of Time magazine that “In more than two decades in China, I have seldom seen the foreign business community more angry and disillusioned than it is today (…) Anti-foreign attitudes and policies in China have been growing and hardening since the global economic crisis pushed the U.S. and Europe into a tailspin and launched China to its very uncomfortable stardom on the world stage. (…) CEOs' banquet-table chatter is now dominated by swapping tales of arrogant and insolent Chinese bureaucrats and business partners. The litany includes purposefully inconsistent and non-transparent enforcement of regulations, rampant intellectual-property theft, state penetration of multinationals through union and Communist Party organizations, blatant market impediments through rigged product standards and testing, politicized courts and agencies that almost always favor local companies, creative and selective enforcement of WTO requirements ... The list goes on”[1].

The Daily Telegraph headlined a story: “UK businesses threaten to pull out of China over protectionism”, noting: “In the wake of Google's decision to stand up to the Chinese government, other firms have complained of a witch-hunt against foreigners that has targeted British, American and European companies with intellectual property theft, blocked market access, rigged tender processes and the deliberately inconsistent enforcement of regulations”[2].

European Union Trade Commissioner Karel De Gucht clearly referred to the difficulties that are increasingly facing European companies in China during his visit to the Expo in Shanghai in July 2010: "European companies are increasingly worried"[3].

1 James McGregor, “The China Fix”, Time, 1 February 2010.
2 “UK businesses threaten to pull out of China over protectionism”, Daily Telegraph, 9 February 2010.
3 EUBusiness, 22 July 2010.

In 2009, the European Union Chamber of Commerce in China issued an important Position Paper that conducted a thorough analysis of the conditions for business. The report carried out a detailed review of the growing number of obstacles facing European companies for the development of their activities in China. In its Executive Summary, the European Chamber of Commerce summarized in a very clear way the concerns about this deterioration: "Right across industries, European businesses are still impeded by issues concerning market access, legal and political transparency and the protection of Intellectual Property Rights (IPR). The spectre of protectionism has also appeared, and European companies are increasingly concerned by the tendency for local companies to be favoured over foreign-invested ones"[4].

Important figures of the business community have publicly expressed their frustration about the worsening conditions for business in China. In an article in the Financial Times, entitled eloquently "China is beginning to frustrate foreign business", Joerg Wuttke, president of the European Chamber of Commerce in China, pointed out that "In the 10 years since the establishment of the European Union Chamber of Commerce in China, I have seldom seen market sentiment among members so bleak or pessimistic. After 30 years of progressive market reforms, many foreign businesses in the country feel as though they have run up against an unexpected and impregnable blockade (…) For the first time I hear of companies contemplating leaving the country altogether. They consider this not because they cannot compete with local rivals – but because they are weary of slogging through an unpredictable business environment where the odds seem deliberately stacked against them. I also hear of big companies preparing strategies to route part of their future investment away from China and into other Asian countries, where a more transparent and predictable market environment means safer and healthier investment opportunities"[5].

"The Chinese authorities should not take the presence and commitment of European companies for granted," said Jacques de Boisseson, president of the European Chamber of Commerce in China, at the end of June 2010. "This massive commitment to the Chinese market is not unconditional. If perceived risks materialise to a great extent, the presence and commitment of our members may disappear"[6]. Mr. Boisseson was speaking at the launch of the chamber's annual survey of European businesses in China. According to this survey, 64% of companies said China was one of their top three destinations for investment. But 39% of European companies said they expected the regulatory environment would worsen over the next two years, with only 10% expecting an improvement.

Leading representatives of companies have raised their voices to present their concern over developments in the business climate in China. BASF's chairman and the chief executive of Siemens made statements almost simultaneously in July 2010, criticizing the restrictions on foreign investment in many sectors and the obligations on technology transfer that the authorities imposed on foreign companies[7].

These concerns were reflected in one of the more important publications about the business climate in China, the Business Climate Survey 2010, prepared by the American Chamber of Commerce in China. In the introduction to the study, the chairman of the Chamber wrote: "This year's findings show the complex challenges facing the US business community in China. While most American companies are doing well in China, they are concurrently troubled by a mounting number of policy challenges ranging from the inconsistent enforcement of laws, to China's discriminatory domestic innovation policies and regulations

4 European Union Chamber of Commerce in China (2009), Executive Summary, p. 6.

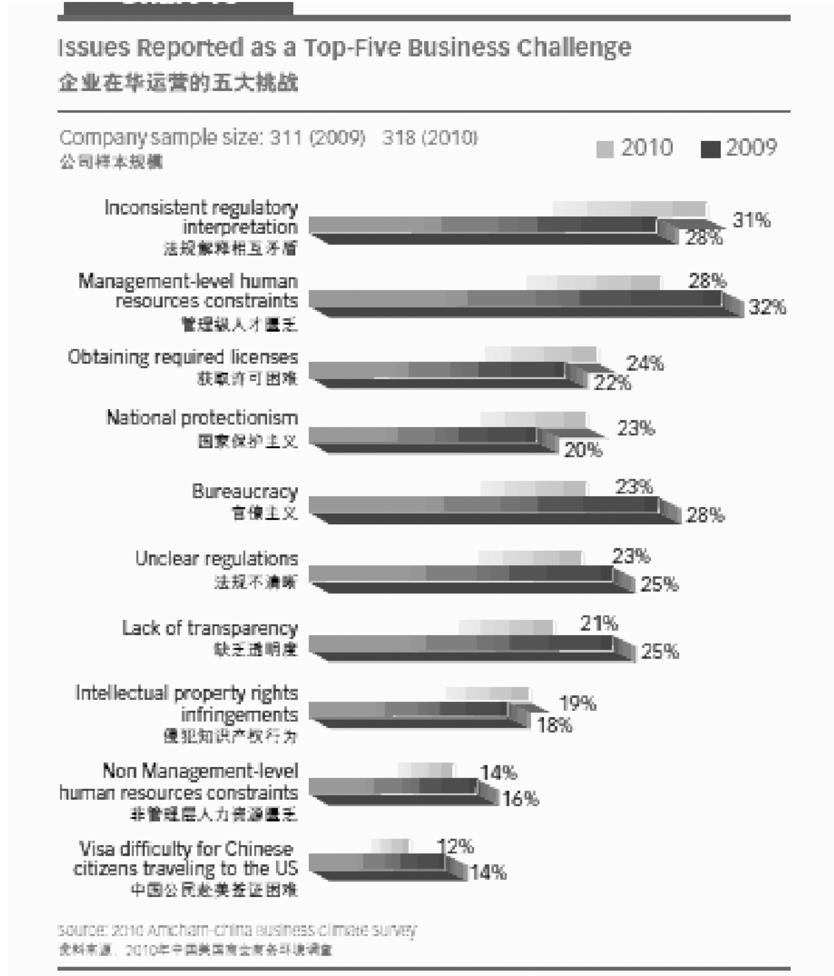
5 Joerg Wuttke, "China is beginning to frustrate foreign business", Financial Times, 7 April 2010.

6 Financial Times, 30 June 2010.

7 EU Observer, 19 July 2010.

that limit market access into sectors that had been increasingly open to foreign investment for the past 30 years. These policies appear to be diminishing the ability of foreign companies to access the Chinese domestic market, right at a time China is shifting from being an export-led economy to a more domestic-consumption-led economy”[8].

According to the study, based on a survey among US companies, they are becoming increasingly concerned with inconsistent regulatory implementation, which they rated as their most significant challenge for the first time on record (see chart).



Source: Amcham-China (2010)

Some particular conflicts, which have had a major impact, have particularly contributed to this deterioration in the perception of business within China. The conflict that has had the greatest media impact was probably that of Google. Another conflict that has generated a strong concern is the case of the four employees of the mining company Rio Tinto formally arrested and charged with receiving bribes. The four employees were sentenced to jail terms, but no bribe payer has been prosecuted.

This arrest raised concern among foreign companies operating in China regarding the status of their employees and the alleged use by the Chinese authorities of intimidating practices in relation to trade negotiations. According to media reports, the arrests came shortly after serious disagreements between

8 Amcham-China (2010), Introduction.

Chinese companies and the Australian mining company. These included the rejection by Rio Tinto of a proposed investment by Chinalco, a Chinese state company in the aluminium industry, and the lack of agreement on the sale price of iron ore to Chinese buyers.

The alarm that these arrests created in the business community was reflected in an exemplary manner in the headline of an article published by Gordon Chang in Forbes magazine: "Is It Safe To Do Business in China"? The article alluded to the alleged reprisals that the arrests and subsequent trial could represent due to the fact that China had not achieved its objectives in trade negotiation: “The retaliation theory had gained such wide acceptance in the business community that the *Wall Street Journal's* James Areddy reported this week that at least two foreign mining companies, before entering commercial negotiations, were asking for waivers from criminal prosecution for their employees' acts committed in performance of their jobs. The extraordinary request shows the business community's almost complete lack of trust in the Chinese government”[9].

The last judicial cases of dispute have cast a shadow over the evolution of the legal system in the P. R. China. According to Jerome Cohen (co-director of the Asia Law Institute at the University of New York), and Yu-Jie Chen, a researcher at the Asia Law Institute, “Despite continuing grave violations of existing international standards for protecting civil and political rights, China's overall direction in international law, at least until recently, has seemed progressive. Now, however, an old, nationalistic tone has begun to mark its criminal prosecutions of foreigners as well as of Chinese dissidents, often explained with vague references to "judicial sovereignty" without further elucidation. This may reflect the setbacks that China's domestic criminal justice system has suffered since the 17th Communist Party Congress introduced tougher policies and personnel in late 2007. It may also reflect a change in the Chinese government's attitude towards international law in the light of its growing influence on the world stage. In any event, it is a development worthy of attention”[10].

Among business circles the concern has emerged that economic nationalism may be increasing in China and that, despite the progress in the process of reform and in particular in the legal framework, there may still be dangerous gaps in the legal certainty with which companies operate, which could even have an effect on the personal security of its employees. In an article on the issue that had a significant impact, Charles Grant, director of the Centre for European Reform, mentioned a slowdown of the process of reforms in China: “Market-orientated reform has slowed down since Hu Jintao became party leader and president in 2002. The government has partly reversed price liberalisation and its plans for privatisation. It has encouraged the consolidation of ‘strategic’ industrial sectors into the hands of a smaller number of state-controlled national champions (these sectors include power, oil, coal, gas, chemicals, telecoms, metals, aerospace, transport, cars, machinery, insurance, grain distribution, railways, aviation, shipping, information technology and armaments). Foreign investors are not welcome in these industries. Indeed, foreign direct investment (FDI) in China has been declining since 2005, partly because the country’s leaders have sought to confine FDI to certain sectors where foreigners can provide key technologies (though mayors and regional chiefs are often more enthusiastic about foreign investment)”[11].

This deterioration in the business environment is occurring in a context in which it is already considered that foreign enterprises in China face a large number of barriers. A study sponsored by the European Commission estimated that European exporters suffered a cost of 12,500 million Euros in 2004 as a result of lost export opportunities due to non-tariff barriers in China. Moreover, in three sectors of services (financial services,

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9 “Is It Safe To Do Business In China”, Forbes, 12 February 2010.

10 “China rips up rule book”, in The Age, 1 April 2010.

11 Grant (2009), p. 26

telecommunications and construction) it was estimated that the cost of lost business opportunities exceeded 8,900 million Euros. In total, therefore, a minimum of 21,000 million Euros was lost per year[12].

Apart from some cases that have had a major impact and that we have mentioned in the preceding pages, a wide range of issues are the subject of complaints by foreign companies (and obviously European companies), such as government procurement, intellectual property rights, foreign investment restrictions, certifications, lack of transparency in law, arbitrariness in the decisions of administrative bodies, etc.

On these issues, which are reviewed in more detail in a later section of this paper, many companies have perceived a deterioration of conditions in the Chinese market, and making an assessment of this, and its appropriate correction, is an essential task in order to improve the perception of the business climate in the Chinese market among European companies.

The Chinese authorities have rejected accusations that there has been a change in China's policy towards foreign investment. The Chinese Commerce Minister Chen Deming wrote in July 2010 ("Thriving China is ever more open for business", in the Financial Times) that "China has kept its market open through the financial crisis". According to Chen, "in 2009, of 12,439 tenders for procurement of electromechanical products, 55% went to foreign investment enterprises".

Regarding the issue of indigenous innovation, the Chinese minister pointed out that foreign companies established in China receive the same treatment as Chinese enterprises: "all foreign enterprises are given equal treatment and that all their products are considered to be "made in China", while the same rules of origin are applied to them as to Chinese products".

Chen recalled that in fact, despite these accusations, China remained a major destination for foreign investment: "in 2009, global FDI dropped by nearly 40 per cent, but investment into China fell by only 2.6 per cent".

Finally, Chen emphasized the beneficial role that, in times of crisis, the Chinese market represented for many international companies, citing the example of General Motors: "in 2009, General Motors filed for bankruptcy in the US, but its sales in China grew by 67 per cent. It sold more than 1m vehicles in China in the first five months of this year, meeting half of its 2010 target of 2m ahead of schedule"[13].

However, it should also be noted that in some business circles there is a significantly different view of this situation. We could summarize this view as the idea that problems do exist, there is nationalism and protectionism, but this must be considered as something irreversible and, nevertheless, China's market still offers good business opportunities. The key to success is to take advantage and be competitive, and to design an appropriate strategy.

This is the opinion of a major consultancy firm operating in the Chinese market, Interchina, that considers that the rise of protectionism is not a recent phenomenon. "The early signs of increased protectionism date back to the beginning of this century"[14].

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12 Emerging Markets Group (2007).

13 Financial Times, 25 July 2010.

14 Borgonjon & Hofmann (2010), p. 2.

According to Interchina, “Probably the strongest hindrance to foreign participation in China’s economy is the power wielded by Chinese companies, particularly SOEs, and their government backers. These groups seek industry consolidation and limits on competition and are thus less willing to adopt good corporate governance practices - including transparency and accountability”.

But the rise of protectionism and nationalism are compatible with the maintenance of business opportunities. “Overall, though, the forces against protectionism have been fighting a losing battle and during the last decade China has completely changed its approach to foreign investment. That does not mean that there is no place for foreign investment in China, or that foreign companies are no longer doing well. It simply means that foreign companies need to learn to adapt to be able to create win-win opportunities (…) in spite of all the noise to the contrary, for most foreign companies business remains good. Foreign companies are enjoying the boom in China, with rapidly increasing sales volumes and in many cases considerable profits, as shown in surveys conducted by the European Chamber and the U.S. China Business Council”[15].

Interchina managers Borgonjon and Hofmann take for granted that China will not open certain sectors to foreign companies: “China is not reneging on its commitments, but it also is not opening these sectors further. Many companies, in particular banks, mistakenly anticipated a further opening of the sector but this is not happening and is unlikely to happen within the next 10 years”[16].

In sectors where the level of protectionism is high, from wind power to cars, foreign firms can nevertheless conduct good business. “Often the successful companies have long histories in China, and a thorough understanding of the market. They also have an experienced China team, with a strategy, which fits the development of its sector in China, and a competitive product offering”[17].

For foreign companies the key challenge is the capacity to be competitive, to understand and adapt to the market, to develop an appropriate relationship with the government. “Being competitive in China requires a whole set of capabilities which are quite different from those required in developed markets. The key to such competitiveness is a strong local team, with strong decision making power and the freedom to work within a framework which is different than that used by the company in other markets, e.g. one which allows faster decision making, faster product development and/or different investment decision processes, etc. A sophisticated government relations approach which addresses the concerns of all stakeholders, not just the government, is essential”[18].

Interchina arrives at the following conclusion about the business climate in China for foreign companies: “Many issues affect a company’s ability to run a profitable business in China today, and protectionism is but one. The majority of foreign companies are doing well, continue to see good opportunities in China’s market and consider a whole range of issues in determining their market strategies. The main challenge for these companies is not protectionism, but the whole set of issues affecting their competitiveness in China. The market not only is booming, but it also is becoming more complex and sophisticated and competitors (mainly Chinese and Taiwanese) are quickly adapting to these changes. They are flexible, fast, have experienced local teams, understand the customer at all levels and all segments and know how to work with the government at

[15] Borgonjon & Hofmann (2010), pp. 3-4
[16] Borgonjon & Hofmann (2010), p. 6.
[17] Borgonjon & Hofmann (2010), p. 6.
[18] Borgonjon & Hofmann (2010), p. 7.

different levels while controlling costs. Rather than focusing on market protection, foreign companies should focus their attention and their energies on the arduous task of becoming and remaining competitive in a very challenging market”[19].

2.2. Irritants in bilateral trade

There have been irritants and disputes in EU-China bilateral trade for many years. However, in recent times we have seen an intensification of these conflicts.

We shall review in this section some of the major irritants.

2.2.1. The EU trade deficit with China

Underpinning this issue lies the strong growth of Chinese exports to European countries, much higher than the exports of the European countries to China, and the consequent increase in the trade deficit for the EU.

The causes of the sharp increase of Chinese exports and lower export growth in Europe are varied and cannot be attributed mainly to protectionism by China.

Overall Chinese tariffs are not high. However, it should be borne in mind that the average levels hide the existence of peaks in certain products and sectors, where tariffs can reach very high levels. This is the case of meat, with maximum levels of between 15 and 25%; certain dairy products, about 25%; 65% for wheat and rice; 40% for certain items of corn; 50% for sugar; up to 65% for drinks and tobacco; 50% for fertilizers; 20% for tyres; 38% for wool; 40% for cotton; between 15 and 25% for certain textiles and footwear; 25% in ceramic tiles; 35% for certain jewellery products; up to 35% for consumer electronics; 28% for cars; and 45% for motorcycles[20].

In 2009, however, the EU trade deficit with China declined as a result of the negative impact that the economic crisis had on imports of European countries.

As shown in Table 1, European imports of Chinese goods fell by 13% from 247,900 million in 2008 to 214,700 million in 2009.

It should be noted, however, that among the ten largest EU trade partners, China was the country with a smallest reduction of EU imports after Switzerland. EU imports from Brazil, for example, were reduced by 29%, from Russia by 35% and from India by 14%.

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[19] Borgonjon & Hofmann (2010), p. 8.

[20] Teijelo (2009), p. 25.

Table 1

Main trading partners – EU27 - non seasonally adjusted data — bn euro

	EU27 exports to			EU27 imports from			Trade balance	
	Jan-Dec 08	Jan-Dec 09	Growth	Jan-Dec 08	Jan-Dec 09	Growth	Jan-Dec 08	Jan-Dec 09
United States	249.9	204.5	-18%	186.8	160.0	-14%	63.2	44.5
China	78.4	81.6	4%	247.9	214.7	-13%	-169.5	-133.1
Russia	105.0	65.7	-37%	177.9	115.4	-35%	-72.8	-49.7
Switzerland	98.0	88.6	-10%	80.3	73.8	-8%	17.7	14.8
Norway	43.8	37.6	-14%	95.9	68.7	-28%	-52.1	-31.1
Japan	42.3	36.0	-15%	75.2	55.8	-26%	-32.9	-19.8
Turkey	54.1	43.9	-19%	46.0	36.1	-22%	8.2	7.8
South Korea	25.6	21.5	-16%	39.6	32.0	-19%	-14.0	-10.5
India	31.6	27.5	-13%	29.5	25.4	-14%	2.1	2.1
Brazil	26.3	21.6	-18%	35.9	25.6	-29%	-9.5	-4.0

Source: Eurostat

European exports to China registered a positive performance in 2009. As shown in the table, China was the only country among the top ten trading partners of the EU that registered a growth of exports (4%). In all other cases, European exports fell in 2009 (by 18% in the case of Brazil, 13% in the case of India). The dynamism of European exports to China has to be necessarily associated with the strong economic growth that this country has maintained in 2009, despite the international economic crisis.

Thanks to these developments, the EU trade deficit with China declined by 21%, from 169,500 to 133,100 million Euros.

Moreover, the trade deficit of the EU with China must be subject to some qualifications in order that a fair assessment may be made of it.

First, the increasing trade deficit with China in recent times has been accompanied by a reduction of the trade deficit with other countries. "During the (…) period 2000-2006, the EU's trade deficit with China rose from 49 to 130 billion Euros. But this is only half of the story. The other half is the *decrease* of the EU's trade deficit with the rest of the world – from 93 to 66 billion Euros. In short, this period has witnessed a massive reshuffling of global trade flows. Many trading partners of the EU export to the EU via China – rather than from their home countries. This is particularly the case of nine large trading partners of the EU (Japan, Korea, Hong Kong, Indonesia, Malaysia, Singapore, Taiwan, Thailand, and the U S)"[21].

As noted in a major study of EU-China relations: "Asia's overall share of EU imports has risen only a little over the last ten years (by 10 per cent, according to the Commission). The reason is that many Chinese exports have replaced goods that previously came from countries such as Japan, Korea and Taiwan. These countries now ship components to China, where they are assembled and then sold as finished goods to world markets. Indeed, many European (and American) companies have their products put together in China. In 2005 such 'processing trade' accounted for more than half of China's exports (and about half the goods exported from China are from foreign owned factories). This shift of manufacturing from other Asian countries to China helps to explain why the EU's overall trade deficit in medium technology goods did not rise much between 1999 and 2006, despite China's spectacular export growth in such sectors"[22].

21 Messerlin/Wang (2008), p. 11.

22 Grant (2008), p. 35.

Secondly, the strong growth of Chinese exports has been due to a large extent to the fact that its products are competitive and attractive. In this sense, European consumers have benefited from the expansion of imports of Chinese products, which have also contributed to the moderation of prices. According to one study, the availability of cheaper Chinese products has allowed European households to save an average of 300 Euros per year[23].

Third, we must not forget that a substantial portion of the Chinese goods exported are manufactured by foreign companies installed in China, including European companies. Protectionist measures affecting China's exports have thus a direct negative impact on many European companies.

In any case, despite the improvement registered in 2009, the trade deficit is a strong potential source of conflict, especially if the economic slowdown in the EU continues and the perception that Chinese products benefit from an unfair advantage is reinforced, as probably would happen if the exchange rate of the Chinese currency is considered to be at an artificially undervalued level.

"China's trade surplus with Europe will become an increasing source of friction. Unlike the Americans, the Europeans are not dependent on Chinese capital to help fund their fiscal deficits. As a result, they can afford to allow relations with China to deteriorate. So far, they have been very cautious about criticising China for fear of damaging their business interests in the country. But against a backdrop of very weak economic growth in Europe, high unemployment and a widespread perception that European firms are not being treated fairly in China, trade relations with Europe could easily worsen. The steep rise in the value of the Euro against the Chinese currency is a source of mounting anger in Europe, reflecting as it does China's refusal to allow a meaningful appreciation of the RMB against the weakening dollar to which the Chinese currency is effectively tied"[24].

2.2.2. EU protectionist measures against Chinese products

Adoption of protectionist measures against Chinese products has been recurrent in the European Union. The alleged unfair competition from Chinese products has been the argument most commonly used to justify these measures. Sometimes, scandals about the safety of Chinese products (potentially toxic toys, contaminated toothpaste) have helped to create a favourable environment for protectionist measures. Of the 1,600 notifications of unsafe products that the Commission received in 2007, half of them were for Chinese goods.

Chinese goods head the list of dangerous consumer products notified through the EU's rapid alert system (Rapex) in 2009, according to a European Commission report published on 15 April 2010. China accounted for 60% of the 1993 notification cases during the year, with toys, clothing, textiles and motor vehicles turning out to be the chief culprits. Harm from dangerous chemicals, general injuries, choking, electric shocks and strangulation were some of the main problems cited by complainants[25]."

Many of these European protectionist measures have been articulated through antidumping procedures, the most common barrier in the EU against imports of products from developing countries. Through these

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23 Grant (2008), p.32.
24 Tilford (2009), p. 4.
25 EUObserver, 16 April 2010.

procedures some labour-intensive sectors (such as shoes and clothing), or that have powerful lobbies, have tried to curb Chinese exports to European markets.

The number of antidumping measures against Chinese exports doubled between 1995 and 2008, while the total number of these measures imposed in the world grew by 16%. In this way, China has gone from receiving one fifth of antidumping measures in 1995 to receive more than one third in 2008. The sectors most affected have been footwear, transport equipment, especially bicycles, building materials and ceramic products, vegetable products, such as garlic, chemicals and steel[26].

Since 2002 the EU also began to adopt safeguard measures, beginning with a safeguard regarding the steel sector (which affected other countries besides China). In 2005 it adopted a new safeguard measure against a wide range of textiles and clothing products. Subsequent negotiations led to voluntary export restraints by China, capping the growth of exports in 10 of the 35 categories of textiles and clothing.

The effectiveness of these measures is disputed. As noted above, a large part of Chinese exports corresponds to foreign companies, including European ones, that can be negatively affected by the adoption of protective measures for European markets. "Trade defence measures are based on an increasingly obsolete view of what a modern industrial economy is, namely a complex production process fragmented among a notable number of countries. Trade defence measures equate industry to manufacturing alone, ignoring the crucial *pre*-manufacturing step (design and preparation of the physical manufacturing processes) and post-manufacturing step (logistics, marketing, advertising, etc). These two steps generate a lot of value added in the importing country. For instance, even in labour-intensive products such as shoes, these two steps represent half to three quarters of the European value added in the shoe sector. In short, not only do antidumping and safeguard measures *not* protect the "old" economy (the manufacturing step *per se*), but they might also hurt the "new" economy (pre- and post-manufacturing steps)"[27].

In February 2010, China filed a formal protest at the WTO against the EU tariffs on imports of Chinese shoes. In December 2009 the EU effectively agreed to extend for 15 months (from January 2010) anti-dumping measures against shoes from China and Vietnam, originally adopted in 2006. These fees add between 9.7 and 16.5% to the price of the shoes imported from China.

The extension of the antidumping duties revealed the existence of significant divisions among European countries. 13 countries voted against the extension, nine in favour and five abstained. According to EU rules on antidumping, abstentions are counted in favour of the proposal from the Commission.

The European Footwear Alliance, which represents several large European manufacturers (such as Adidas and Timberland) supported the Chinese decision to go to the WTO, saying in a statement that "Ironically, the measure hurts European business and consumers the most".

In March 2010 the Federation of European Sporting Goods Industry (FESI), which includes companies such as Adidas, Puma, Nike and Lacoste, announced that it had decided to take legal action against the decision of the EU to extend antidumping duties on footwear. "We have taken this case to court not only because we firmly believe that these duties are unjustified but also because it is clear to us that the European

[26] Teijelo (2009), p. 27.

[27] Messerling and Wang (2008), p. 10.

Commission is ignoring the basic economic realities of the footwear business," FESI president Horst Widmann said in a statement[28].

Presumably the implementation of such measures will continue in the coming years, especially considering that there are not good prospects for the EU to agree to China's Market Economy Status (MES). China and the EU have conducted negotiations in relation to the MES, but there is a wide gap between the positions of the two parties. According to its 2001 protocol of accession to the WTO, China will definitively be awarded MES in 2006. Henceforth the adoption of protectionist measures against their products will become substantially more difficult. But until then, trade disputes, in particular the imposition of antidumping measures against Chinese products, will remain a potentially destabilizing irritant in trade relations.

2.2.3. The issue of the exchange rate of the Chinese currency

The exchange rate of the Chinese currency has become a major irritant in recent months. The alleged undervaluation of the Yuan has led to growing discontent in the first place in the United States but also in Europe, and threatens to trigger a serious conflict in the near future.

The basic positions on the subject are well known. Relevant business and academic circles of Western countries believe that China is maintaining the exchange rate of its currency artificially low, in what amounts to a subsidy to its exports and increased tariffs on its imports. The competitiveness thus provided to exports is probably the key factor that has allowed the strong growth in exports and in the surpluses of the Chinese balance of trade, making China the country of the world with the largest amount of foreign exchange reserves (more than two trillion dollars at the end of 2009).

The assessment of the magnitude of the undervaluation of the Yuan varies. According to one recent estimate of the undervaluation of the Chinese currency based on the purchasing power parity (PPP) approach, Arvind Subramanian, of the Peterson Institute for International Economics, finds that the renminbi is undervalued by approximately 30%[29].

In practice, China has kept the exchange rate of its currency tied to the dollar. In 2005 the Chinese government announced that the Yuan's exchange rate would be tied to a basket of currencies, although the mechanism was not defined and it appears that the dollar has remained the central reference element.

This exchange rate policy has strongly affected European exporters. Between 2002 and 2007 the dollar fell by around 40% against the Euro, taking with it the Yuan and other Asian currencies. This has produced a strong appreciation of the Euro against the Yuan, with the consequent reduction in competitiveness of European exports.

Prominent and prestigious international economists have harshly criticized the exchange rate policy of China. According to Financial Times columnist Martin Wolf, “China has kept its exchange rate down, to a degree unmatched in world economic history. Finally, China has, as a result, distorted its own economy and that of the rest of the world. Its real exchange rate is, for example, no higher than in early 1998 and has depreciated

28 Reuters, 19 March 2010.

29 Subramanian (2010).

by 12 per cent over the past seven months, even though China has the world's fastest-growing economy and largest current account surplus"[30].

One of the best known critics of China's exchange rate policy has been the economist Paul Krugman, who has strongly defended the need for the United States to take vigorous action: "China's policy of keeping its currency, the renminbi, undervalued has become a significant drag on global economic recovery" (…) Today, China is adding more than $30 billion a month to its $2.4 trillion hoard of reserves. The International Monetary Fund expects China to have a 2010 current surplus of more than $450 billion – 10 times the 2003 figure. This is the most distortionary exchange rate policy any major nation has ever followed"[31].

The Chinese stance, as is well known, is first to defend that the exchange rate of its currency is a "domestic" matter, that China has the right to manage independently, without negotiating with international partners. Secondly, China does not offer concrete indications of what its policy in this area will be, normally only giving very general statements in relation thereto: "We will maintain the stability of the renminbi at a reasonable and balanced level", said Premier Wen Jiabao after the EU-China summit last December 2009.

In June 2010, shortly before a meeting of G20, the Chinese government announced that the renminbi's fixed peg to the dollar would be replaced by a more flexible system. The Chinese currency appreciated slightly in the following weeks. However, most observers and analysts rule out a major appreciation. Forecasts point rather to a slow process of appreciation. The Economist Intelligence Unit, for example, estimates that the Yuan will appreciate by 2% annually in 2010 and 2011[32].

It is important to remember that the situation of the Euro against the Yuan is very different from that of the Dollar. In early 2010, largely as a result of the fall of the Euro caused by the problems of sovereign debt, the Euro depreciated sharply against the Yuan, a process which must surely have a relationship with the improvement of trade balance between the EU and China.

2.3. Changes in the Chinese economic model of growth

There is a fairly general consensus among analysts of the Chinese economy that it needs to undertake a thorough rebalancing if it wants to maintain balanced and sustained growth in the long term. This rebalancing of the economy has broad implications on China and the international economy, and in regard to the subject of this paper, opens up new business prospects for European companies.

As noted repeatedly, Chinese economic growth has been based on investment and exports. China has spent more than 40% of its GDP on investment. According to the Asian Development Outlook 2010, in 2009 "total investment contributed 8 percentage points, or a record 92%, of total GDP growth on the demand side. The investment-to-GDP ratio rose to nearly 46%, the highest level in at least three decades"[33].

Industrial production accounts for nearly 50% of GDP, while services do not reach 40%. The saving rate of households is very high, while household consumption accounts for 35% of GDP, a very low participation in

30 Financial Times, 8 December 2009.

31 "Taking On China", New York Times, 15 March 2010.

32 Viewswire, 21 June 2010.

33 Asian Development Bank (2010), p.135.

relation to most countries. "Growth in consumption is limited by household income's declining share of total income. The share of household income in total national disposable income shrank from about 66% in 1997 to 58% in 2007, while the share of government income increased from about 17% to 20% and that of enterprises from 17% to 22%"[34].

According to Simon Tilford, "At least in terms of the relative importance of industry and services, China continues to look much more like a communist country than a capitalist one"[35].

This structure of the Chinese economy has an important bearing on some of the issues that cause friction in the international community. China has produced much more than it has consumed, and the gap has been channelled to exports, largely, it is alleged, thanks to an undervalued exchange rate. Thus China has obtained such high trade surpluses with many countries which are a source of discontent.

China has also obtained a large surplus in its current account, which has allowed it to transfer a substantial amount of capital abroad, for example through the purchase of US treasury bonds. As noted by Simon Tilford, "This is an unprecedented reversal of the norm. Developing countries usually import capital because their domestic savings are inadequate to meet their high investment needs. For a developing country to be lending capital to the most important developed economy in order for it to buy the developing country's goods is not something that has happened before"[36].

There is general agreement that the new model of growth of the Chinese economy should be oriented according to the following trends:

- An increased share of consumption at the expense of savings and investment.

- Reduced weight of exports, which must be offset by increased domestic demand.

- A growth of services at the expense of industrial production.

To promote these changes, and in particular to encourage greater consumption and lower savings, it is necessary to further develop basic social services, especially education and health. If the propensity to save is so high, this is due largely to a matter of safeguarding against risks. Chinese citizens have to save in order to be prepared for medical expenses (which can be very high). They also have to save to finance the education of their children. As noted by Tilford, "much has been made of the allegedly strong cultural disposition to save on the part of the Chinese. The Chinese may well be more cautious than the famously optimistic Americans. But the principal reason for China's high savings rates has little to do with culture and a lot to do with public policy. The absence of any meaningful social security system and the high cost of healthcare and other essential services relative to average incomes ensure that the Chinese have no option but to save a very high proportion of their incomes"[37].

The Chinese authorities have for a long time indicated the desirability of encouraging this rebalancing in the growth model. The crisis, however, has slowed the change. The huge stimulus package launched by the

[34] Asian Development Bank (2010), p. 139.
[35] Tilford (2009), p. 1.
[36] Tilford (2009), p. 2.
[37] Tilford (2009), p. 5.

Chinese authorities to counter the effects of the economic crisis has been implemented to a significant extent through an increase in loans to state enterprises, with which they have financed investments in infrastructure projects. To a lesser extent the stimulus package was aimed at boosting consumption. Thus the share of investment in GDP has even increased in 2009, as we mentioned earlier.

However, some authors have stressed that the negative effects on consumption of China's policy to tackle the crisis have been exaggerated. Nicholas R. Lardy, a foremost international specialist on Chinese economy, has written: “The charge that the stimulus program focused excessively on expanding investment demand and has set back China’s efforts to achieve more balanced growth by encouraging private consumption seems wrong. Consumption growth in 2009 was actually quite robust; indeed on the basis of preliminary data it appears that 2009 was the first year since 2000 that the growth of consumption outstripped the growth of GDP. Thus the long-term decline in the consumption share of GDP probably ended, at least temporarily, in 2009”[38].

According to Lardy, consumption has benefited from several factors:

- Increased investment, particularly in the construction sector, has offset much of the job losses in export sectors;

- The government has continued to increase transfers to lower income citizens, as well as pensions;

- The government has taken other measures to promote consumption, such as tax cuts for the purchase of cars, subsidies for the purchase of appliances by residents of rural areas, etc.;

- And finally, there has been a substantial increase in household debt, part of which went to finance the purchase of houses, and a substantial part to finance consumption expenditures.

“Contrary to repeated criticisms, this stimulus had a substantial consumption component and directed investment primarily toward infrastructure rather than expanding capacity in traditional industries such as steel”, according to Lardy[39]. State spending on education and health has grown strongly in recent years but still has a long road ahead.

On the other hand, the structure of taxation should also change, with a reduced load on consumption and an increased load on companies. Increased corporate tax will reduce corporate profits and therefore investment. A lower tax burden on individuals will increase disposable income and consumption.

Similarly, the financial system should also be reformed in order to redirect funding from businesses to consumers. Interest rates on loans to state enterprises are very low, which encourages a high level of investment. For their part, consumer credit and mortgage credit are very underdeveloped.

The development of services also requires drastic changes. According to the Asian Development Bank, the “unlocking the sector’s potential requires policy action on a long list of constraints”. The bank mentions in this respect:

38 Lardy (2010), p. 7.
39 Lardy (2010), p. 8.

- Excessive market concentration and entry barriers. "As a result, state-owned enterprises dominate services, a fact that restrains competitiveness and obstructs the entry of new players, thus reducing the benefits that greater competition and liberalization would bring. Entry barriers include administrative hurdles; opaque regulations; cumbersome licensing requirements; and restrictions on the geographic range in which businesses can operate, their legal structure, and their access to banking services".

- Restrictions on direct foreign participation. "With the exception of a few subsectors, such as hotels and some types of banking, services remain largely closed to foreign firms".

- Incentive bias toward manufacturing. "Fiscal incentives direct investment to the production of goods, and exemptions and rebates favor export of goods, discouraging investment in services".

- Inefficient allocation of capital. "Large state-owned enterprises, including those in services, receive about two-thirds of total lending. In contrast, private enterprises get only one quarter of the credit available and face much higher interest rates".

- Incomplete urbanization and labour market rigidities. "Service providers generally thrive in cities, where demand is strong and customers are concentrated in a relatively small area. While there are many cities, about 65% of the population still lives in far-flung rural areas. Urbanization has been slowed by rigidities in the labour market, in particular by the *hukou* system".

- Underinvestment in education and training. "The policy investment bias favours the acquisition of equipment and materials, to the detriment of investment in training"[40].

Finally, the exchange rate should play a key role here also. As indicated, the undervalued exchange rate is an export subsidy and favours in this regard firms (and investment), harming consumers. The appreciation of the Chinese currency would raise the income level of consumers and reduce the external competitiveness of Chinese products. This would encourage a reorientation of the bases of growth from exports to consumption.

Progress toward an exchange rate more in line with market forces would not only help to reduce conflicts with trading partners, but also favour the reorientation of the growth model that the Chinese authorities themselves have acknowledged as necessary.

In short, this process of rebalancing the Chinese economy, which seems both desirable and irreversible, has a broad impact not only on China but on the international economy. No doubt it will create, in certain aspects, challenges and difficulties for European companies. But it could also open up new niches of opportunity, as we shall discuss later.

[40] Asian Development Bank (2010), p. 141.

3. Access barriers to the Chinese market

Despite the strong growth of trade and investment, there have traditionally been complaints about the problems of access to the Chinese market, by international companies in general and European companies in particular.

Early in the last decade the situation began to improve gradually, largely as a result of the commitments made by China with the access to the World Trade Organization. In the last two or three years, however, this trend seems to no longer apply. Entry barriers have increased dramatically, according to the general opinion of many operators, chambers of commerce, etc.

In its opening statement to the Trade Policy Review (TPR) meeting in Geneva on 31 May, the EU summarized its main concerns:

- "The continued problem of non-tariff barriers in China. EU pointed to the burdensome regulatory regime, which is characterised by low alignment to international standards, the recurrent use of export barriers, and investment restrictions to foreign companies. For the EU it is also essential that China's innovation policy ensures open and fair competition without restrictions in terms of market access.

- The EU acknowledged improvements in Intellectual Property Rights protection in China, but emphasised the urgent need for greater enforcement efforts, including effective customs controls and criminal prosecution.

- The unjustified state interference in the economy persists. This is true notably in the manufacturing sectors, in which China has become a leader worldwide, such as automobiles. The Chinese government's guidance in allocating resources and official trade finance support are other examples.

- The need for greater transparency in policy-making and regular public consultations with foreign and domestic stakeholders. EU urged China to make its trade regime significantly more predictable and transparent"[41].

The following is a brief overview of the main problems of access to the Chinese market.

3.1. Public procurement

European companies feel discriminated in public procurement. According to the European Chamber of Commerce in China, "Equal treatment for domestic and foreign companies is conspicuously absent in the public procurement process, and China's signing up to the WTO's Government Procurement Agreement (GPA) seems to be further delayed by a disappointing first offer from the Chinese side"[42].

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41 European Commission-Directorate-General for Trade, Press Release, 2 June 2010.

42 European Union Chamber of Commerce in China (2009), Executive Summary, p. 10.

The European Chamber of Commerce mentions for example licenses for wind farms, “a sector in which not a single foreign wind turbine manufacturer has won a bid since 2005”[43].

When China joined the WTO, it agreed to start negotiations as soon as possible to become a signatory to the Agreement on Public Procurement. China currently has observer status. "The Chinese proposal on the coverage of its offer can be described as disappointing. Among other shortcomings, it does not include sub-central entities (representing 80% of the total Chinese procurement), public enterprises and services sectors of most interest to European companies (transport, electricity, telecommunications, construction, infrastructure and public works etc.). It also establishes thresholds too high, so that large number of tenders would not be subject to the provisions of the agreement. Similarly, the transition period of 15 years since its membership is clearly excessive"[44].

Beijing presented a second proposal to the GPA (Government Procurement Agreement) – which includes the US, Japan and all 27 European Union member states – in July 2010. It seems unlikely that this new proposal can be accepted, as it does not include substantial progress from the previous proposal. In an analysis of the Chinese proposal, the Financial Times indicated that the new text retained the key limitations of the previous one: “the main concern about China’s latest proposal is that it does not offer foreign companies access to local government and state-owned enterprise procurement contracts, which account for the vast majority of state contracts in China. Another stumbling block is China’s proposal to only open government construction contracts to foreign companies if those projects are larger than a threshold three times higher than most other major GPA members”[45].

Noteworthy in the area of public procurement is the entry into force in late 2009 of new rules on promoting domestic innovation ("indigenous innovation"), which have aroused serious concerns among foreign companies.

With these rules the Chinese authorities try to promote the development of technologies owned and developed by Chinese companies, and reduce reliance on the use of foreign technologies. Indigenous innovation products will enjoy preference in public procurement.

To qualify as an indigenous innovation, a product must

- Have been produced by an enterprise that has full ownership of intellectual property rights in China either via its own technological innovation activities or because the Chinese enterprise, work unit, or citizen has, by legal means, obtained the Chinese rights;
- Have a trademark that is owned by a Chinese company and registered in China;
- Embody a high degree of creativity and innovation;
- Offer a strong degree of reliability and dependable quality, with certification from the China National Certification Administration or its provincial departmental branches.

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43 European Union Chamber of Commerce in China (2009), Executive Summary, p. 10.

44 Teijelo (2009), p. 29.

45 Financial Times, 19 July 2010.

There are six areas identified for inclusion in the indigenous innovation catalogue: computer and application devices, communication products, modern office equipment, software, new energy equipment and energy efficient products.

“Over the past three years, a few provincial and municipal governments have developed their own product catalogues, which include lists of products accredited as indigenous innovation. To date, very few products made at a foreign-invested facility have received accreditation. Of the 523 products listed in the Shanghai catalogue, only two are made by foreign-invested enterprises (FIEs)–and those are from Chinese-foreign joint ventures with majority Chinese ownership. Of Beijing's 42 qualified products, just one comes from a foreign company”[46].

Foreign companies established in China fear that it will be very difficult to obtain the accreditation of local technology. “The biggest obstacle for foreign companies is the requirement that the applying China entity fully own the IP and first register the trademark in China. The primary concern of foreign companies is that they will be excluded from China's government procurement market simply because they have developed IP and owned trademarks in other jurisdictions”[47].

In reality, the situation, as in so many other issues, is not clear. Probably as a response to the criticism of foreign companies, the Ministry of Science and Technology published a document in April that said that any company whose products conformed to Chinese laws, regulations and technology policy and which possessed legal rights to the related intellectual property could gain accreditation under rules on “indigenous innovation” to bid for government contracts.

The American Chamber of Commerce published in March 2010 the results of a survey of U.S. companies in connection with the new innovation policy, which reflected the concern and pessimism about the impact of new regulations (see chart). “Although the current policy only targets select industries and has not yet been implemented, 28 percent of American companies responded that they are already losing out on business as a result of indigenous innovation (…) Looking more closely at the *Innovation Policy Survey* data, among American high-tech companies (whose industries have been targeted), 57 percent report that they expect to lose business because of indigenous innovation policies. Overall, more than 40 percent of companies responded that they expect to be negatively affected by these policies once they are fully implemented”[48].

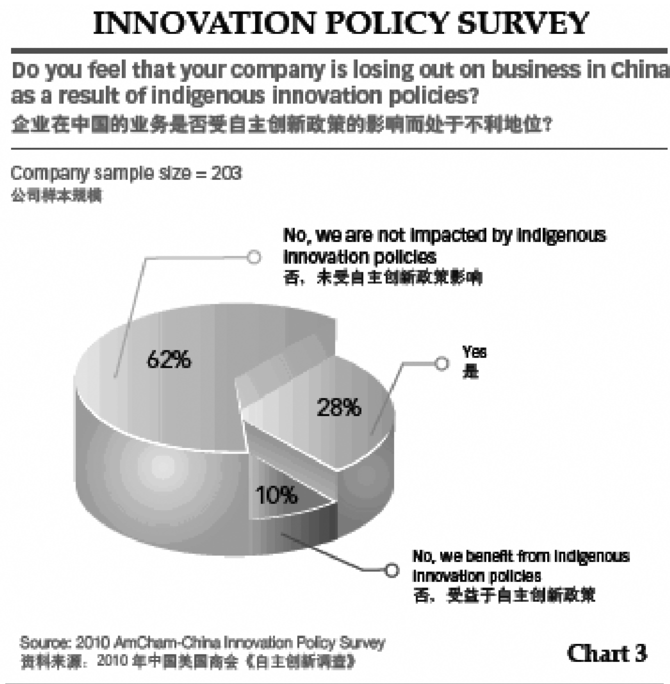
According to some analyses, the new rules on indigenous innovation are the expression of a more general, and worrying, shift in the politics of China in its foreign economic relations. According to a 2010 publication of the U.S. Chamber of Commerce, “while indigenous innovation is considered by China to be a bold second act of Deng’s reform and opening, in the West the campaign is increasingly perceived as anti-foreign and regressive. Indigenous innovation seems to be a policy borne as much out of China’s fear of foreign domination as China’s pride in its great accomplishments and desire to be a leader in the rules-based international system. For many multinationals – especially tech companies - the policies appear to signal that the pretence of goodwill is gone. The belief by foreign companies that large financial investments, the sharing of expertise and significant technology transfers would lead to an ever opening China market is being replaced by boardroom banter that win-win in China means China wins twice (…) The indigenous innovation campaign and surrounding web

[46] “Domestic Innovation and Procurement”, The China Business Review, March-April 2010.

[47] “Domestic Innovation and Procurement”, The China Business Review, March-April 2010.

[48] China Brief, American Chamber of Commerce in China, April 2010.

of industrial policies represent the beginning of a new era in not only the US-China economic and political relationship but in China's relationship with international business and the developed world"[49].



Source: American Chamber of Commerce in China

3.2. Restrictions on foreign investment

The activities of foreign firms in the Chinese market are severely constrained by existing legal limitations on foreign equity participation in many sectors.

Some examples of these limitations, which especially affect European companies, are:

- **Cars.** There is still a rule requiring the establishment of 50/50 joint ventures. As noted by the European Chamber of Commerce, "It is remarkable that, at a time when Chinese investors are acquiring numerous European auto makers, Europe's own car makers can still not establish their own car manufacturing facilities in China. Incredibly, market access conditions for these auto companies have hardly changed in the three decades since the reform and opening up policy began. To operate in China, they are still forced to establish 50/50 joint ventures just as they were 30 years ago"[50].

  The lack of reciprocity may be particularly striking in the case of automobiles. As noted in an article by the president of the European Chamber of Commerce in China, foreign firms "are asking why Geely can buy Volvo, while foreign motor manufacturers still have to form joint ventures to manufacture their cars in China"[51].

49 McGregor (2010), p. 6.
50 European Union Chamber of Commerce in China (2009), Executive Summary, p. 10.
51 Joerg Wuttke, "China is beginning to frustrate foreign business", Financial Times, 7 April 2010.

- **Clean Development Mechanism**. Chinese law requires joint ventures with 51% of Chinese capital in the projects under the Clean Development Mechanism. “As a consequence, not one of the world’s top five wind operators has a single wind development project in China”[52].

- **Computer Reservation Systems**. Foreign firms are unable to provide services directly to travel agents and airlines in China. This particularly affects Amadeus, the reservation system based in Madrid.

- **Banking**. The ceiling on foreign investment per company is 20% for the individual shareholder, and 25% for total foreign holdings.

Chinese law includes significant restrictions on foreign capital participation.

The “Guidelines for state-owned enterprise reform”, approved on December 2006, gave a list of sectors in which the state should be the sole owner or have a majority share. Among the sectors covered by these restrictions are power generation and distribution, oil, petrochemicals, natural gas, telecommunications and armaments. Moreover, the state must have a controlling stake in the coal, aviation and shipping industries.

In December 2007 a new “Catalogue for the guidance of foreign investment industries” was published. The catalogue classifies industries for potential investment as prohibited or restricted (for instance, only permitted in a joint venture with a Chinese partner) or encouraged (investments the government is willing to support). The investments that do not fall into one of the three categories are considered permissible, but they are not entitled to receive policy incentives.

“New industries on the list of encouraged FDI are, for instance, modern agricultural methods, resource conservation and environmental protection (e.g. recycling, renewable energy, clean production), services outsourcing and modern logistics, advanced or new technologies and new materials. On the other hand, FDI in certain kinds of basic manufacturing that China has clearly mastered (e.g. clothing) will be permitted, but no longer encouraged. Foreign investments in highly energy- or resource-intensive and highly polluting projects are now either restricted or have been added to the prohibited category, which also includes mainly strategic and sensitive industries such as mining of certain minerals (e.g. tungsten, rare earths). The restricted category includes, for instance, the smelting of various metals, telecommunication companies, printing of publications and the construction and operation of high-grade real estate”[53].

At this point the relationship between greater openness to foreign investment in services and the necessary orientation of China towards a new model of economic growth must be taken into account. Foreign investment, particularly European investment, has great potential to stimulate the development of services that support the expansion of consumption, which in turn would encourage imports, reducing trade surpluses and so favouring a more balanced exchange rate of the Chinese currency.

Foreign direct investment in services contrasts in this regard with the investment in manufacturing sectors, which stimulates the production of goods for export with its consequent impact on trade disputes.

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52 European Union Chamber of Commerce in China (2009), Executive Summary, p. 10.

53 Urban (2009), p. 60

3.3. Certifications

In certain sectors requirements for certification to operate in the Chinese market are being introduced, certifications that may be difficult to obtain for foreign companies.

The European Chamber of Commerce in China gives an example of such problems:

"A successful Chinese Wholly Foreign Owned Enterprise (WFOE) has for many years used commercial encryption technology to provide solutions for Chinese banking, telecoms and public transportation companies - the great majority of which are state-owned. However, this Company is finding it increasingly difficult to do business in China, because its clients now require product certifications from the Office of Security Commercial Code Administration (OSCCA). Whilst relevant regulations do not exclude foreign or foreign-owned companies from OSCCA certification, no such companies have been certified to date. Additionally, the OSCCA certification is a precondition for the China Compulsory Certification (CCC) certification which will be required for commercial encryption products purchased by any Chinese government agency from May 1st, 2010. Based on experience, there is a serious risk that, in practice, the company's state-owned clients will also start procuring only those products bearing the CCC mark"[54].

Another sector hit by regulatory protectionism is that of mobile phones. China approved new emission standards that require expensive and complicated testing of foreign models that had already passed EU and other international testing. "Most of these tests are simply revenue-earners for the ministries that charge for the certificates," according to Duncan Clark, the chairman of BDA, a technology consultancy in Beijing, "and they appear designed to make life hard for foreign manufacturers"[55].

3.4. Lack of transparency in regulations

The lack of transparency in the rulemaking process, discretion in implementation of rules, and a lack of coordination between government bodies, are factors that can negatively affect the activity of foreign companies.

One can again turn to the European Chamber of Commerce for the description of a particular and famous case, the blocked acquisition of Huiyuan Juice Group Ltd. by Coca-Cola, under Article 28 of China's Anti-Monopoly Law (AML). "This was the first time MOFCOM blocked a merger after the AML came into effect on August 1st, 2008. A brief statement outlining MOFCOM's decision in this case was published on the Ministry's website. However, although the statement outlined the primary areas of concern in relation to the transaction, it offered very little detail about the case and, in particular, contained no substantive analysis or evidence supporting the decision to block the deal. Nor did it include any information on key issues such as the market definition or the balancing of the positive and negative impacts of the proposed deal on industry competitiveness. The lack of detail about the decision was widely criticized, and a MOFCOM spokesperson subsequently gave a media interview in which further information about the Ministry's investigation and conclusions were provided"[56].

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54 European Union Chamber of Commerce in China (2009), Executive Summary, p. 11.

55 Telegraph, 4 July 2010.

56 European Union Chamber of Commerce in China (2009), Executive Summary, p. 12.

3.5. Arbitrariness in the operation of the government

In recent years complaints about arbitrary conduct of the Chinese government have intensified. “China’s move towards economic openness has slowed noticeably since 2006, and there have been various setbacks and reversals. Nontariff barriers to trade make it hard for foreign exporters and investors to do business in China. These include unclear or arbitrary health and safety requirements; licensing and registration rules that discriminate against foreign companies; subsidies for Chinese companies through direct cash payments, cheap energy or soft loans; public tenders that are opaque and inaccessible for foreign bidders; and the widespread violation of intellectual property rights (IPR). Trade commissioner Peter Mandelson claims that non-tariff barriers and discriminatory rules cost European companies S55 million a day in lost business opportunities. The EU Chamber of Commerce in Beijing reports a long list of complaints from its member companies about China’s bureaucracy, which can be obstructive and un-transparent. Examples include the imposition of proprietary technical standards to replace Western ones; the sudden announcement of new laws on taxation or foreign investment, without prior consultation or sufficient time for implementation; and the use of ‘impossible’ regulatory requirements in sectors that are, in theory, open to foreigners”[57].

3.6. Intellectual property protection issues

The problems of intellectual property protection have long been cited as one of the most important problems faced by foreign companies in the Chinese market. The Chinese authorities have made important efforts to promote intellectual property protection, but this is not yet as effective as it should be.

In 2005 the EU and China established a working group to address these problems. On the other hand, the US launched WTO consultations proceedings against China for breaching the obligations to protect intellectual property, in which the EU has officially requested to participate as interested party.

The EU objective is to increase the pressure on the Chinese authorities on issues such as payment of royalties, audiovisual piracy and, in particular, the need to strengthen the pursuit of crime in this area.

3.7.Geographical Indications

The protection of Geographical Indications (GI) of origin is another area of concern for the European Union.

In the second session of the EU-China High Level Economic and Trade Dialogue, in 2009, it was agreed that the EU and China would launch formal negotiations on an agreement for GI.

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[57] Grant, Charles (2008), p. 36.

4. Windows of opportunity

Trade and investment between Europe and China continues to offer many areas of opportunity. In this section we review some of the windows of opportunity we see as most significant:

4.1. Opportunities in consumer goods and services in the Chinese market

With economic growth and rising living standards in China, European companies have a wide range of opportunities in the consumer goods sectors in which Europe has a long experience and tradition, with numerous internationally renowned brands. As noted in preceding pages, the new model of growth of the Chinese economy has to move towards a greater weighting of consumption.

The key objective is the sector of China's population with a high income level, which is concentrated in urban areas. Professionals, business managers and senior officials, are purchasers of goods and services in which European companies already have a real market, but with a huge potential for future growth.

This high-income sector is a relatively small proportion of the population but represents, given the existing income inequalities in China, a high proportion of the national income. Some studies estimate that in 2004 10% of households accounted for 35% of total income, and that 20% of the more affluent households accounted for more than 50% of income. Other studies show that the affluent Chinese middle class may be about 300 million people.

To the extent that China moves towards a new economic model with an increased share of consumption and services, European companies will find business opportunities in diverse sectors such as health, tourism, education, food, trade, etc., provided that barriers do not hinder their activities.

4.2. Green technologies

A sector that must be given special attention is that of new energy and climate change, in which there is already a well developed relationship between the EU and China. Europe is already a significant investor in green technologies in China. European companies are investing around 1,500 million Euros a year in Chinese projects aimed at reducing greenhouse gas emissions under the Clean Development Mechanism of the Kyoto Protocol, while the EU spends 60 million Euros per year in official bilateral cooperation on issues of climate change. The European Investment Bank has a credit facility of 500 million Euros to invest in projects aimed at reducing carbon emissions in China.

European companies are very active in this field and account for 80% of the market for emission reduction credits under the Clean Development Mechanism, a market estimated globally at 20,000 million Euros in the period 2008-2012.

The Chinese authorities have realized the importance and impact of climate change, but must seek a delicate balance between decarbonization and the impact on economic growth and employment. On the other hand,

China sees correctly that the change towards low carbon levels is an opportunity to move up the value chain in the production process.

There have been various types of proposals to strengthen cooperation between the EU and China in these fields. The "establishment of a senior EU-China low carbon economy taskforce, with an agreed workplan and mandate to produce joint initiatives over the coming year. In terms of flagship projects, one critical area where progress is required is on the EU-China CCS demonstration plant that was agreed at the 2005 EU China summit. The targeted completion date of 2020 for this project has been overtaken by events, with the EU itself planning to complete eight to ten CCS projects by 2015 and at least eight other major CCS demonstration plants underway in the US, Australia, Norway and Canada. The summit could build on the extensive work carried out on this project to date by agreeing to complete the CCS plant by 2015, make it a full part of the knowledge sharing process under the EU's CCS demonstration programme, and agree to jointly identify a workable financing mechanism by May 2010. A credible aim would be to have completed the selection of a demonstration site and a commercial consortium in advance of the next EU China summit"[58].

The climate change issue is of great relevance, in two ways. On the one hand, it offers opportunities for cooperation between European and Chinese companies and institutions. On the other hand, we must not forget that disagreements over how to tackle climate change globally have a dangerous potential for becoming a source of confrontation.

Many analysts believe one of the reasons for the failure of the Copenhagen summit in 2009 was China's refusal to accept quantitative commitments to reduce emissions. "If the Chinese continue their current line of resisting quantitative targets for cutting CO2 emissions, the Europeans may feel they have little choice but to take punitive action. Many European industrialists, and some EU politicians, are already talking about the need to apply 'carbon tariffs' to goods from China or other countries that shun any post-Kyoto system for curbing carbon emissions. China sees such talk as de facto protectionism, driven by fear of its economic success"[59].

China has developed a series of arguments to justify their reluctance to take on ambitious commitments to reduce emissions. "China's leaders, however, have stock answers prepared for those westerners who demand action from them. They point out that their country has become the workshop of the world, for example producing a third of its steel. The shift of polluting industries to China enables the West to have cleaner air and feel good about reducing its carbon emissions. They also stress that China's carbon emissions and per capita consumption of energy are much lower than those of developed countries. For example, in 2005 per capita emissions in the US were 19.6 tonnes; in Germany 9.9 tonnes; and in China 3.6 tonnes"[60].

The climate change issue can become a major source of conflict between the EU and China. Some Western countries have advocated the adoption of punitive measures against countries that do not take strong enough measures to address the threat of climate change, such as special tariffs on imports of such countries. The adoption of such tariffs would probably open the door to a wider trade war.

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58 Mabey (2009), p. 6.

59 Grant (2008), p. 71.

60 Grant (2008), p.72.

4.3. Cooperation in third markets

There is a broad field of cooperation, as yet little explored, among Chinese and European companies in third markets, for the joint development of projects in the industrial field, infrastructure, energy, etc.

The basis to establish business collaboration must be the existence of a synergy of contributions, whereby both parties perceive a benefit from the potential alliance.

In principle, there are four major factors of synergy on which to base partnerships between European and Chinese companies to carry out industrial and technological projects in third markets:

1 - Technology. There may be projects in which Chinese or European companies do not have the appropriate technology, and this could be provided by the other party.

2 - Financing. When the size of a project, and funding required for it, makes it difficult to offer it from a single country, there is an obvious basis for an alliance. The increasing availability of foreign exchange reserves has already made China a lender of increasing importance to developing countries.

Some European companies have already begun to consider or negotiate the use of Chinese financing for projects in other countries. This is one of the aspects that most clearly mark the changes that have occurred in the Chinese economy. From being a major recipient of funding in the past, China has become a potentially major external financing source, both through direct investments and loans. Given the increased willingness of China to lend to countries in which the ability to obtain funding from Europe may be limited (such as African or Latin American countries), the use of Chinese financing by European companies has considerable potential to become a major issue of bilateral cooperation.

3 - Prices. One of the two parties has very competitive prices in certain types of goods, machinery, services. There have been already a number of cases in which European companies have incorporated in their offers equipment manufactured by Chinese companies, more competitive on price. Chinese construction companies can also be very competitive partners for projects in areas such as Asia, the Middle East or Africa.

4 - Commercial Support. One of the two parties can have a commercial presence and market knowledge that the other party lacks.

The great challenge is to identify specific cooperation possibilities, where these complementary factors can be put into action. To this end, it is necessary to increase mutual knowledge among European and Chinese companies.

The celebration of "partnership seminars", organized by business entities such as the chambers of commerce or business associations that several European countries have with China, could contribute to this mutual understanding and to the exploring of specific opportunities for cooperation.

4.4. Chinese investments in Europe

The issue of investment of Chinese enterprises in European countries is an issue that, on one hand, offers significant business opportunities but, on the other, presents difficulties and gives rise to misgivings of various kinds.

Investment by Chinese enterprises in Western countries has sometimes been viewed with suspicion. In some cases, significant investment operations have ended up being blocked in the destination countries. In 2005 a Chinese oil company, CNOOC, tried to buy a U.S. company, Unocal, but the operation failed due to opposition from Congress and the government of the United States. In late 2008, Chinalco, a Chinese state company in the aluminium industry, reached an agreement to increase its stake in Australian mining company Rio Tinto. The opposition from the shareholders of Rio Tinto and distrust on the part of the Australian authorities scuppered the transaction.

In both cases the state character of the Chinese buying companies was a key factor in the opposition to their investment. Selling state enterprises to private companies was seen as a retrograde step in terms of what was a general trend in the Western world towards privatization of economic activity and reducing of the economic role of government.

There are also misgivings relating to the delivery of control of strategic assets to companies controlled by a foreign government. "The most frequent problem of concern for China's partners is where the assets targeted by the SWFs (Sovereign Wealth Funds) originate. SOE-based SWFs go against two decades of privatizations undertaken in the market economies. These privatizations have often been hard to decide upon. It was not easy to convince the public that privatization in a market-driven context was more likely to ensure a more efficient allocation of resources in the long run than public enterprises. It is also hard to achieve successful privatizations. Privatized companies have often maintained anti-competitive features from the former public enterprises and have continued to operate under very imperfect competitive conditions: in short, private quasi-monopolies have sometimes replaced public monopolies, with no gains for consumers. Acquisitions by SOE-based SWFs could endanger the slow and long efforts, and potentially lead to some kind of "re-nationalizations" under the influence of powerful foreign governments"[61].

Fears have also been expressed over the fact that purchases by sovereign funds may involve the transfer of companies to governments that do not share the same principles politically and economically, something that can be applied to Chinese sovereign funds. According to Grant, "Many politicians and a growing number of voters in Europe and the US are nervous that such huge sums are being managed by funds linked to governments that are not unequivocal supporters of economic or political freedom. Even those who are relaxed about the potential political agendas of SWFs express concerns about the low standards of corporate governance and transparency of certain funds. Although some SWFs are managed professionally and at arm's length from the state, others have close institutional and personal links with authoritarian regimes"[62].

In this regard, in 2008 the European Commission issued a communication on sovereign wealth funds in which it called on Member States to keep open their economies, but at the same time demanding that SWFs have certain minimum requirements of transparency and accountability.

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61 Messerlin and Wang (2008), p. 21.

62 Grant (2008), p. 51.

European officials, both at the level of member countries and from the Commission, should study and reflect on this issue, and establish lines of action. China has launched an ambitious "Go Abroad Policy", encouraging Chinese companies to invest abroad, with the primary aim of ensuring raw material supplies, but also for other reasons such as market expansion, access to new technologies, etc.

A key basis for Chinese policy is the availability of substantial foreign exchange reserves. In 2007 China established a sovereign wealth fund, China Investment Corporation (CIC), which was provided with U.S. $ 200,000 million, two thirds of which must be invested in China and one third abroad. CIC acquired a stake in investment bank Morgan Stanley and in the Blackstone investment fund.

5. Some recommendations

In this final section we are going to formulate some suggestions on strategies and measures that could be useful in encouraging commercial relations and business cooperation between the EU and China.

5.1. Prioritizing issues

It might be appropriate to establish an agenda of priority issues, which would focus the efforts of dialogue and negotiation between the EU and China. Currently the EU and China have agreements and negotiations on many subjects. Defining priority areas and issues could contribute to further progress.

Some of the topics that could have this priority are:

- Clean energy and climate change, in which there is already considerable collaboration, as we saw, and great opportunities for the future.

- The restrictions in China on foreign investment.

- The public procurement policy, which is a third area of great importance and of grave concern to many European companies.

5.2. Dialogue on the exchange rate of the Chinese currency

The dialogue on this difficult and complex topic could contribute to a more balanced view of it. China must assume that the exchange rate of the currency is not an entirely domestic issue that can be managed with total autonomy. The exchange rate of one currency expresses its price in terms of other currencies.

5.3. A careful and nuanced approach to trade irritants

Trade irritants should be studied and tackled with extreme care. On issues like the exchange rate of the Chinese currency, or the alleged dumping of Chinese products, the situation may be much more complicated than might at first appear, as we have had occasion to analyze in the preceding pages.

In regard to action by the EU, it is important to listen to and take into consideration the views of the various business sectors affected. We have seen examples of antidumping measures taken by the Commission which have been vigorously challenged by certain industrial sectors (as has happened with antidumping measures on footwear, which have been challenged by major European manufacturers).

The EU, in its trade disputes, should as far as possible seek multilateral channels in which to address them. The position of the EU will be stronger when embedded in a multilateral framework for each case than in a strictly bilateral context.

5.4. Clarification of the business environment in China for foreign companies

We believe that it is important that China convey messages, backed up by specific measures, that reduce the uncertainties that have arisen in recent times in the business community about the business climate in China.

As seen in the first part of this work, since 2009 there has been a sharp deterioration in the perception by international companies of the business framework in China. Some specific incidents (Google, Rio Tinto) have contributed heavily to propagating the idea that foreign firms are no longer as welcome as they used to be in the Chinese market. The Chinese authorities should seek to clarify this issue, affirming, as is expected to be the case, that China has not entered a period of nationalism and economic protectionism.

In any case, the Chinese authorities must explain as clearly as possible what their policy is, and what the business context is for which foreign companies should prepare. Companies need a clear definition of the business context they face. Uncertainties have a negative influence on business activity.

Thus, the Chinese authorities must identify what are the sectors in which they intend to maintain restrictions on foreign investment in the medium and long term, and what will be the policies that will favour domestic technologies in public procurement, to cite two of the hottest issues at the present time. European companies would then know what to expect, and can develop appropriate strategies in relation to the Chinese market.

European companies may also discuss these issues with senior officials of the EU and their national governments, and design a strategy for negotiating with China, both bilaterally and multilaterally. These issues could then be raised under the High Level Economic Dialogue between China Trade and the EU. They could also be raised in the course of negotiations for granting China Market Economy Status, a status that China would have great interest in obtaining from the EU.

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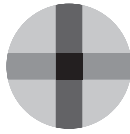

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Resumen: El presente documento de trabajo analiza el comercio y la cooperación empresarial entre la UE y China con el objetivo de hacer propuestas para mejorar y expandir las relaciones comerciales y la cooperación UE-China en el futuro.

Este documento de trabajo se centra principalmente en determinados ámbitos e interrogantes que han alcanzado una importancia preeminente en los últimos años.

Palabras clave: China, divisa china, barreras en el mercado chino, innovaciones autóctonas, relaciones empresariales UE-China.

Abstract: The aim of this paper is to analyze trade and business cooperation between the EU and China, in order to make proposals for improving and expanding such trade and cooperation in the future. The paper mainly focuses on issues and questions that have achieved a particular prominence in recent times.

Keywords: China, Chinese currency, barriers in the Chinese market, indigenous innovation, EU-China business relations.

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