Comments on Prospects for EU-China Investment and Trade

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Economic relations between China and the EU can be significantly enhanced between now and 2025. The EU and China have respectively the second and third largest GDP in the world. They are each other's largest source of imports and second-largest export destination. Moreover, the annual rate of growth of Chinese real GDP has stabilized around 6.5%, still among the world's highest, and the EU economy has recovered to a steady 2% annual rate of growth. Chinese household real consumption has been growing at more than 10% per annum and has shifted towards higher-quality goods and services. Despite the rapid growth in household consumption, Chinese savings remain in excess, especially because there are few good investment opportunities due to the excess production capacities in many industrial sectors. Thus, the savings will need to be deployed outside of China. There is therefore great potential for EU and China to further deepen their investment and trade relationship in the future. Furthermore, it should be easier for the EU and China to do so, because unlike China and the U.S., they are not competitors, geo-politically or otherwise. However, there still exist obstacles to be overcome.

Investment

Direct investment is an area where EU China economic relations is under-developed. In 2015, the stock of cumulative EU FDI in China (excluding Hong Kong) was about €168 billion, while the Mainland Chinese FDI stock in the EU was only €35 billion. This contrasts with the stock of EU FDI in the U.S. of €2.6 trillion and U.S. FDI stock in the EU of €2.4 trillion. The low levels of the investment stocks to date show that there is room for a huge increase in the coming years and decades in foreign direct investment in both directions. Over the next five years, China's outbound FDI is expected to reach €625 billion, and it aims to attract €500 billion of inbound FDI. Even greater quantities are possible for portfolio investment in both directions, if and when Chinese capital control is fully lifted.

The main drivers of Chinese investment in Europe include access to markets, brands and technology, with some sectoral investments driven by the competitiveness of Chinese manufacturing. There are also investments that aim to acquire brands and technology with a view to developing the Chinese market back home. European investment in China is attracted by the potential access to the enormous and rapidly-growing Chinese consumption market, especially in services.

FDI flows between the EU and China can be greatly accelerated with a bilateral investment agreement, which has been under negotiation for quite some time. These negotiations can be used as a platform for addressing differences between the two sides and facilitating further investment.

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However, it is in the interests of both sides to aim to conclude an investment agreement as soon as possible. Such an agreement will replace all existing bilateral agreements between China and EU member states. The objective is to create a more open, transparent, fair, predictable, secure and stable business environment for greater future flows of both direct and portfolio investment, so that investors from both sides can enjoy equal treatment regardless of their country of origin. Moreover, it will also strengthen intellectual property rights protection in China, which has improved significantly in recent years.

China is committed to opening up its markets further to foreign investment. In accordance with the principle of competitive neutrality, the Chinese authorities have pledged to create a fair and non-discriminatory competitive environment for state-owned enterprises (SOEs), privately owned enterprises (POEs) and wholly foreign-owned enterprises (WFOEs) alike. In addition, China will be accelerating market-oriented reform to enable the market mechanism to play a decisive role in the allocation of resources.

Market access is currently the most challenging issue in these negotiations. Potential Chinese investors in the EU perceive growing scrutiny from EU national regulators, on grounds of national security and unfair competition. Conversely, EU companies perceive major limitations in accessing the Chinese market because of Chinese domestic development strategy and protection of certain sectors. However, it should be recognized that China has been more open to foreign direct investment than either Japan or South Korea at a similar stage of development.

Another issue relates to Chinese SOEs. There is concern that the SOEs may receive support from the government through explicit or implicit subsidies, either domestically or in the EU market, resulting in unfair competition. Other EU concerns relate to perceptions that Chinese investments in Europe may be driven in part by non-economic objectives and therefore may pose political or national security risks. However, SOEs are likely to remain an important sector in the Chinese economy in the foreseeable future. It is therefore more productive for both the EU and China to focus on prescribing the behavior of enterprises rather than the type of ownership.

One important step towards reaching an agreement would be for China to begin implementing the application of its "negative list" on investment to its whole national territory rather than solely in the free trade zones (FTZs). Afterwards, shorter, more coordinated "negative lists" for investment could be agreed between China and the EU over a period of time. Meanwhile, the EU-China investment agenda should focus on opening up each other's service sector. It may also be useful to distinguish between greenfield investments and acquisition of existing firms. Greenfield investments should always be welcome as they create new GDP and new employment. An EU-China investment agreement also has the potential to spur a new round of economic reform and market liberalization in China.

A couple of weeks ago, President Jean-Claude Juncker of the European Commission proposed the establishment of a formal screening framework for foreign direct investment in the EU. I believe a formal screening framework should be welcome by all, provided that it is explicit, transparent, and expeditious. It will be mutually beneficial for both the EU and China to have such a framework as it will go a long way to help to reduce the uncertainty of proposed mergers and

acquisitions. I also hope that China will establish a similar screening framework for inbound foreign direct investment.

Finally, I believe both EU and Chinese enterprises should be encouraged to list their shares in each other's stock exchanges. Hopefully over time, we can have Sino-European enterprises similar to the British-Dutch firms like Royal Dutch Shell and Unilever. Then the national origin of firms will cease to be an issue.

Trade

Trade in goods between EU and China should continue to increase rapidly. One focus should be to increase EU exports of goods to China, so that railroad cars and container-ships can be filled on their way back from Europe to China instead of being empty, as they are now. This will also help to reduce the China-EU trade surplus. Chinese imports of services from the EU grew at an average annual rate of more than 25 per cent between 2010 and 2015, and the EU's trade surplus in services with China has been growing at an average annual rate of 37 per cent since 2010, reaching €11 billion in 2015. There are also great potential for the expansion of tourism between China and the EU. The EU and China should consider issuing ten-year multiple entry visas for their citizens to visit each other, as China and the U.S. have done. This will facilitate not only tourism, but also academic, cultural, scientific and people-to-people exchanges as well as business travel between China and the EU.

Trade will also be boosted by EU–China cooperation on procurement as well as increased connectivity under the Belt and Road Initiative (BRI) and the Juncker Plan. Cross-border e-commerce between the EU and China will also be growing substantially. One possibility is to experiment with a waiver of tariffs on individual e-commerce imports from each other on a mutual basis, which should accelerate the growth of EU-China e-commerce.

Negotiations on an EU-China Free Trade Agreement (FTA) can be initiated upon the successful conclusion of the investment agreement between the EU and China. Chinese research estimates that an FTA in 2020 could increase the EU exports to China by one-third over the five years to 2025, while Chinese exports to the EU would be 20 per cent higher. A mutual reduction of tariffs on each other's exports should encourage direct imports (certainly from the EU to China) in place of purchases by tourists and greatly reduce potential smuggling. An FTA will also encourage innovation in both the EU and China on account of a much larger potential market.

Finally the EU and China can cooperate and collaborate on harmonization of standards on existing products and standard-setting on future consumer goods such as electric cars and fifth-generation (5G) handsets, which should also enhance future EU-China trade.