



## China EU- A Partnership for Reform

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Ladies and gentlemen,

Thank you to the EU Chamber of Commerce in China for again making this trip to Brussels.

China is Europe's second largest trade partner, a major destination for EU investment and a growing source of investment into the European Union.

If we just look at our exports alone, over 3 million jobs here in Europe depend on sales in China. And that's an underestimate of the total value of the relationship, given the number of European companies who depend on imports from China to make their businesses competitive.

Together with the European Union and the United States, China's has today a central position in the world. Its more uncertain economic performance over the last year only reinforces the point. The mere prospect of a slowdown in the Chinese economy has shaken financial and commodities markets around the world.

China continues, therefore, to be one of the European Union's most important partners.

But our relationship with China is also a challenging one. There are major differences between our economic and political systems. And China's uniquely interventionist approach to industrial and trade policy regularly brings us into disagreement...

... even as we seek to strengthen a partnership that is vital for both sides.

For all these reasons the European Commission values our regular and fruitful cooperation with the EUCCC. And we eagerly await your annual pilgrimage to Brussels.

You have insights, born of experience, on where China is really going. Your assessment helps us to go beyond the headlines.

So I was glad to meet with your delegation earlier this week and I'm looking forward to our discussion today.

But before we get to that, I'd like to say a few words on how the European Union views our relationship with China today.

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\* EUCCC: European Union Chamber of Commerce in China

\* EUCBA: EU-China Business Association

There's no doubt that China is at a crossroads.

Its model of development served the country well for three and a half decades. It was based on an abundance of low-cost labour, state-led investment in infrastructure, and a financial system geared to support state-owned enterprises.

But - as the government knows only too well - if China is to continue its development, that model needs to change.

And if there were any doubts about that, then the uncertainty of 2015 has removed them. This year, most economists are predicting a further slowdown in growth. President Xi himself has said 6.5% is the minimum target for the year. Rates like that would be a miracle in Europe. But they are a significant drop from over 10% in 2010.

Of course, in some ways this slowdown is evidence of success.

Continuing its climb up the development ladder actually implies slower growth for China. When productivity increases come from applying existing technologies developed elsewhere huge and rapid returns are possible. When productivity increases require cutting edge innovation growth is necessarily slower. And this is what China needs for the next stage in its development. On top of this, moving from investment-led to consumption-led growth also implies a gradual slowdown.

At the Third Plenum in 2012 the government committed to a path of reform towards a more market orientation of the economy. This new normal was designed to bring about a transition to more measured growth. A slowdown is the natural result of such a significant shift.

But the world is rarely as orderly as we would like. And a risk of bumps in the road always remains. Though we should not overestimate its economic importance, the recent instability on China's financial markets is one such example.

The question is how policymakers react to cases like these. In an atmosphere of uncertainty, the human instinct may be to reach for the approaches of the past. The temptation for China to return to the tried-and-tested ways of export-led growth and shutting foreign operators out of the market is strong. Sticking to the new path of reform is much more challenging.

This is perhaps why – as the EUCCC's latest position paper shows – that three years after the Third Plenum, major reforms have yet to be seen.

Projects to open markets, like the free trade zones, have made relatively limited progress or been completely abandoned...  
... and in some unfortunate cases, China has taken worrying steps backwards.

This can be seen in the new law on national security reviews, in the law on non-governmental organisations and in the initiatives in the field of cybersecurity.

In the same context, the limitations on lawyers are also worrying. They should be allowed to operate freely and independently, supporting the work of foreign business and citizens. We have recently witnessed a case in which foreign citizens were arrested without respect for the rule of law or international human rights obligations. Measures like these that impact human rights can also have – incidentally – an effect on the business climate as they add an extra element of uncertainty.

Postponing meaningful reform – or indeed backtracking – will only prolong the current period of uncertainty, and therefore China's own development.

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It also affects China's relationships with the wider world, including its vital relationship with the European Union.

The European Union has a huge stake in China's economic success, as I have just pointed out.

And - as the EUCCC's work demonstrates - we also have an interest in a reform process that levels the playing field for European companies operating in China.

China also has a massive stake in its relationship with the European Union. Up to now, that stake has been measured mostly on manufactured goods exports. But this is changing as Chinese economy changes. Last year services overtook manufacturing in China's GDP. We can also expect them to play an increasing role in its international trade. As a matter of fact, Chinese investment flows into the EU have also been on the increase. It will not come as a surprise if one day in the near future they overtake EU investment flows into China.

This increasing mutual dependence means China and the EU need to work together - on a variety of fronts - to support each other's economic success.

The most important of these are the negotiations for an EU-China bilateral investment agreement. An agreement is in both sides' interest in four ways:

- European investors would have better access to the Chinese market and their Chinese counterparts would be more encouraged to invest in Europe.
- Companies operating in both Europe and China would be able to operate on a more level playing field – no matter what their origin or ownership structure.
- Chinese investors will be protected under a single and modern state of the art agreement that will replace the existing 26 bilateral investment agreements between China and 27 of the EU Member States.
- A deal would add to legal certainty and improve the balance between investment protection, sustainable development and the capacity of states to regulate in the public interest.
- Finally, the EU hopes that these negotiations are seen by China as an inspiration for its wider efforts at reforming its investment regime. We will continue to engage with China on these issues.

I'm happy to say that an ambitious agreement like this is within reach. At the last EU-China summit, leaders asked negotiators to make serious progress. In 2015 we intensified our talks to fulfil that mandate. We managed to agree on the scope of the deal and to establish a text we will work from as we move in to the final phase of the talks.

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This is good news. And, if we do succeed, it begs the question of what happens next for the EU China relationship. That will involve addressing three important issues:

First, the question of changing the methodology in anti-dumping investigations. It's still quite premature, I'm afraid, to say much about this from an EU perspective.

What is clear is that certain provisions of China's protocol of accession to the WTO related to this issue will expire in December. The Commission is now examining the implications of this, including the economic impact of any change to our anti-dumping rules. We are looking at this for all Member States and for all sectors. But let me be clear that the overall economic importance of our close relationship with China is also an important part of our analysis.

Second, is the question of a free trade agreement. China has been proposing this as the next step for our relationship for several years now.

The EU takes that request seriously. As you may know, last year we reassessed our overall trade strategy. And this question was one of the most important we examined.

We concluded, in the *Trade for All* communication, that while we may be favourable to such an agreement, two conditions must be met first.

- Before any next step we must reach a good outcome on the investment negotiations. This is not only because it makes sense to do one big project at a time. It's also because we need to be convinced that China is committed to the kind of ambitious trade and investment agreements that the European Union negotiates.
- In addition, China needs to make progress in its internal reforms, and particularly, the goal of giving the market a more decisive role. Any FTA with the EU would have to address a whole range of issues related to creating a level playing field for EU industry on the Chinese market. This includes the state moving from away from being an economic operator and towards a role as an economic regulator. It also includes allowing inefficient companies to go bankrupt as well as making adjustments to reduce overcapacity.

The current massive overcapacity in industries like steel is simply unsustainable. It is unsustainable for the economy and it is unsustainable for the environment. Millions of tons of carbon dioxide are emitted to produce cheap steel and cement that nobody wants to buy. Highly polluting coal-fired power plants are generating electricity to produce aluminium and other raw materials despite lower domestic consumption.

There is an urgent need to adjust supply, and this will be the real test of the reforms in China.

Third comes our joint work on the international stage.

We can both be proud of the successful outcome of the Paris conference on Climate Change and the World Trade Organisation's 10<sup>th</sup> Ministerial Conference in Nairobi last December. The ambitious WTO deal on export subsidies in agriculture, which will do much to help some of the world's poorest people, involved work by both the EU and China. The same can be said for the updated and expanded deal on information technology equipment that was also finalised during our time in the Kenyan capital.

What I hope that this progress shows is that China now understands that the huge benefits it derives from the open multilateral trading system can only be guaranteed if it shows leadership within that system. China's G20 Presidency is an opportunity to demonstrate that this is the case.

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Ladies and gentlemen,

While we certainly have our differences, there is no escaping the fact that the economic relationship between the European Union and China is vital for both of us. It's also vital for the world economy as a whole.

To keep it strong and to strengthen it further we need close engagement. The EU is always ready to provide the necessary political and human resources to do that.

But a really significant deepening of our ties requires urgent reform in China. The EU will support reforms, as we did fifteen years ago when ambitious and courageous reforms brought China into the WTO and global trade. The same courage and vision will lead China to a better future.

Building the relationship will need the continuing support of organisations like the EUCCC.

So I look forward to hearing your views about the way forward.

Thank you.