

Informal Expert Group on Trade and Investment Relations with China

Report of the 4th Meeting, Brussels, 12 December 2013

Representatives of all 28 Member States participated in the 4th meeting of the Informal Expert Group, with 19 Member States sending capital-based experts.

Discussions followed the agenda as circulated prior to the meeting, with the exception of the point on China's commercial diplomacy, which was moved to the end of the afternoon. The meeting was chaired by Peter Berz, Head of Unit for Trade relations with the Far East.

Introductory remarks

In his introductory remarks Mr Berz recalled that during the last meeting of the Informal Expert Group, the EU was in the middle of dispute over solar panels. Additionally, the EU faced uncertainty about the High Level Economic and Trade Dialogue (HED) and China's position on the investment negotiations. However, a successful solution was eventually reached on the solar panel case and the EU managed to reactivate the HED after three years of hiatus. The Summit that took place in November in Beijing was also remarkable as it provided for ample interaction with the new leadership, and delivered tangible results in terms of the Agenda 2020 and an official launch of the investment negotiations. Over the year the Commission managed to hold also other meetings such as Economic and Trade Working Group, Trade and Investment Policy Dialogue and Joint Committee. It proves that a comprehensive agenda with China has been developed which lays down a good foundation for work in 2014. Although there are some outstanding issues (other TDI cases are still pending or looming) it should not distract the EU from looking forward and thinking of ways to engage more with the new Chinese leadership.

Point 1- Update on latest trade and investment data

In order to recall the overall context and to illustrate the overall long term potential in the EU-China trade and investment relations Mr Deraedt, DG TRADE, started the discussion by introducing China's macroeconomic environment and recent trade and investment figures. The presentation was partly based on data from the upcoming China Observatory Report and the recent FDI Flash Report covering FDI transactions into and out of China up to September 2013.

On the macro side it was noted that China is **slowly reducing its reliance on investment as the main driver of the economic growth**. As a result, the slowdown from the double-digit growth in the previous years to 7,5% in 2013 is predicted to continue in future. Although during the last two years China's Central Bank successfully managed to maintain a 10% growth in industrial production while

keeping inflation at a relatively low level of 2-3%, this model is unlikely to be sustainable. One of the pressures is a narrowing gap between the increase in productivity and increase in labour costs. In a way this is a sign of rebalancing the economy, which should point to more disposable income and higher consumption. Yet the years of rapid and "easy" growth may be coming to an end. However, the consensus view is that **forthcoming reform in China will not be implemented at the expense of the overall economic stability.**

As far as *trade* figures are concerned the Commission expects the bilateral deficit to be 9 to 10% lower; **however, this may be temporary as the main driver behind the drop is a lower demand in Europe rather than increased exports to China.** As growth resumes in the Eurozone, we may see the bilateral deficit increasing again, in a way that is not yet likely to be off-set by a corresponding growing surplus for the EU in services trade – unless China would open up dramatically. Mr Deraedt also drew the attention to potential problems ahead as regards the evolution of China's current accounts surpluses. Although the surplus has decreased drastically *in percentage terms* to 2.3% of GDP (from about 10% in 2007) in 2012, it will again rise to nearly 3% in 2013. According to the IMF International Economic Outlook it would increase further as the growth picks up again in US and Europe to 4.3% of GDP by 2018. If this would materialize it would correspond to a surplus of around USD 600 billion – which would need to be absorbed by other nations, most likely the US, turning this again into a major political issue. It was suggested to keep monitoring this trend in future meetings.

In 2012 Germany represented 46% of EU exports to China and it was the only MS with a positive trade balance. However, it needs to be pointed out that the figures may be distorted by the so-called "Rotterdam effect". Up to October 2013, imports from China have been decreasing not only in southern Europe but across the EU, including Germany. While total EU exports to China have remained fairly flat in 2013, a considerable growth in exports has been noted from UK, France, Italy and Hungary.

With regard to *investment*, Mr Deraedt pointed out that China's outward investment is projected to be higher in 2013 than China's inward investment, making China a net capital exporter. Chinese overseas acquisitions are moving beyond natural resources and becoming more diversified. Although **the EU is a partner with whom China makes the largest number of deals, the EU is in 2013 not the largest partner in terms of absolute value.** So far overall amounts have remained fairly low; no transactions in the EU with a value exceeding USD 1 billion have been registered this year.

A new record is expected in 2013 in terms of total outward investment flows from China; however, in comparison to previous years it is not going to be a drastic increase. Also in Europe overall levels of investments remain relatively low, and although Chinese investment get broad coverage in the press, the facts do not yet point to a tsunami of Chinese FDI. Mr Deraedt also updated MS on the main Chinese FDI operations (both inward and outward) in the first three quarters of 2013.

Questions by Member States focused on currency appreciation and the Rotterdam effect.

Point 2 - Debrief on recent high level events

Mr Cunningham, Deputy Head of China Division-EEAS, debriefed MS about the EU-China Summit that took place on the 21st of November this year in Beijing. He gave a basic overview of the Summit including areas not related to trade.

The Summit was important in terms of relations building because of special timing. It was the 10th anniversary of the EU-China Comprehensive Strategic Partnership. The Summit took place after the leadership transition in China, and soon after the Party 3rd Plenum and announcement of the future reforms.

The two sides exchanged views on the strategic partnership, domestic developments and the economy, trade and investment relations, bilateral cooperation, international and global issues. Both parties welcomed the launch of the China-EU Dialogue on Innovation Cooperation, and highly appreciated the successful dialogue and outcomes at the China-EU Urbanisation Partnership Forum, the China-EU Urbanization Exhibition and the 6th round of China-EU Energy Dialogue, which all took place at the side of the Summit. They also welcomed the holding of the Business Summit and of the High-Level Regional Policy Dialogue.

China and the EU **announced the launch of negotiations of the China-EU Investment Agreement**. Both sides also jointly adopted **the China-EU 2020 Strategic Agenda for Cooperation including an agreement on the annual review mechanism**, a comprehensive document setting out China and the EU's shared aims to promote cooperation in the areas of peace and security, prosperity including trade and investment, sustainable development, and people-to-people exchanges, to take forward the China-EU Comprehensive Strategic Partnership over the coming years. The two sides will fully implement the Strategic Agenda through their annual Summit, which provides strategic guidance to the relationship; through the three pillars directly underpinning the Summit (the annual High Level Strategic Dialogue, the annual High Level Economic and Trade Dialogue and the bi-annual High Level People-to-People Dialogue); through their regular meetings of counterparts; and through their broad range of sectorial dialogues.

On human rights, the EU acknowledged progress made by China in raising standards of all citizens and the same time emphasized that more could be done. The protection of minorities and freedom of expression was raised. President Van Rompuy expressed the EU wish to work with China to improve the bilateral human rights dialogue and welcomed the visit to China of the EUSR for Human Rights. He recalled both parties interest in starting a new bilateral dialogue on the rule of law. On people to people dialogues, China unfortunately backtracked from a previous agreement to link discussions on visa waivers for holders of a diplomatic passport to negotiations on a readmission agreement.

Mr Cunningham commented also on the 16+1 meeting in Bucharest between China and 16 Central and East European Countries (CEEC) which followed the Summit. He wondered how this would impact investment and government procurement negotiations and warned against **"divide and rule" tactics among Member States.**

Mr Bardon, DG TRADE, completed the report on the Summit and elaborated more on the trade and investment part of the Agenda 2020, covered in the Prosperity and Sustainable Development chapters. Mr Bardon summarized the final wording of these chapters as fully consistent with EU priorities.

He noted that China focused on increasing the volume of trade whereas the EU emphasized ensuring sound framework conditions and trade facilitation.

Mr Bardon highlighted that there is good language on **launching investment negotiation including strong investment protection and market access (liberalization of investment, elimination of restrictions), promoting transparency and a level playing field, intellectual property rights.** The Agenda 2020 recalls the importance of WTO, ITA negotiations and GPA as well as **reaffirms the importance of HED.** Although there is a reference to a possible FTA in future it is highly contingent to conclusion of a comprehensive investment agreement, when the conditions are right, and as a longer term perspective.

Ms Middlebro', DG TRADE, then went on to debrief MS on the 4th HED that took place on 24 October 2013. She reminded that HED is a platform to discuss strategic and forward looking issues in the overall EU-China trade and investment partnership at a high political level. The 4th HED was special in terms of being **successfully re-launched after three years of hiatus and being the first HED with the new Chinese leadership.** Ms Middlebro' noted that the meeting was held in a positive atmosphere and reported on two main outcomes in the form of an agreement to officially launch the investment negotiations at the Summit, and a frank and open discussion with Vice Premier Ma Kai about the management of trade frictions, in a more restricted session. She emphasized that the HED can feed properly into the Summit and can act as an umbrella dialogue for any other dialogues in the trade and economic area.

In the context of the increasing number of MS activities and bilateral contacts with China, Mr Berz called for a **more coordinated approach, especially in view of the upcoming investment negotiations, and encouraged MS to share information and updates on recent meetings.**

Several MS provided feedback during the meeting, while others undertook to provide more detailed information in writing.

Point 3 - Update on investment

Mr Palacios Sureda, DG TRADE, presented the overall context of the upcoming investment negotiations and briefed MS on the current state of play.

The decision to launch negotiations was supported by the positive outcome of the impact assessment conducted last year. China officially confirmed that both **investment protection and market access** will be included and that the negotiations would be conducted on the basis of a **negative list**. Both sides accepted to conduct 4 negotiation rounds per year; however, the dates have not been fixed yet. Mr Palacios Sureda noted that the negotiations will take place **in the context of parallel bilateral talks with the US** and although these are separate negotiations, interaction is inevitable.

Some national experts raised questions on timing, the negative list approach, exchanges of documents and possible consultations with MS before the first round.

Mr Coget, DG TRADE, elaborated on the main objectives of the **Shanghai Pilot Free Trade Zone**, namely: to experiment economic reforms before implementing them at the national level as well as to contribute to China's economic development by making Shanghai an advanced international service and high tech hub. He presented the main areas where the reforms are envisaged and explained the negative list approach that has been applied in the process of reform. The FTZ is clearly a centrally driven experiment and acts as a blueprint for market access relaxation that China can offer in its bilateral and multilateral negotiations.

Point 4 – China's role in multilateral and plurilateral negotiations

Mr Berz briefly commented on China's position in **MC-9**. The conference had made progress on the Doha round of trade negotiations, adopting decisions on trade facilitation, agriculture, cotton and development and least-developed-country issues.

Mr Keijzer, DG TRADE, updated MS on the **ITA** (Information Technology Agreement) negotiations and China's position in particular. He recalled the need for ITA extension and stressed the importance of the agreement, covering 10% of world trade. Mr Keijzer said the EU will continue to pass the message on the importance of China contributing to a successful ITA expansion and he invited Member States to do the same.

Mr Fridrich, DG TRADE, updated MS on China's request to join the **TiSA** (Trade in Services Agreement) negotiations.

In order to complete the picture of China's position in plurilateral initiatives Mr Berz informed MS about the next round of the international working group on **export credits** to be organized in Brazil in

early 2014, and China's 4th revised **GPA** offer which is expected soon. He also highlighted the attempts to multilateralise into the WTO the APEC initiative on **green goods**, and referred to the specific wording on green goods in the Agenda 2020.

Point 5 – Presentation by Professor Brødsgaard: The CPC Third Plenum: content and implications of the "Decision concerning some major issues in comprehensively deepening reforms".

Prof Brødsgaard, Director of the Asia Research Center at Copenhagen Business School, presented his reading of the outcome of the Third Plenum and its possible implications. In his view, the Third Plenum may signalize a turning point and be a harbinger of a far bolder approach.

Prof Brødsgaard described the outcome (the Decision) as an extremely comprehensive document touching all the major issues and problems facing China's current development trajectory. The main aim of the reform is to further strengthen **the importance of the market in resources allocation and mobilization by giving it a decisive role** (as opposed to the previous 'basic' role). This may have serious implications for SOEs which will be faced with pricing reforms in water, oil, natural gas, electricity etc. The special emphasis is also put on developing an economic system characterized by **diversified ownership and on administrative reforms**. In regard to SOEs reforms Prof Brødsgaard remarked that although some of them will be exposed to market competition, SOEs in the most important sectors will nevertheless remain monopoly or oligopoly enterprises. Consequently, there will be **no fundamental SOE reform**. Despite of the fact that the Decision covers changes in the leadership selection and in evaluation criteria, **the CPC nomenclature system will continue**.

In order to predict possible changes Prof Brødsgaard drew an analogy between Deng Xiaoping and Xi Jinping. Similar to Deng Xiaoping, Xi Jinping **pushes for economic reforms but is not advocating political reforms**, instead he promotes administrative reforms. Prof Brødsgaard noted that is not a fundamental change of the system but rather a tinkering with the system, and concluded that if Xi Jinping manages to strike a balance between economic reforms and political authoritarianism, he will establish a benchmark for other authoritarian systems.

In the ensuing Q&A session, questions were raised on the potential threats for the system such as pollution or the increasing income gaps and pressures in society (Prof Brødsgaard saying that the air pollution is already putting significant pressure on the leaders, with environmental criteria now being used to evaluate cadres). Prof Brødsgaard took the view that although Li Keqiang is well prepared to become the main economic reformer he may be overshadowed by the strong leadership of Xi Jinping. Nevertheless, he pointed that it is too early to know yet how the division of labour will be.

Point 6- Chinese economic diplomacy and the use of development aid and lines of credits for Chinese commercial and political objectives. Presentation by Michal Makocki, the EU delegation to China.

Mr Makocki, EU Delegation to China in Beijing, gave an insight of how China uses its current reserves to support its exports and how this is affecting European commercial and political interests in third countries.

In the Q&A session questions were raised on the level of indebtedness of African countries.

Point 7 Coordination initiatives: dialogues and planning

Mr Berz informed MS about upcoming meetings at EU level (expected schedule to be: ETWG, TIPD, Joint Committee, HED, and Summit). He also reminded MS about **the overview of dialogues between MS and China** that had been produced by EEAS and circulated during the last meeting.

Mr Berz recalled that the EU had provided MS with "**China reference points**" with suggested lines to take in bilateral meetings with China. These reference points will be updated to reflect recent developments in investment, ITA, GPA, TDI etc.

It is extremely important to make China aware that the Commission and MS are working together and the EU is speaking with one voice. In this regard, he asked MS to debrief upon their planned high level encounters with China.

Point 8 Conclusion

Mr Berz explained that the Commission intends to maintain the frequency of meetings of the Informal Expert Group and thus organise two meetings in 2014. The next meeting would be held towards the end of the first semester.

Annex – agenda of the meeting

<p>4th Meeting of the Informal Expert Group on Trade and Investment Relations with China Thursday 12 December 2013</p>

- 09.30 onwards: *Registration, processing of travel reimbursement forms.*
- 10.00 – 10.10: Introduction and tour de table.
- 10.10 – 10.30: Update on latest trade and investment data - FDI Flash Report and FDI Monitor database (presentation by DG TRADE)
- 10.30 – 11.30: Debrief on recent high level events
- Debrief on the 16th EU-China Summit and the trade and investment related parts of the 2020 Strategic Agenda
 - Debrief on the 4th HED
 - Debrief by MS on recent high level bilateral dialogues or visits.
- 11.30 – 11.45: *Coffee break*
- 11.30 – 12.00: Update on investment
- Planning as regards the launch of the negotiations for a bilateral investment agreement
 - Recent developments in China: launch of the Shanghai Pilot Free Trade Zone; announcements of a negative list approach
- 12.00 – 12.30: Update on Bali and recent plurilateral initiatives
- Debrief on MC-9 and China's position in particular
 - China's position in TiSA, ITA, Green Goods, GPA, export credits: update and exchange of views
- 12.30 – 13.00: Chinese economic diplomacy and the use of development aid and lines of credits for Chinese commercial and political objectives (presentation by Michal Makocki, EU Delegation to China)
- 13.00 – 14.30: *Lunch break*
- 14.30 – 16.00: The CPC Third Plenum: content and implications of the "Decision concerning some major issues in comprehensively deepening reform"
- Presentation by Prof Kjeld Erik Brødsgaard, Professor and Director, Asia Research Centre, Copenhagen Business School
 - Q&A and free discussion
- 16.00 – 16.15: *Coffee break*
- 16.15 – 16.45: Coordination initiatives: dialogues and planning
- Overview of upcoming events, and planning for 2014 (update by Commission and Member States)
- 16.45 – 17.00: Conclusion