Informal Expert Group on Trade and Investment Relations with China

Report of the 2nd Meeting, Brussels, 20 December 2012

Representatives of 24 Member States participated in the 2nd meeting of the informal expert group, with 20 Member States sending capital-based experts.

Discussions followed the agenda as circulated prior to the meeting. The meeting was chaired by Mauro Petriccione, Director Asia and Latin America, and Peter Berz, Head of Unit Trade relations with the Far East.

Point 1 - The EU's overall trade and investment strategy towards China

In his introductory remarks, Mr Petriccione started by explaining how the general perception on China is changing. Whereas in the past most operators saw China as an opportunity, more are regarding China now as a challenge and this is even becoming more pronounced due to the economic crisis. This is also the background to a number of discussion with Member States that have been held - and will continue in 2013 - to reassess the EU's strategy vis-à-vis China.

He recalled that the EU looks at engaging China on positive long-term initiatives, while remaining firm on compliance with China's international commitments. He highlighted the three main elements of the EU's trade strategy, as already mentioned in all previous Council debates: investment, innovation, and procurement – however acknowledging that the latter is the weaker point since we do not have enough leverage to incentivise China. The proposed procurement instrument aims to address this, but is controversial. Wind energy was mentioned as a textbook example of how China first obtained the technology and then took control of the market. China is interested in procurement markets in Europe, but their model is based on cheap labour and therefore not easy to replicate. Export credits is a relatively new area, but one with great potential if we can agree on common guidelines. Although China has deep pockets, they too have an interest to avoid a race to the bottom.

As far as the enforcement of WTO rules is concerned, China has proven to be a master in exploiting the grey zones. As a result it has been difficult to make China regulate not only by the letter but also by the spirit of the WTO principles.

A notable recent development is the rise of high-profile anti-dumping and anti-subsidy cases. In times of crisis, competitive imports hurt European producers – and even more so when there is dumping at play. We have the legal instruments to find out whether there is indeed dumping or subsidisation involved – not examining this would actually send the wrong signal. It may also create leverage and bring China to the table.

At EU level we have numerous dialogues with the Chinese government, but they have not yet led to sufficient market opening. We need to recognise that the HED has not been working lately. It will be important to resume talks under the new leadership. There exists good cooperation with third countries, who are sharing the same interest on many files. However, the Commission is of the opinion that there is not enough exchange of information *within* the EU. We are already doing better in terms of exchanging information with Member States on planned meetings with the Chinese, but there remains much room for improvement in terms of speaking with one voice.

The external speaker, Ms Françoise Nicolas (IFRI), questioned a number of common perceptions on China. She found it highly debatable whether the EU's large imports from China were the result of unfair practices. While true in some cases, she argued that this is mostly a matter of competitiveness. She said we ought to avoid systematically blaming China; the EU risk overusing trade defence instruments. The same applies to EU exports – also in this respect we should be careful not to overemphasize market access constraints and neglect competitiveness issues. Currency is another issue that would be wrong to pursue.

As regards investment, press reports depicting China as a threat are much exaggerated; levels of Chinese FDI into Europe are still very small. By contrast, Ms Nicolas expects gradual opening of the market in China and therefore increasing opportunities for EU FDI in China. Over time we can also expect a shift in Chinese FDI from market-seeking investments towards more technology-driven and strategic assets. Investment should therefore be the key focus of the EU's policy vàv China. For the future investment negotiations to work, EU markets must be kept open, but safeguards against forced technology transfer should be included. As far as procurement is concerned, she recalled the importance of including SOEs in the coverage of the GPA.

Ms Nicolas also strongly insisted on speaking with one voice, especially as China regards the EU as a market. More prioritisation is needed (some issues, some WTO violations are more important than others). The EU should also focus on "positive" reciprocity (i.e. leading to mutual opening), rather than using the reciprocity argument as a threat.

Many Member States took the floor in the ensuing discussion round, several of them stressing the persistent market access problems their operators face when exporting to, or investing in, China.

The UK (echoed by DK, NL and SE) recalled the papers that it recently circulated as background documents for discussion in the TPC informal, and the general desire to prioritise more, to focus on selected number of market access issues, and to have all Member States supporting this by repeating the same main messages. On TDI, one also needs to look at wider interests, while more information would be welcome on how to approach the investment negotiations.

One delegate deplored the one-sided neo-liberal views taken in the intervention by the guest speaker. The issue with China is not about competitiveness but the pervasiveness of state-controlled capitalism, which is completely tilting the level playing field and leading to unfair competition. Another delegate stressed IPR and tech transfer issues. Market access is not only about competitiveness but also a matter of registration and licensing issues that are de facto blocking access. Consumers would also be wise to better consider the quality of cheap imported goods.

SE suggested closer contact between TPC and COASI, more coordination is required to develop a strategic, coordinated approach. The EEAS should function as the one-stop shop on the many bilateral dialogues. The investment agreement should be the main priority; IPR and export credits are a major issue. SE also pointed to the massive Chinese interest in green cooperation.

The delegate of IE, also incoming Presidency, stressed that several instruments are being developed or reviewed in order to make EU action more effective, such as the TDI review, the procurement instrument, or the enforcement instrument. Regarding investment, it is inevitable that Member

States aim to attract incoming Chinese FDI and compete with other Member States, thereby strengthening China's bargaining position.

FR said it broadly agreed with the Commission policy, and while noting the point made by others on prioritising, the delegate stressed that we cannot have trade-offs across the three pillars. ES stated that as a strategic partner we should expect China to respect its WTO obligations. However it is not always the case, and in particular TDI retaliation is a reason for grave concern. DE said that even for Germany China was a challenge. Export credits and IPR issues are serious concerns. DE would like the future EU-China bilateral investment agreement to keep the high level of investment protection as presently exists in the sino-german BIT.

(note: the paragraphs above do not aim to reflect *verbatim* all interventions that were raised; many points were also supported by other Member States in their later interventions)

Point 2 - Market Access barriers and irritants: update on recent developments

The Commission updated Member States on the exercise that had been launched to update the key barriers listed in the market access database. Deliberations would start in Beijing but would then be further discussed in the Market Access Advisory Committee. In parallel, the Commission had circulated a translation of Mofcom's 2012 market access report, with a view to preparing defensive lines on China's offensive interests. The Commission invited Member States to submit comments on both documents.

Following reporting of the main lines discussed in the break-out sessions (see reports below) the Commission (Taina Sateri, TRADE D3) also informed Member States about a new issue regarding wood packaging materials originating from China, which would oblige the EU to take additional plant safety measures in the form of increased custom supervision and inspection checks on a series of certain commodities (mainly building stones) being imported on wood pallets. Measures would come into force on 1 April 2013.

Break out session on dispute settlement and trade defence:

Thomas Juergensen (TRADE F1) first gave a short overview of the EU's approach to the WTO dispute settlement system as part of the general market access and enforcement policy. In order to assess if a case should be raised, the legal, economic and systemic elements would be considered. This is done irrespective of the counterpart. China has become one of the most important parties in dispute settlement proceedings, but still mainly as the respondent. It has so far only challenged U.S. and EU measures. Its main focus has been non-discrimination in a broader sense, non-market status, safeguards, and the use of the DSU for retaliation ('tit-for-tat'). The EU's main challenge with Chinese measures is the opacity of their rules and scarcity of firm evidence. Most important offensive cases pending are raw materials (I and II) and China x-ray scanners. Defensive cases include footwear, fasteners and renewable energy sector measures in Greece and Italy (consultation stage). Mr Juergensen also answered questions on the specifics on the pending cases.

Fred Michiels (TRADE H5) started by explaining the reasons for the increasing prominence of TDI in EU-China relations: the number of cases has grown (although still only affecting around 1% of the total value of Chinese imports), anti-subsidy cases that were started two years ago have been considered by the Chinese as more political, and the recent solar panel cases are politically and economically very important (about €20 billion yearly exports to the EU, 80 % of the Chinese production is exported to the EU). China has in the last years reacted strongly at political level but is increasingly also using TDI measures for retaliation purposes (examples are cases lodged against the EU such as on steel fasteners, x ray scanners, and potato starch). For the EU the recent cases are business as usual: TDI is a technical instrument and industry complaint driven. There is no trade war. On a question about Chinese retaliation in the wine sector, Mr Michiels noted that there had not been any formal action taken by Mofcom so far despite having received a complaint from the Chinese industry.

Break-out session on procurement and intellectual property rights:

On procurement, Marc Poulain (DG TRADE B3) presented the latest Chinese offer to join the GPA. Despite some progress, many shortcomings remain (very high thresholds, only central institutions within the provinces are covered, etc.). The aim of the EU is now to push China to speed up the accession process and improve the quality of its offers. It is the message that we should all convey - to Beijing and to the main provinces. In terms of market access, China is in principle a closed market, which opens only when availability problems or a price gaps appear. Indigenous innovation issues are looming: new document of June and October 2012 on product and services catalogues concerning the strategic emerging industries may bring back issues that previously had been tackled jointly with the US. During the discussion, the Italian delegate stressed the political dimension of procurement and the issue of catalogues. Finland highlighted services and SOEs. The fact that procurement does not feature so high anymore on the priority list of business surveys is because EU companies have factored in that the situation is not likely to improve anyway.

On IPR, Benoit Lory (DG TRADE B3) explained that there is progress with regard to legislation, but enforcement remains the tricky issue. DG TRADE is currently revitalizing its IPR dialogue with Mofcom, including with an Action Plan. The support of Member States will be needed, especially on the new 3-year € 7.5 million IPR programme called IPR Key, and in the work of the Market Access teams on the ground in Beijing. Italy suggested circulating the Action Plan and details of the IPR Key programme. Denmark stressed the issue of execution of patent rights for pharmaceutical companies while the delegate from Finland explained that IPR appeared in a recent study as top concern for Finnish companies in China, stressing also that support to SMEs should be a priority. The delegate of Spain also highlighted that IPR was a priority, especially the enforcement of registration of trademarks.

In concluding, the Commission called upon Member States to report any incidents of procurement, indigenous innovation, or IPR complaints that Member States would notice or hear of, in particular at local or provincial level.

Point 3 - Presentation of the China Observatory report

The afternoon session started with a presentation by Mr Thierry Apoteker and Sylvain Barthélémy (Thierry Apoteker Consulting) of the main findings of the 16th China Observatory Report. The China Observatory project monitors since 2007 the main macro, trade and investment trends in China.

Mr Apoteker and Barthélémy analysed the main findings and presented an initial outlook for the New Year. China is clearly diversifying its range of export partners, and China's trade surplus for 2012 is expected to rise. They noted a large discrepancy in the ability of Member States to capture Chinese demand, with one Member State (DE) accounting for almost half of the EU's total exports to China. Mr Apoteker also wondered if the EU export mix is well suited to the demands of China's emerging middle class.

The authors expect a modest recovery for 2013 with GDP at or slightly below 8.5%. Structural rebalancing is under way but complex. The main risk identified in the very high aggregate indebtedness (at levels unseen for developing countries) with a fragile corporate situation (extremely high leverage, high return on equity but very low return on assets), where profits are likely to be under even more pressure in future due to the on-going rebalancing and increasing wages. In addition the report's topical theme included an examination of the intra-asia trade and corporate integration (where they find that China is gradually replacing Japan as key trading partner in the region; although China is, except for some sectors, not yet at the technological level to really compete with Japan). Trade agreements play some role in establishing Asian integration, but are not found to play a critical role. Mr Apoteker also shared that most Japanese companies are now actively considering exit strategies out of China, following a recent series of anti-Japanese incidents.

The consultants also highlighted the trends noticed in their FDI Monitor database, tracking all inward and outward Foreign Direct Investment in China, Hong Kong and Taiwan. FDI outflows from China are catching up with FDI inflows. Total FDI into China (at USD 16.8 bn) saw a strong rise in Q3 2012, due to some very large transactions from Daimler Benz (new plant near Beijing for USD 2.4 bn), Volkswagen (new gearbox plants in Tianjin for USD 1.1 bn), Ford (600 mio, Chongqing), a major real estate project from Singaporean CapitaLand in Chongqing (3.4 bn), and a large investment from DreamWorks in Shanghai. Chinese investment in Europe in Q3 dropped significantly (but Q1 and Q2 data had been influenced by some very large utility deals in Portugal). Like in 2011, Germany remains the main European investor into China, by far.

The powerpoint presentation has been circulated to all participants. The final 16th Observatory report is available at the following link: http://trade.ec.europa.eu/doclib/html/150739.htm

Point 4 - Investment: state of play of the planned investment negotiations, and recent developments

Felipe Palacios Sureda (DG TRADE B2) updated Member States on the state of play regarding the planned investment negotiations, recalling the agreement reached at the September EU-China Summit that the negotiations should cover all issues of interest to either side, meaning covering both investment protection and market access.

In terms of process, the impact assessment had been concluded in fall, and the Commission services are in the process of drafting the draft negotiating directives. The Commission is expecting to adopt the mandate in the College early in 2013, with a view to then transmitting it to the Council.

Mofcom is claiming to be ready to start the negotiations, but ambiguities on the market access component remain. Discussions with the US have revealed that in the recent US-Sino BIT discussions US colleagues have mainly explained the US model, which foresees a negative list approach for both pre- and post-establishment. China has made clear that they feel uncomfortable with that model. The Commission is still reflecting on how to approach the market access component.

Mr Palacios Sureda also drew the attention to a recent report by the US Chamber of Commerce on China's investment approval process[1].

Filip Deraedt (DG TRADE C1) informed that an M&A transaction involving an EU company was allegedly being reviewed under China's National Security Review mechanism – the first case since the regime was established in early 2011.

Member States were also informed that Mofcom had recently released a list of all unconditionally approved mergers since 2008, and would henceforth be updating this list on a quarterly basis. On a less positive note, Member States were alerted to recent complaints that EU companies are encountering major delays in concluding merger control reviews, including in cases that seem to have little commercial importance on the Chinese market but appear to be driven by more political (e.g. anti-Japan) motives. Another reason for concern are recent indications of cases where merger control appears to have been used for industrial policy considerations, by imposing excessive conditions / remedies going beyond pure competition concerns. Member States were invited to be alert and to report any similar cases to the Commission.

In the Q&A, Member States highlighted the need for the investment agreement to cover market access. The delegate of NL stressed to aim for an as high as possible level of investment protection. While having to be realistic in terms of market access demands, one should also take into account that this agreement would serve as an important precedent.

Point 5 - Engaging with the new leadership

George Cunningham (Deputy Head of Division, EEAS) gave an initial assessment of the new Chinese leadership as elected at the 18th CPC Party Congress. The main bilateral event with the EU would be the 16th EU-China Summit, which will be the first to be chaired by Li Keqiang. 2013 will also mark the 10th anniversary of the EU-China strategic partnership. Mr Cunningham also informed about the plans to reply to the Chinese proposal of a cooperation package with a more forward-looking Plan of Action. This was followed by an exchange on planned visits at both Commission and Member States level. Due to the leadership transition, a high frequency of visits can be expected during the second quarter of the year and in early summer.

Finally, Mr Cunningham updated Member States on the on-going work to provide Member States with updated common speaking or reference lines (to be circulated in COASI) as well as on-going work to review, and streamline as necessary, the list of Commission dialogues with the Chinese government. The list would be shared with Member States via COASI, and in return Member States were invited to also share the overview of their bilateral meetings with their Chinese interlocutors.

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[1] http://www.uschamber.com/sites/default/files/international/asia/china/files/1210_Chinainbound_inside.pdf