

IN-DEPTH ANALYSIS

Trade and economic relations with China 2014

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Abstract

Although China managed to sustain its previous year's level of economic growth in 2013, its economy is headed towards further change and possible upheaval. Beijing has accordingly widened its focus, and is no longer concentrating solely on economic growth.

Inflation remained stable in the country. However, falling producer prices present challenges for Chinese production. The real estate bubble and growing debt are threatening the country's economic stability. Beijing has liberalised a number of areas, reinforcing perceptions that the country is moving towards a market economy.

The EU's trade and economic relations with China, the largest trading nation in the world, are generally good, and the number of disputes reasonable. However, the EU is dissatisfied with China's reluctance to fully implement its WTO commitments and, more generally, with its protectionist measures, which hurt EU interests. For its part, Beijing is still dissatisfied with the EU's refusal to grant the country 'market economy' status. The two parties recently settled three major trade defence cases (solar panels, wine and polysilicon), which poisoned bilateral trade relations during the last year.

Negotiations for an EU-China partnership and cooperation agreement, initiated in 2007, have yet to be concluded. In January 2014, China and the EU held the first round of negotiations for a bilateral investment agreement. Beijing has also recently offered to open talks for an EU-China FTA, but Europe's reaction has been lukewarm.

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1. Introduction

Trade relations between the EU and China significantly improved over the course of 2013. An agreement reached on solar panels early in 2014 and the subsequent termination of China's antidumping investigation into wine from the EU ended the decline of bilateral economic relations that had afflicted both partners.

The economic crisis is, however, still dulling consumer demand in Europe, resulting in a notable reduction of the EU's traditional trade deficit with China. This positive news for the EU's trade balance sheet was further boosted by the Chinese upper and middle classes' growing consumption of EU-branded or high value-added products. It is still early to say whether the shift is temporary or likely to become structural and strengthen the EU recovery. Recent data has suggested a relative slowdown in the Chinese economy, which could mean that Chinese demand for imported goods from the EU will shrink in the coming months.

The opening of negotiations for a bilateral investment treaty with China ended the protracted stalemate that had characterised bilateral trade relations since Beijing negotiated the Chinese accession protocol to the WTO. During the Chinese president's successful trip to Europe in March 2014, he proposed a deep and comprehensive free trade agreement (FTA) – a significant departure from the external trade policy followed by the People's Republic to date.

China has tended to privilege agreements with other Asian countries – which have gradually been integrated into Chinese production process (mainly as a supplier of components) – as well as with developing countries in Africa and Latin America, which have become privileged sources of raw materials and energy for China's industrial sector.

Beijing's recent overture towards the EU has likely been triggered by the opening of negotiations on the Trans-Pacific Partnership (TPP) and on the Transatlantic Trade and Investment Partnership (TTIP). If successfully negotiated and ratified, these US-launched initiatives could have a dramatic impact on the world trading system. Beijing has tried to respond to what it perceives as an impediment to its drift towards regional – and even global – economic supremacy.

Initial EU reactions to the Chinese proposal have been only lukewarm. The Commission would prefer to consolidate progress in the EU-China investment deal before embarking upon a full-fledged and more controversial trade deal with Beijing. Yet the EU may at least accept launching a 'feasibility study' on the FTA, just as it has for previous trade negotiations.

2. Short economic overview

The new leadership¹ in China has emphasised that the country's future depends on modernising its economy. This means transforming the world's second-largest economy into a more market-driven model by liberalising government-controlled areas. Improving Chinese citizens' quality of life will also involve investing in a better environment, as well as providing proper health services, social security and a more inclusive pension system.

China's economic growth exceeded official targets and market expectations in 2013.

In 2013, **the Chinese economy** grew 7.7 %², slightly more than the 7.6 % foreseen. Throughout most of the year, growth remained above the official target of 7.5 %³ and exceeded market expectations.

Figure 1:
Quarterly gross domestic product growth in China



SOURCE: WWW.TRADINGECONOMICS.COM | NATIONAL BUREAU OF STATISTICS OF CHINA

The GDP growth is expected to be around 7.5% in 2014.

China's leaders have left their 2014 target unchanged from the previous year's - around 7.5% - although this remains flexible⁴. The World Bank projects that China's GDP growth will stay flat – around 7.7% in 2014, slowing to 7.5% during the following two years⁵. The IMF's forecast is similar, with stable growth of 7.5% projected from 2014⁶. As Chinese Premier Li Keqiang announced, 'the G.D.P. growth we want is one that brings real benefits to our people, helps raise the quality and efficiency of economic development and contributes to energy conservation and environmental protection'⁷.

The value of the **Chinese renminbi** (also referred to as RMB, CNY and yuan) has continued to depreciate over the past year, dropping from 6.35

¹ Of the 18th National Congress of the Communist Party of China in 2012

² Reuters, [China official PMI hits eight-month low, adds to slowdown signs](#), 28 February 2014

³ The Economist, [China's Growth Target: Lou or Louer](#), 14 July 2013

⁴ Reuters, [China premier warns on economic slowdown as data fans stimulus talk](#), 13 March 2014

⁵ The World Bank, [Global Economy at Turning Point, Says World Bank](#), 14 January 2014

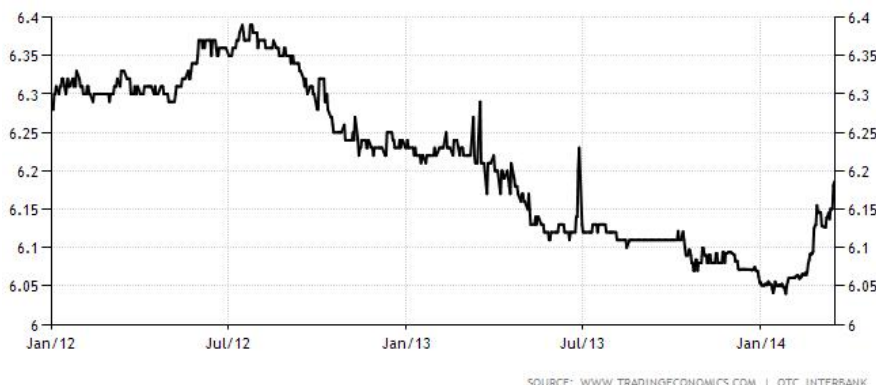
⁶ The IMF, [World Economic Outlook \(WEO\) Update: Is the Tide Rising?](#), January 2014

⁷ The New York Times, [Its Growth Targets Elusive, China Focuses on Jobs and Quality of Life](#), 13 March 2014

The Chinese Central Bank has loosened the dollar/renminbi exchange rate margin – one indicator that Beijing is liberalising its economy

RMB/USD in July 2012 to 6.19 in March 2014. In mid-March 2014, the Chinese Central Bank loosened its monetary policy and increased the RMB/USD daily margin to +/-2 %, up from +/-1 %. This was considered the government’s first step towards allowing the renminbi to float freely on the market.

Figure 2:
USD/RMB exchange rate



Most projections foresee a 2 % rise in the renminbi value from current levels⁸.

The inflation rate is estimated at 3.2% per annum.

The inflation rate (consumer price index) was 2.6 % at the beginning of 2013, increasing to 3.2 % by the end of the year, partly as a result of seasonal food demands. This year's target for consumer inflation in China remains at 3.5 % - the same as last year, when inflation remained below the target.⁹ The inflation rate dipped to its lowest point – 2 % – in February 2014.

Figure 3:
China Inflation rate



The deflation of producer prices is a concern for the Chinese government.

Producer prices, on the other hand, have depreciated over the past two years. This has been explained as the result of low demand, weak commodity prices and/or excess capacity in material industries. In 2013, the deflation rate for these prices was 1.9 %. The issue has become a more pressing concern for the Chinese government than inflation.

⁸ Financial Times, [Renminbi hits 11-month low after PBoC loosens its grip](#), 17 March 2014

⁹ Bloomberg, [China Inflation Slows to 13-Month Low](#), 09 March 2014

Figure 4:
China producer price change
(2012-2014)



The liberalisation of interest rates has not been welcomed by state banks.

The banking sector has been further liberalised by the authorisation of private banks and internet banking.

Setting interest rates has long been one of Beijing's privileged instruments for steering the economy. A governmental cap on annual interest on saving deposits is set at around 3 % for household deposits and 0.35 % on demand deposits¹⁰. The Chinese government has expressed its intention to liberalise the deposit rate within the next 1-2 years¹¹. This was already done for lending rates, in July 2013, i.e. the floor on what banks can charge for loans was removed. However, due to the continuous control of deposit rates, there is little room for the banks to float the loan rates China's one-year benchmark rate has been held at 6 % since July 2012, and the Central Bank now allows banks to offer lending rates of up to 10 % above the benchmark, and financial institutions to offer loans at up to 30 % below the benchmark¹². This move has not been welcomed by state banks, which had enjoyed a monopoly in these areas.

Another step towards further deregulation of the state's autonomy in the financial sector is the government's authorisation of **private banks** owned entirely by private investors. Generally, private investments account for only 12 % of the Chinese banking sector¹³, which was worth RMB 151.4 trillion¹⁴ at the end of 2013. **Internet finance services** have expanded greatly over the past year and is considered by the Chinese government an important contributor to the liberalisation of China's financial markets¹⁵. Internet finance challenges the banks autonomy on deposits and flow of money. It opens the competition between banks, changes the traditional bank payment systems, and leaves the market a larger role. As imagined, neither this new step in the financial industry has been welcomed by state banks.

¹⁰ The NY Times, [China Details Plans to Liberalize Interest Rates and Encourage Private Banks](#), 11 March 2014

¹¹ Reuters, [China suggests full interest rate liberalisation in 2 yrs](#), 11 March 2014

¹² Bloomberg, [China Removes Floor on Lending Rates as Economy Slows](#), 20 July 2013

¹³ The Financial Times, [China opens door to private banks](#), 11 March 2014

¹⁴ The Financial Times, [China Details Plans to Liberalize Interest Rates and Encourage Private Banks](#), 11 March 2014

¹⁵ The Financial Times, [Explosive growth pushes Alibaba online fund up global rankings](#), 10 March 2014

Private loans have become a serious issue, with corporate debt in particular soaring to unprecedented heights.

Loans to the private sector reached a four-year high in 2014. In January, loans by Chinese banks to consumers and corporations reached RMB 1.3 trillion, up RMB 246.9 billion in a year¹⁶. The growth of **corporate debt** has soared during the past five years, with a recent analysis estimating the increase at more than 260 % (to RMB 4.74 trillion) between December 2008 and September 2013¹⁷.

In a decade, China has developed the third-largest corporate debt market in the world, after the US and Japan. At the end of 2013, the total value of Chinese corporate bonds reached RMB 8.5 trillion¹⁸.

Figure 5:
China loans to private sector in RMB

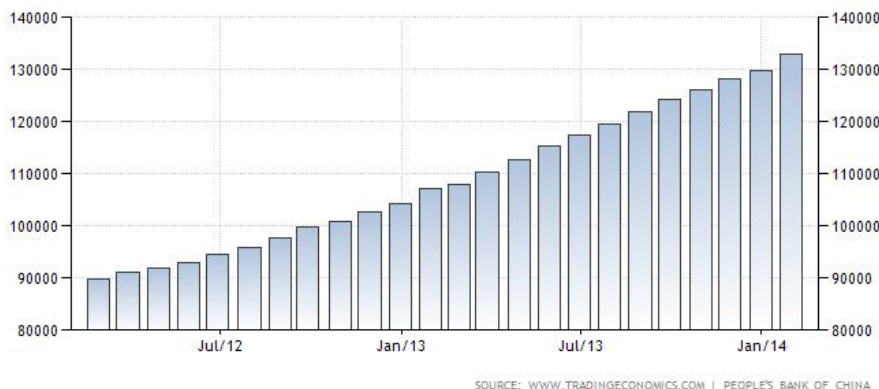
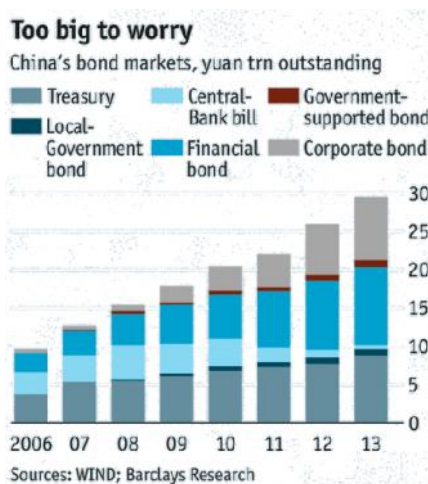


Figure 6:
China bonds market



Beijing has not bailed out all indebted Chinese companies.

In March 2014, China experienced its first bond default when solar equipment supplier Chaori was unable to repay interest on its bonds. The Chinese government did not bail the company out, as it had for other companies in the past. This inaction was interpreted as deliberate, demonstrating a new economic line; 'isolated cases of default will be unavoidable', declared Premier Li. However, Chaori does not imply that a chain reaction of defaults will follow, since around 80 % of corporate

¹⁶ Trading Economics, [People's Bank of China Drains Funds to Curb Lending Surge](#), 18 February 2014

¹⁷ Reuters, [China premier warns on economic slowdown as data fans stimulus talk](#), 13 March 2014

¹⁸ The New York Times, [Default Signals Growing Maturity of China's Corporate Bond Market](#), 7 March 2014

The shadow financial system has become one of the biggest challenges to the Chinese economy.

Figure 7:
China real estate prices
(year-on-year change)



The real estate sector remains one of the most important in China, accounting for 16 % of China's GDP.

The real estate sector has become severely indebted, and could become very vulnerable in the case of an economic downturn.

The **real estate** sector is of major economic importance to China. It accounts for about 16 % of China's total GDP²³, and land sales reached a record USD 672 billion²⁴ in 2013. Accounting for 40 % of government revenues in 2013, the sector is a principal driver of the Chinese economy²⁵. In 2012, various government policies kept prices down for most of the year. However, house prices steadily increased in 2013, with an increase of 9.90 % in December 2013²⁶. The largest cities, including Shanghai, Shenzhen and Beijing, experienced particularly significant increases, with prices up more than 20 %²⁷.

After years of increased investments, the risk of oversupply has become more apparent in some parts of China. The property 'bubble' in China has also greatly increased debt in the country, as many Chinese have placed their savings in real estate²⁸. The situation is considered risky, as Zhiwei Zhang, Chief Economist China at Nomura, said: 'We believe that a sharp property correction could lead to a systemic crisis in China, and is the biggest risk China faces in 2014'.

Migration from the countryside to the cities has contributed to this

¹⁹ The Financial Times, [Investors and economists poised to cheer China bond default](#), 5 March 2014

²⁰ i.e. lending to customers who have been considered too risky for the Chinese banks

²¹ The Telegraph, [Chinese Lending hits four-year high](#), 16 February 2014

²² According to Bloomberg's recent survey;

Bloomberg, [China Bond Risk Exceeds Ireland as Defaults Unavoidable](#), 14 March 2014

²³ Reuters, [The uncomfortable truth in China's property market](#), 6 November 2013

²⁴ The Financial Times, [China land sales pull in record \\$672bn](#), 12 February 2014

²⁵ The Financial Times, [China's central bank holds bailout talks with property developer](#), 18 March 2014

²⁶ Trading Economics, [China Newly Built House Prices YoY Change](#)

²⁷ The Financial Times, [China property prices continue to rise](#), 24 February 2014

²⁸ The Economist, [Property in China: Haunted housing](#), 14 November 2013

Migration from rural areas is encouraged, as it is considered a great driver of economic growth.

situation, although the Chinese government still encourages hundreds of millions rural townspeople to move to the cities, as this migration is considered an engine of economic growth. China gains 1.8 million new urban residents a year, according to the World Bank²⁹. It is estimated that moving 10 million people every year for 20-30 years would lead to approximately RMB 100 billion (USD 16.3 billion) in additional consumer spending every year³⁰.

Reforms of pension schemes in China aim to increase equality and migration to cities.

To encourage greater mobility, the government pledged to create a **unified pension system** by 2020. Migrant workers have faced inequalities in accessing pension pay-outs, and many Chinese save for health care and retirement to compensate for the weak public welfare system. Under its new pension scheme, the Chinese government would cover pension distributions fully in the poorest regions, while covering half in the wealthy. Beijing hopes this will encourage consumer spending and lead to greater economic growth. However, Robert Pozen has argued that 'true equality among pension programs still remains decades away'³¹.

3. China's role in world trade

China became the largest trading nation and the second biggest consumer nation in the world in 2013.

In 2013, China's total trade (in goods) accounted for USD 4.16 trillion³². Total exports for the year reached USD 2.21 trillion, an increase of 7.9 %, while imports rose 7.3 % from a year earlier to reach USD 1.95 trillion³³. The year marked a milestone in China's economic ascent, as the country attained the rank of largest trading nation in the world, previously held by the United States³⁴.

²⁹ Financial Times, [World Bank urges China to reform urban development](#), 25 March 2014

³⁰ Bloomberg, [China Urbanization to Hit Roadblocks Amid Local Opposition](#), 12 August 2013

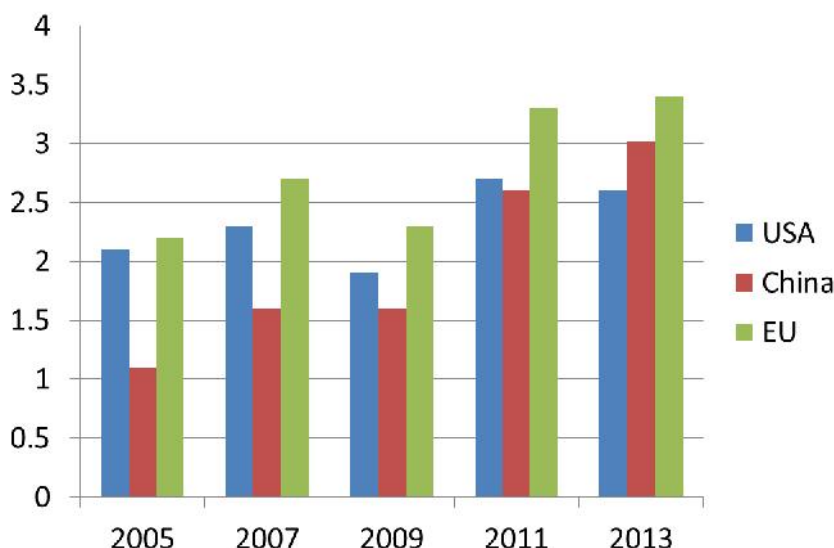
³¹ The Wall Street Journal, [China to Create Unified Pension System](#), 7 February 2014

³² Financial Times, [China overtakes US as world's largest goods trader](#), 10 January 2014

³³ Financial Times, [China overtakes US as world's largest goods trader](#), 10 January 2014

³⁴ Financial Times, [China overtakes US as world's largest goods trader](#), 10 January 2014

Figure 8:
Trade in goods with world
(volume of trade in
EUR trillion)



While China has long been known for its powerful productive basis, it also became the world's second biggest consumer country in 2013, surpassing Japan³⁵. China's **competitive advantage** in manufacturing has been undermined over the past five years by rising wages, the shrinkage of its qualified labour base and its appreciating currency – all factors that have encouraged companies to move their production to neighbouring countries such as Vietnam and Bangladesh³⁶.

China was the largest exporter of fishery products in 2013.

China's main exports are electronic equipment, machinery and textiles. However, other export commodities have also become important. In 2013, China became the world's fifth-largest arms exporter, accounting for 5 % of the world's total arms trade³⁷. Since 2002, China has been the largest exporter of fishery products³⁸, valued at USD 19.6 billion in 2013³⁹. China was also among the top three importers of fish, after the US and Japan, in 2013⁴⁰.

China also became the largest importer of red wine and

China has also exhibited a growing demand for meat, leading to increased imports of pork, beef and dairy products. In 2013, China consumed more than half of the 107 million tonnes of pork eaten worldwide⁴¹. The increase of imports is partly due to the increase of disposable income within the country, as well as the increase in production costs at home, and China's paucity of disposable farming

³⁵ The Economist, [China's economy. The world's second biggest consumer](#), 18 February 2014

³⁶ Bloomberg, [China Export Prowess Wanes in U.S., Europe](#), 12 March 2014

³⁷ Reuters, [China replaces Britain in world's top five arms exporters: report](#), 18 March 2013

³⁸ FAO, [FACT SHEET: The international fish trade and world fisheries](#), April 2010

³⁹ FAO, [World fish trade to set new records](#), 21 February 2014

⁴⁰ FAO, [World fish trade to set new records](#), 21 February 2014

⁴¹ Forbes, [How Increased Meat Consumption In China Changes Landscapes Across The Globe](#), 26 March 2014

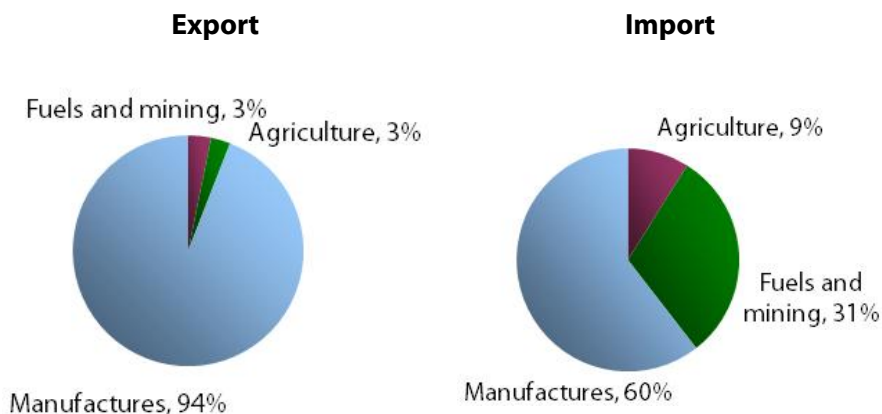
gold.

Solar power has become an increasingly popular source of energy in China.

land capable of meeting domestic demands.

China also became the world's leading importer of red wine in 2013⁴², thanks to its growing wealthy class. Another result has been increasing imports of gold, which increased 41 % to more than 1 000 tonnes in 2013. China became the world's largest consumer of gold that year, surpassing India⁴³.

Figure 9:
Export and import by sector in 2012



The Chinese economy started the year on a slow note, with both exports and imports decreasing during the first quarter of 2014.

Chinese President Xi Jinping has opened the door to a bilateral trade agreement.

Natural resources, including crude oil, iron, cobber, steel and coal, remain important Chinese imports. In 2013, crude oil imports increased 4 %, iron ore increased 10.2 %, and coal 13.4 %⁴⁴. Solar power has rapidly gained popularity and no less than 12GW of solar power were installed in China in 2013 –more than any other single country has ever built in one year⁴⁵.

Chinese trade started off on a slow note in the first quarter of 2014. While exports rose by 10.6 % in January compared to the year before, they then fell 18.1 % in February and 6 % in March⁴⁶. Imports rose 10.1 % in February, but then fell 11.3 % in March, resulting in a trade balance surplus of USD 7 billion⁴⁷ in March 2014. Some have suggested that these large differences are due to over-invoicing by Chinese companies in 2013, which created an artificially high base for comparing exports. Beijing, in any case, has downplayed the seriousness of any dip: 'Our country's international trade is really encountering some difficulties, but we should not over-estimate the problems',⁴⁸ stated a spokesperson from the Chinese customs administration.

In April 2014, Chinese President Xi Jinping called for an active exploration of a possible bilateral trade agreement between the EU and

⁴²The Guardian, [China becomes world's biggest market for red wine, with 1.86bn bottles sold in 2013](#), 29 January 2014

⁴³ Reuters, [China's gold demand tops 1,000 tonnes for first time](#), 10 February 2014

⁴⁴ Reuters, [China's crude oil imports rise 4 pct in 2013](#), 9 January 2014

⁴⁵ Bloomberg, [China Installed a Record 12 Gigawatts of Solar in 2013](#), 23 January 2014

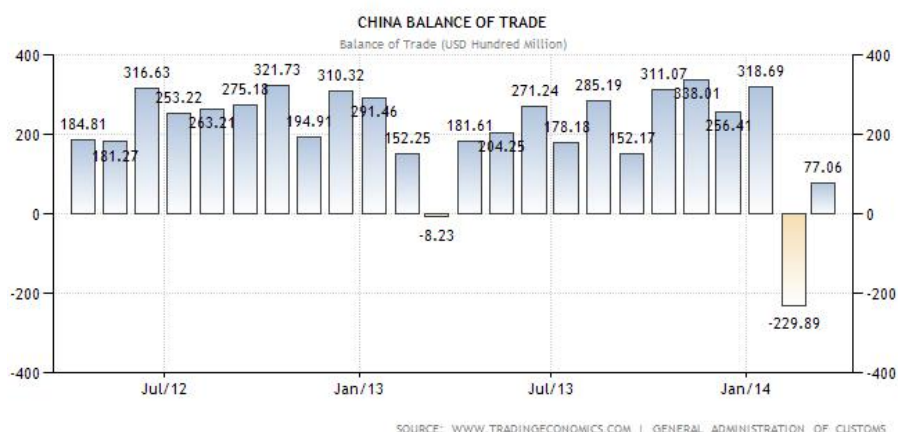
⁴⁶ Reuters, [China February exports tumble unexpectedly](#), 8 March 2014

⁴⁷ Financial Times, [China rattles nerves with weak trade data](#), 10 April 2014

⁴⁸ Financial Times, [China rattles nerves with weak trade data](#), 10 April 2014

China, saying 'We must work to make China and the EU the twin engines for global economic growth'⁴⁹.

Figure 10:
China balance of trade



3.1. China FTA strategy

China is a growing world trading power with a very active FTA agenda.

China is increasingly expanding its trade and economic relations with third countries, implementing FTA agreements with partners far beyond its neighbourhood, including Costa Rica, Peru and Iceland.

Figure 11:
China's FTAs network

| Implemented | Under Negotiation | Under Feasibility Study |
|-------------|--------------------------|-------------------------|
| ASEAN | Gulf Cooperation Council | India |
| Pakistan | | Switzerland |
| Singapore | Norway | |
| Macao | South Korea | |
| Costa Rica | Australia | |
| Peru | Japan / South Korea | |
| Chile | | |
| New Zealand | | |
| Hong Kong | | |
| Iceland | | |

In 2013 China supplemented its extensive FTA network, implementing a new FTA agreement with Iceland and negotiating with five other potential trading partners⁵⁰.

Despite growing tensions between Beijing and Tokyo related to maritime disputes, China, the Republic of Korea (ROK) and Japan officially announced the opening of negotiations for a trilateral FTA on 11 November 2012. If concluded, the new treaty could pave the way to the

⁴⁹ Financial Times, [China courts EU on bilateral trade agreement](#), 1 April 2014

⁵⁰ These figures are taken from the [China FTA Network](#) internet site. See also, China briefing, [Understanding China's Free Trade Agreements](#), February 2014.

An FTA announced with Japan and South Korea may have major repercussions for the EU.

establishment of a northeast Asia FTA that could compete with the EU and NAFTA, the world's largest customs and economic unions. It is still unclear whether the new FTA will be inspired by the EU or the NAFTA model, but it is likely that the process of integration among three leading Asian economies will continue for some time before being completed. The three countries have also announced the conclusion of an investment treaty that should make cross investments in the region easier and safer⁵¹. The fourth round of negotiations took place on 4 March 2014 in Seoul⁵². Meanwhile, bilateral negotiations for a PRC-ROK FTA have also progressed. In December 2013, the negotiating parties announced the conclusion of the first stage talks on trade in goods, the agreement's scope, the principles and the framework of negotiations.

China is still in the process of negotiating FTAs with Norway and Australia. The Australian talks have been delayed for several years due to concerns from Australia's agricultural sector, but may be concluded in 2014.

China is also pushing to complete negotiations for an FTA with the Gulf Cooperation Council (GCC) FTA. As major oil exporters, GCC countries are essential to China's economic development. President Xi has been directly involved in these negotiations and has pressed for their rapid conclusion.

China is also a strong promoter of the annual meeting of the BRICS countries (Brazil, Russia, India, China and South Africa). China perceives this gathering as an alternative to the G20. In the March 2013 BRICS summit held in Durban, participants announced the creation of a 'Bank of Development' — again, perceived as an alternative to the current dominant institutions, the International Monetary Fund and the World Bank. Significantly, the currency the bank will use to finance trade credits is not the US dollar, but rather a combination of the currencies of Brazil, Russia, India, China and South Africa. China would happily become an influential contributor to this project and considers the forum an effective platform for making the renminbi a world currency⁵³.

3.2. Trade in goods with the EU

The first half of 2013 witnessed a decrease in exports from the EU28 to China.

Total merchandise trade between the EU28 and China decreased during the first six months of 2013, both for imports and exports. Total exports from the 28 EU Member States to China accounted for EUR 71 billion during the first half of 2013 – a decrease of almost EUR 1.4 billion from the same period the previous year. Imports from China decreased during the same period to EUR 133 billion from EUR 141 billion the year before. In

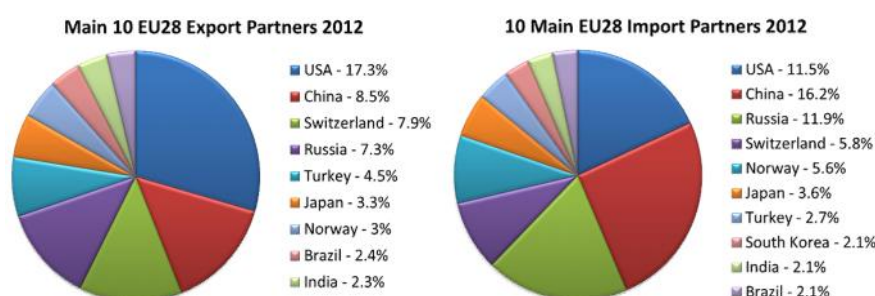
⁵¹ The Wall Street Journal, [Asia powers agree on Free-trade negotiations](#) (14 May 2012)

⁵² MOFCOM, Ministry of Commerce of China, [The First Round of China-Japan-ROK FTA Negotiations Held in ROK](#) (29 March 2013)

⁵³ Deutsche Welle, BRICS Summit stalls (27 March 2013)

total, the EU28's trade deficit with China decreased to EUR 121.6 billion in 2013 compared to EUR 136.8 in 2012⁵⁴, largely due to a fall in EU consumption.

Figure 12:
Top 10 EU 28 trade partners
(2012)



Source: European Commission⁵⁵

Germany remains the largest exporter and importer of goods to and from China.

Germany remains the EU's largest exporter of goods to China, providing 45 % of EU28 exports in the first half of 2013, well ahead of France (10 %) and the UK (9 %)⁵⁶. Germany is also the largest importer of Chinese goods, absorbing EUR 27.7 billion in the first half of 2013, or around 21 % of all the EU28's Chinese imports. Except for Finland and Germany, all EU28 Member States had a trade deficit with China during the first six months of 2013, with the largest registered by the Netherlands (EUR 20.9 billion) and the UK (EUR 12.2 billion)⁵⁷.

Figure 13:
EU28: trade in goods with
China (in billion euro)

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|-------------------------|-------|-------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| China | | | | | | | | | | | |
| Exports | 35.1 | 41.5 | 48.4 | 51.7 | 63.7 | 71.8 | 78.3 | 82.4 | 113.5 | 136.4 | 143.9 |
| Imports | 90.4 | 106.6 | 129.2 | 161.0 | 195.8 | 233.9 | 249.0 | 215.3 | 283.6 | 294.8 | 291.1 |
| Balance | -55.3 | -65.1 | -80.8 | -109.3 | -132.1 | -162.0 | -170.7 | -132.9 | -170.1 | -158.4 | -147.2 |
| Total extra-EU28 | | | | | | | | | | | |
| Exports | 885.3 | 861.9 | 945.2 | 1 049.5 | 1 152.4 | 1 234.3 | 1 309.1 | 1 094.0 | 1 353.2 | 1 554.2 | 1 680.3 |
| Imports | 937.0 | 935.3 | 1 027.4 | 1 183.9 | 1 364.6 | 1 446.8 | 1 585.2 | 1 235.6 | 1 532.1 | 1 727.1 | 1 794.0 |
| Balance | -51.7 | -73.4 | -82.2 | -134.4 | -212.2 | -212.5 | -276.1 | -141.7 | -178.9 | -172.9 | -113.7 |
| China / Total | | | | | | | | | | | |
| Exports | 4.0% | 4.8% | 5.1% | 4.9% | 5.5% | 5.8% | 6.0% | 7.5% | 8.4% | 8.8% | 8.6% |
| Imports | 9.6% | 11.4% | 12.6% | 13.6% | 14.3% | 16.2% | 15.7% | 17.4% | 18.5% | 17.1% | 16.2% |

⁵⁴ Eurostat, [First estimate for the fourth quarter of 2013: EU28 current account surplus 47.9 bn euro 42.1 bn euro surplus in trade in services](#), 7 March 2014

⁵⁵ European Commission, [The European Union Trade Policy 2014](#)

⁵⁶ Eurostat, [EU - China Summit: EU28 deficit in trade in goods with China down to 62 bn euro in the first six months of 2013](#), 19 November 2013

⁵⁷ Eurostat, [EU - China Summit: EU28 deficit in trade in goods with China down to 62 bn euro in the first six months of 2013](#), 19 November 2013

Figure 14:

EU28: trade in goods with
China (per product, in million
euro)

| | Exports | | Imports | | Balance | |
|---------------------------------|---------------|---------------|----------------|----------------|----------------|----------------|
| | Jan-Jun 2012 | Jan-Jun 2013 | Jan-Jun 2012 | Jan-Jun 2013 | Jan-Jun 2012 | Jan-Jun 2013 |
| Total | 72 770 | 71 402 | 141 256 | 133 624 | -68 486 | -62 222 |
| Primary products: | 7 778 | 8 323 | 3 882 | 3 568 | 3 897 | 4 756 |
| <i>Food & drink</i> | 1 970 | 2 258 | 2 137 | 2 077 | -167 | 181 |
| <i>Crude materials</i> | 5 133 | 5 206 | 1 607 | 1 401 | 3 526 | 3 805 |
| <i>Energy</i> | 675 | 859 | 138 | 89 | 538 | 770 |
| Manufactured goods: | 64 099 | 61 924 | 136 740 | 129 496 | -72 641 | -67 572 |
| <i>Chemicals</i> | 8 299 | 8 725 | 6 655 | 6 777 | 1 644 | 1 948 |
| <i>Machinery & vehicles</i> | 43 584 | 40 923 | 71 614 | 67 845 | -28 030 | -26 922 |
| <i>Other manuf'd articles*</i> | 12 216 | 12 276 | 58 471 | 54 874 | -46 255 | -42 599 |
| Other | 894 | 1 155 | 635 | 561 | 259 | 594 |

Figure 15:

EU28: trade in goods with
China (per EU Member State,
in million euro)

| | Exports | | Imports | | Balance | |
|----------------|--------------|--------------|--------------|--------------|--------------|--------------|
| | Jan-Jun 2012 | Jan-Jun 2013 | Jan-Jun 2012 | Jan-Jun 2013 | Jan-Jun 2012 | Jan-Jun 2013 |
| EU28 | 72 770 | 71 402 | 141 256 | 133 624 | -68 486 | -62 222 |
| Belgium * | 3 918 | 3 314 | 6 826 | 6 407 | -2 907 | -3 093 |
| Bulgaria | 279 | 264 | 431 | 382 | -153 | -118 |
| Czech Republic | 690 | 706 | 3 285 | 3 069 | -2 595 | -2 363 |
| Denmark | 1 068 | 1 251 | 2 359 | 2 407 | -1 291 | -1 157 |
| Germany | 34 235 | 32 379 | 29 943 | 27 700 | 4 292 | 4 679 |
| Estonia | 58 | 50 | 263 | 311 | -204 | -262 |
| Ireland | 775 | 726 | 909 | 934 | -134 | -208 |
| Greece | 183 | 181 | 1 132 | 1 127 | -949 | -946 |
| Spain | 1 782 | 2 020 | 7 212 | 6 698 | -5 430 | -4 678 |
| France | 7 716 | 7 230 | 12 617 | 11 941 | -4 902 | -4 711 |
| Croatia | 19 | 27 | 572 | 771 | -553 | -744 |
| Italy | 4 485 | 4 788 | 12 858 | 11 514 | -8 372 | -6 726 |
| Cyprus | 12 | 19 | 141 | 103 | -129 | -84 |

| | | | | | | |
|-------------------------|----------------|----------------|----------------|----------------|----------------|---------------|
| Latvia | 25 | 42 | 155 | 168 | -130 | -126 |
| Lithuania | 34 | 43 | 247 | 275 | -213 | -231 |
| Luxembourg | 90 | 114 | 808 | 543 | -718 | -429 |
| Hungary | 699 | 710 | 2 650 | 2 746 | -1 952 | -2 036 |
| Malta | 23 | 26 | 85 | 72 | -62 | -45 |
| Netherlands* | 3 911 | 3 994 | 25 863 | 24 936 | -21 953 | -20 942 |
| Austria | 1 373 | 1 313 | 2 070 | 2 102 | -698 | -789 |
| Poland | 630 | 759 | 3 826 | 3 941 | -3 196 | -3 183 |
| Portugal | 440 | 331 | 692 | 673 | -253 | -341 |
| Romania | 192 | 224 | 1 033 | 929 | -842 | -705 |
| Slovenia | 73 | 91 | 448 | 474 | -375 | -382 |
| Slovakia | 858 | 772 | 1 098 | 1 175 | -241 | -402 |
| Finland | 1 362 | 1 380 | 1 600 | 849 | -238 | 531 |
| Sweden | 2 222 | 2 361 | 2 904 | 2 921 | -682 | -560 |
| United Kingdom | 5 620 | 6 288 | 19 225 | 18 457 | -13 606 | -12 169 |
| Total extra-EU28 | 826 026 | 870 568 | 895 974 | 840 544 | -69 947 | 30 024 |
| China / Total | 8.8% | 8.2% | 15.8% | 15.9% | | |

* Dutch imports and therefore the trade deficit are over-estimated because of the "Rotterdam effect" where goods destined for the rest of the EU arrive, and are therefore recorded in harmonised EU external trade statistics, in Dutch ports. This then has a positive effect on the external trade balances with China of those Member States to which the goods are re-exported as these shipments would be recorded as intra-EU trade with the Netherlands rather than extra-EU trade with China. To a lesser extent, Belgian trade figures are similarly over-estimated.

Source: Tables provided by Eurostat⁵⁸

3.3. Trade in services with the EU

There was a surplus in the EU27 trade in services in 2012.

The trade in services between the EU and China has grown continuously since 2010, yet still presents an enormous potential for future expansion. In 2012, the EU27 exported services to China valued at EUR 30 billion – mainly surplus activity in the areas of travel and 'other services', including royalties and license fees, computer and information services, and other business services.

Imports of services from China were valued at EUR 20.1 billion, with 'other services' experiencing a steady increase. In total, the services trade provided the EU27 with a surplus of EUR 9.9 billion in 2012 – EUR 2 billion more than the year before.

⁵⁸ Eurostat, [EU - China Summit: EU28 deficit in trade in goods with China down to 62 bn euro in the first six months of 2013](#), 19 November 2013

Figure 16:EU27: trade in services with
China (million euro)

| | Exports | | | Imports | | | Balance | | |
|--|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| | 2010 | 2011 | 2012 | 2010 | 2011 | 2012 | 2010 | 2011 | 2012 |
| Total | 23 892 | 26 245 | 30 024 | 17 263 | 18 314 | 20 105 | 6 629 | 7 931 | 9 919 |
| of which: | | | | | | | | | |
| Transportation | 7 997 | 8 136 | 8 392 | 8 771 | 8 849 | 9 022 | -775 | -713 | -630 |
| Travel | 2 472 | 3 142 | 4 118 | 2 151 | 2 206 | 2 472 | 321 | 936 | 1 647 |
| Other services | 13 414 | 14 961 | 17 497 | 6 315 | 7 237 | 8 572 | 7 100 | 7 724 | 8 925 |
| of which: | | | | | | | | | |
| <i>Communications services</i> | 377 | 523 | 685 | 233 | 337 | 225 | 144 | 186 | 460 |
| <i>Construction services</i> | 1 187 | 1 163 | 1 170 | 325 | 450 | 413 | 862 | 713 | 757 |
| <i>Insurance services</i> | 252 | 248 | 286 | 333 | 356 | 327 | -81 | -108 | -41 |
| <i>Financial services</i> | 368 | 393 | 442 | 112 | 183 | 145 | 256 | 210 | 297 |
| <i>Computer and information services</i> | 1 458 | 1 558 | 1 617 | 297 | 335 | 443 | 1 161 | 1 223 | 1 174 |
| <i>Royalties and license fees</i> | 1 961 | 2 156 | 2 306 | 89 | 79 | 126 | 1 872 | 2 077 | 2 179 |
| <i>Other business services⁵</i> | 7 572 | 8 619 | 10 735 | 4 775 | 5 349 | 6 736 | 2 797 | 3 270 | 3 998 |
| <i>Personal cultural and recreational services</i> | 94 | 137 | 91 | 46 | 58 | 64 | 48 | 79 | 27 |
| <i>Government services n.i.e.</i> | 148 | 165 | 165 | 108 | 89 | 92 | 40 | 75 | 73 |
| Total extra-EU27 | 566 558 | 603 941 | 657 387 | 463 563 | 482 902 | 510 641 | 102 995 | 121 040 | 146 746 |
| China / total extra-EU27 | 4.2% | 4.3% | 4.6% | 3.7% | 3.8% | 3.9% | | | |

Source: Eurostat⁵⁹

3.4. Investments

More Chinese companies
have been expanding abroad.

Foreign direct investment inflows in 2013 reached a historic high in China: USD 117.6 billion⁶⁰. While investments in manufacturing fell by 21.7 %⁶¹, new investment focused on the service industry. Outbound FDI from China also increased by 47.2 % in January from a year earlier, reaching USD 7.23 billion and reflecting the growing presence of Chinese companies abroad⁶².

Flows into China accounted for an estimated USD 127 billion in both financial and non-financial sectors. The country again ranked second in

⁵⁹ Eurostat, [EU - China Summit: EU28 deficit in trade in goods with China down to 62 bn euro in the first six months of 2013](#), 19 November 2013

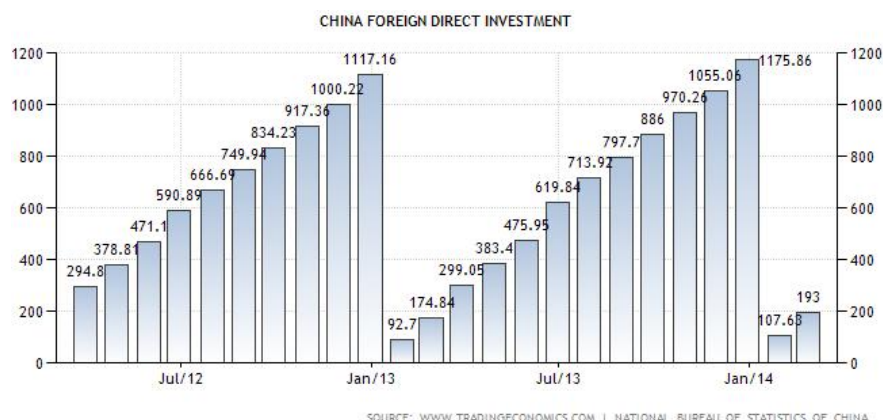
⁶⁰ Trading Economics, [China Foreign Direct Investment](#)

⁶¹ Reuters, [China January foreign direct investment rises in sign of confidence](#), 18 February 2014

⁶² Reuters, [China January foreign direct investment rises in sign of confidence](#), 18 February 2014

the world as a destination for FDI, and the gap between China and the US – the top FDI destination – narrowed to USD 32 billion⁶³.

Figure 17:
China Foreign Direct Investment



The US is the main destination of Chinese investments, which accounted globally for USD 14 billion in 2013⁶⁴. Chinese outward FDI is primarily placed in real estate, in the US and Australia as well as in Europe. In the six biggest metropolitan areas in the US, Chinese investments in commercial real estate accounted for USD 2.88 billion in 2013 – USD 2.5 billion more than in 2012⁶⁵.

Bilateral investments between the EU and China are relatively anaemic. While bilateral trade represents almost EUR 1 billion a day⁶⁶, Chinese investments into the EU accounted for only 2.6% of total FDI flows into the EU in 2012. However, the EU remains among the top 5 FDI providers to China. The share of total EU flows of FDI into China remained at 20% of all inward FDI in 2012⁶⁷. Certain Chinese measures have hindered EU investments. Nonetheless, both parties agreed last year to negotiate a bilateral investment treaty.

4. EU - China bilateral relations

Negotiations for an EU-China Partnership and Cooperation Agreement (PCA) were launched in 2007 and based on two pillars: political cooperation and trade and investment liberalisation. The PCA is not a free trade agreement, since it does not include tariff reductions for agricultural and industrial products or specific commitments for services. However, it may include provisions that facilitate trade and investment. China has always shown a much lower level of ambition than the EU, and has made it clear that it would prefer an agreement mainly covering broad cooperation and dialogue principles. According to the European

⁶³ UNCTAD, [Global FDI Rose by 11 %; Developed Economies are trapped in a historically low share](#), 28 January 2014

⁶⁴ Time, [Wake Up America, the Chinese \(Investors\) Are Coming!](#), 16 January 2014

⁶⁵ Bloomberg, [Chinese Steer Billions Abroad in Quest for Safety](#), 19 November 2013

⁶⁶ EU Trade, [Facts and Figures on EU-China Trade](#), March 2014

⁶⁷ EU Trade, [Facts and Figures on EU-China Trade](#), March 2014

Bilateral investments between the EU and China are lacking. However, there have been talks about a bilateral investment treaty.

Commission, some of the 22 chapters on the trade and investment have been finalised, but the conclusion of the deal does not appear to be within reach⁶⁸.

At the 15th EU-China summit held on 20 September 2012, China and the EU agreed to launch negotiations on a bilateral investment agreement. Negotiations started in January 2014, and the second round of talks took place on 24 March 2014, before President Xi's visit to Brussels.

During his visit on 31 March 2014, President Xi actively promoted opening negotiations for a **comprehensive EU-China FTA**. This represented a radical change in the Chinese position, apparently triggered by the parallel launch of negotiations on the EU-US Transatlantic Trade and Investment Partnership (TTIP) last year, and by the slow but steady advance of talks on the TPP (Trans Pacific Partnership), which has linked the US and a number of Asian countries.

The TPP has sometimes been depicted as an anti-Chinese tool whose goal is to create an economic 'containment belt' around the People's Republic. Other commenters have suggested that the TPP's aim is to convince China to be more open to discuss trade and economic issues (including global imbalances) with the US⁶⁹.

The EU's first reaction to the Chinese proposals has been rather cautious. In the final communiqué of the summit, both parties agreed that negotiating and concluding the 'EU-China Investment Agreement, covering investment protection and market access, will convey both sides' joint commitment towards stronger cooperation as well as their willingness to envisage broader ambitions including, once the conditions are right, towards a deep and comprehensive FTA, as a longer term perspective⁷⁰.

As has been the case previously, Beijing hopes to convince the EU to 'work jointly to create conditions for launching a feasibility study of a China-EU free-trade agreement'⁷¹. The European Commission, however, considers that the necessary conditions for formally opening preliminary talks on an ambitious EU-China FTA have not yet been met.

4.1. Trade irritants with China

Access to the Chinese market, although improved in recent years, remains difficult. China has only partly implemented its obligations under the WTO Protocol of Accession and has not hesitated to protect its industry and service sectors.

⁶⁸ European Commission, [Trade relations with China](#) (Memo, 2010).

⁶⁹ Financial Times, It won't be easy to build an 'anyone but China' club (22 May 2013). But these conclusions have been criticised by other scholars, see e.g. Brookings The Containment Fallacy: China and the TPP (24 May 2013).

⁷⁰ European Commission, [Joint Statement](#): Deepening the EU-China Comprehensive Strategic Partnership for mutual benefit (31 March 2014)

⁷¹ The Diplomat, [Beijing Pushes For China-EU Free Trade Deal](#) (28 January 2014)

Access to the Chinese service market is difficult for foreign companies.

Certain key sectors, such as banking and telecommunications, remain particularly difficult for foreign companies to access. The Chinese government often applies excessive regulatory requirements that limit foreign investors and service providers. In this respect, and despite steady liberalisation, the Chinese government's control over the domestic economy remains relatively tight. For example, of the 22 000 telecoms licenses granted since 2001, only 23 have gone to foreign companies. Foreign law firms in China are still not allowed to employ Chinese lawyers, and their employees are not permitted to participate in bar exams to gain Chinese qualifications⁷².

China increasingly applies country-specific standards and other regulatory barriers that impose a heavy burden — both in terms of money and time — on foreign operators. Foreign companies in China often complain about the lack of a level playing field, as their Chinese competitors benefit from generous subsidies and other financial schemes. Foreign companies report a persistent lack of transparency and predictability in government and rulemaking issues.

The Commission's 2014 report on trade barriers highlighted sectors that it considers priorities. Barriers to accessing the information security sector and cosmetics regulations are noted to still cause concern.

Liberalisation of foreign direct investments is still under way, and the last revision of the foreign investment catalogue (end of 2011) was restricted to a limited number of areas. China maintains investment and ownership caps in many sectors, including banking, construction and telecommunications.

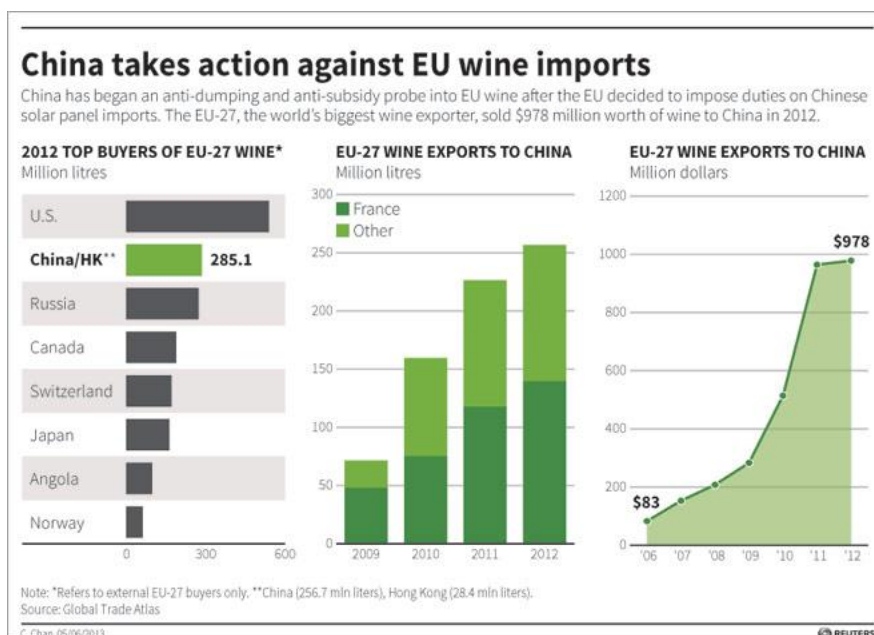
Country specific standards effectively limit access of foreign companies to the Chinese market.

In June 2013, China launched an anti-dumping and an anti-subsidy investigation into wines imported from the EU. This investigation, clearly related to the EU solar panels case (*see below*), had the potential to damage the EU wine and spirit sector; China has gradually become one of the biggest markets for EU wines. In 2012, the Chinese wine market was worth no less than EUR 700 billion for EU exporters, a tenfold increase since 2006.

⁷² European Commission, facts and figures on EU-China trade (March 2014).

Figure 18:

EU wine exports to China increased substantially during the last decade



Despite the rise in EU wine exports to the PRC, the complaint brought by Chinese local producers appeared rather weak; it was difficult to demonstrate that the surge of imports into China was due to dumped or subsidised products, or that China's local wine industry was suffering injury.

By March 2014 the EU and China settled both solar panel and wine cases.

After that the solar panels dispute was resolved, China initially refused to terminate the wine case, insisting that it constituted a separate issue. In a sign of goodwill and in anticipation of President Xi's visit to Brussels (March 2014), China terminated its investigation into EU wines. (Beijing also accepted a price undertaking in a smaller, non-related, investigation on polysilicon⁷³.) The wine agreement includes, *inter alia*, a pledge by the European wine industry to help China develop domestic wine production. China will, in return, organise tastings of European wine in China⁷⁴.

On a more positive note, discriminatory measures on customs and taxation measures affecting the logistics and shipping industry (introduced by China in May 2013) were repealed in December 2013. This was the result of concerted international pressure, coordinated by the EU.

4.2. Indigenous innovation policy

Indigenous innovation policy measures were partly

In 2006, China inaugurated a series of policies aimed at developing its local technological capability. The set of policies was named the 'Indigenous Innovation Policy' and served to link intellectual property

⁷³ European Commission, [Trade Defence Instruments: European Commission welcomes EU industry's agreement with China in the polysilicon anti-dumping and anti-subsidy cases](#) (18 March 2014)

⁷⁴ European Commission, [European Commission welcomes agreement reached between European and Chinese wine industries which will put an end to China's anti-dumping and anti-subsidy cases](#) (21 March 2014)

suspended in 2011, but the problem may resurface.

with government procurement. The areas targeted for development included clean energy and information technology, with the aim of accelerating China's development of technology and thus improving the competitiveness of Chinese firms in the high-tech sector. The policy required foreign companies to share some of their technologies with local labs, in the hope that local firms would profit from a technology 'spillover'⁷⁵.

This policy was perceived to be discriminatory towards foreign companies and came under heavy criticism in 2009, when 30 leading foreign firms publicly condemned the measures⁷⁶.

In March 2011, three key measures — including the linking of government procurement with indigenous domestic innovation firms — were suspended. The suspension was probably due to the unprecedented pressure applied on the Chinese government (and may have represented an implicit admission of failure). The EU also played an important role in having these measures revised and/or suspended⁷⁷.

In its 2013 'Trade and investment barriers' report, the Commission noted that 'elements of indigenous innovation continue to reappear under one form or another' and concludes that the progress achieved to date remains fragile.⁷⁸ The situation has not substantially changed in the intervening period.⁷⁹

4.3. Intellectual property rights (IPRs)

Despite improvements, China is still the chief violator of European intellectual property rights.

Since its accession to the WTO in 2001, China has made a measurable effort to comply with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (the TRIPS Agreement). Beijing introduced a rather complete and modern framework of laws and regulation into its legislative system to protect the intellectual property rights (IPRs) of domestic and foreign right holders.

Despite these efforts to comply with international rules, critical changes to China's legal framework are still needed in a few areas, such as copyright protection on the internet and criminal IPR enforcement.

As acknowledged by the United States Trade Representative (USTR) office in its annual report to the Congress on China's WTO compliance, 'effective enforcement of China's IPR laws and regulations remains a significant

⁷⁵ Wall Street Journal, [Beijing is stifling Chinese Innovation](#), (1 September 2011)

⁷⁶ Forbes, [China Pulls Back Indigenous Innovation Policies](#), (7 March 2012)

⁷⁷ The key pieces of legislation linking indigenous innovation to government procurement suspended by the Chinese Government are as follows:

(a) evaluation measures on indigenous innovation products for government procurement, (b) administrative measures on budgeting for the procurement of indigenous innovation and (c) products and administrative measures on government procurement contracts for indigenous innovation products.

⁷⁸ European Commission, Report from the Commission to the European Council on ['Trade and investment barriers'](#) (2013).

⁷⁹ European Commission, [Report from the Commission to the European Council on 'Trade and investment barriers'](#) (2014).

challenge. Despite repeated anti-piracy campaigns in China and an increasing number of civil IPR cases in Chinese courts, counterfeiting and piracy remain at unacceptably high levels and continue to cause serious harm to US businesses across many sectors of the economy⁸⁰. Similar considerations apply to EU exporters.

The global picture is, however, gradually improving. In fact, in the same report, the USTR acknowledged that Beijing's efforts to develop innovative industries and technologies demonstrate that China 'has an increasing stake in effective IPR enforcement'. That said, 'real progress was made, but much more work remains to be done'.

Despite its notable improvements, China is still the first source of counterfeited products seized by the EU customs authorities at European borders (64 % of the total). Most European companies operating in China report serious IPR violations with a potentially strong negative impact on their revenues in China⁸¹.

4.4. Public procurement

China is slowly progressing toward full GPA membership, but its procurement market remains largely closed.

China applied to accede to the WTO Agreement of Government Procurement (GPA) in late 2007. However, its offer was deemed 'very disappointing' for the lack of genuine openness of its markets. Although the Chinese market has vast potential, it also presents sizeable obstacles — again, a lack of transparency and of a clear legal framework. Following negotiations, Beijing has agreed not to require Chinese companies to purchase Chinese goods, although Chinese companies operating in 'sensitive' sectors continue to receive preferential treatment⁸².

The US administration estimated in 2007 that Chinese accession to GPA could open as much as USD 35 billion (EUR 26 billion) of the public procurement market in the PRC. The PRC procurement market is currently far from transparent and efficient. The situation is even more opaque when it comes to regional and local public entities.

The Chinese government seems to have been inspired by restrictive US practices rather than EU legislation, which is designed to prevent 'buy national' and other restrictive practices. As stated above, procurement laws passed in China in 2003 do not impose the mandatory purchase of Chinese goods, although they do allow preferential treatment for domestic companies in certain sensitive sectors, such as informatics.

During the period of reference, operators reported increasing local content requirements (imposed especially by provincial and local governments), which, coupled with murky procedures, prevented foreign companies operating in the country from competing on equal footing

⁸⁰ United States Trade Representative, 2013 USTR Report to Congress on China's WTO Compliance (December 2013).

⁸¹ European Commission, Facts and figures on EU-China trade (March 2014)

⁸² For more details on Public procurement in general and with regard to the PRC please refer to the DG EXPO Policy Department briefing note entitled [Public Procurement and International Trade](#), 2012

with Chinese companies in public procurement bids.

In December 2011, China put forward a new offer to the GPA. The EU judged the offer's content a step forward, but the US still considered it insufficient. In particular, the US complained that state-owned enterprises (SOEs) and a number of local entities were not included in the proposal.

The European Commission (EC) asked China to table a revised GPA offer along with additional market access commitments on SOEs and local entities (provinces in particular). The EC also asked that some exclusions in China's offer — mainly involving industrial policies — be removed. In March 2014, China made public its fourth revised offer, which is currently under scrutiny by the EU and the US.

The EU has devised a legislative scheme to 'increase our leverage to secure improved symmetry in access to public procurement markets in developed and large emerging economies'⁸³. The original proposition for the scheme, which was due to be published in 2011, was postponed due to intense opposition from within and outside the European Commission. The proposal is still pending the European Parliament's and Council's approval⁸⁴.

The EU proposed legislative scheme on rebalancing of public procurement could have an impact on China.

5. Trade irritants with the EU

Like other third countries, China has often complained about a European overemphasis on health, safety and other regulatory issues, which Beijing views as excuses hindering access to European markets.

China is also worried that the EU may raise trade barriers more often as European prospects of growth darken and unemployment surges, in turn impacting the already-declining rate of Chinese manufactured goods shipped to the EU. A similar evolution has taken a toll on Chinese-US trade.

Anti-dumping (AD) and countervailing (CVD) measures applied by the EU on Chinese products have already contributed to a slowdown in the EU's imports of Chinese goods.

Beijing has expressed strong objections to the EU's insistence of defining the Chinese economy as a 'non-market economy' (NME). (*See below for*

Generally displeased with the EU's trade defence measures, China has urged the EU to grant it 'market economy' status.

⁸³ European Commission, [Trade, Growth and World Affairs](#), trade policy as a core component of the EU'S 2020 Strategy.

⁸⁴ See Public procurement: access of third-country goods and services to the Union's internal market and procedures supporting negotiations on access of Union goods and services to the markets of third countries ([2012/0060/COD](#)). This legislative proposal is pending before the EP's Committee on International Trade and the Council for consideration.

more on this.)

Finally, the reform of the EU's Generalised System of Preferences (GSP), which entered into force on 1 January 2014, foresees the *de facto* exclusion of China from the list of GSP beneficiaries⁸⁵.

Generally displeased with the EU's trade defence measures, China has urged the EU to grant it 'market economy' status (see below).

5.1. Trade defence instruments

China is by far the principal target of EU trade defence measures.

On 31 March 2014, the EU had 55 definitive anti-dumping and countervailing duty measures against Chinese products in force (seven fewer than in 2012), affecting less than 2 % of EU trade with China⁸⁶. In 2013, the EU initiated only four new anti-dumping investigations into Chinese products⁸⁷ and three countervailing duty investigations. China has always criticised the imposition of trade defence measures on its products and considers the EU antidumping measures a protectionist tool.

The antidumping and anti-subsidy investigation into Chinese solar panels was the largest ever opened by the EU.

The most notable recent case involved anti-dumping (AD) and countervailing duty (CVD) investigations against Chinese solar panels. Initiated in September 2012, the investigation was the biggest single-product investigation ever opened by the EU; the value of Chinese solar panels and components exported to the EU totalled EUR 21 billion in 2011. The PRC is the largest producer of solar panels (about 65 % of total world's production originates in the country), and the sector — like other industrial sectors that have recently expanded in China — is almost completely driven by exports (about 80 % of the Chinese production is exported). The EC has calculated that 80 % of these exports are shipped to the EU, and 10 % sold in the US.⁸⁸ The chart below clearly illustrates the dramatic rise of the sector.

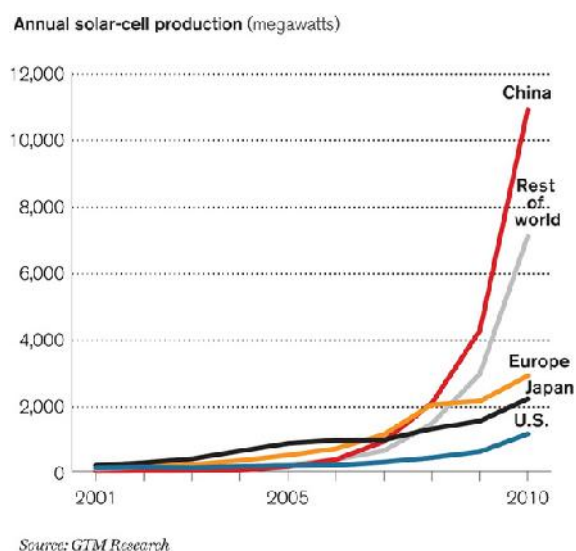
⁸⁵ Legislative Observatory, [Reform of the EU GSP Schemes](#) (recapitulative table). For more details on the proposed reform please refer to the DG Expo Policy Department briefing entitled [The Reform of the EU GSP Scheme: an early impact assessment](#) (August 2011)

⁸⁶ European Commission; [Anti-dumping, Anti-subsidy, Safeguards, the first month of 2014](#) (March 2014).

⁸⁷ Global Trade Alert. [EU-China](#) (29 March 2014)

⁸⁸ European Commission, [EU initiates anti-dumping investigation on solar panel imports from China](#) (6 September 2012). (See also [factsheet](#) on the parallel CVD investigation).

Figure 19:
PRC: annual production of solar-cells



The decision by the EC to open an investigation against Chinese solar panels was not a surprise. European producers (mostly located in Germany) had repeatedly complained about the aggressive commercial practices that allowed Chinese competitors to conquer the EU and US markets in only few years. In November 2012, the US Department of Commerce and International Trade Commission ended a similar investigation by imposing heavy AD and CVD duties on Chinese solar panels exported to the US⁸⁹.

On 4 June 2013, the European Commission announced its decision to impose provisional anti-dumping duties on imports of solar panels (including cells and wafers) from China. Following a rarely used phase-in approach, the initial duty was set at 11.8 % until 6 August 2013. After that date they were to increase to a prohibitive 47.6 % ad valorem⁹⁰.

On 27 July 2013, the Commission announced that it had reached an agreement with China allowing Chinese solar panels to enter free of duties if exporting companies accepted a price undertaking^{91 92}.

The solar AD case ended with a price modulation which was welcomed by Chinese

The definitive AD and CVD measures that were imposed on 2 December 2013 do not differ substantially from the Commission's provisional

⁸⁹ DG Expo Policy Department, '[Duel in the sun: The US imposes punitive antidumping duties on Chinese solar panels](#)' (Policy briefing May 2012).

See also US International Trade Commission, '[Crystalline Silicon Photovoltaic Cells and Modules from China](#)' (November 2012).

⁹⁰ European Commission, '[EU imposes provisional anti-dumping tariffs on Chinese solar panels](#)', 4 June 2013.

⁹¹ Price undertakings are a form of an amicable solution in trade defence proceedings permitted by the WTO and EU laws. It is an alternative form of a measure: a duty is replaced by a price undertaking based on a minimum import price. Exporting companies accepting the price-undertaking are subject to its terms and notably avoid exporting below a commonly set 'minimum price'. In return companies are exempted from the anti-dumping duties.

⁹² European Commission, '[Commissioner De Gucht: "We found an amicable solution in the EU-China solar panels case that will lead to a new market equilibrium at sustainable prices"](#)' (27 July 2013).

producers.

findings. Beijing apparently appreciated the compromise found with the EU, as it ended the AD measures it had imposed on imported European wine.

5.2. Market economy status (MES)

China's lack of market economy status (MES) is one of the country's principal points of contention with the EU. China's WTO accession protocol allows WTO members to treat China as a 'nonmarket economy' until 2016. This applies only to anti-dumping investigations, and often makes it easier for the EU to impose duties and apply higher anti-dumping rates.

Despite progress, China is still not ready for market economy status.

A bilateral process was initiated by the EU to examine whether changes in China's economy allow for MES status to be granted before 2016. This process demonstrated that many aspects of the Chinese economy remain under state control and that the country therefore does not qualify for MES status.

To be considered a 'market economy', a country must have a floating exchange rate, a free market, a non-intrusive government, effective business accounting standards and, lastly, a clear definition of property rights and bankruptcy laws.

In a 2011 report, the Commission concluded that China had only fulfilled one of the five criteria required by the EU to gain MES status — the 'absence of barter trade and absence of state-induced distortions in the operations of enterprises linked to privatisation'. Since the Commission's report was published two years ago, China has made no appreciable progress in the other areas.

Market economy status issue is considered by China to be an obstacle in a development of EU-China commercial relations.

Yet China has often criticised the EU's persistent refusal to recognise the country as a full-fledged market economy. Beijing considers this issue a serious obstacle to the development of closer commercial relations with Europe.

The market status of Vietnam is relevant to that of China. Vietnam recently announced that the EU may be ready to grant the country MES status in the context of on-going FTA negotiations, which are expected to conclude in late 2014⁹³. This could pave the way to reconsidering China's MES status. The Commission only has the right to propose that countries obtain MES status; the final decision must be taken by the EP and Council under ordinary legislative procedure.

⁹³ Vietnam Briefing, [Vietnam-EU Free Trade Agreement Expected by Late 2014](#) (18 November 2013)

6. WTO dispute settlement cases

6.1. Offensive cases

6.1.1. DS 425 China – Definitive anti-dumping duties on x-ray security inspection equipment from the EU (Procedural stage: panel)

On 25 July 2011, the EU requested consultations on China's definitive antidumping duties on x-ray security inspection equipment. The EU argued that these measures did not comply with the WTO Agreement on Anti-Dumping.

Consultations took place on 19 September 2011 in Geneva. On 9 December 2011, the EU requested the establishment of a panel for the case. The panel was established at the 20 January 2012 meeting of the Dispute Settlement Body (DSB). India, Japan, Norway, Thailand, Chile and the United States reserved their third-party rights.

On 26 February 2013, the WTO Panel found that China's anti-dumping measures were in breach of WTO rules on three grounds: (a) China did not apply a WTO-consistent methodology in analysing the effects of EU exports on prices of X-ray security scanners in China's domestic market; (b) China's assessment of injury caused to its domestic X-ray security scanners producers was flawed; (c) the Chinese investigators failed to respect certain procedural requirements, notably related to the transparency and motivation of decisions⁹⁴.

On 26 February 2013, the panel report was circulated to WTO Members. The panel found that China violated WTO rules in all aspects of the investigation challenged by the EU (price effects analysis, injury determination and causality and transparency claims), including crucial aspects of China's assessment that determined the imposition of the duties. While the panel rejected a limited number of EU claims and exercised judicial economy regarding certain other claims, the outcome was clearly positive to the EU.

China did not appeal the report, which was consequently adopted by the DSB on 24 April 2013. At the following DSB meeting (24 May 2013), China asked for a reasonable period of time to implement the recommendations and rulings.

On 19 July 2013, China and the EU agreed that the reasonable period of time to implement the DSB's recommendations and rulings would be 9 months and 25 days. This expired on 19 February 2014.

The EU attacked Chinese AD measures on X-ray security inspection component.

The WTO panel found that China breached WTO rules and asked Beijing to implement its decision.

⁹⁴ European Commission, [Q&As: China's anti-dumping duties on X-ray security scanners from the EU found illegal by WTO panel](#) (reference memo 13/137 du 26 February 2013)

6.1.2. DS 432 China – Measures related to the exportation of rare earths, tungsten, and molybdenum (Procedural stage: panel)

On 13 March 2012, the EU, the US and Japan jointly requested consultations with China on Beijing's export restrictions on various forms of rare earths, as well as tungsten and molybdenum. The restrictions are chiefly export duties, export quotas, a minimum export price system and requirements and procedures linked to quota administration and licensing.

The EU attacked Chinese measures limiting exports of rare earths from China.

According to the European Commission, Chinese export restrictions on rare earths are in breach of the 1947 General Agreement on Tariffs and Trade (GATT) and the commitments contained in China's Protocol on Accession to the WTO. The EU alleged that the Chinese measures were in particular in breach with Articles VII, VIII, X and XI of the General Agreement on Tariffs and Trade (the 1994 update to the GATT) and that they were inconsistent with China's obligations under Part I of the country's accession protocol to the WTO (2001)⁹⁵.

Consultations took place in April 2012 in Geneva but did not lead to progress. As a result, on 27 June 2012 the EU, together with the US and Japan, requested the establishment of a WTO Panel. The Panel was established in September 2012.

The Panel report found that China acted incompatibly with its obligation.

On 26 March 2014, the Panel report was circulated to WTO members. The report concluded that Beijing had breached international trade rules by applying restrictions on its exports of various forms of rare earths, tungsten and molybdenum. The WTO panel essentially upheld the EU's and other complainants' allegations and dismissed most of China's arguments. According to the panel, 'the overall effect of the foreign and domestic restrictions is to encourage domestic extraction and secure preferential use of those materials by Chinese manufacturers'.

The WTO ruling is not definitive, and China has 60 days to appeal.

6.2. Defensive cases

6.2.1. DS 397 – EC – Definitive anti-dumping measures on certain iron or steel fasteners from China (Procedural stage: compliance panel)

China attacked certain EU AD practices on treatment of non-market economies.

This case, which Beijing brought against the EU, was the first offensive case against the Union since China joined the WTO in 2001. At stake are various aspects of EU anti-dumping practice — in particular, Article 9(5), the provision in the EU Basic Anti-Dumping Regulation on the 'individual treatment' of exporters from non-market economy countries. China has also criticised other technical aspects of the EU's anti-dumping investigation.

⁹⁵ See reference at [GATT 1994](#), China's [Protocol of Accession](#) to the WTO (2001)

Both the WTO Panel and Appellate Body ruled (at least partly) against the EU. While both courts found that alleged violations of WTO law did not undermine the general soundness of the anti-dumping measure, they also concluded that the EU's 'individual treatment' procedure was in breach of WTO law, because it subordinates the determination of individual dumping margins and the imposition of individual antidumping duties to the fulfilment of an 'Individual Treatment Test'.

The EU duly accepted the WTO ruling. On 19 January 2012, the European Union and China agreed that a reasonable period of time for implementing the DSB recommendations and rulings would be 14 months and two weeks from the date the DSB adopted the report, which meant the period expired on 12 October 2012.

The case was lost by the EU and is still in its compliance phase.

On 30 October 2013, China requested consultations with the European Union pursuant to Articles 21.5 and 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes, claiming that the EU had failed to ensure the full implementation of the DSB recommendations and rulings in this dispute. The EU accepted China's request for consultations.

On 5 December 2013, China also requested the establishment of a compliance panel. The DSB established this panel on 18 December 2013.