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The EU and China: trade and investment in the global economy

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Ladies and gentlemen,

Thank you to the China-Britain Business Council and to the British Chamber of Commerce in China for bringing us here today.

It's always a good time to discuss China.

- It's the world's third largest economy after the European Union and the United States.
- It's the EU's second largest trade partner, and the UK's second largest partner outside of the EU.
- It's a major investment partner too. The EU has stocks of 117 billion pound sterling in the Chinese economy. And China is a growing source of foreign investment for the EU. Chinese investment in EU in 2014 is four times what it was in 2008.
- And, if we just look at our exports alone, over 3 million jobs here in Europe depend on our sales in China.

But if it's always a good time to talk about China, it's even more important to talk about it right now.

That's because we seem to be at an inflection point in China's development.

For three and half decades, China grew breathtakingly fast. That growth brought hundreds of millions of people out of poverty. It reshaped vast sectors of the world economy. And it brought China back to global politics.

But the Chinese economic miracle was based on a specific model of development:

- Abundant low-cost labour…
- State-led investment in infrastructure…
- Growth based on exports
- And a financial system geared to support state-owned enterprises.

Today we are seeing some elements of that model reach its limits.

This is of course something economists have been arguing about for years.

But one doesn't have to be a pessimist about China's future - and I am not - to see that things have changed.

Let me be clear, I am not saying that a slowdown is a problem. In fact in some ways it shows the government's policy towards an economy based on consumption and less on exports and investment is working.

This new model of growth is required to move to the next stage of economic development. And that change actually implies slower growth.

Development economists will tell you that productivity increases are much faster when you apply existing technologies developed elsewhere.

But once you reach today's technological frontier, productivity requires innovation, which is slower by definition. But that is what is needed if progress it to happen.

So if growth is slower now it's an indication that this transformation is happening.

China has chosen this path. President Xi calls it the 'new normal' of more measured growth and structural reform.

There is always a risk of unintended consequences. And that's part of the explanation for the recent instability on China's financial markets and in global commodity markets

The question is about the ability – and confidence – of the government to react to situations and many other short term challenges that slower growth implies.

In an atmosphere of uncertainty, many people will be tempted to go back to the old ways of pump priming the economy, and exporting the problems like overcapacity or deflation to partners like the European Union.

Sticking to the new path of reform is much more challenging.

We can see that fact clearly in the record of the reforms. Unfortunately it's quite limited.

Projects to open markets have made relatively limited progress. In some cases they have been completely abandoned. And in some unfortunate cases, China has even taken worrying steps backwards.

This can be seen in new laws on national security reviews and non-governmental organisations and in initiatives on cybersecurity.

In the same context, I am worried about the step backs in human rights, now affecting the business climate too.

We have recently witnessed cases of European citizens - a Swedish national arrested in Beijing in January, or a British bookseller who disappeared from Hong Kong end of last year - without respect for the rule of law or international and human rights conventions. This is creating doubts and concern among foreign business travelling and operating in China. Similarly for Chinese lawyers who face all kind of obstacles to operate freely and independently, and who are necessary to supporting the work of foreign business and citizens.

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The way ahead is continue with reforms. Postponement only means delaying the problem and more uncertainty, in China and the global markets.

And not just for China's own economy, but for its vital relationship with the world, including the European Union.

Even a reformed Chinese economy will be dependent on international trade with Europe. Services and investment outflows will grow even as goods production is reoriented towards domestic consumption.

From the EU's perspective the relationship is also vital. We want to see a reformed China with a level playing field for our companies.

We also have a major interest in a smoothly managed economic transition and tackling some urgent issues, let me address four of these:

First, **steel**, the biggest issue in EU-China trade relations today. The current massive overcapacity is simply unsustainable. That's why the EU is doing everything we can to address this issue.

In January I wrote to the Chinese Minister of Commerce, Minister Gao to express my concern and urge him to address overcapacity. And we are continuing to press the case in all other fora.

We are also using the trade defence system, within the law and where it is justified, to help level the playing field. The EU now has 37 trade defence measures in place on imports of steel products, while nine investigations are still ongoing. We have also made clear to the industry that we are willing to move expeditiously on any justified new cases we receive.

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The second issue I want to raise is the question of changing the methodology in anti-dumping investigations concerning Chinese products, the so-called **market economy status.**

This is a sensitive issue. And it's become even more so with the steel situation. That's why the EU is conducting a thorough impact assessment and public consultation before we make up our minds on where to go.

But what is clear is that certain provisions of China's protocol of accession to the WTO related to this issue will expire in December.

We need to be very careful how we approach this and we need to work cooperatively. We will need the constructive engagement of all Member States, including the UK.

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These are two difficult questions, which put the emphasis on the difficulties in our relationship with China.
But let me move to more positive territory: the ongoing negotiations for an EU-China bilateral investment agreement.

An **investment agreement** is in both sides' interest.

- European investors would have better access to the Chinese market and their Chinese counterparts would be more encouraged to invest in Europe.

- Companies operating in both Europe and China would be able to operate on a more level playing field – no matter what their origin or ownership structure.

- A single, modern agreement would replace the existing 26 bilateral investment treaties that currently apply, increasing legal certainty.

- And this new approach would also improve the balance between investment protection, sustainable development and the right of states to regulate in the public interest, while addressing the functioning of state-owned enterprises.

I'm happy to say that an ambitious agreement like this is within reach. At the last EU-China summit, we agreed to speed up the negotiations.

If we do succeed in finding agreement, it begs the question of what happens next for the EU China relationship.

Many of you will be aware that China has been proposing a free trade agreement for several years now.

The EU takes that request seriously. But we believe two conditions must be met before any next step:

- A good outcome on the investment negotiations. This will show China is committed to the kind of ambitious trade and investment agreements that the European Union negotiates.

- And progress on China's internal reforms, most importantly the goal of giving the market a more decisive role. Signing up to a European-style FTA would mean making real changes. The state would need to be a regulator not an economic operator; allow inefficient companies to go bankrupt, and make adjustments to reduce overcapacity.

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My fourth and final example is also a positive one. As two of the world's largest economic powers, the EU and China have a responsibility to work together on the international stage.

The successful outcomes of the Paris conference on Climate Change and the **World Trade Organisation's** 10th Ministerial Conference in Nairobi last year showed that this is possible.

The ambitious WTO deal on export subsidies in agriculture, which will do much to help some of the world's poorest people, involved work by both the EU and China.

The same can be said for the updated and expanded deal on information technology equipment that was also finalised during our time in the Kenyan capital.

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

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Ladies and gentlemen,

I know that for this audience it's obvious that the relationship between Britain and China and the European Union and China is vital.

And I'm sure you also deeply understand that it is a challenging one.

What we need to address these challenges is both firmness on core principles and a spirit of cooperation.

That's what I try to bring to my contacts with China. I hope we can count on your support in those efforts as well.

Thank you.