

European Business in China

POSITION PAPER 2016/2017

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Reform Promises

While previous plenums had described the market as having a ‘basic role’ in the economy, the ***Decision of the Third Plenum*** in 2013 stated that:

"The focus of the restructuring of the economic system... is to allow the market to play a ‘**decisive role**’ in the allocation of resources."

Key Takeaways

1. 13FYP and China Manufacturing 2025 must be driven by **market forces**, not government intervention.
2. With the reform agenda stalled, the *Decision* needs to be '**dusted off**'.
3. Increased Chinese investment into Europe, while European investment in China drops, highlights the lack of **reciprocity** in market access.
4. The **EU-China Comprehensive Agreement on Investment (CAI)** should be finalised in 2017.

Bigger Government Role in 13FYP

- Larger role carved out for the Chinese Government in the economy is unexpected.
- It is no longer clear that reform is still a top priority.
- Contradictions in SOE reform agenda are increasingly stark.
- ‘Indigenous innovation’ is mentioned six times in the plan, up from four times in the 12FYP.

The view of Chinese private business

China lacks advanced manufacturing because "the government has interfered, even in management, which should be left to market mechanisms".

—**Zhao Weiguo**, CEO of chipmaker **Tsinghua Unigroup**

“We hope that government will reduce the introduction of some subsidies. Such stimulus and subsidy policies will eventually lead to insufficient market competition. It should therefore instead depend on the power of the market to force enterprises to transition.”

—**Fang Hongbao**, Chairman of **Midea**

35-year plan to win at football...

- It shall tackle “China’s defective [football] system”.
- Mid- and long-term plans developed by government, targets set for 2016-2050 and major funds spent.
- Creating the right environment for talent to develop vs. trying to dictate how and where it happens.
- Europe’s success in football in part due to its open system, as seen in the number of players with immigrant backgrounds.

...and innovation as well

- China Manufacturing 2025 is also driven by government and has set hard targets, including for market share.
- Government can facilitate and support innovation but cannot control it, especially through SOEs.
- Will the ‘Strategic Emerging Industries’ replicate the overcapacity stories of the past Green Technologies?
- Will European business be able to participate, or will the focus be on ‘indigenous innovation’?

Decision needs to be ‘dusted off’

- President Xi described the move to establish the market as the decisive force in the economy as a “**theoretical breakthrough**” of the *Decision*.
- Develop a correct understanding of market-government relations: help the country transform its economic growth pattern and the government to change its functions.
- The *Decision* presented a blueprint, but a **roadmap** with proper sequencing of reforms is needed.

Money talks

- Expansion of private investment has fallen from 10.1% in 2015, to 2.8% in H1 2016.
- Expansion of investment by SOEs has leaped from 10.9% in 2015, to 23.5% in H1 2016.
- In May 2016, a *People's Daily* article outlined why the status quo can't continue.
- OECD 2015 ranking on 'stringency of environment for foreign investment' places China 58th out of 59.
- World Bank ranks China in 84th place in terms of the ease of doing business.

The lack of reciprocity

- China's investment in Europe is growing by leaps and bounds, SOEs are 70% of all investors.
- China's outbound investment may double again during the period 2016-2020.
- In Europe, Chinese investors seems to be focused on industries outlined as priorities in China Manufacturing 2025.
- The current lack of reciprocity in market access is politically unsustainable.

Europe prevented from making similar investments in China

Pirelli - *tyres*

- Purchased by the SOE ChemChina in 2015.
- Italy's Economic Development Minister stated that Rome had "no right to intervene".

Kuka - *robotics*

- Purchased by Midea in mid 2016.
- Permitted in spite of its relevance to Germany's Industry 4.0.

Major investments in infrastructure: Toulouse Airport, Greek Port of Piraeus and the Portuguese power grid

- European business is prevented from acquiring 'Famous Chinese brands'

Europe expects reciprocity

“The EU welcomes productive Chinese investment in Europe provided it is in line with EU law and regulations. In return, the EU expects improved market access for foreign companies in China and a level playing field for business and investments.”

—*Elements for a new EU Strategy on China*, July 2016

If we are open, "it must be possible to find good solutions in China too. We do, of course, expect reciprocity from the Chinese side.“

—German Chancellor Angela Merkel, July 2016

China's struggle to become a market economy

- For the sake of mutual prosperity, European business needs China to succeed.
- Providing reciprocity in market access will help China to reach goals outlined in 13FYP.
- The CAI should be completed before the European Chamber publishes its next *Position Paper* in 2017.
- When market forces are permitted to operate, China's economy moves forward.

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