

China-EU economic relations in the era of US-China economic competition

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Roadmap to presentation

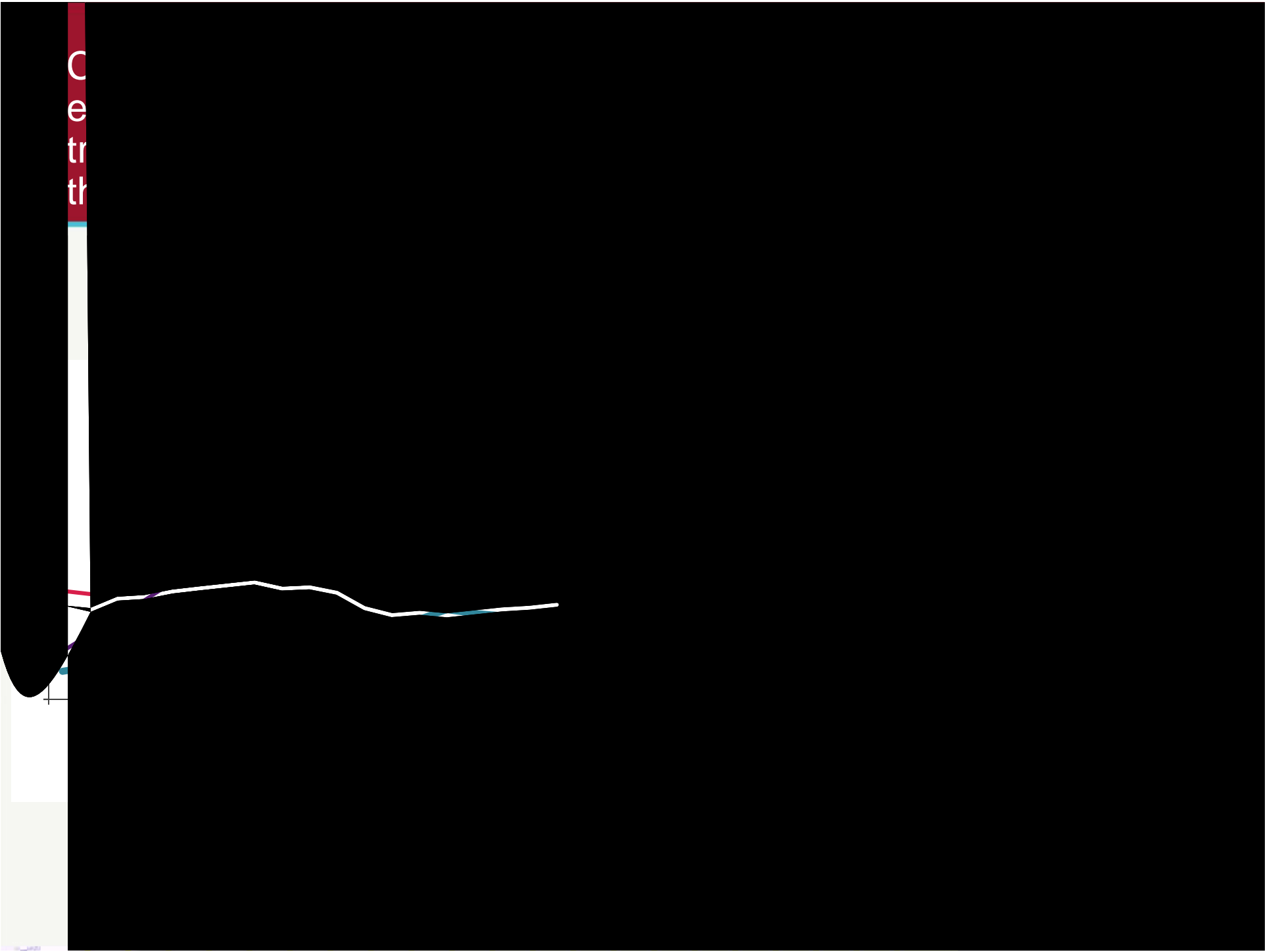
- 1. Where do we stand with our trade relations?**
- 2. Why is trade in services falling behind?**
- 3. US-China strategic competition is hurting**
- 4. For China's outward FDI, it is not about size but about objectives**
- 5. What to expect going forward**

1. Where do we stand with our trade relations?

Trade ties between EU and China has strengthened markedly



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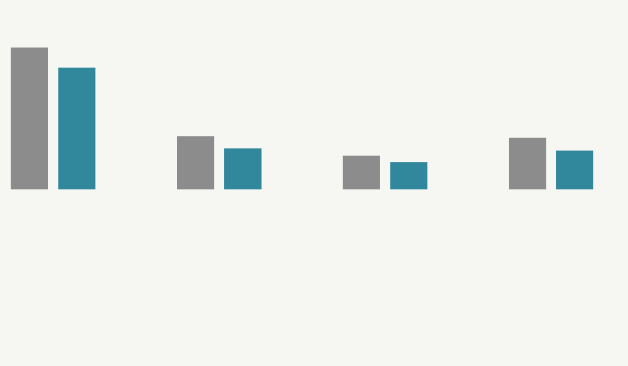


The trade deficit masks a better position for Europe in value-added terms, but the difference is shrinking rapidly as China moves up the ladder



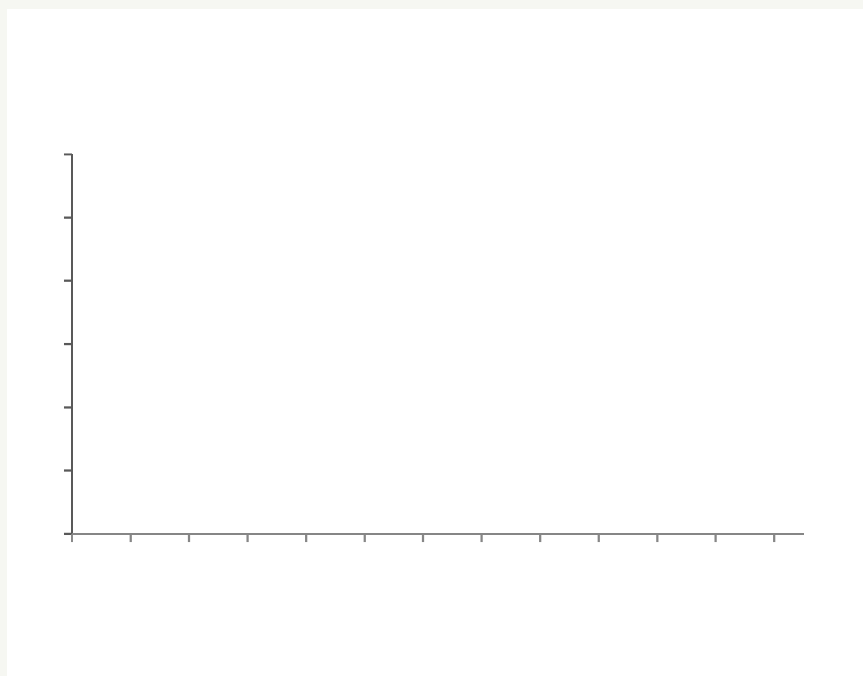
This is clearly seen in China's increasingly central role in global value chains (GVCs)

- While the size of GVCs is shrinking globally, China is losing much less ground than the European Union
- The EU's rapid decreasing size in the global value chain is also true within the single market while China's role as exporter of intermediate goods in the EU is increasingly important



2. Why is trade in services falling behind?

In contrast to trade in merchandise, China's share of trade in services remained low, even when compared to other developing economies



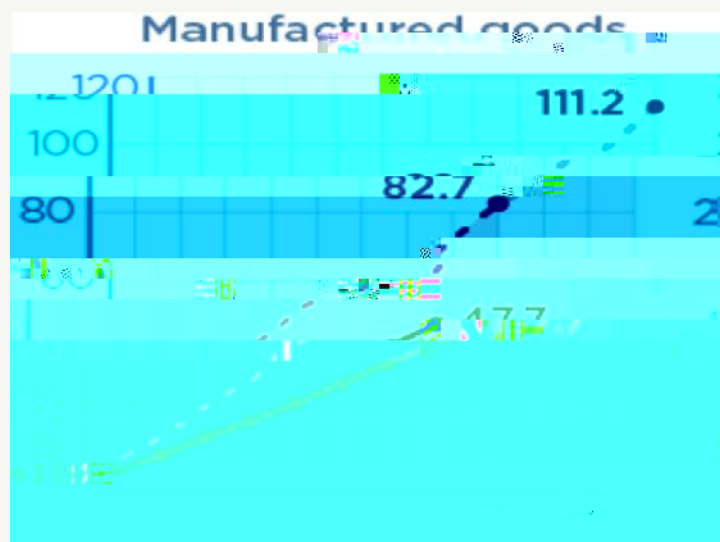
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3. US-China strategic competition is hurting

EU hurt from US-China strategic competition due to trade diversion but also decoupling

- Phase 1 deal with China's commitment to import USD 200 billion from US creates trade aversion.
 - USD 120 billion are US manufactured products which directly compete with EU (aerospace, chemicals, machinery and autos are the key sectors)

Chinese imports from US in 2020



Source:PIIE

EU gets hurt also because of tech decoupling as costs increase and also role as standard setter at risk

- Tech decoupling is by now a reality:
 - Starting with China's internet social media/google ban
 - Followed by US on hardware (5G and beyond) through entity list and sanctions.
 - More recently also software and social media (TikTok)
- All the above increasingly forcing companies into two ecosystems.
- This hampers European companies' competitive edge as they need to adopt two ecosystems without having control on either of the two.
- This also puts at risk Europe's long-standing role as global standard setter

4. For foreign direct investment, the size is very low but with clear objectives

European FDI into China has been stagnating for years and heavily concentrated in manufacturing, especially autos



There are economic as well as non-economic challenges for the EU companies not to increase their FDI in China

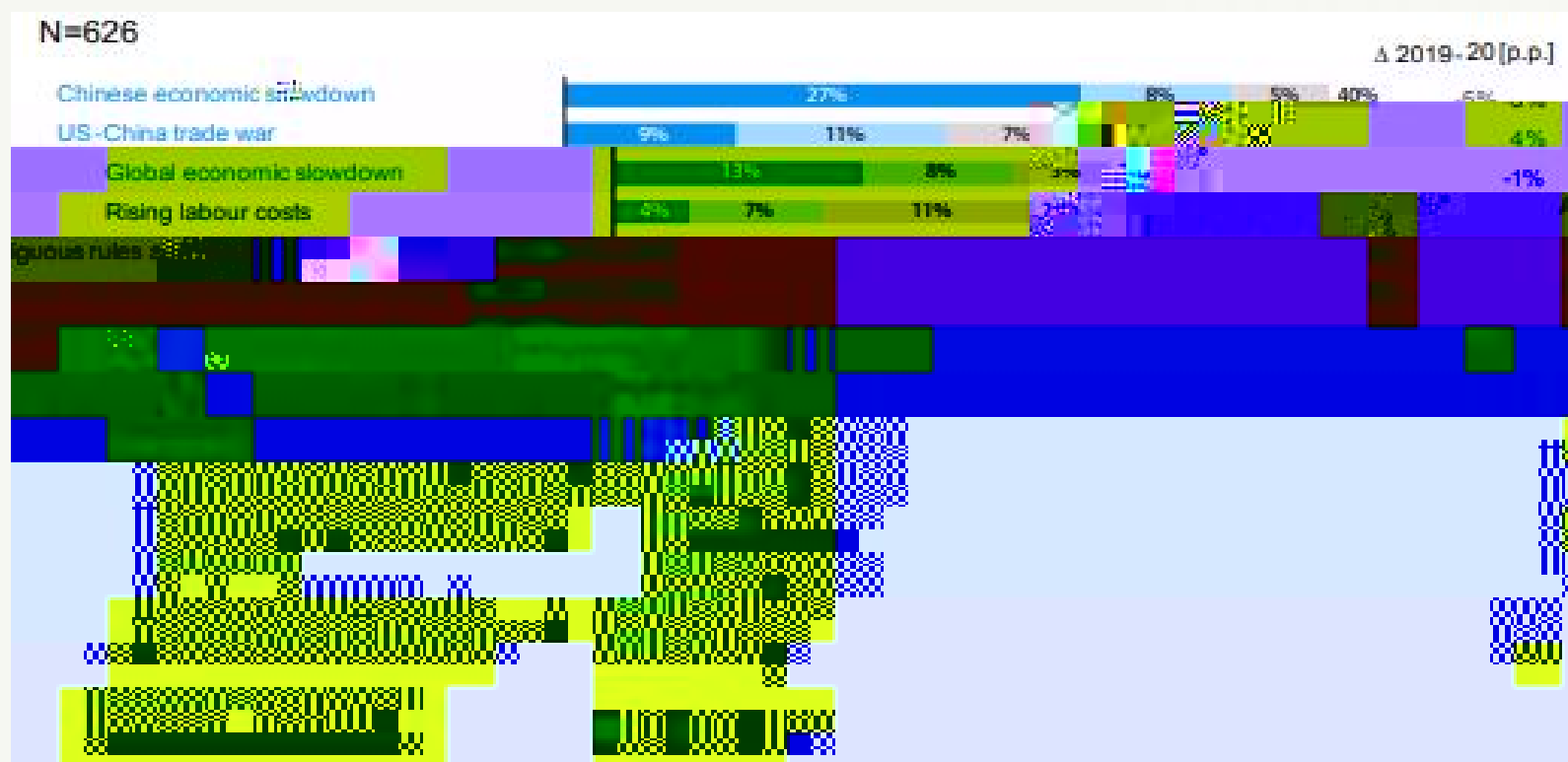
- **Economic factors**

- *Rising labor costs*
- *Competition with local companies*

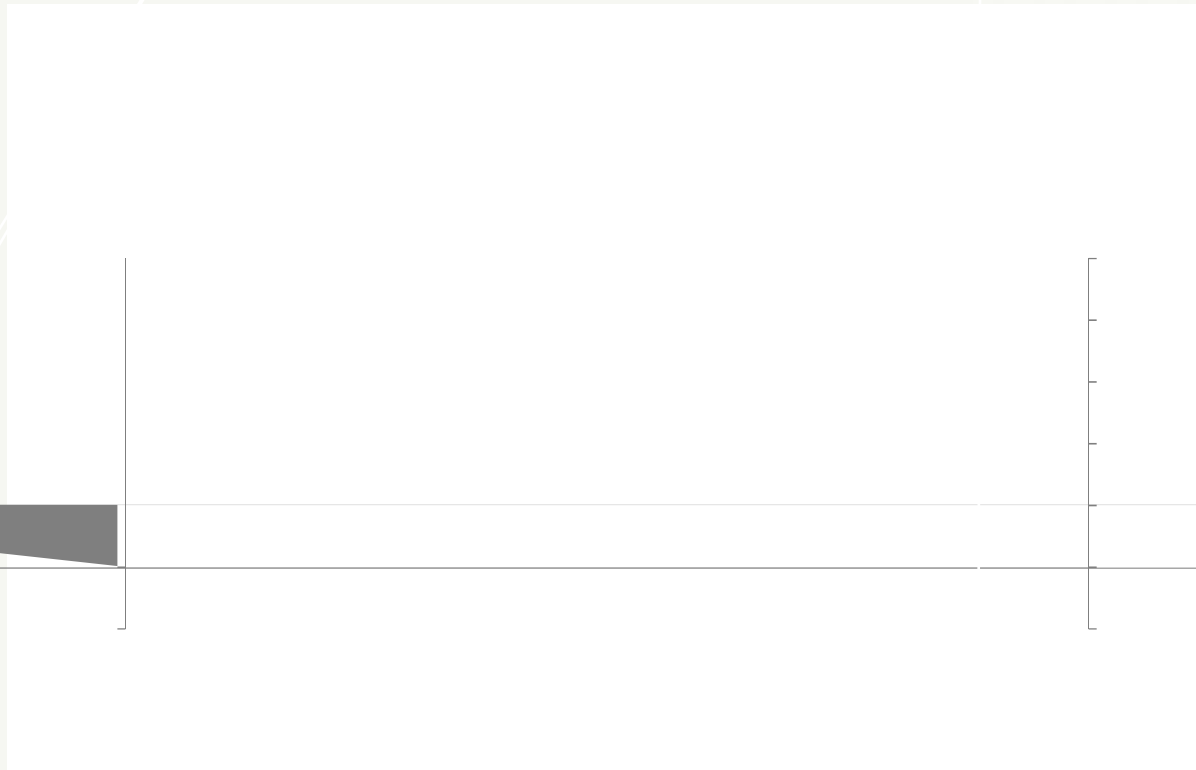
- **Non-economic factors**

- *Institutional inefficiency*
- *The US-China trade war*

Table: Macroeconomic challenges lie ahead for EU companies (from EU chamber of Commerce)



China has been pushing for more investment in the EU but the size remains very small according to both China and the EU's statistics



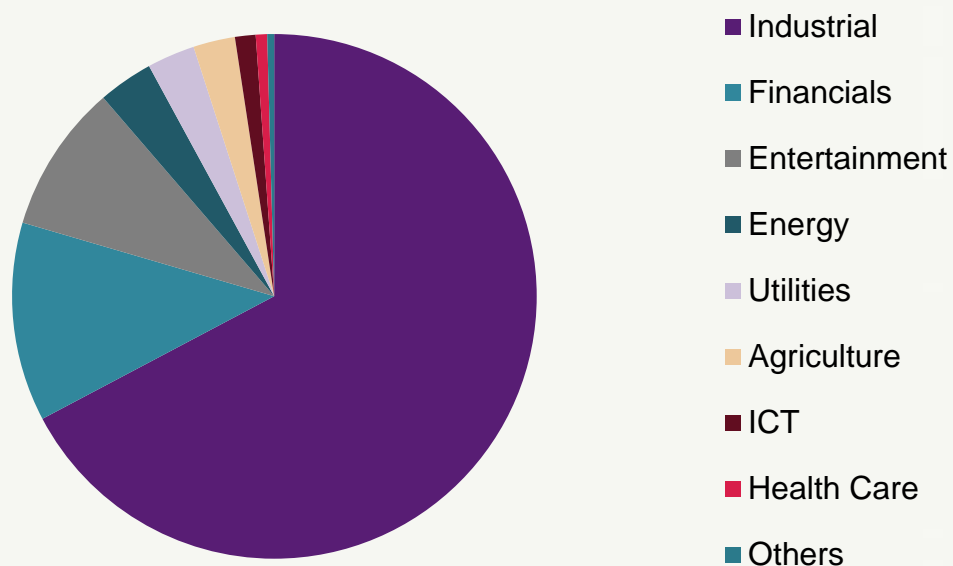
The EU has been a significant destination for Chinese investors, but the momentum faded, at least temporarily, since

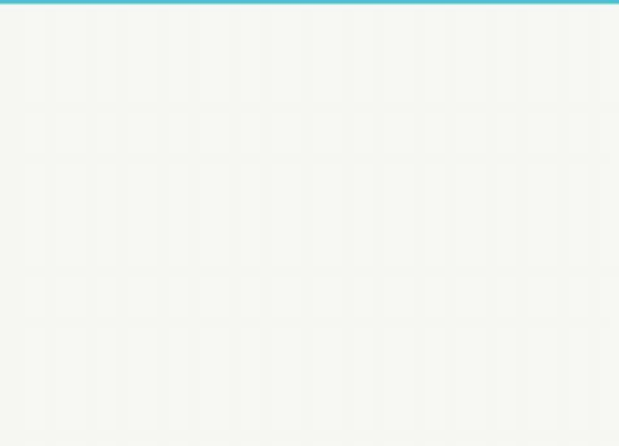
But Chinese companies has kept its interest in accessing the smaller-sized deals in the EU

Source: Mergermarket, AEI, NATIXIS

But most of the deals are going to high-value added sectors, especially industrial one (robotics, etc)

Sectoral distribution of China's overseas M&As in EU since 2018



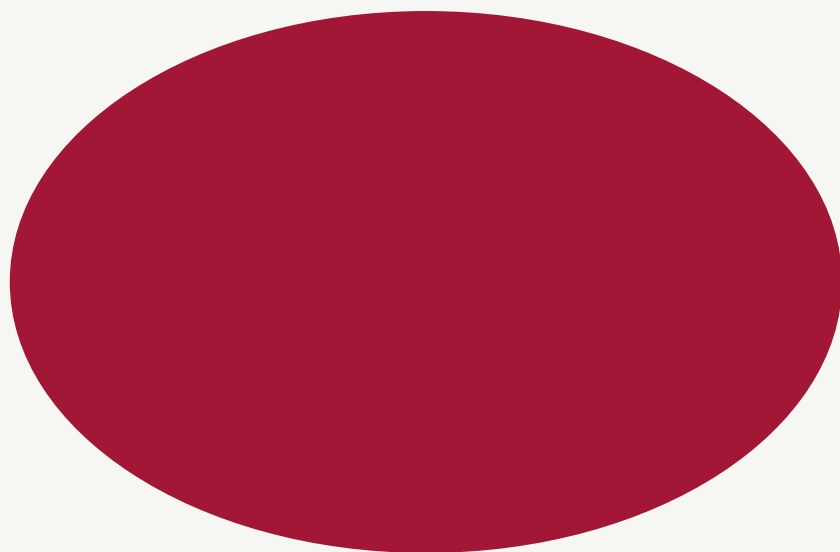
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5. What to expect going forward

China in a new era: What does it mean for EU-China economic relations

- China is moving into its 14th Five Year Plan with self reliance in mind: dual circulation
- Two main reasons for this:
 1. A hostile and more protectionist external environment;
 2. Readiness to move up the ladder in terms of achievements in innovation and human capital as well as value added in production
- Improved economic relations with Europe are important but not essential
 - The key bottleneck for China to move up the ladder is the semiconductor industry and EU does not rank highest on that (US, Taiwan and South Korea are much more important)
 - Reaching a deal for the Comprehensive agreement on investment (CAI) is especially important as a signal to the US

Should the EU go for CAI by year end?: It is all about how far we are in our economic models



What to do?

- It's not only an investment treaty, but a coordination and reciprocity of two growth models
- China needs to
 - Move from a ***Foreign Investment Law*** to a more fair and united ***Company law***
 - Quantify its subsidies to Chinese companies before going for negotiation, preparing for more equal treatment of every market participant
 - Narrow negative list to make it reciprocal to the foreign inventors
- The EU needs to
 - A transparent and reciprocal EU-version investment screening framework
 - The complement of the competition policy to pre-entry checks
 - Push for multilateral solutions to coordinate between China and the US