OPPORTUNITIES AND CHALLENGES OF THE EUROPEAN BUSINESSES IN CHINA

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Both the EU and China stand to gain from our trade and economic partnership. If we are to recognise its full potential, closing Europe's doors to Chinese competition is not the answer. But to build and maintain political support for openness towards China, the benefits of engagement must be fully realised in Europe. China should open its own markets and ensure conditions of fair market competition. Adjusting to the competitive challenge and driving a fair bargain with China will be the central challenge of EU trade policy in the decade to come. A closer, stronger strategic partnership is in the EU's and China's interests. But with this comes an increase in responsibilities, and a need for openness which will require concerted action by both sides.

Key-words: fair competition, transparency, commercial policy, dialogue, partnership

EU and China – diversity and cooperation

China and Europe both have very diverse regions, with significant income disparities, which they are working to integrate fully as part of their respective 'single' markets. The EU has been largely successful in promoting regional convergence over the last 20 years, through policies such as: dedicated investments in trans-European infrastructure to reduce the effects of distance and regional exclusion; the development of human capital through investment in regionally-targeted training; and the promotion of innovation and research and development in underdeveloped areas. The recent inclusion of ten new member states in the EU has brought new challenges in terms of convergence and integration. Meanwhile, the Chinese government is making considerable efforts to narrow the growing divide between its coastal east and interior west through its "Go West" development plan and major projects to extend infrastructure into western regions. There are opportunities for mutual learning as both economies work towards regional cohesion.

Europe's social welfare structures vary across the region in terms of form and impact – while some have stifled entrepreneurship and job creation, others such as the Nordic model have demonstrated that it is possible to combine social protection with incentives for innovation, employment creation and productivity. However, demographic and global forces are rendering some of these models unsustainable. At the same time, China's shift toward a market economy is leading to the dismantling of its legacy state-guaranteed social support structures. In redesigning their respective welfare systems, both China and Europe can look to learn from each other's experiences.

European companies have invested 4.5 billion euros on average each year over the last six years in additon to the transfer of know-how and state-of-the-art-technology. A number of Multinational Corporations have partnered with Chinese counterparts and established Research and Development bases in China, introducing new management techniques and play an important role in training the next generation of Chinese business executives and engineers.

Moreover, the enhanced dialogue between the European Comission and the Chinese Government is having a very positive influence to the European business in China.

China's integration into the global trading and investment system has been beneficial for both Europe and for China. The EU represents more than 19% of China's external trade. European companies trading in China have brought capital goods, knowledge and technology that have helped China develop its productive capacity. Reciprocally, trade with China helps to promote growth and jobs in Europe through increasing exports, continuing specialisation in high-value products and services and strengthening the global competitiveness of EU companies.

Investments in China have allowed EU firms to remain competitive by gaining access to lower-cost inputs. A significant part of the value added of products "made in China" accrues to European companies. It has also helped European business maintain jobs and viable economic activities in the EU such as research, design, marketing, global management and complex manufacturing. Some investments in China have allowed EU firms to gain market share in the China market and supported our exports.

Strategic Considerations for CE Companies

Increased government efforts to combat corruption in the Chinese economy could have both positive and negative implications for foreign CE producers. As a positive matter, increased transparency and decreased corruption could help reduce operational risks that foreign companies bear when their subsidiaries or affiliated companies have to operate in a commercial environment in which corruption is not only accepted, but also expected.

In other words, in the long-run, Chinese government achievements in reducing corruption will be helpful for foreign companies – it will help companies compete on an even playing field (since competitors will not be able to obtain contracts through illicit payments); it will increase transparency in governmental dealings; and it will help these companies manage regulatory risk and ensure proper internal controls. Conversely, government enforcement efforts also could increase pressure on businesses, especially those companies that have not established rigorous internal control systems regarding corrupt practices. If Chinese government investigators and prosecutors begin to target specific foreign producers, the short-term effects of this initiative would likely be challenging for companies who have not yet developed anti-corruption and local law compliance programs.

It is widely reported that U.S. companies across numerous sectors use Chinese distributors to perform certain negotiating activities with governmental officials.However, U.S. companies are accountable for any illicit activity engaged in by third parties on their behalf under U.S. law, even when the U.S. companies are unaware of the illicit activity. U.S. producers must be particularly careful to develop internal controls and compliance programs that ensure against violations of the Foreign Corrupt Practices Act (FCPA), whether in the form of improper payments or through failure to maintain adequate books and records.

Although enforcement has not historically been consistent, the potential sanctions for violation of anti-bribery provisions can be very difficult in China including imposition of the death penalty or incarceration against individuals, imposition of onerous fines, and the cancellation of various types of professional licenses and product certifications. Also, given that Western countries are pressuring China to reduce corruption, it would not be surprising for Chinese officials to target a Western company to demonstrate its “commitment” to fighting corruption.

Opportunities for EU businesses

The evolution of EU-China trade reflects the evolution in overall EU trade with emerging economies. While the latter, and China in particular, are making significant gains in some segments of high technology products (such as laptop computers, mobile phones and DVD players), the EU is strengthening its specialisation in high-quality products in preference to low- and middle-quality goods.Commission studies indicate that the expansion of the Chinese market will continue to bring important benefits to EU operators. Although Chinese companies will become competitive in more market segments (for example in basic chemicals or some types of vehicles), other segments will expand rapidly (for example, specialty chemicals, demand for capital-intensive car components) offering new opportunities to EU operators.

The EU is particularly strong in exports of machinery and vehicles which account for two thirds of all EU's goods exports and one third of all Chinese imports of machinery. EU exports to China of chemicals have doubled in the last five years, making China the EU's second export market. The EU market share in China in 2005 was 16% - similar to that in Japan and ASEAN countries but lower than its market share in the USA (20%), India (21%) or in Brazil (31%). There is potential to increase EU market share in line with EU performance in other markets. As China develops, its demand for high-end branded European consumer products will increase.

In order to succeed, EU operators will need to develop a more thorough knowledge of the Chinese market and play on their comparative advantage. Europe’s chief assets in its trade relationship with China are innovation, specialisation, quality, related services and brand identity. High unit labour costs are not necessarily an impediment to export success: the strongest performing European exporters to China have some of the highest labour costs in Europe.

While Chinese tariffs have gone down significantly as a result of China's WTO accession, EU exports still face a number of tariff and non-tariff barriers to trade and restrictions on investment in manufacturing and in services. In the course of WTO accession China's tariffs were reduced to an average of 8.8% for non-agricultural products. However, China has maintained a number of tariff peaks in some industries of particular importance for the EU such as textiles and clothing, leather and fur, footwear, ceramics, steel and vehicles.

European exporters and investors are facing an increasing number of unjustifiable non-tariff barriers in the form of product certification, labeling standards, import approval requirements and customs clearance delays. The application of laws is often not uniform and regional variations in customs procedures have a negative impact on trade. Unreasonable sanitary and health requirements can create barriers that hamper exports to China, in particular for agricultural products. Chinese national standards often differ significantly from international standards. This results in high compliance costs and extended delays for business which impact on their ability to sell on the China market, affecting in particular EU small and medium-sized enterprises.

China committed itself to opening its procurement market and acceding to the multilateral Government Procurement Agreement as soon as possible after its accession to the WTO. The accession negotiations has just begun in 2008. However, many procurement markets remain closed to European businesses. In some sectors, technology transfers have been made a condition for foreign companies to participate in international bids.

In key sectors such as automobiles, steel, semiconductors or shipbuilding, new policies are emerging which appear to be based on a 'China first approach' contrary to the non-discriminatory principles of the WTO. In a number of industries China has been imposing local content requirements, either through direct legislation or investment authorisation, limiting EU exports and unfairly aiding local industry. There is a growing risk that competition policy will be used against foreign operators and that the lack of independence or transparency of many regulators results in decisions favouring Chinese operators.

In the manufacturing and services sectors European investors are still prevented from setting up wholly owned foreign enterprises and are required to establish joint ventures with Chinese partners. In the telecoms and financial services sector, EU firms have been unable to expand significantly because of high capital requirements and complex approval procedures. In the manufacturing sector, China continues to maintain investment restrictions on some key industries for Europe such as automobiles, petrochemicals or steel.

EU companies often find themselves competing on unfair terms in China. The absence of conditions of fair market competition and inadequate legal protection pose serious problems. China's policies on the environment, social standards, currency valuation and natural resources can distort trade. The adequate protection of intellectual property rights such as patents, copyrights and trademarks is central to the exercise of Europe's comparative advantage in innovation, design and high-value production. Insufficient protection of intellectual property represents a pressing challenge for EU businesses in China. China is by far the largest source of counterfeit and pirated products seized at the EU's borders. While China has made welcome progress in setting up an intellectual property regime, loopholes remain and effective implementation and enforcement of laws remains uneven or lacking. EU companies also face an opaque and burdensome legal and judicial system that offers insufficient guarantees of legal protection of the rights of EU companies.

Demand for EU products in China is also suppressed by low domestic demand resulting from high savings as a result of limited public provision of health and social security services. Enterprises' savings are also very large and account for about half of China's savings. This both suppresses domestic demand, including for EU goods and services and ensures that the bulk of domestic production is exported.

China's regulatory regime for the protection of the environment remains incomplete and implementation on the ground inadequate or discriminatory in favour of local producers. This is contributing to the rapid deterioration of China's environment. China has also maintained restrictions on investment or imports of certain environmentally friendly products and services. Chinese companies also often fail to meet reasonable safety standards for their products; half of the alerts in Europe for dangerous non-food products are for products manufactured in China. The lower environmental, social and safety standards applied in China confer a competitive advantage to production in China.

As a conclusion, Europe should pursue a fair and robust trade policy on China. It should insist that openness benefits both Europe and China, and that an economically strong China is in Europe's interests. It cannot call for openness from China from behind walls of its own.

The EU will continue to press China to improve its record in protecting the rights of EU companies through a transparent legal and judicial system where the regulators are fully independent. In recent years the European

Commission has established a number of important economic dialogues with China that have trade implications. The Commission, the European Parliament and the Economic and Social Committee have been at the forefront of this activity. These dialogues cover issues such as intellectual property, market access, macroeconomic and financial sector issues, agriculture, competition, regulatory and industrial policy, and general product and food safety.

The EU's partnership with China should be used to draw the two economies closer together and to engage China on global issues, which is already a major beneficiary of the international trading system.

Conclusions

Even though chances to improve the business environment still exist, China represents a constant and strong opportunity for the European Business.

The openness of the Chinese Government to discuss the issues affecting European investors and the successful dialogue between the European Commission and the China is giving to the European Business in China the possibility to look optimistically to the future development of the European investments.

China's re-emergence will continue to have a major impact on every part of the global economy. It will be felt in people's daily lives, from the cost of petrol to the price we pay for our clothes. It entails major challenges for global sustainable development. Adjusting to the competitive challenge and driving a fair bargain with China will be a central political and economic challenge of EU trade policy in the decade to come.

European trade policy towards China will seek to promote openness and cooperation to mutual benefit, taking into account the significant domestic challenges China faces. Europe must accept a tough competition, China has to ensure that it respects the laws of fair competition.

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