EXECUTIVE SUMMARY

STATE-OF-PLAY The EU and China are economically interdependent for the benefit of both entities. The 40th anniversary of EU-China diplomatic relations is an appropriate moment to review the trade relations and address shortcomings to improve the mutual market integration.

AMBITIOUS AIMS In order to keep pace with the increasing importance of bilateral commerce both entities have to create an even more business friendly environment by further opening markets and removing trade barriers. The European retail sector puts high expectations on the on-going negotiations for an investment agreement which – in the long-term – should pave the way for an ambitious free trade agreement.

IMPORTS TO EUROPE Trade is a double-edged sword and has both an external and internal face. Despite the high relevance of Chinese imports for the Single Market, the Asian country is wrongly perceived as a menace to the economic prosperity of the EU. More efforts are needed to refute this distorted perception.

MARKET ACCESS IN CHINA The many barriers European companies face when running business activities in China jeopardise progress in establishing closer trade relations:

- Missing level-playing field for European retailers in China because of many persisting technical barriers, unnecessary bureaucratic hurdles, and discrimination of foreign-invested enterprises.
- The poor implementation of intellectual property rights cause severe economic damage to FTA members.
- The proposals for a revised security law and a new NGO legislation – because of their restrictive character – would likely lead to disturbing retail and supply chain operations in China.

WAY FORWARD For the sake of mutual growth both players have to cooperate more effectively together and refrain from any protectionist measure. Removing the many existing trade barriers remains the paramount challenge in bilateral relations.

ANNEX A list of existing trade barriers European retailers are exposed to in China can be found in the Annex.
1. INTRODUCTION – TWO INTERDEPENDENT TRADE BLOCS

In 2015, the European Union and China are celebrating the 40th anniversary of the establishment of diplomatic relations. In these four decades, the bilateral relations have undergone significant change and have developed into a real success story. In 2014, the EU was China’s largest trading partner (13.4% of total share) and China was the EU’s second largest trading partner – and might soon replace the USA as the first economic partner.

Not surprisingly, the Foreign Trade Association (FTA) attaches utmost importance to the trade relations with China. China is by far the most important supplier for European importers and retailers, and therefore the importance of China as sourcing country is immense, even though imports recently have a declining tendency. According to FTA statistics, the share of China in the total volume of imported non-food products is 54%. At the same time, China is gaining importance as an export and investment destination for FTA members. European retailers are progressively penetrating the Chinese market, owing to rising incomes and population density.

In order to keep pace with the increasing importance of bilateral commerce and an increasingly globalised world both entities have to create an even more business friendly environment by further opening markets and abolishing trade barriers. Not all potential has been exploited yet. Therefore, FTA highly welcomes two recent initiatives to continue improving trade relations between the EU and China:

- The EU and China are negotiating a bilateral investment agreement which should lead to liberalisation of investments and elimination of restrictions for investors to each other’s market. FTA pushed to launch the negotiations and will accompany the talks until conclusion.
- President Xi Jinping suggested that the EU and China could work together on negotiations for a wide-reaching free trade agreement. The ambitious idea of such an agreement was already formally included in the summary of the bilateral summit in 2014 and is not anymore solely a consideration.

The increasing relevance of EU-China trade in comparison with other economic powers:

![Total trade with goods (billion €)](chart.png)

(Source: European Commission 2015)
2. OBSTACLES AND SHORTCOMINGS – MORE EFFORTS NEEDED

a) Acknowledge the importance of Chinese imports for the Single Market
Many European companies have production facilities in China or source from local manufacturers to benefit from competitive cost structures and the country’s ability to produce quickly, economically and in high volumes. As a consequence, European consumers have now access to a larger variety of products than ever before and can take advantage of affordable merchandise of high quality. In other words, the purchase of imports from China has become an integral and natural part of our consumer behaviour.

Despite this evolution, many European policy makers and the public perception tend to underestimate or even overlook the added-value of a liberal trade regime with China. It is therefore one of the main objectives of the FTA to raise awareness of the crucial role of Chinese imports for the internal market. The EU institutions should recognise more actively the benefits of the current trade exchange and pursue a policy of openness in bilateral commerce.

The Single market must remain open and protectionist temptations must be resisted, especially against the background of the lasting economic recovery affecting the EU after the financial crisis. The use of trade defence instruments is legitimate to defend European producers against unfairly subsidised or traded imports. However, the use of such instruments has to be clearly framed and should not be dictated by narrow and short term goals or by calls to protect outdated European industries from competition. Hence, calls to have an increased recourse to such measures should be rejected.

An excessive and unjustified application of trade defence instruments will only provoke countermeasures by China and diminish the prospects of growth in bilateral trade. This is all the more important since trade statistics indicate that European exports to China are expanding at a higher pace than imports from China to the EU. In the years between 2010 and 2014, exports from the EU to China grew by 45.2%, during the same period imports from China to the EU increased only by 6.6%. This trend demonstrates that the EU is already on the right track and that China is more open and increasing demand exists for exports from Europe.

b) Facilitate retail and supply chain activities in China
The retail market in China is undergoing a profound transition. In 2014, retail sales in China amounted to around €2,800 billion and, and the Chinese retail market is expected to be the world’s largest by 2018. Already today, the country is the largest e-commerce market of the world. Despite this considerable growth prospects, the business activities of European retailers and brand companies operating on the Chinese market continue to be affected by the risks of technical barriers, the violation of intellectual property rights, and the mistrust in foreign and local non-governmental organisations (NGO).

Reach a level playing field for European retailers
Although ownership restrictions and geographic limitations for foreign investment have been removed in 2004 in nearly all retail sectors, major market access obstacles remain:

- CUSTOMS: European retailers have experienced various difficulties with Chinese customs. Practices may be substantially different from one part of the country to another as procedures are not properly harmonised. The lack of clear implementation guidelines is leaving broad
discretionary power to local seaport and airport authorities. Moreover, import procedures do often not allow for very large consignments which have to be divided into smaller batches.

- **PRODUCT SAFETY**: The trading sector is strongly and naturally committed to bringing only safe products onto the market. Therefore, the European retailers welcome the robust testing and enforcement policy in place in China. Legislation on consumer protection, however, needs to be balanced and manageable, and should not lead to a disproportionate level of trade distortion. The current testing scheme discourages exporting to China because of the complexity of the system, the intensive costs for quality and safety testing, and the exaggerated delay before the approval of shipments.

- **PROTECTIONISM**: The “Buy Chinese” policy, limiting the access of foreign companies to public procurement, contradicts the Chinese government’s stance to treat foreign goods fairly with regards to stimulus spending and their calls to other governments to stick to the principle of free trade. The “Buy Chinese” policy is governed by the Government Procurement Law and entered into effect in 2003.

- **LICENSING PROCEDURE**: Experience has shown that foreign retail companies face stricter licensing processes than domestic players, adding costs and wasting time for foreign investors. Provincial commerce authorities, being in charge of granting business permits, tend to favour domestic over foreign retailers and therefore either restrict the number of licences available or certain licences can just not be obtained by foreign companies. In short, the licensing procedure lacks transparency and often remains inconsistent, slow and cost intensive.

- **REAL ESTATE**: In many cities local authorities are inclined to grant prime real estate spaces to domestic retailers, clearly disadvantaging foreign players. Furthermore, with the recent soar in estate prices, loopholes in the lease contracts are included to force foreign renting parties out of their contract, if better offers by local retailers are available.

**Achieve a high level of Intellectual Property Rights (IPR)**

FTA recognises the efforts to align China’s laws and procedures to international standards and for raising awareness on the consequences of piracy. Nevertheless, the scale of the problem is still very significant and IPR infringement has a serious impact on European companies. European single-brand companies and retailers with own-brands are strongly affected and become frequent and common targets of counterfeiting. Heavy economic losses are the direct consequence. Moreover, counterfeiting is a crime and European retailers are exposed to legal actions for selling counterfeited goods involuntarily to their customers. Hence, further support should be provided in order to assist China in enforcing relevant laws and regulation.

Despite its notable progress, around 64 percent of the counterfeit products that were detected at EU-borders in 2013 originated from China. China remains by far the leading country of provenance from where goods suspected of infringing IPR were sent to the EU with – detected – goods worth a total of around 494 million €. To understand the magnitude, Hong Kong is ranked second in entities of provenance with IPR infringements and sent “only” a total of 52 million € worth of goods to the EU in 2013.

**Legislative proposal on Security and NGOs: The damage would be substantial**

Whilst FTA acknowledges the brave reform process triggered by the Chinese leadership to modernise the country, two recent draft legislations give serious cause for concern:

- The planned new Chinese national security law aims at establishing a centralised, efficient and authoritative national security leadership system which will also have a strong negative impact on retailers: (1) Internet communication and intra-organisation data flow of foreign-invested companies will be subject to tighter controlling and maybe even censorship; (2) Because of the
vague formulation of the draft legislation the business environment would become less predictable, giving government authorities and courts greater leeway in taking unilateral decisions.  
- The improvement of social and environmental conditions is an essential feature of the retail sector’s engagement to make global supply chains more sustainable. In China, like in many other sourcing countries, FTA is running two successful programmes to promote this objective, the Business Social Compliance Initiative (BSCI) and the Business Environmental Performance Initiative (BEPI). According to the draft law on “Governing foreign NGOs”, business associations such as the FTA with its sustainability arms, the BSCI and BEPI, would be classified as foreign non-state organisation and placed under strict state supervision. This would mean that heavy administrative burdens are imposed onto the FTA and its field of activity considerably limited. Without any doubt, this would significantly impede the positive effect of the retail sector’s compliance and capacity building programmes in China. In other words, the legislative proposal needs a comprehensive revision.

3. THE BILATERAL INVESTMENT AGREEMENT: STEPPING STONE TO A FREE TRADE AGREEMENT?

With the negotiations for a bilateral investment treaty between the EU and China which started in late 2013, a new dimension of a strategic relationship is reachable. The EU seeks to replace the existing 27 individual member states’ treaties with one single EU-China investment agreement.

- So far six rounds of negotiations took place, but at the moment progress is slow and more efforts are needed to accelerate the talks. The conclusion of an investment agreement can have far-reaching consequences, because it is expected that this will be the first step to a bigger free trade agreement.
- The agreement should incorporate a strong implementation chapter to ensure that economic operator can derive maximum benefit from the provisions. A dispute settlement mechanism is indispensable and should allow companies to challenge governmental decisions with regard to unfounded investments and market access obstacles.
- An investment agreement should also aim at improving bilateral cooperation and dialogue on sustainability issues without that one side would try to impose its model and views. Representatives from both entities, including from the civil society, should have periodic meetings to evaluate the implementation of the sustainability provisions.

4. WHAT NEXT? WAYS FORWARD TO IMPROVE BILATERAL TRADE RELATIONS

In view of China’s outstanding importance as an economic partner for Europe it is our core objective to promote economic opportunities and to limit the risks. In order to create a business environment that is even healthier for both the EU and China, the FTA would like to make the following recommendations:

- PERCEPTION: The European retail sector encourages the EU to more proactively acknowledge the vital role of imported products from third countries and to put more emphasis on the added-value of Chinese imports for the European economy in official publications and political declarations.
- INCREASED COOPERATION: Both entities should intensify cooperation between enforcement authorities. EU and China have a common interest in streamlining their cooperation and work
together towards harmonising customs practices, improving IPR protection, and ensuring a transparent legal environment.

- **BILATERAL INVESTMENT TREATY**: FTA calls on the EU and China to progress with the ongoing negotiations of the investment agreement to reach a deal by end 2016. A strong market access chapter and efficient implementation tools should be included, with a built-in company-state arbitration court to challenge investment and markets access obstacles.

- **FREE TRADE AGREEMENT**: FTA welcomes the initiative by President Xi Jinping, encouraging the opening of negotiations for a comprehensive EU-China free trade agreement. Since China’s middle-class and consequently average income is growing, a bilateral trade agreement could be of significant importance for generating future demand for European products. Further discussions are needed to guide progress on this subject.

- **MARKET ECONOMY STATUS**: China aspires to receive Market Economy Status (MES) at the WTO at the end of 2016. The European Union and the United States of America are both considering the change in status, but remain vague about their intentions. FTA incites the EU to make further efforts for supporting China’s transition to a market economy.

- **CHINESE REFORM AGENDA**: The FTA welcomes the ambitious reform agenda by the Chinese leadership and, if correctly implemented, it will make considerable changes to the economic direction of China. The ultimate goals remain to shape a more business-friendly and competitive environment for foreign companies.

- **TAIWAN**: In parallel to strengthening the EU-China commercial relations the EU should not neglect the importance of Taiwan as a leading economic power in the East Asia region and beyond. The EU and Taiwan should explore the feasibility of an investment agreement with the objective to launch negotiations within the next two years.

- **MULTILATERAL**: The FTA calls upon the EU and China to use their power as major economic players to conclude the stalled WTO Doha negotiations, even if the outcome would be less ambitious than initially intended. Following this, a new round with fresh and updated objectives should be kicked-off. The EU should also continue promoting the inclusion of China into the group of countries negotiating the Trade in Services Agreement (TiSA).
## ANNEX: LIST OF MAIN LEGAL AND PROCEDURAL OBSTACLES IN CHINA

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<tr>
<th>Outlet Opening</th>
<th>Obstacle</th>
<th>Problem description</th>
<th>Specific impact</th>
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<tbody>
<tr>
<td>Approval process</td>
<td>Measures imposing discriminatory approval requirements constitute an important obstacle to foreign investment, especially if requirements do not apply to domestic investors.</td>
<td>Licensing for retail outlet opening appears to be tightly controlled and lacks transparency. In addition, lack of predictability.</td>
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<td></td>
<td>Local authorities tend to favour domestic companies when allocating retail outlet licenses and premium real estate locations.</td>
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<td>Outlet Opening</td>
<td>Sampling</td>
<td>Chinese authorities take samples from almost all (!) shipments for quality and safety testing. Testing results by foreign laboratories are not allowed.</td>
<td>Tests are abnormally expensive. Major delays for shipments affected by sampling; the commercialisation of these goods is delayed by a minimum of two weeks.</td>
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<td>Labelling (Based on GB (Guo Biao) National Standards)</td>
<td>Extremely difficult and burdensome labelling requirements. Multitude of codes to be defined in addition to the standard codes (e.g. size codes, special Chinese size codes, direct skin contact, indirect skin contact).</td>
<td>Heavy burden for importers in their procurement operations and cost structures. Refusal of import permission in case of false labelling which happens frequently due to the opaque regime.</td>
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<td>Testing (GB National Standards issued by the SAC, Standardisation Administration of China)</td>
<td>The GB National Standards system is characterised by a high level of complexity. To determine the valid “GB standard code” (which determines the required testing regime) for an imported product a multitude of parameters have to be taken into account (e.g. type of product, composition of fibre, age-group, gender). Example: The assignment of a non-denim GB standard code to a denim product will automatically lead to a “fail” result, even if the product is safe.</td>
<td>This complex system is leading to unnecessary administrative burdens and a high level of false assignments. With the exception of labelling errors, for most types of fails all garments of the same shipment need to be destroyed. This is very drastic and unproportioned measure.</td>
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<td>Obstacle</td>
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<td><strong>PROCEDURES</strong></td>
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<td>Customs</td>
<td>• The import procedures are complicated and overly bureaucratic.</td>
<td>• Local import authorities have a high level of discretionary power which inevitably leads to unequal treatment and lack of predictability and transparency.</td>
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<td>• Regulations and procedures in the different entry ports are not harmonised.</td>
<td>• Bigger import volumes need to be divided into smaller batches causing delays and extra costs.</td>
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<td>• Customs and CIQ declarations are limited to just 20 lines each which poses a manifest problem for large consignments.</td>
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<td>Enforcement of IPR policies</td>
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<td>(Patent Law, Trademark Law and Copyright Law)</td>
<td>• Even with comprehensive intellectual property laws that meet international standards, IPR violations and counterfeiting remain a very pressing concern.</td>
<td>• China is the country where most counterfeited products originate and the most IPR violations happen.</td>
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<td></td>
<td>• The main obstacles is the poor level of implementation of existing laws and procedures.</td>
<td>• In 2013, 64% of products confiscated due to IPR infringements on the EU borders came from China.</td>
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The Foreign Trade Association (FTA) is the leading business association of European and international commerce that promotes the values of free trade. We bring over 1500 retailers, importers, brands and national associations to improve the political and legal framework for trade in a sustainable way.