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**A LONG TERM POLICY
FOR CHINA-EUROPE RELATIONS**

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**A. INTRODUCTION
THE NEED FOR A LONG TERM POLICY FOR CHINA**

This Communication seeks to chart a long-run course for EU-China relations into the 21st century.

The rise of China is unmatched amongst national experiences since the Second World War. Japan has made its mark as an economic power, the Soviet Union survived essentially as a military power. China is increasingly strong in both the military-political and the economic spheres. China is in the midst of **sustained and dramatic economic and social change at home**. Abroad, China is becoming **part of the world security and economic system** at a time of greater economic interdependence and when global problems, from protection of the environment to nuclear non-proliferation, require coordinated commitment from governments worldwide. China is seeking integration into international structures: China has been a member of the IMF and the World Bank since the early 1980s; it participates in regional fora such as APEC, and is actively negotiating membership of the World Trade Organisation. China made an important contribution to the results of the World Conference on Human Rights held in Vienna in June 1993. China will also host a major UN conference on women in Beijing later this year.

It is 20 years since **diplomatic relations** were established between the EC and China, and 10 years since the signing of the existing Trade and Cooperation Agreement. The steady development of bilateral relations was interrupted by the 1989 Tiananmen Square events. Europe, like other major international partners of China, reacted with a range of sanctions. But the normalisation of relations, particularly in the past three years, has paved the way for a renewed surge in bilateral trade and investment. 1994 also saw major strides in bilateral cooperation and the establishment of a new arrangement for political dialogue.

The time has come to redefine the EU's relationship with China, in the spirit of the "new Asia strategy" endorsed by the Essen European Council. Europe must develop a **long-term relationship with China** that reflects China's worldwide, as well as regional, economic and political influence. Europe's relations with China are bound to be a cornerstone in Europe's external relations, both with Asia and globally. Europe needs an action-oriented, not a merely declaratory policy, to strengthen that relationship.

A.1 THE RISE OF CHINA AND ITS GLOBAL AND REGIONAL IMPLICATIONS

The rise of China represents enormous opportunities and challenges to the international system. The question is how China can share in the responsibilities and opportunities suited to its rapidly increasing power. China's political importance makes its stability of great concern both to its neighbours and to the world community at large. We believe that this stability is best served by political, economic and social reform in line with international norms.

The mere size of China, in terms of land and population, makes it impossible to address the central **global issues of the 1990s** without particular reference to the impact of China on their evolution and management. China is not only a nuclear power and a permanent member of the UN Security Council, but also one of the world's biggest arms producers and exporters. Her role across the whole **security spectrum** is central to global, as well as regional security.

Most observers, including the IMF and the World Bank, now believe that on the basis of purchasing power parities, **the Chinese economy** is similar in size to Japan and second only to the USA. Extrapolations of recent growth rates have led to forecasts of China becoming the biggest world economy in a generation's time. Although these estimates are subject to enormous margins of error, it is beyond dispute that after 15 years of economic reform, China's economy has already become one of the largest in the world.

China's size makes its impact on the physical environment unique. Despite its one-child policy, China's population increases by around 15 million people every year. But in addition, China's energy consumption is already second only to that of the USA. The consequences for the environment of such a huge country reaching western levels of consumption, and pollution, in the future are impossible to ignore. Hence the importance of China playing a full part in the wider policy exchange on such key issues as the environment, population, or health.

Although in the long term, the continued growth of China's economy could provide employment to its entire population, there is undoubtedly a short to medium term problem due to the substantial number of Chinese seeking to emigrate. With the possibilities for legal immigration to Western countries limited, trafficking of illegal immigrants has become increasingly prevalent. This not only affects North America; traffickers have also set up routes through Central America and the former Soviet Union towards Europe. It will be necessary to address the very real resultant problems in close cooperation with China.

China's size is also reflected in the multiplicity of players (central government agencies, both in Beijing and elsewhere, provincial and municipal authorities, emerging economic actors) who can influence Chinese policy and practice. In many respects, for example, Chinese provinces represent differing markets for EU exporters. Moreover, the rapid devolution of economic power is shifting responsibility for economic and trade policy-making and implementation to provincial level. This makes it all the more important to have firm commitments on the enforcement of China's international commitments at sub-national level, for example, during the WTO negotiations. It also makes it crucial to expand our bilateral trade and cooperation discussions to include provincial and local authorities which, de jure or de facto, are in charge of economic and trade policy in many fields.

A.2 CHINA'S IMPORTANCE FOR EUROPE

To update EU policy towards China and better coordinate EU relations with this country, the European interests at stake must be clearly understood.

- **Shared global and regional security interests** which will benefit from co-operative and responsible Chinese policy on all fronts, including adherence to the treaties governing nuclear and other weapons proliferation, an international drive to contain arms sales and encouragement of Chinese domestic political, economic and social reform in the interests of its people (20% of all people alive on the globe today). It is in everybody's interest - including that of China itself - to see China demonstrating a cooperative and responsible attitude in the international community, whether as a signatory to UN Human Rights instruments and the Non-Proliferation Treaty, or by becoming a WTO Member and an active promoter of the post-Rio Summit environmental agenda at the heart of government policy.
- **Shared interests on other global issues:** China should be engaged in dialogue and co-operation towards sustainable development and for the protection of the environment and global resources, scientific and technological development, the information society, demographic growth, poverty alleviation, the preservation of forests, addressing the problem of illegal immigration, and the control and eradication of disease, AIDS, drugs and

crime.

- **Global economic stability:** China's size and influence on world trade gives its economic policy global significance. It is in the world's interest, as well as China's, that the Chinese economy continues to grow and to open up, and that China takes its place as a major player in the world system of economic rules and policies. It is also essential to help China to participate fully in the rules-based system of the World Trade Organisation.
- **Competitiveness:** in order for European industry to be globally competitive we must be present on the world's most dynamic markets. China is now the Union's fourth largest market and fourth largest supplier. China's market could become the largest in the world in many high tech sectors, from telecommunications to aircraft and from computers to energy. An active role for EU business in China, where US and Japanese competition is already fierce, is essential.

Given the breadth of these interests and the key role played by China, Europe must set itself the overriding general objective of promoting the fullest possible Chinese involvement in the international arena, whether on security, political, environmental, social or economic issues. We must also increase mutual understanding between Europeans and Chinese and raise the EU profile in China.

In addition, the influence of China's domestic evolution on its international policies cannot be ignored. EU interests will therefore be well served by supporting the development in China of institutions and a civil society based on the rule of law.

B. POLITICAL RELATIONS : ENGAGING CHINA IN THE INTERNATIONAL COMMUNITY

B.1 CONSTRUCTIVE ENGAGEMENT

China's own policy of a gradual opening up over recent years has been illustrated by its desire to join or rejoin international organisations and to intensify links with other key partners such as the United States and Japan. China now wishes to play the full part on the world stage that is appropriate for a country of its importance.

The EU is eager to see China sharing in the opportunities and responsibilities at the heart of the international community as China opens up to a freer flow of ideas and cooperation, both in the key Asian region and globally. We support the wholehearted participation of China in the international community. As the Commission stated in last year's review of European policy towards the region, we have an interest in a stable and peaceful Asia. China's decisions on how to employ its economic and military weight will have an essential impact on this.

Without exaggerating the role that the EU can play, we must use the opportunity offered by participation in regional fora and by bilateral dialogue to promote a responsible and constructive Chinese role in the region, including issues such as nuclear weapons on the Korean peninsular and territorial differences such as the Spratleys. As we recalled in March

1995, the EU believes in the peaceful and negotiated handling of such problems, whether in the South China Sea or elsewhere.

It is in the interests of Europe, and of the international community as a whole, to engage China in a political dialogue on disarmament and arms control issues. Nuclear Non-Proliferation, the missile technology control regime, the non-proliferation of chemical and biological weapons, conventional weapon sales, and control of trade in dual-use goods, should all be embraced in such a dialogue.

An ambitious new framework for **bilateral political dialogue** was set up in June 1994 to encourage this mutual goal of full Chinese participation in global affairs. Regular meetings between the EU Troika and China at ministerial level, as well as high level political consultations between the Commission and China, will continue. But these will now be supplemented by ad hoc Foreign Ministers' meetings, and twice yearly meetings, both between the Chinese Foreign Minister and the EU ambassadors in Beijing, and between the EU Presidency's Foreign Minister and the Chinese Ambassador in the EU Presidency capital. There will also be regular meetings of senior officials responsible for a range of policy areas. This dialogue should develop to include all issues of common interest and global significance. By the same token, with the ban of contacts between military personnel now lifted, the political and economic influence of the People's Liberation Army makes it appropriate to include the People's Liberation Army among potential dialogue partners.

These new arrangements have already made possible a sustained exchange of views, not only on respective internal developments, but on global and regional security interests, as well as human rights. All such matters can be examined in depth whilst continuing to respect the sovereignty of both parties. China and the EU can now discuss mutual interests and find common ground on the full range of political and security issues.

Collaboration should also be stepped up in dealing with the migratory consequences of a more open Chinese economy: in this respect, the EU and China should work together in fighting illegal immigration, taking into account existing principles and practices of readmission.

The EU welcomes opportunities to develop such a dialogue in a regional context. Links with the ASEAN Regional Forum are already well-established, and the Euro-Asia meeting in spring next year will provide an excellent opportunity for the EU and China to discuss mutual interests in the region.

B.2 HUMAN RIGHTS

A commitment to human rights and fundamental freedoms is at the heart of EU policy worldwide. Violations are not only a cause for concern in their own right, but because the EU believes that espousal of international standards of human rights and acceptance of political liberalisation is vital for long-term social and political stability. The key criterion for pursuing human rights initiatives must be effectiveness, the impact that an initiative would have on the ground. For this reason, there is a danger that relying solely on frequent and strident declarations will dilute the message or lead to knee-jerk reactions from the Chinese government. To make progress, all the EU institutions should pursue human rights issues through a combination of carefully timed public statements, formal private discussions and

practical cooperation.

The EU will pursue the issue of human rights through action on three levels. First, it will support potential efforts in China to open up and liberalise all areas of Chinese life, in different sections of society as well as different parts of the economy. These trends inevitably reinforce moves towards the development of a civil society based on the rule of law. Second, it will systematically and regularly continue to raise human rights issues in bilateral dialogue with China. Third, it will engage the international community in the dialogue through multilateral fora such as the United Nations. The framework for all these activities is clearly delineated by the common acceptance by both the EU and China of the Declaration and the Programme of Action of the World Conference on Human Rights of Vienna in June 1993¹.

There are already signs that the increasing exposure of all areas of Chinese life to the outside world is having a deep - if gradual - impact through social change and increased mutual understanding. EU policy is based on the well-founded belief that human rights tend to be better understood and better protected in societies open to the free flow of trade, investment, people, and ideas. As China continues its policy of **opening up** to the world, the EU will work to strengthen and encourage this trend. This is a major reason why the EU will continue to support the active participation of China in the international community in all fields of policy, political and economic, and to welcome China's increasing openness to dialogue. It is also an important reason for using the EC cooperation programme to encourage China's own efforts towards opening up, socially and economically.

The World Conference on Women in Beijing in September 1995 has focused attention on China as host, and Chinese policy in this area will inevitably come under particular scrutiny. The EU hopes for a successful outcome to the Conference, and looks forward to supporting China's efforts to build on the Conference in the years to come. In this context, the follow-up to the World Conference on Social Development, in Copenhagen in March 1995, should be mentioned. Such efforts to internationalise China are wholly consistent with a strong position on human rights - indeed they must be part of it and at the heart of a long-term strategy of engagement.

The EU institutions have consistently demonstrated their commitment to giving a clear message to China on human rights. In February 1995, the EU proposed a resolution before the UN Commission on Human Rights, summarising and deploring the violations which are still an everyday part of life in China. The resolution acknowledged the steps taken by China to reduce poverty and to reform the legal system. But reports of human rights violations by authorities at every level continue, with severe restrictions on the right of citizens to freedom of association, expression, and religion, as well as to due legal process and fair trial. China does not yet enjoy a fully impartial administration of justice and respect for the rule of law. Arrests of pro-democratic Chinese dissidents continue. With more than 50 minority groups in China, notably in the Autonomous Region of Tibet but also elsewhere, respect for the distinct cultural, ethnic, linguistic and religious identity of minorities also remains wholly inadequate.

The importance attached to human rights has been a consistent feature of the EU's policy towards China. Immediately after the Tiananmen Square events in June 1989, the EU imposed a number of sanctions which have been only gradually relaxed (a ban of arms sales is still in place). The Parliament has passed a number of resolutions on China and senior European Ministers and Commissioners consistently raise human rights when they meet their Chinese

¹ As incorporated in the Resolution adopted by the General Assembly of the United Nations.

opposite numbers. In order to achieve maximum effectiveness, public statements have been reinforced by detailed discussions in private.

The EU must pursue a detailed dialogue on all aspects of human rights at every opportunity. The new and more systematic arrangements for **political dialogue** provide regular fora for exchanging views and deepening understanding on human rights issues. At the same time, effective concertation in the human rights debate at the **international level** is a prerequisite for a successful policy. The EU puts particular stress on the involvement of the international community through the UN Commission on Human Rights. The level of international support attracted for the resolution criticising the situation in China in February 1995 suggests that this approach is bearing fruit.

On top of all this, a new **dialogue specifically devoted on human rights** has recently been launched at China's suggestion. This dialogue centres on a biannual meeting between the EU troika and the Chinese government, which will not only improve the flow of information, but will also provide an opportunity for detailed discussion leading to concrete action.

Practical action is essential if this government-to-government dialogue is to be fully effective. The EU can promote practical cooperation, such as training and technical assistance in the **legal and judicial fields**, to back the efforts being made in China to establish a civil society based on the rule of law. Up till now, concrete action by the EU to encourage cooperation with individuals in the legal and judicial systems has been small-scale. The EU should henceforth coordinate with the Member States and the many active European NGOs to support the development of the rule of law in China.

B.3 HONG KONG AND MACAU

The historical ties between Europe and Hong Kong and Macau inevitably mean that the European Union has taken a particular interest in the arrangements for the transfer of **sovereignty to China**.

The Council of Ministers has made clear the importance of implementing the principles contained formally in the two Joint Declarations signed by China and the United Kingdom and Portugal respectively. The high degree of autonomy guaranteed to the two Special Administrative Regions under the Declarations is of great importance to the well-being of the two Regions, and is recognised in Beijing to be in the interests of China. The Joint Declarations acknowledge that Hong Kong and Macau each have distinctive characteristics which need to be respected. Both territories already run their own affairs in economic and trade policy. The principle of continuity will govern the EU's relations with Hong Kong and Macau in the years leading up to the transfer of sovereignty and beyond.

Continued close relations with the EU are essential to both Hong Kong and Macau, and to Europe. Hong Kong is the EU's eleventh largest trading partner. Five of the Member States enjoy bilateral trade with Hong Kong of over 2 billion ECU. It is also a key destination for investment from across the EU Member States, with 40 EU banks and 45 insurance companies licensed in Hong Kong. Some 40,000 EU citizens are resident in Hong Kong.

The Commission's Office in Hong Kong responsible for relations with Hong Kong and Macau

opened in 1993, and China has agreed that it will continue to operate as an independent entity after transfer of sovereignty. Equally, there will be no change in the functioning of the 1992 Trade and Cooperation Agreement with Macau. Relations in the WTO will continue, as Hong Kong and Macau both participate autonomously. Cooperation is already developing bilaterally on customs, standards, culture, university and business links. But the EU will also seek to take advantage of the particular opportunities offered by closer relations in the years to come:

- both territories have important roles to play as **gateways to other regions of China**, and can act as key facilitators for increased European trade and investment with China;
- the traditions of **free trade and internationalism** established by Hong Kong and Macau. These traditions serve as important examples for China and in the region as a whole, and suggest a continuing role for the territories as partners for the EU as the new WTO dialogue develops in the years to come.

B.4 PROPOSALS

The European Union and China are both major global players. They should sustain a comprehensive, long-term bilateral dialogue. The EU's particular goals should include the following :

- to promote a dialogue on regional and global security issues which encourages full Chinese engagement in the international community through accession to all the key international instruments governing non-proliferation and arms control;
- to give practical support for the trend towards creating a reformed public management system in China based on civil society and the rule of law;
- to develop a programme of effective and coordinated cooperation in the legal and judicial fields;
- to support the principles of the Joint Declarations governing the transfer of sovereignty of Hong Kong and Macau.

C. ECONOMIC AND TRADE RELATIONS : THE RISE OF A NEW ECONOMIC POWER

The economic reform process launched by Deng Xiaoping sixteen years ago has dramatically changed the economic and social landscape in China. Despite its incremental nature it has exceeded all initial expectations.

It is in Europe's interests that this trend is accepted as irreversible. Although different opinions are still voiced in Beijing on the pace of reform, as well as on specific measures, there is widespread consensus among China's senior leaders about the necessity to deepen and broaden reforms to achieve the objective, enshrined in China's Constitution, of creating a "Socialist

Market Economy" by the turn of the century (see Annex 1). This process has accelerated since 1992 to reach new areas, from banking and taxation to real estate and infrastructure. New sectors - and regions - have been opened to private, including foreign, activity. However, China still falls well short of having a full market economy, with adequate social protection including freedom of association for employees. Reform of state-owned industry, and the creation of a social security system to cope with its consequences, remain as key challenges for the future. The establishment of an effective legal framework, properly enforced, is an essential element in the process.

C.1 A BOOMING ECONOMY

Reform has changed the structure of China's economy beyond recognition. Collective, private and foreign-funded companies produce and sell well over half of China's industrial goods. Whilst over 80% of industrial output was subject to mandatory planning only ten years ago, the figure is now only 15%. The same is true for price controls, which affect less than 10% of retail sales at present. Public industry's share of total output has fallen from 77% to 44% and its share of retail sales to an even lower level. Although these figures should be treated cautiously, because production factor markets remain more controlled than goods markets in China, they clearly show a steady trend towards liberalisation of the economy.

China's macroeconomic performance since the launching of reforms can only be described as remarkable. GNP growth rates reached around 9% during the 1980s, and 12-13% in the last three years, with industrial output and investment growing at over 20% for several years. China's total trade rose from 20 \$ billion to 237 \$ billion between 1979 and 1994, growing twice as fast as output. Despite fluctuations, China's trade balance looks healthy and its foreign exchange reserves big enough to cope with a substantial foreign debt.

A shadow is cast on this generally rosy picture by an accelerating inflation rate. The reasons for this are structural, due to an undeveloped monetary policy and expansive fiscal policy. Other important structural imbalances exist which could undermine future development. Traditional disparities between the coastal and inland areas are widening rapidly, leading to massive migrations, infrastructure bottlenecks and environmental degradation. The inevitable transfer of production from public industry to the private sector and the slowing down of the agriculture sector could lead to massive unemployment.

The EU has much to offer to help China in its difficult process of transition. An exchange of experience and information could support China's efforts towards reform, whilst also increasing European knowledge about the modern Chinese economy. Training for economists has already been provided as part of the EC-China cooperation programme: an economic dialogue in areas such as monetary policy between officials could be the next step.

Another potential area for fruitful dialogue is social policy. An exchange would help to provide an important basis to discuss the evolution of social policy in the 1990s and beyond. Such a dialogue could include the development of internationally recognised labour standards, including International Labour Organisation standards in areas such as child and prison labour.

Another important element is the involvement of China with key international economic organisations. In the case of trade, this should mean WTO membership for China (see section

C.3). But the importance of China to the world economy should also be acknowledged by other organisations. The decision by the May 1995 OECD Ministerial meeting to promote a new dialogue with China is to be welcomed; Europe should consider how to make a reality of these ties. The G-7 should also consider how the growing economic importance of China can be recognised in its deliberations.

The dramatic changes in the Chinese economy have inevitably had a great impact on EU-China trade with total two-way trade exceeding 30 billion ECU in 1993 and reaching an estimated 35 billion ECU for 1994.

EU-China trade has increased over fourteen-fold since the beginning of reform in China (see Annex 2). But EU exports have not kept pace with imports. The EU's trade surplus of the mid 1980s turned into a bilateral trade deficit, which has remained in the 8-10 billion ECU range in the last four years. However, this is dwarfed by the US trade deficit with China and the proportion of EU imports covered by exports (55%) is much higher than that of the US (26% in 1993). Moreover, the EU share in the Chinese total imports grew from 11% to 15% in the first half of this decade, a better export performance than that of the US in the Chinese market (rising slowly to 12%) but less than the Japanese one (22%). Indeed, the EU market share in China is higher than that enjoyed by the Union in other parts of the Asian region.

The picture in the field of **direct investment**, one of the crucial elements in China's reforms, is less bright for Europe. The EU share in total FDI in China (around 4%) remains far lower than its share in other emerging markets. EU companies are lagging clearly behind not only Hong Kong and other overseas Chinese but also US and Japanese companies.

EU (15) companies invested a total of 2.5 \$ billion in the 1979-1993 period (7.3 \$ billion pledged) in some 3,000 projects. This represents less than half of the investment of either US or Japanese companies. Although the average size of EU projects tends to be bigger than that of its competitors and some of them are the undisputed leaders in key sectors of China's industry (like automobiles, telecommunications, or pharmaceuticals) there is a clear perception, both within the Chinese, European and foreign business communities, that EU companies are being less dynamic than their competitors in the Chinese market - and are hence missing opportunities. This could not only have negative implications for future trade, but also weaken the EU's global competitiveness.

It is, of course, up to each company to evaluate the risks and rewards of such a difficult undertaking as a Chinese venture. The long term perspective adopted by big corporations, ready to incur short-term losses in order to gain a strategic presence, is usually not possible for SMEs. Smaller firms may on the other hand be able to take advantage of opportunities with shorter payback periods and narrower initial objectives : an attractive option in periods of uncertainty. The challenge for Europe is not to find the opportunities but simply to explore possible openings in China with as much energy as our main rivals.

At the very least, the EU should try to help EU companies to make well-informed investment decisions about the opportunities on offer in China by promoting better two-way information on investment conditions and opportunities, as well as direct business-to-business contacts.

C.2 A UNIQUE ECONOMIC SYSTEM

Information and contacts will not, however, in themselves be sufficient to resolve the problems faced by those seeking to trade with China and make investments there.

China has over the last years made enormous strides to liberalise its trade regime and open its economy to the world. Tariffs have come down, trading rights have been granted to firms on a wider basis, the dual exchange rate has been unified, foreign investment has been attracted on a large scale, the basic framework for an effective judicial structure to handle property rights has been established.

Although these measures represent important steps forward, they are clearly insufficient to make the Chinese trade system compatible with internationally accepted rules. The right to import and export goods in China remains largely a state monopoly. Customs duties are prohibitive, particularly for many consumer products (and are applied in an ad hoc manner). Non-tariff measures such as licences and quotas abound. Exports continue to enjoy numerous unfairly favourable conditions, foreign currency controls remain a major obstacle, and new technical barriers are introduced to frustrate imports. Transparency remains a big problem due to unpublished administrative rules and orders, and secret trade plans on some products. These are only some examples: Annex 3 provides a full summary.

The EU's efforts to increase the WTO-compatibility of trade rules, and to improve market access and the investment environment in China, have focused on the multilateral negotiations for China's WTO membership and on bilateral trade meetings. The objective is a coherent and consistent one: to bring about the **application of general internationally agreed trade principles**, and at the same time to deal with specific issues of mutual concern.

C.3 MEMBERSHIP OF THE WORLD TRADE ORGANISATION

As a founder member of the GATT and once more a major player on world markets, China's membership of the World Trade Organisation is in the interest of all trading nations. Since China's application to return to the GATT in July 1986, the EU has consistently sought to accelerate progress towards a decision on Chinese membership, based on conditions which will guarantee both China's ability to meet the extensive requirements of WTO membership and the integrity of the WTO system.

The EU has taken a leading role in the negotiation, in particular in establishing the principle that of the commitments that China would make when joining the WTO, most would be implemented on the date of membership, but some could be implemented under multilateral surveillance over a specified period of time after entry into the WTO. This general approach reflects a sympathetic understanding of the fact that China is a country that is rapidly developing, but, in important respects, has not yet become a developed economy with all the characteristics of a fully-fledged market-economy system.

Despite the stand-off in these negotiations in late 1994, the Commission continues to believe that the structure of the deal proposed by the European side last year, and later carried further

by the Chairman of the GATT Working Party on China, remains valid. Both China and its trading partners must now show additional political commitment to progress if a deal is to be reached. The full integration of China into the WTO system is in the interest of all parties concerned: for WTO Members it would contribute to guaranteeing the continuation of China's reform process until a mature market economy is established, and for China it would guarantee that its goods and services have open access to export markets around the world. Although contacts have been re-launched in recent weeks, it remains to be seen whether substantive WTO negotiations can resume and a deal can soon be struck.

In our view, the key remaining issues are:

- commitments in the field of **import tariffs**. China should be ready to envisage binding its duties at levels which, at the end of an implementation period, would result in a weighted average tariff not higher than about twice the OECD average;
- initial commitments in the field of **traded services** across all sectors under negotiation. Commitments should not be undermined by geographical limitations, access specifications or other restrictions;
- the liberalisation of the **foreign trade monopoly**, if necessary with transitional provisions. An automatic right of individuals, both national and foreign, to engage in direct import or export trade in all products is a basic feature of the WTO system, but does not yet exist in China;
- adherence by China to the **Tokyo Round Civil Aircraft Code** and the **Government Procurement Agreement**. Chinese implementation of the Procurement Agreement will create opportunities abroad and cut government costs at home, and it could be implemented in stages;
- elimination by China of all WTO-inconsistent **quotas** or other **non-tariff barriers**, over a transitional period;
- making China's **industrial policies** WTO compatible;
- acceptance of appropriate provisions on other **horizontal issues** such as subsidies, standards, state-pricing, state trading and the elimination of export duties.
- the definition of an appropriate transitional trade defence mechanism, which could be invoked in cases of market disruption.

Beyond the requirements that aim to establish appropriate access to China's market as a balance for the effective access which Chinese exports and investments enjoy in the markets of WTO Members benefit, an essential precondition of any final deal must be firm Chinese adherence to the principle of **non-discrimination**. This will be a precondition for EU support of any successful WTO package.

The approach outlined above reflects the recognition of China's current transitional position in its suggested use of the technique of **transitional periods**. But it properly pays regard to the principle that there are some principles of the international trade order which are so fundamental that it is reasonable to expect their application by countries participating in that international trade order, whatever their stage of development.

C.4 BILATERAL TRADE DISCUSSIONS

Bilateral trade talks since 1992 have had three interrelated objectives: promoting China's economic and trade reforms, helping China into the multilateral trade system, and achieving better market access for European goods and services.

This dialogue was institutionalised in 1993 by an **Economic and Trade Working Group**. 1994 saw detailed, **sectoral meetings** on IPR, Agriculture, and Financial Services. This process should continue, with the expansion of trade talks to other sectors and their extension through discussions with sectoral Ministries, as the only way to achieve concrete results. One subject of possible future dialogue might be competition matters, as cooperation in this field will enhance the effectiveness of international trade.

The main results (Annex 3) so far have been **solutions to specific issues**, from trademark infringements to veterinary restrictions and other technical barriers. Although many of the EU bilateral requests are already being discussed in the framework of the WTO accession process, it has also been useful to discuss bilaterally key EU concerns.

A sustained trade dialogue has also enabled Europe to **avoid any risk of discrimination** and to ensure that EU economic operators enjoy the same treatment as their competitors in China.

This has been particularly important in areas where the US and China have concluded bilateral agreements, like intellectual property, maritime transport, and market access. In each case, including the February 1995 IPR deal, China has formally undertaken to ensure equal treatment for EU persons and entities.

Bilateral discussions also give an opportunity to **link trade issues and cooperation activities**. For example, the EU-China industrial property technical assistance programme followed the signing of agreed minutes on IPR protection. In the case of IPR for example, the cooperation that is being provided may well prove essential in making it possible for China to apply on the ground the agreements that have been signed.

C.5 PROPOSALS

- a) **The EU should continue to strongly support reform as an integral part of its trade and cooperation policies.**
- b) The Commission is ready to engage with Chinese authorities in a dialogue on economic, social and monetary issues.
- c) The EU should encourage dialogue between China and other key bodies such as the OECD, and raise the profile of China in debate in the G-7.
- d) The EU should pursue China's entry to the WTO as soon as possible, under the right conditions, and monitor closely the implementation of China's WTO commitments.

- e) In order to increase the effectiveness of our **bilateral trade dialogue**, the EU should:
- increase the frequency of the Economic and Trade Working Group meetings,
 - consolidate the sectoral meetings in the three sectors, IPR, Agriculture and Financial Services, as permanent fora for in-depth discussions,
 - expand these meetings to new sectors or subjects (like technical barriers to trade, consumer goods, in the transport sector, and on competition),
 - develop contacts with sectoral ministries and provincial authorities,
 - establish more links between trade and investment talks and cooperation activities (in sectors like standards and public procurement).
- f) Direct investment in China is bound to be crucial both for ensuring access to this market and for bolstering the global competitiveness of EU industry. The EU therefore should to develop a new programme of business cooperation with China (see section D.2).

D. COOPERATION THE NEW PRIORITIES

China is a vast country, and the EU has limited resources for cooperation. When China's importance is taken into account, the resources allocated to cooperation work with China have remained small. Under the basic budget lines for development aid and economic cooperation in Asia, under 20 million ECU was set aside each year during the period 1991-1994. This compares with some 90 million ECU for India, or 460 million ECU for the former Soviet Union countries under the TACIS programme in 1994.

D.1 COOPERATION STRATEGY

The following types of activity should be given priority:

- cooperation in areas of critical importance for the Chinese economy;
- cooperation which has a catalytic effect on best practice within the Chinese system;
- cooperation which bolsters reform.

EC cooperation should both be reinforced and more closely targeted on **support for reform** in all areas of Chinese society: reform to promote the integration of China into the world trade and investment system, reform of the underdeveloped and restrictive civil society in China, reform to bring China closer into the global information society, and reform to prevent further damage to the physical environment in China. The rural and urban poverty which remains a scourge for millions of Chinese and the need to feed such a huge population is at the heart of Chinese

government policy, and underlies all EC cooperation.

Effectiveness and impact over the long term remain essential.

There are three key targets for EC-China cooperation:

- The Chinese government is acutely aware of the deficiencies in the skills base in China and of the enormous need for further **human resource development** as Chinese society and the Chinese economy evolve. This message is increasingly echoed by European entrepreneurs finding that their opportunities to expand in China are held back by the lack of appropriate skills in China. We need to identify a coherent European contribution in education and training. The EU should build on the China-Europe International Business School (CEIBS) in Shanghai to bring the best of European expertise, including community experience in education and training policy-making and programme development, to China. We need to identify partners in other provinces for initiatives to promote technical and vocational training, for which one option would be to follow the CEIBS format of a permanent centre to address skill shortages in fields from engineering to accountancy. On the university front, 60,000 students from China are in the US but only 6,000 in Europe: we must redouble our efforts in higher education.
- **Economic and social reform** should be encouraged through a more wide ranging programme of support to reforms touching on individual Chinese in different professions and walks of life. In particular the development of a fair and effectively working system for the administration of justice should be assisted and encouraged, stepping up judicial cooperation between the EU and its Member States on the one hand, and China on the other. One approach worth exploring would be to establish a cooperative programme in the legal and judicial field through an EU-wide exchange programme for young lawyers, judges and finally law enforcement officials. This would require careful coordination among Member States actors, but would provide (following language training) for internships at European civil, administrative and perhaps constitutional courts as well as selected law firms. A reciprocal programme for Europeans could be attractive in some areas of the project.
- The facilitation of **cooperation between private sector actors** by the EU and the Chinese government will support the healthy evolution of both economies. This conviction is at the core of a developing programme of business cooperation, with three central goals: to support the general evolution of the business environment in China, to develop new skills central to the management and administration of the modern Chinese economy, and to give direct encouragement to closer ties between EU and Chinese enterprises, through the provision of information and the facilitation of face-to-face contacts. Supporting the development of industrial cooperation with China should reinforce the presence of European operations in China and encourage new economic links. These objectives are already central to several existing initiatives, but have not kept pace with the growth in EU economic interests and opportunities in China.

These objectives can be pursued across a range of policy areas. Two areas of particular potential for future development are the environment, and scientific and technological cooperation:

- The **environmental challenge** faced by a rapidly developing China has been recognised by the Chinese government in its "Agenda 21" follow-up programme to the Rio Summit, with

its accompanying list of specific projects leading to sustainable development. The problems faced by China in the environmental field are partly systemic - a low awareness of the long-term consequences of inaction - partly technological, and partly that China does not believe that it can afford the costs of high environmental standards. Of critical importance is the need to integrate environmental considerations into other areas of policy, such as economic planning. A new working group has been set up to discuss how the EU can best help Chinese efforts. We need to identify a coherent European contribution in a field where there is multiplicity of signals from the Chinese side. Our contribution must be defined clearly before it is launched and must make best use of EU expertise in environmental policy-making and technology, including clean energy technology. It is therefore essential that initiatives make full use of the willingness of European business to commit itself to a long-term technological partnership with China.

Scientific and technological cooperation promotes an enabling environment for cooperation in general, as well as helping the search for science-based solutions to common global problems. S&T cooperation with China should therefore be pursued under the Community's Fourth Framework Programme so as to strengthen the European scientific and industrial base and to contribute to other Community cooperation with China. S&T cooperation should mobilise complementary skills from across Europe and China, supporting innovative research and promoting the development of human and institutional capital, with a particular emphasis on the training and mobility of young researchers.

D.2 PROPOSALS

The EC should step up its cooperation programme and ensure that it fits the economic and political realities of China in the 1990s.

In view of the limited resources available, it also requires a clear choice of priorities and concentration on them, rather than a dissipated efforts which would achieve less for China and render the EC's cooperation effort far less apparent within China.

Current financial resources are not sufficient to fulfil all these objectives, but increasing budgetary resources is not the only way to improve the effectiveness of EU action in China. The size of China makes it particularly worthwhile to ensure **synergies between Member States and EU activities**, as well as to **concentrate resources**. Cooperation should also be central to the objective of raising the profile of the EU in China, and of China in the EU. New cooperation work should have an information strategy as an explicit element for all major new projects (see section E.2).

Opportunities for EC-China cooperation should be sought in the following areas:

Support for **human resource development** in China should follow the opening of the China-Europe International Business School with new initiatives at different levels, including: a programme to build ties and networks between individual higher education institutions in China and the EU and provide opportunities for Chinese students to benefit from European expertise, and a new programme of technical and vocational training targeted on the needs identified by economic operators in China.

- **Economic and social reform** should be pursued through training and technical assistance in sectors critical to reform. A second phase of the IPR training programme should shift the emphasis towards new areas such as copyrights and enforcement measures, and should be followed by new programmes in the areas of quality and standardisation, and public procurement. New cooperation should be organised to promote the development of civil society in China, and in particular to support the evolution of the legal and judicial professions with a view to strengthening the rule of law in China.
- Action should continue to address **rural and urban poverty** and agricultural productivity through encouragement to the development of local economies. Initiatives need to be in tune with the needs of a rapidly changing China.
- EU business and technical expertise must be involved in a dialogue on the **environment**, with a transfer of EU expertise in environmental policy-making and technology relevant to Chinese circumstances in key sectors such as energy. We should promote exchanges of information on the environment between the Commission, the Member States and China; and improve communication with other organisations helping China to improve its environment.
- A new programme of **business cooperation** should bring together the commercial slant of much cooperation work and should be a key element in an intensified dialogue with the EU business community. This should have two new elements:
 - promoting a two-way flow of relevant commercial information and support to EU and Chinese businessmen, through the establishment of a network of **Business Information Centres** in China, in provinces of China where existing business ties to China are scarce;
 - facilitating direct business-to-business contacts in sectors of particular potential for industrial cooperation, through a coordinated programme of collaboration between enterprises and business to business trade or investment seminars, both in Europe and in China.
- Enhanced forms of **scientific and technological cooperation** under the Community's Fourth Framework Programme should be based on a continuing effort to promote high quality research in key areas of cooperation with China.

Projects which are not central to these objectives should be phased out or not renewed.

E. COORDINATION AND INFORMATION

E.1 A POLICY APPROACH ADAPTED TO A CHANGING CHINA

China is embarked on a period of change. Europe's policies, as outlined above, can both support the trend to reform in China and accommodate any uncertainties about the future direction of Chinese (and European) domestic policies. The development of the EU-China

relationship must be a **sustained long-term goal**.

EU policy should seek to promote the objectives that have been described above in a comprehensive way, but should also be **flexible** enough to cope with unavoidable uncertainties in the future development of China. Most observers agree on the existence of a great variety of possible future economic, and in particular political, scenarios for the decades to come. But whatever temporary ups and downs come in the wake of trade quarrels or political differences, EU policy should never lose sight of its strategic interests in China.

The various programmes and instruments at the EU's disposal will always be small relative to a country of China's size. At the same time, several Member States are very active in areas like training, technical assistance, business facilitation, and the environment, all of which are priorities in EU policy. There is much to be gained by pooling experience and, if appropriate, resources in designing and implementing these common activities. **If we do not cooperate, our voice will not be heard.**

Several **Chinese provinces** have larger populations than the largest EU Member States. In addition, recent years have seen the proliferation of special economic zones and other development areas, as well as a devolution of economic power which has shifted responsibility for economic and trade policy-making and implementation to provincial level. Provincial authorities have wide powers across a variety of policy areas. The institutional interlocutors for the EU will always be the ministries in Beijing. But it is important for EU policy to acknowledge the importance of the provinces and for dialogue on some economic and cooperation issues to reach the provincial level.

The "Asia strategy" Communication called for a **higher profile for the European Union** in Asia. Given China's strong cultural identity and language, and given the shortcomings of its communication system and its sheer size, China presents a particular challenge.

The most important factor in the EU's image is our policy towards China. The deeper political dialogue now launched must be used to put a greater stress on the long-term common interests of the EU and China. The EU and China should gradually become more used to working together on a variety of policy issues and to debating key areas of mutual interest. A closer economic partnership will help to further the interests of Europe and China, already increasingly intertwined. Closer and better-focused cooperation will bring the work of the EU to a broader cross-section of society. But a more active **information policy in China** is essential to create a stronger profile for the EU.

In addition, the EU's activities in China too often go unnoticed in Europe, with many who might make a positive contribution or become more closely involved unaware of the opportunities. If a deeper partnership is to develop between Europeans and Chinese, openness and interest must be fostered on both sides. **Informing the European public** of the EU's activities should be seen as an inherent part of the Commission's responsibility to implement policy.

E.2 PROPOSALS

The impact of EU policy should be maximised by better coordination. This could be achieved by improving the links between the Member States, the Commission, and the private sector,

both in Europe and in China:

- A **China Experts Group** (along the lines of the existing ones for Japan and Korea) could act as a forum for the exchange of ideas and information about China between experts from Member States' administrations and the Commission, across all policy areas.
- The possibility of **closer coordination of cooperation activities** in China with the Member States and other international organisations should also be explored more thoroughly. Co-financing could bring benefits in pooling experience and strengths (the Commission only manages some 8% of total EU assistance to China, but offers grant financing rather than soft loans). A co-financing facility could be introduced to set aside a proportion of resources each year for joint projects with the Member States. Bringing together initiatives such as business service centres or cultural centres in one place could also help to consolidate the EU presence in China; "Europa Houses" in big provincial cities could house a number of different activities.
- An **EU Business Council in Beijing**, giving voice to EU businesses in China and taking advantage of existing networks both in China and in Europe, would help to articulate the views of the European business community and could act as an important input to policy formulation.
- Business, Commission and Member States should also be brought together in sectoral committees, to help effective monitoring not only of respect of China's WTO commitments but, more generally, of China's new commercial legislation.
- Business could also be more closely involved in sponsorship of EU-funded cooperation projects (as is already the case with the China-Europe International Business School in Shanghai). Certainly the **close association of EU industry** in cooperation is essential, not only to help target real industrial needs but also to ensure the strong link between EU initiatives and business which will keep such cooperation in tune with economic realities.

An **information strategy for China** could include a variety of initiatives to build up awareness of the EU in the media and amongst opinion-formers in China, and to foster awareness of EU initiatives amongst the wider European public:

- Better targeted **information products** and intensified press and information activities. One way to reach an influential audience in both Europe and China would be to publish a professionally edited regular journal, like those already issued in the United States and Russia. Another, which requires a careful feasibility study, is the creation of European inputs to the growing Chinese electronic information society. There should also be a greater information component in cooperation work.
- Better **collaboration with Member States' cultural activities** in China. The Council could invite Member States to include where possible a European element in their cultural initiatives in China.
- Expansion of the current **EU visitors programme**, under which the Commission invites media representatives and opinion-formers to Brussels and at least two Member States. Better networking of those involved in cooperation work.
- Encouragement of the development of **European Studies in China** as part of the proposed

programme of university cooperation (see section D.2), to build a better picture of the EU in China over the long term. Support to promote knowledge about China in Europe, through the development of research and networks between those engaged on **Chinese studies in Europe**. We also need to review the usefulness of European Documentation Centres in China.

F. CONCLUSIONS

China is embarked on a period of change. Europe's policies, as outlined above, can both support the trend to reform in China and accommodate any uncertainties about the future. The development of the EU-China relationship must be a **sustained long-term goal**.

The rise of China presents China and the world with new challenges and opportunities. It is in Europe's interest that the current process of economic and social reform be encouraged and sustained. Europe and China need a **long-term bilateral relationship** in order to secure shared goals. Some such goals - such as the mutual interest in a smooth transition for Hong Kong and Macau - are based on ties of long standing. Others reflect new interests. But in both cases, Europe and China can work together in many practical ways: progress towards full integration in the world market economy, strengthening of civil society, poverty alleviation, environment protection, human resource development, scientific and technological development, the information society, trade and investment cooperation.

The Council is invited to:

- adopt the approach set out in this Communication;
 - to encourage China to become fully integrated in the international community
 - widening political dialogue to include all issues of common interest and global significance
 - supporting China's WTO membership on the basis of clear commitments to create a fully-fledged market economy;
 - to contribute to reform inside China
 - pursuing EU concerns on human rights and promoting the development of a civil society in China through support to the opening up of China, public and private bilateral ties, and international dialogue in multilateral fora
 - using cooperation to pursue the goals of human resource development, the promotion of economic and social reform, and cooperation between economic actors, including action in the field of the environment and science and technology;
 - to intensify ties between the European Union and China
 - developing commercial contacts to improve the business environment for EU business in China and to increase market access on a non-discriminatory basis
 - encouraging contact between Europeans and Chinese, with a particular stress on business cooperation;

The Council is invited to endorse the strategy outlined in this communication, and to invite the Commission, Member States, business and other actors to cooperate in pursuing the approach outlined. The Commission intends to move forward with the initiatives outlined in the months ahead.

Following the Third Plenum of the Chinese Communist Party's Eleventh Congress in December 1978, Deng Xiaoping led China on an ambitious reform process which has substantially changed the Chinese economic system as well as its relations with the world economy. This process has been neither smooth and steady nor the result of a clearly defined plan from above. On the contrary, it has been driven by a multitude of initiatives at various levels (central, local, individual), largely on a trial and error basis, and has resulted in an uneven path with several switches in focus and emphasis. Nevertheless, reforms have undoubtedly brought about a dramatic economic revitalisation and improved living standards.

Over the 16 years of this process, different phases can be identified:

- a) **Launching of Reforms and emphasis on Agriculture** (December 1978 - September 1984): as seems logical in a country with some 800 million people living in the countryside, the first phase of reform focused on agriculture. The key measures included the raising of the prices paid by the state for farm goods and the introduction of a Contract Production Responsibility System, which replaced people's communes with the encouragement of individual productivity. In contrast, urban reform was only tentative. Perhaps the most significant step was the creation of Special Economic Zones to boost foreign investment in four coastal areas.
- b) **Efforts towards creating a market economy** (October 1984 - September 1988): this phase tried to tackle the reform of state enterprises and price liberalisation, two key requirements for change. The objective was to separate ownership (public) and management through new legislation in areas like bankruptcy, and experiments in share holding and financial markets. In the area of price deregulation, progress was made for most consumer goods.
- c) **Retrenchment** (October 1988-December 1991): this phase saw the Chinese authorities trying to regain control of an overheated economy by freezing prices, stopping reforms and slashing investment. But it appeared increasingly clear during this period that a decade of reform has substantially reduced the government's ability to control economic actors. However, reform was continued in areas such as prices and trade.
- d) **Re-launching at higher speed** (since January 1992): the present phase, launched by Deng Xiaoping's trip to the South in January 1992, has drastically altered the political and economic climate, with a generalised rush towards accelerated reform in all areas of the economy, including areas like services or land use rights, previously little affected by reforms. Furthermore, new inland and Yangtze areas (like Nanjing, Wuhan and Chongqing) have opened for foreign trade and investment. New measures have been announced in the key areas of enterprise management and price liberalisation. The new Company Law entered into force in 1994. The reform of the banking system was launched and the new taxation system, including a VAT and a modified sharing of fiscal resources between Beijing and the provinces, were both enacted in 1994. The decision to abolish the official exchange rate and to allow the unified exchange rate to float (though controlled) in the swap markets, and the new taxation system, are the most recent and crucial reforms. Attempts to impose a credit squeeze had some effect during 1994, but the economy's momentum and growing provincial autonomy ensured that such attempts by the centre to slow the economy had only limited effect. Such reforms have been enshrined in China's Constitution under the new formula of socialist market economy.

Macroeconomic Performance

Since the launching of reforms, China has enjoyed a clear acceleration of GDP growth, averaging around 9% per year during the 1980s. Both industry and agriculture showed faster growth than in the past. Although output grew more rapidly in industry (12.6% annually during the 1980s) and especially in manufacturing, the acceleration in output growth was also dramatic in the agriculture sector. However, fast growth was accompanied by growing inflation. China had a long tradition of almost no inflation, but this trend changed abruptly with the liberalisation of production and prices, reaching a peak of over 18% in 1989.

Chinese economic performance since 1992 can only be described as remarkable. GNP growth reached 12.8%, 13.4% and 11.8% in the last three years, with industrial output up by 13%, 20% and 21% respectively. Fixed investment surged by 29% last year. But inflation at around 25% in 1994, up from 15% in 1993, has aroused the traditional fears of overheating.

Another spectacular result of Chinese reforms has been the rapid growth of foreign trade. Since 1979 Chinese trade grew twice as fast as output, a clear outcome of China's new open-door policy. At the beginning of the reform period in 1978, total Chinese trade amounted to 20 \$ billion and was roughly balanced. By 1994 this had surged to 237 \$ billion. In addition, after trade deficits which reached as high as 15 \$ billion in 1985, the Chinese trade balance went back to a surplus position in 1990. With the exception of a 12 \$ billion deficit in 1993, China has enjoyed surpluses ever since, bolstered by what amounted to a devaluation of the Yuan at the time of currency unification in January 1994. This good performance in trade has helped to ease the foreign debt burden, which started to worry Chinese policy-makers during the 1980s, but now China has a very healthy foreign-exchange reserves at around 50 \$ billion, even if foreign debt remains substantial at 80 \$ billion.

Structural Problems

However, economic reform and booming trade has been concentrated in only a few Chinese provinces. With some exceptions, traditional regional imbalances in China between the rich and dynamic Southeast coastal areas (from Shanghai down to Canton) and the more backward North and West inland areas have been compounded since the beginning of reform. The establishment of five Special Economic Zones (Shenzhen, Zhuhai, Shantou, Xiamen and Hainan) followed by the "opening" to foreign investment of 14 coastal cities and the creation of Free Trade Zones and 5 Open Economic Zones accentuated the gap between the "two Chinas". The whole coast from North to South has progressively become an open zone that includes 11 provinces (292 cities and districts) which represent less than 5% of Chinese territory and around 17% of population, but which produce one third of China's GNP.

Other structural problems, like **infrastructure bottlenecks and environmental degradation**, risk undermining sustainable long term economic growth in China. The problems of acute energy shortages, a transport system which is clearly inefficient and unable to meet demand, and primitive telecommunications, are bound to get worse as economic growth gathers speed and investment in these key sectors lags far behind. Environmental deterioration is already serious and, despite the government's awareness of the dangers of long-term damage, China's economic development strategy has focused on rapid wealth creation, leaving the consequences to be dealt with in the future.

Traditionally, China watchers used to focus on **inflation** as the most obvious signal not only of economic difficulties but also of political trouble ahead (and 1989 certainly proved them right). Recent figures have again pointed to overheating of the economy and growing urban inflation. Monetary policy rests on administered credit and not on interest rates or an open market policy. The recent negative interest rates make overheating a risk. Fiscal policy, and the protection of loss-making state owned enterprises, are also typically inflationary. A **growing budget deficit** (over 8% of GDP) and a rapidly expanding money supply are likely to exacerbate the problem.

Unemployment could become a much more serious long-term problem, especially if reform of the inefficient state-owned sector gathers pace. Already, migration on a huge scale has taken place from the poor West to the coastal cities - some estimates have put this as high as 100 million people.

The making of a "Socialist Market Economy" with Chinese characteristics

The effects of over one decade of reform can be analysed in terms of the degree to which the market economy has developed in China, both as a way of organising production and as a way of matching supply and demand. In other words, what proportion of Chinese output is the result of mandatory planning (instead of individual decisions by companies) and what proportion of Chinese prices is controlled (instead of freely set by market forces). Evolution in company ownership is another key factor in assessing progress in reform.

- a) **Planning versus market in output and prices:** the share of individual output which was the object of mandatory planning has been reduced sharply from around 80% in the early 1980s to just 17% in 1991. In other words, from an economy in which only 20% of industrial production escaped mandatory output targets, China moved to a new situation in which less than 20% of this output was under the strict control of the plan. Recent liberalisation has further reduced state production quotas. The hand of the state is still felt in China in numerous ways; but the crude influence of planning has been largely swept aside. The same trend towards liberalisation is noticeable in price determination. Some estimates indicate that the share of products under controlled prices has been reduced to 22% for agriculture, 20% for consumer goods and 36% for means of production. A new wave of liberalisation, announced during 1993, left only less than 10% of retail sales under state pricing.
- b) **Ownership:** diversification in the ownership of production units, especially the growth of the non-state sector, is a clear indication of the development of a market economy. In 1978, 77.6% of industrial output and 54.6% of retail sales were in the hands of state companies. 1994 estimates put the output share of state-owned companies at 44% and their share of retail sales at only 41%. If we look at recent growth rates in the different sectors, the importance of the non-state sector is bound to continue its upward trend. Another feature has been the growing variety of different types of enterprise, from the township and village enterprises of the countryside to the burgeoning foreign invested joint ventures.
- c) **Smashing the iron rice bowl:** the key to the Chinese reform process in the years to come is very probably going to be the sensitive issue of restructuring the huge, inefficient and loss-making state-owned industry, over 100,000 enterprises, of which about 11,000 are medium or large sized, employing some 100 million workers, of whom one-third could be made redundant. By 1994, some 40% of the state-owned companies were losing money (by official calculations). Their combined losses rose by 30% in 1994, and those still in the black saw a sharp decline in profits, leading to 4.7 \$ billion of public subsidies (60% of the total public deficit). The debt chain between different companies is surging (some estimates put it at 69 \$ billion) making restructuring of China's public industry all the more crucial but, also, more difficult.

Failure to tackle this sector will continue to undermine China's modernisation drive; but a destructive approach could have enormous social, economic and political consequences. Reform has so far been hesitant in this area. Besides a modest attempt at separating ownership and management (the contract management responsibility system) and partial separation of companies and the state by taxing profits and allowing some profit retention autonomy, few measures have really attacked the core of the problem. When they have, like the Bankruptcy Law, they remain just a declaration of good intentions implemented only sporadically. This sector as a whole remains a serious brake on China's future development.

EU-China Trade

In parallel with China's booming total trade, the **bilateral trade flows** between the EU and China have also surged. Total bilateral trade in 1978 was only 2.4 billion ECU (EC - 9), but by 1993 this had boomed to 30.8 billion ECU (EC-12). EU-China trade has increased almost thirteen-fold since the beginning of reform in China (see statistical annex).

The EC enjoyed a positive trade balance between 1983 and 1987, reaching a peak in 1985 with a 3.2 billion ECU trade surplus vis-à-vis China. Since 1988, however, the situation has changed dramatically. China enjoyed a 1.2 billion ECU trade surplus that year and from then until 1991, doubled it every single year. However, after growth in the surplus slowed in 1992, 1993 showed a reversal of the trend. EU exports grew by 65%, leading to the first reduction of our bilateral trade deficit since 1988, to 8.2 billion ECU. It should be noted that, in contrast, the US trade deficit vis-à-vis China continued to grow rapidly during 1992 - 1994, reaching 30 \$ billion last year. But the available figures for 1994 indicate that China's bilateral trade surplus with the EU has started to grow again, and could have exceeded 10 billion ECU.

Of course, despite many efforts to analyse the reasons for **discrepancies between EU and Chinese statistics**, these remain significant. For example, Chinese figures showed a bilateral trade surplus for the EU of 2.4 \$ million in 1993. Both Eurostat and a GATT statistics subgroup have explained these discrepancies as the result of differences over how to include Hong Kong re-export figures in the statistics.

Concerning **trade by product category**, EU exports continue to be concentrated in areas like machinery, both mechanical and electrical, transport equipment, and nuclear reactors, which amounted to over 65% of total EU exports to China in 1993. As for Chinese exports to the EC, the main items continue to be textiles and clothing (20% of the total), toys, electrical material, leather goods and footwear. These five categories together represent over 57% of total EC imports from China in 1993.

A longer term analysis of EU's trade performance in China shows the Community slightly losing market share in the Chinese import market during the 1980s. The EC (9) had a 12% share of Chinese imports in 1980, and the EC (10) reached a 13% share in 1985. But the EC (12) fell to 11% in 1990. However, this slight reduction compares favourably with the collapse of US (from 19% in 1980 to 8% in 1990) and Japanese (from 26% in 1980 to 10% in 1990) shares in the total of China's imports in the same period. Therefore, the US, the EU and Japan all lost market share in China during the 1980s, but the EU managed to retain its relative position much more successfully than its competitors. Recent figures suggest a growth in market share for the EU (around 15%), less dramatic than that of Japan, but more impressive than a stagnant US position. It is also worth noting that, in contrast to the US, the EU share of the Chinese market is higher than those enjoyed in other Asian markets such as the NICs, ASEAN or Japan.

A positive factor in China's surging exports to the EU has undoubtedly been the Community's GSP system. It should be noted that China has been, by far, the biggest beneficiary of the EU GSP in recent years. China's exports enjoying GSP benefits jumped from 2.1 billion ECU in 1988 to 6.6 billion ECU in 1992 and the Chinese share in the total benefits of the EC system went up from 13.7% to 22.2%, three times as much as the second beneficiary.

Investment

Foreign borrowing by China and foreign direct investment in China have also been growing rapidly since the beginning of reforms. Foreign Direct Investment exploded in 1992 and 1993. In the period 1979-1992, China borrowed almost 75 \$ billion (60 \$ billion actually disbursed) and foreign companies set up 90,710 joint ventures, with a total value contracted of 110 \$ billion and 36 \$ billion actually used. FDI in China grew even more rapidly in 1993, reaching 111 \$ billion of contracts and 25.8 \$ billion actually used for the 83,000 new joint ventures established. Figures for 1994 showed a decrease in the amount of projects (47,490) and contracted FDI (much of which was simply Chinese capital going through Hong Kong to benefit from an advantageous FDI regime) but another growth in used foreign capital to over 33.8 \$ billion. All in all, in the 1979-1994 period, over 221,000 of Joint Ventures have been created, over 301 \$ billion have been pledged and over 95 \$ billion actually invested in China. They employ some 12 million Chinese workers and they represent around 40% of China's total foreign trade.

Hong Kong and Macau companies are by far the biggest investors in China, with 114,147 projects, 150 \$ billion of contracts and some 50 \$ billion disbursed between 1979 and 1993. This represents around two-thirds of projects and contracts and three-quarters of used foreign capital. Taiwan comes second, increasing to 3/4 the share of FDI of Chinese origin. From the rest, the performance of the EU, USA and Japan in the period 1979-1993 can be summarised as follows:

	Projects	Contracts (\$ million)	Used (\$ million)
EU (12)	2,741	6,952	2,442
EU (15)	3,070	7,319	2,549
USA	12,019	14,659	5,237
JAPAN	7,182	8,935	5,203

Therefore, EU investment lags behind that of the main competitors both in terms of number of joint ventures and capital invested. However, these figures show that the average size of EU projects tends to be bigger than those of other origin. Both the USA and Japan have invested a similar amount, 5 \$ billion, to Taiwan, more that twice the EU figure. In terms of Member States, the biggest investors in China are:

	Projects	Contracted Capital (\$ million)	Used Capital (\$ million)
FRANCE	547	920	602
UK	616	3,018	578
GERMANY	569	1,458	527
ITALY	467	552	397

1993-1994 COMMUNITY TRADE WITH CHINA

Ecu millions

	EUR 12	D	F	I	NL	B/L	UK	Ir	DK	GR	E	P
<u>JANUARY-DECEMBER 1994</u>												
IMPORT	22 706	7 644	2 651	2 629	1 732	1 484	4 280	207	536	233	1 174	136
EXPORT	12 447	5 320	1 826	1 921	537	910	1 060	27	145	15	672	14
BALANCE	-10 259	-2 324	-825	-708	-1 195	-574	-3 220	-180	-391	-218	-502	-122
<u>JANUARY-DECEMBER 1993</u>												
IMPORT	19 639	6 869	2 397	2 214	1 403	1 263	3 509	205	503	248	870	158
EXPORT	11 339	4 955	1 377	2 108	596	608	946	25	115	36	547	26
BALANCE	-8 300	-1 914	-1 020	-106	-807	-655	-2 563	-180	-388	-212	-323	-132

From January-December 1993 until January-December 1994, EC imports increased 15,6%, the exports 9,8% and the community balance passed from -8 300 to -10 527 millions of Ecu.

Source: EUROSTAT -Estimate for november-december 1994, for the Netherlands and Greece

1992-1993 COMMUNITY TRADE WITH CHINA
Ecu millions

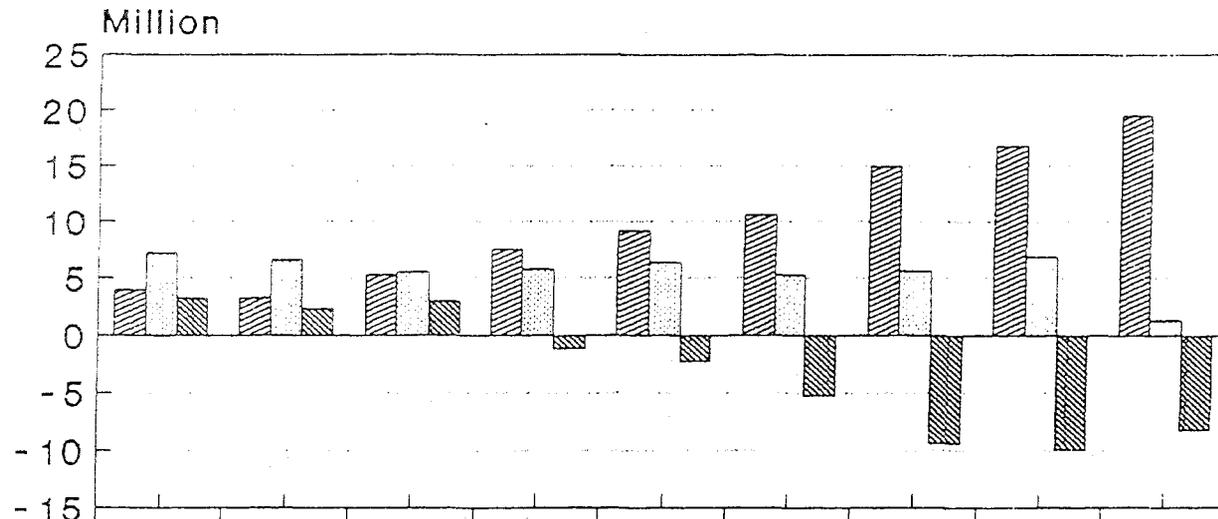
	EUR 12	D	F	I	NL	B/L	UK	Ir	DK	GR	E	P
<u>JANUARY-DECEMBER 1993</u>												
IMPORT	19 528	6 868	2 420	2 215	1 276	1 263	3 509	205	502	248	875	157
EXPORT	11 302	4 955	1 338	2 108	599	608	946	25	114	36	544	29
BALANCE	-8 236	-1 913	-1 082	-107	-677	-655	-2 563	-180	-388	-212	-331	-128
<u>JANUARY-DECEMBER 1992</u>												
IMPORT	16 783	5 423	1 941	2 148	1 603	1 012	2 672	140	545	184	1 031	84
EXPORT	6 852	2 852	1 250	1 144	340	341	578	12	98	14	209	14
BALANCE	-9 931	-2 571	-691	-1 004	-1 263	-671	-2 094	-128	-447	-170	-822	-70

From January-December 1992 until January-December 1993, community imports increased 16,4%, exports 64,9% and the community balance passed from -9 931 to -8 236 Ecu millions (-17%).

Source: EUROSTAT

1985-1993 COMMUNITY TRADE WITH CHINA

Source: EUROSTAT - EUR 12



	1985	1986	1987	1988	1989	1990	1991	1992	1993
EC Import	3.936	3.223	5.239	7.539	9.148	10.587	14.972	16.783	19.538
EC Export	7.181	6.533	5.533	5.801	6.372	5.271	5.605	6.852	11.302
EC Balance	3.245	2.316	2.946	-1.204	-2.276	-5.316	-9.367	-9.931	-8.236



TABLE - IMPORTS AND EXPORTS WITH CHINA, BY PRODUCT GROUP

	EUROPEAN UNION				UNITED STATES				JAPAN			
	1990	1991	1992	1993	1990	1991	1992	1993	1990	1991	1992	1993
	IMPORTS (BN ECU)											
ALL PRODUCTS	10,6	15,0	16,8	19,5	12,8	16,4	21,1	28,8	9,5	11,5	13,1	17,5
PRIMARY PRODUCTS	1,6	1,8	1,8	1,8	1,3	1,2	1,2	1,1	4,9	5,1	5,0	5,7
AGRICULTURAL PRODUCTS	1,3	1,5	1,4	1,4	0,6	0,5	0,7	0,7	2,2	2,7	2,8	3,5
MINING PRODUCTS	0,3	0,3	0,3	0,3	0,7	0,7	0,6	0,4	2,7	2,4	2,2	2,2
NON-FERROUS METALS	0,0	0,0	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1
FUELS	0,1	0,2	0,2	0,1	0,6	0,5	0,4	0,2	2,4	2,0	1,8	1,8
PETROLEUM/PETR. PR	0,0	0,0	0,0	0,0	0,6	0,5	0,4	0,2	2,1	1,7	1,6	1,6
NON-AGRICULT. RAW MAT.	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
MANUFACTURED PRODUCTS	8,9	13,1	14,9	17,7	11,4	15,0	19,6	27,5	4,5	6,4	8,0	11,7
MACHINERY	1,4	2,0	2,5	3,5	1,9	2,6	3,4	5,1	0,4	0,6	0,7	1,3
OFFICE/TELECOM. EQUIP	1,0	1,2	1,5	2,0	1,0	1,5	1,9	2,9	0,1	0,2	0,3	0,6
POWER/NON-ELECT. MACH	0,2	0,3	0,4	0,5	0,3	0,4	0,5	0,7	0,1	0,1	0,2	0,2
ELECT. MACH./APPARATU	0,2	0,5	0,7	1,0	0,5	0,7	1,1	1,5	0,1	0,2	0,3	0,4
TRANSPORT EQUIPMENT	0,1	0,2	0,2	0,1	0,1	0,1	0,2	0,3	0,0	0,0	0,0	0,1
AUTOMOTIVE PRODUCTS	0,0	0,0	0,0	0,0	0,0	0,0	0,1	0,1	0,0	0,0	0,0	0,0
CHEMICALS	0,6	0,7	0,7	0,8	0,3	0,3	0,4	0,5	0,4	0,5	0,5	0,6
MEDICAL/PHARM. PROD.	0,1	0,1	0,2	0,2	0,0	0,1	0,1	0,1	0,0	0,0	0,1	0,1
PLASTICS	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
OTHER MANUFACTURED PROD.	6,7	10,1	11,4	13,2	9,1	11,9	15,6	21,5	3,7	5,3	6,8	9,8
TEXTILES AND CLOTHING	2,9	4,3	4,3	4,9	3,4	3,9	4,9	6,5	2,5	3,4	4,6	6,4
IRON AND STEEL	0,0	0,0	0,0	0,0	0,1	0,1	0,0	0,1	0,3	0,4	0,2	0,3
PAPER/ARTIC. OF PAPER	0,0	0,1	0,1	0,1	0,0	0,1	0,1	0,1	0,0	0,0	0,0	0,0
NON-METAL. MIN. MANUF	0,1	0,2	0,3	0,3	0,2	0,2	0,3	0,4	0,1	0,1	0,2	0,3
OTHER PRODUCTS	0,1	0,1	0,1	0,1	0,1	0,1	0,3	0,2	0,1	0,0	0,0	0,1
	EXPORTS (BN ECU)											
ALL PRODUCTS	5,3	5,6	6,9	11,3	3,8	5,1	5,8	7,5	4,8	6,9	9,2	14,7
PRIMARY PRODUCTS	0,6	0,5	0,4	0,3	1,0	1,1	1,1	1,0	0,3	0,4	0,5	0,8
AGRICULTURAL PRODUCTS	0,4	0,3	0,2	0,2	0,8	0,8	0,6	0,4	0,0	0,0	0,0	0,0
MINING PRODUCTS	0,1	0,1	0,1	0,1	0,1	0,2	0,4	0,6	0,1	0,1	0,3	0,5
NON-FERROUS METALS	0,0	0,0	0,0	0,0	0,0	0,1	0,1	0,1	0,0	0,1	0,1	0,1
FUELS	0,0	0,0	0,0	0,0	0,0	0,0	0,2	0,2	0,0	0,1	0,2	0,3
PETROLEUM/PETR. PR	0,0	0,0	0,0	0,0	0,0	0,0	0,2	0,2	0,0	0,1	0,2	0,3
NON-AGRICULT. RAW MAT.	0,1	0,2	0,1	0,1	0,1	0,2	0,1	0,1	0,2	0,2	0,2	0,2
MANUFACTURED PRODUCTS	4,5	4,7	6,1	10,5	2,7	3,9	4,6	6,4	4,5	6,5	8,6	13,7
MACHINERY	2,4	2,3	2,9	5,7	0,9	1,1	1,3	2,4	1,8	2,6	3,8	6,1
OFFICE/TELECOM. EQUIP	0,2	0,3	0,4	0,7	0,2	0,2	0,3	0,7	0,8	1,2	1,4	1,9
POWER/NON-ELECT. MACH	1,9	1,7	2,3	4,5	0,6	0,8	0,8	1,4	0,7	1,0	1,9	3,6
ELECT. MACH./APPARATU	0,2	0,3	0,3	0,4	0,1	0,1	0,1	0,2	0,3	0,4	0,4	0,6
TRANSPORT EQUIPMENT	0,5	0,6	1,5	2,1	0,6	0,9	1,8	2,6	0,3	0,6	1,1	2,1
AUTOMOTIVE PRODUCTS	0,2	0,5	1,0	1,4	0,0	0,0	0,2	0,7	0,2	0,4	0,9	1,5
CHEMICALS	0,5	0,8	0,6	0,6	0,8	1,4	0,9	0,7	0,6	0,9	0,8	0,9
MEDICAL/PHARM. PROD.	0,1	0,1	0,1	0,1	0,0	0,0	0,0	0,0	0,1	0,1	0,1	0,1
PLASTICS	0,1	0,1	0,1	0,1	0,1	0,2	0,2	0,2	0,2	0,2	0,3	0,3
OTHER MANUFACTURED PROD.	0,8	0,8	0,9	1,9	0,4	0,6	0,6	0,8	1,8	2,5	2,9	4,7
TEXTILES AND CLOTHING	0,0	0,1	0,1	0,1	0,0	0,0	0,0	0,0	0,4	0,6	0,8	1,0
IRON AND STEEL	0,2	0,3	0,4	1,2	0,0	0,1	0,1	0,0	0,8	1,1	1,1	2,5
PAPER/ARTIC. OF PAPER	0,0	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1
NON-METAL. MIN. MANUF	0,1	0,0	0,0	0,1	0,0	0,0	0,0	0,0	0,1	0,2	0,1	0,1
OTHER PRODUCTS	0,2	0,4	0,4	0,4	0,0	0,0	0,1	0,1	0,1	0,1	0,1	0,1

COMMUNITY EXPORTS TO CHINA BY PRINCIPAL COMMODITY¹⁾

Ecu millions

Code ²	Product	1989	1990	1991	1992	1993	% on 93 total
84	Nuclear reactors, boilers, machin. & mechanical appliances...	2 491	2 250	1 921	2 491	2 724	41.6
87	Vehicles other than railway or tramway rollingstock...	305	232	464	935	1 312	11.5
85	Electr. machin. & equipment. Television image. Sound/ image reproducers	518	571	691	744	1341	11.8
00	Products classified as secret	216	224	390	393	393	3.5
90	Optical, fotogr., cinematogr., measuring , precision, medical instruments..	199	191	223	235	331	2.9
29	Organic chemicals	194	186	261	219	271	2.4
73	Articles of iron or steel	343	249	237	163	276	2.4
88	Aircraft, spacecraft, and parts thereof	265	14	8	258	403	3.6
72	Iron and steel	350	97	92	261	1 051	9.3
39	Plastics and articles thereof	119	69	154	131	145	1.3
38	Miscellaneous chemical products	73	73	98	89	72	0.6
31	Fertilisers	77	97	121	83	50	0.4
55	Man-made staple fibres	105	97	99	73	39	0.3
48	Paper and paperboard ; articles of paper pulp, of paper or paperboard	49	40	63	69	54	0.5
30	Pharmaceutical products	23	30	36	46	36	0.3
51	Wool, animal hair, horsehair yarn and woven fabric	67	29	51	43	43	0.4
89	Ships, boats and floating structures	115	101	30	37	49	0.4
76	Aluminium and articles thereof	50	23	33	39	29	0.3
32	Tanning extracts. Tannins, dyes, pigments, paints, mastics and inks	24	22	35	32	30	0.3
	Total of the 19 products					10 648	93.2
	Total exports to China	6 372	5 271	5 605	6 852	11 339	100,0

1) Source: EUROSTAT (EUR 12)

2) Combined Nomenclature

COMMUNITY IMPORTS FROM CHINA BY PRINCIPAL COMMODITY¹⁾

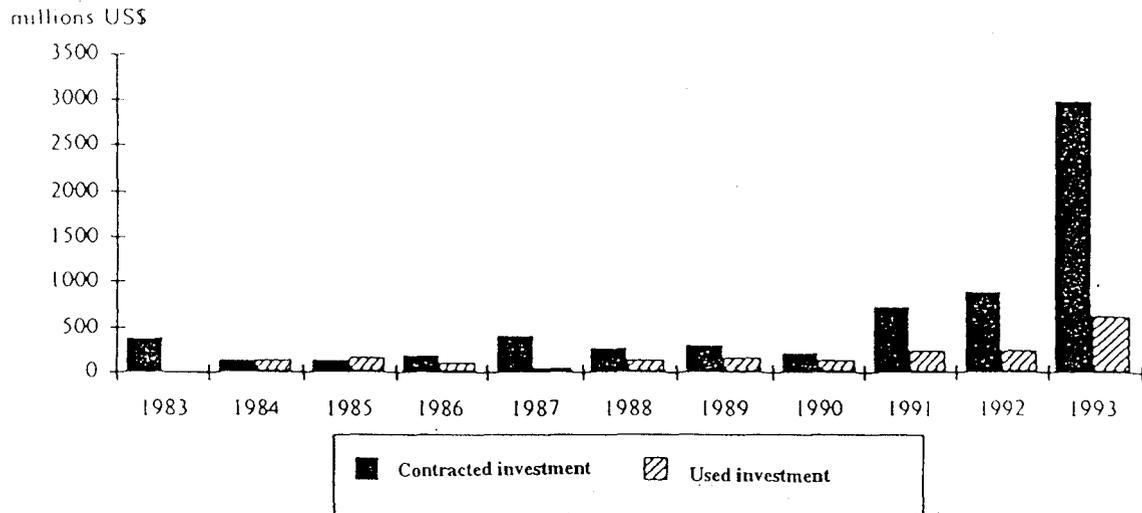
Ecu millions

Code ²⁾	Product	1989	1990	1991	1992	1993	% on 93 total
61/63	Articles of apparel and clothing accessories, other made-up textile articles...	1 482	2 127	2 249	2 489	3 923	20.1
95	Toys, games, and sports requisites	911	1 077	1 680	2 108	2 359	12.1
85	Electr. machin. & equipment. Television image. Sound/image reproducers	896	1 306	1 679	2 071	2 710	13.9
42	Articles of leather, travel goods, handbags,	551	710	1 029	1 135	1 305	6.7
64	Footwear	224	267	526	728	877	4.5
84	Nuclear reactors, boilers, machinery & mechanical appliances...	196	267	438	586	898	4.6
39/40	Plastics & articles thereof; rubber & articles thereof	195	255	374	451	572	2.9
67	Prepared feathers and down. Artificial flowers, articles of human hair	196	223	314	314	311	1.6
94	Furniture; bedding, mattresses, cushions; lamps....Prefabricated buildings	87	121	235	318	475	2.4
07	Edible vegetables and certain roots and tubers	168	160	291	247	230	1.2
91	Clocks and watches and parts thereof	139	145	204	261	288	1.5
50	Silk	519	359	275	241	212	1.1
73	Articles of iron or steel	139	163	204	247	297	1.5
82	Tools, implements, cutlery, spoons and forks, of base metal...	129	136	210	202	258	1.3
65/66	Headgear, umbrellas, walking sticks, seat sticks, whips, riding-crops...	95	113	164	178	238	1.2
27	Mineral fuels, mineral oils & products of their distillation.....	167	129	161	162	135	0.7
46	Manufactures of straw, of esparto... Basketware & wickerwork	133	127	147	148	152	0.8
51	Wool, fine or coars animal hair; horsehair yarn and woven fabric	183	115	146	148	141	0.7
57	Carpets and other textile floor coverings	128	117	146	145	156	0.8
12	Oil seeds and oleaginous fruits; miscellaneous grains, seeds and fruits....	107	137	224	136	132	0.7
20	Preparations of vegetables, fruit, nuts, or other parts of plants	113	132	153	147	116	0.6
28	Inorganic chemicals; organic or inorganic compounds of precious metals...	199	133	163	113	154	0.8
52	Cotton	149	149	120	105	115	0.6
a	Total of the 23 products	6 910	8 201	11 899	12 094	16 054	82.2
b	Total imports from China	9 148	10 587	14 972	16 783	19 639	100.0

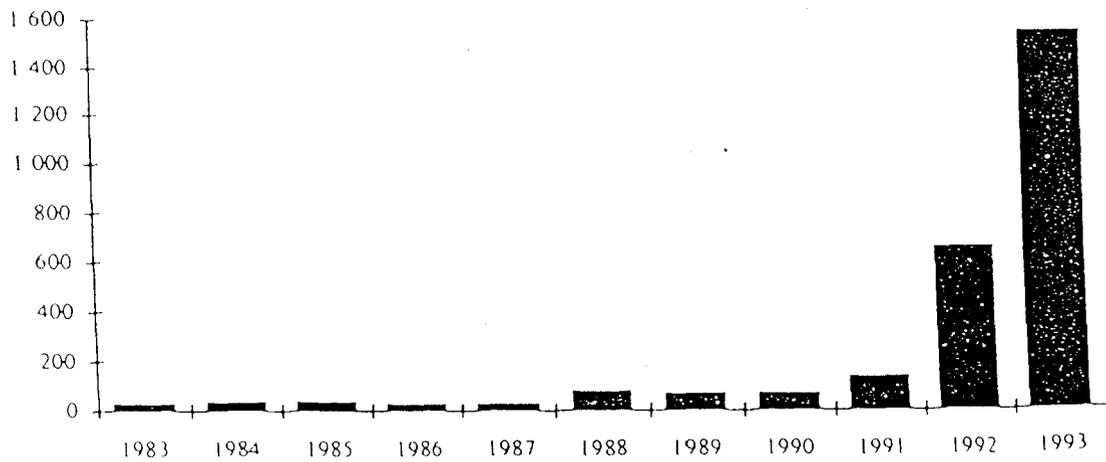
1) Source: EUROSTAT (EUR 12)

2) Combined Nomenclature

Evolution of direct investment of the European Union



Evolution of the amount of direct investment of the European Union



Direct investment in China (up to December 31, 1993)

Countries	Number of Projects	Contracted Amount (US\$ mln.)	Realised Amount (US\$ mln.)
United Kingdom	616	3,018	578
Germany	569	1,458	527
France	547	920	602
Italy	467	552	397
Netherlands	191	406	176
Spain	168	289	24
Belgium	100	137	67
Denmark	51	102	63
Ireland	8	49	5
Luxembourg	13	16	2.3
Portugal	9	5	0.3
Greece	2	0.5	
	-----	-----	-----
EU (12)	2.741	6.952,5	2.442
Austria	174	187	35
Sweden	133	150	42
Finland	22	30	30
	-----	-----	-----
EU (15)	3.070	7.319,5	2.549
USA	12.019	14.659	5.237
Japan	7.182	8.935	5.203

ANNEX 3: EU-CHINA BILATERAL TRADE ISSUES

Following continuous pressure by China's trading partners, both bilaterally, and multilaterally in the GATT accession discussions, some **improvements** have been made to the Chinese trade system.

- a) centralisation of foreign trade rules publication in a single office and publication of all existing rules to increase transparency (not yet fully implemented). The first ever Foreign Trade Law was adopted in May 1994 and entered into force in July (although some provisions seem not fully GATT-compatible);
- b) lowering of certain customs duties;
- c) reduction in the number of products subject to import licences or quotas: as of June 1994, a total of 413 items were still subject to NTM's without renewal plans; abolition of import substitution policies and import and export planning;
- d) elimination of the import regulatory tax, direct export subsidies and the import substitution policy;
- e) elimination of the official exchange rate as of 1 January 1994 and unification of China's exchange rate at the swaps market rate, whose floating is controlled;
- f) introduction of VAT, a uniform corporate tax and improved budget accounting rules;
- g) conversion of some state owned enterprises to shareholding or limited liability companies, subcontracting of management of some remaining state owned enterprises, creation of a bankruptcy law.

Although these measures represent important steps forward, they are clearly insufficient to make the Chinese trade system compatible with internationally accepted rules. Remaining problems include :

- . Absence of transparency, certainty and uniformity
- . Trade planning (plans which are often secret)
- . Trade monopolies and other privileges of foreign trade corporations
- . Foreign currency controls
- . Very high customs tariffs
- . Licensing system, quotas, tendering, and other import restrictions
- . Tendering restrictions on imports
- . Technical, veterinary and phytosanitary measures used not always in accordance with international rules
- . Export subsidies (mostly indirect)
- . Export taxes and restrictions
- . Industrial policies which can have a severe impact on trade and investment conditions, for example in the automobile sector.

This list of measures clearly shows the dilemma for an exporter who has to face not only the classic deterrent of high customs duties and the requirement of an import licence, but also uncertainty about the rules applied, which are often unpublished and implemented on an ad hoc basis. Secret trade plans, import substitution policies carried out by the sectoral Ministries and foreign currency controls amount to a system which lacks transparency and certainty.

Bilateral Trade Discussions

A **bilateral trade deficit** of 8-10 billion ECU in the last four years deserves close analysis. Of course, bilateral trade imbalances are not a problem in themselves, but only if they reflect structures and practices which are not compatible with free and fair trade rules. We believe this is the case in China.

In order to deal more effectively with this problem, the Joint Committee, in its October 1991 meeting, decided to hold a **Trade Experts' Meeting** (which further evolved into a series of periodical discussions) to examine the specific problems hampering the adequate development of trade. The agendas of those meetings have included not only specific problems (phytosanitary and veterinary matters, industrial metals, footwear, silk, alcoholic beverages, services) but also horizontal issues (transparency, foreign exchange controls, etc.).

The purpose of these meetings was threefold. First, to increase mutual understanding on outstanding contentious issues and maintain pressure on the Chinese authorities to ease the existing problems; second to seek solutions to specific problems of EU interest; and finally, to avoid any discrimination that might result from China's deals with other partners, in particular with the US. Of course, most of the main issues of contention about access to the Chinese market are now being addressed also in the context of the negotiations on Chinese WTO accession.

The Joint Committee of April 1993 decided to set up a **Working Group on Economic and Trade matters** in order to institutionalise the on-going trade discussions. During the Joint Committee meeting of February 1994 it was decided to supplement the Economic and Trade Working Group with three **sectoral meetings on Financial Services, IPR and Agriculture**. Other sectors could be added in the future. This approach of backing up a global summary meeting on economic matters with detailed technical-level discussions is designed to ensure a realistic and fruitful dialogue: a genuine attempt to improve mutual understanding and facilitate economic ties between two important commercial partners.

The EU has raised bilaterally, a variety of sectoral issues in recent years.

- **Non-ferrous Metals** (notably the surge of imports at abnormally low prices which are at the origin of several anti-dumping procedures);
- **Silk Products** (in particular double pricing policies which lead to manufactured goods being sold by China more cheaply than the raw material);
- **Alcoholic Beverages** (the whole import regime, including the import monopoly, extremely high customs duties, unknown rules for trading and taxation, and unpublished import plans and quotas);
- **Financial Services** (limitation in the activities of foreign banks and insurance companies, possibility of establishment in areas like commerce, consulting and law firms);
- **Agriculture** (phytosanitary and veterinary measures which hamper trade in sectors like bovine meat, tobacco, and dairy products; discussion for concluding an administrative arrangement to govern phytosanitary and veterinary matters; and a request for an EC unit to be set up in the China Commodity Inspection Bureau);
- **IPR** (proper enforcement of existing legislation, notably infringements in the area of trademarks and unfair competition (counterfeiting and passing off), copyrights, as well as proper implementation of agreements on pipeline patent protection);
- **Shipping** (proper application of the 1992 Agreed Minutes, not yet fully achieved);

- **Technical Barriers** (the whole system remains non-transparent, mixing up private and public inspection and is not always based on international standards leading to trade obstacles as, for example, in the field of chemicals);
- **Taxation** (in particular the new VAT, which include discriminatory elements for foreign companies, and Consumption Tax);
- **National Treatment** for foreign-funded companies (constraints and discriminations affecting their operation in China).

Potential discrimination emerged after the US launched a first Section 301 investigation of the issue of intellectual property rights in 1991. A Memorandum of Understanding between the US and China provided for a substantial improvement in the level of patent and copyright protection in China. The MOU contained, however, provisions that would have discriminated against the Community. The subsequent dialogue with China led to an agreement on the subject, avoiding what could have been a major trade conflict. Discrimination of the Community vis-à-vis the US has also been prevented by negotiations in the area of maritime transport.

A second investigation under Section 301 was launched on the general question of access to the Chinese market for US exports. A compromise solution was finally reached and the US and China signed a Memorandum of Understanding on 10 October 1992 in which China agreed to publish all laws, regulations, rules, decrees, administrative guidance and policies affecting trade. Unpublished rules will no longer be enforceable and publication will be centralised in one official journal. In addition, China agreed to progressively reduce import restrictions, quotas, licensing requirements and controls; to give confirmation on the elimination of all import substitution rules and policies; to avoid the utilisation of veterinary and phytosanitary standards and testing requirements as import barriers, applying the same requirements to domestic and imported products; and to reduce tariffs on several products. It was clear that the benefits of the agreement would be enjoyed by all of China's trading partners, particularly in terms of transparency. But concern was expressed about one discriminatory element, a special provision allowing unrestricted importation of spare parts and kits only for US automobile joint ventures. The Chinese government accepted an exchange of letters whereby EU companies will enjoy exactly the same treatment, and agreed to consider EU's priority products for early liberalisation.

The recent US-China agreement on several IPR issues, most notably on copyrights enforcement, is another step, as long as it is applied erga omnes, towards not only better Chinese legislation but, particularly, adequate enforcement of it. The Commission should make sure that EU products enjoy the same protection granted to US ones, de jure of course but particularly in practice, and that the provisions regarding joint ventures and market access are extended to EU companies and products.

EC Import Regime

Following the completion of the internal market, a review took place of the rules regulating a variety of nationally-set quotas, some 4,700 quotas on Chinese products were in place¹. At the same time, this substantial liberalisation was only acceptable to European industry when accompanied by a minimum, of protection, in view of the unique nature of the Chinese economy and its consequent potential to disrupt the EU market in some sectors.

¹ Regulation 3420/83

In the wake of the conclusion of the Uruguay Round, the abolition of all national QRs and the establishment of a few EU-wide was agreed. This new regime puts only seven product categories under quota (footwear, gloves, tableware and kitchenware, glassware, radio-broadcast receivers and toys) which represent around 13% of Chinese non-textile exports to the EU (in 1992). Other products will be subject to a surveillance regime with no quantitative limitation.

A new import regime was also established for Non-MFA textiles products, particularly silk and silk products. This autonomous regime has been negotiated with the Chinese and was soon transformed into a bilateral agreement.

It is clear that this new regime represents a substantial improvement on the old one, not only in terms of scope (volume of trade and number of products covered) but also in terms of transparency and certainty. In addition, the quota levels have been substantially raised in 1995 to take account both of enlargement and of specific problems in certain sectors.

ANNEX 4: COOPERATION ACTIVITIES

Financial and Technical Assistance

The first project to be financed by the European Community came in 1984, just before the normalisation of cooperation activities through the Trade and Cooperation Agreement. A full-scale development aid programme developed in the wake of the signing of the Agreement in 1985. To the end of 1994, the EC financed a total of 25 development projects in China in the field of technical and financial assistance, by far the bulk of total resources devoted to relations with China. Projects have tended to combine expert advice on the spot, some training of Chinese in the EU, and support towards the modernisation of equipment. The projects have centred on the rural sector in its broadest sense, covering such varied fields as soil and water conservation, food processing and storage, as well as the improvement of crop yields. The programme was designed to spread the influence of the EC into a variety of sectors, and a variety of provinces. As a result, the programmes have touched on products as varied as citrus fruits and cashew nuts, shrimps and rubber. The geographical spread of activities has meant that the work has spread from Xinjiang in the west to Liaoning in the east, and from Jilin in the north to Hainan in the south.

One result has been that starting from scratch, an EC presence was established in diverse parts of China. The importance of the programme has also been given added force by the fact that few other foreign donors have entered the rural sector in China. However, in the face of such a vast country as China, the overall effect of a such a programme has necessarily been small. It has proved difficult to establish a national profile through the adoption of such a "bottom-up" strategy. In operational terms, the pooling of knowledge and experience between EU expert teams separated across the country has not been achieved. A further problem has been that at a time of rapid change in China, institutional partners sometimes find it difficult to fulfil their long-term commitments.

The largest single technical and financial assistance project in China has been the Dairy Development Project. The central aim of the project was to improve nutrition standards in China through supporting the dairy sector. First, EC milk powder and butter oil were made available to China at local prices. Then the proceeds were ploughed back into the development of the dairy industry in China. European experts from across the EC were sent to China to advise on the evolution of a sound dairy industry, cattle stocks were built up, and equipment was provided to enlarging the milk processing capability in China. The project was one of few foreign-funded projects in the heart of the Chinese rural sector, and the only EU project to have developed a network approach with true national scope and participation. The project promoted and modernised the dairy sector in 20 major municipalities and established a national strategy for the dairy sector. It set up structures and introduced new technology to ensure that the dairy products market and dairy production develop in tandem. A one year interim phase for the project agreed in 1994 involves 30 project areas and has moved away from supporting mainly milk processing capacity and the increase of cattle numbers towards strengthening the productivity of dairy farming and improving quality control throughout the dairy sector.

The Commission has now launched a feasibility study of a possible second phase. The study is examining the extension of the project to have an impact from the farm level right to the marketplace, addressing weaknesses such as quality control, hygiene and productivity to improve the responsiveness of the industry to the market. The commercial orientation of a second phase could include measures to promote the EU investment in the Chinese dairy sector.

To develop projects on such a national scale obviously requires greater resources and infrastructure. Another approach which has increasingly been adopted is to adopt a policy of

institutional strengthening, supporting the development of policy at the centre. With this in mind, the China EC Centre for Agricultural Technology (CECAT) was established in Beijing. This Centre was set up to encourage the transfer of technology between the EC and China, and to consolidate the experience gained from the development aid of the EC and others over many years - to develop a centre of knowledge and know-how. CECAT seeks to spread the benefits of this work to as wide an audience as possible through seminars, special papers and audio-visual material, and by assisting European agro-businesses operating in the Chinese market. With current CECAT arrangements coming to an end next year, an assessment will be made to judge whether the Centre should continue on its current institutional footing for a second phase.

The objective of supporting minority populations in China has been pursued by defining projects in such a way that the benefits flow to minorities, for example by targeting regions or sectors in which minorities are concentrated. For example, an ongoing project to develop livestock in Qinghai province targets the upland areas, where farmers come largely from Tibetan stock.

Economic Cooperation

In parallel with the programme of technical and financial assistance, a programme of economic cooperation developed in the 1980s. This programme also sought to combine action at the local level with institutional strengthening at the centre.

During the late 1980s, the largest project at the micro level was a programme to support the modernisation of Chinese enterprises. This programme took advantage of consultancy expertise within the EU to address the particular needs of Chinese companies in transition. However, it proved difficult to ensure that the programme had a knock-on effect throughout the country, and its implementation was discontinued after 1989. A more successful attempt to strengthen the infrastructure of the Chinese economy came in the field of management education. From 1985, the China-Europe Management Institute (CEMI) offered management training to Chinese students, with European faculty teaching courses on management with an international focus. Its main task was the establishment of an MBA course, through which some 235 students have graduated. The MBA courses provided a new dimension to management training in China, a course with an international focus which quickly achieved an impressive reputation. CEMI also undertook research, producing publications and case studies, and in recent years placed a much greater emphasis on developing a range of management development courses, from which some 600 students have benefited since 1989. A variety of companies, from state owned companies to foreign joint ventures, were involved with CEMI, with close links to European companies. The CEMI MBA alumni can now be found in some of the most dynamic sectors of the Chinese economy. However, CEMI was not without its problems, notably poor facilities and a lack of independence which prevented it from establishing long-term stability and sustainability.

1994 saw the EU's efforts to develop management training in China enter a new phase. As the work of CEMI continued, it gradually became clear to the Commission, the Chinese government, and the business community in China and the EU that the time had come for a more ambitious attempt to address the severe shortage of Chinese managers trained to international standards. The result was the China-Europe International Business School (CEIBS), a fully-fledged business school set up in Shanghai in 1994. A partnership between a network of business schools in Europe and the Shanghai Jiaotong University, CEIBS is the first business school in China, offering international-level MBA and other courses to Chinese

students from March 1995.

A permanent faculty source primarily in EU business schools will be built up, housed in a building constructed specifically for the school. CEIBS is an independent legal entity, managed through a Board of Directors in much the same way as a commercial joint venture, although it is non-profit making. The academic standard of the School is monitored and protected by an international group of scholars in an Academic Council, whilst sponsors of the project will influence the development of the School through an Advisory Council. Close links with the business community are central to CEIBS' philosophy, not only as sponsors but to ensure the continuing economic relevance of CEIBS's teaching to the modern Chinese economy. CEIBS symbolises a new concern to ensure that actions are properly in tune with the economic realities in China, as well as respecting the requirement that economic cooperation is of genuine mutual benefit.

Another element in the programme has been the provision of **training to officials**, where the EU could offer particular expertise and support. One example has been a programme of training for Chinese interpreters, to facilitate the internationalisation of key parts of the Chinese Ministry of Foreign Affairs and Ministry of Foreign Trade and Economic Cooperation. Since these interpreters later go on to policy-making roles in their ministries, the programme now includes an element to teach the interpreters about key issues concerning the European Union and the world trading system. Almost 150 interpreters have now benefited from intensive training at the Commission's Joint Interpreting and Conference Service. Another important example has been a programme of customs cooperation, aiming to facilitate trade by supporting the modernisation of customs authorities in China.

The complaints of the international community about standards of IPR protection in China are well known. But if China's efforts to develop an effective legal framework for IPR protection are to succeed, they will need technical assistance from the international community. With this in mind, the EU and the European Patent Office launched an **industrial property training programme** in China in 1993. The objective of the programme was not only to help bring Chinese legislation into line with international norms, but to assist the institutions in charge of implementing the laws, to encourage the development of an industrial property profession, and to improve awareness about the importance of effective IPR protection to the healthy development of a modern economy. So a variety of training schemes and symposia were organised for officials, lawyers, judges and businessmen, as well as the provision of key documentation.

Another example has been an ongoing programme to train economists from key ministries involved in economic reform in China. This has combined an introductory course on the economies of the EU and a series of seminars with a month-long stage in important economic institutions in Europe. The objective is to help economists learn more about the realities of how market economies function in Europe. Issues of particular interest to China and with a particular EU interest, such as regional policy or monetary policy, are given special weight in the programme. Other training has been organised in the field of accountancy and financial management, customs administration, and cooperation between statistical authorities.

Finally, a series of activities have been developed to encourage **business-to-business contact**, facilitating the establishment of business cooperation between entrepreneurs from China and from Europe. Such action has largely taken the form either of participation at trade fairs, or of organising business meetings and seminars with complementary participants "matched" in advance. A particular stress has been put on actions involving small and medium sized

companies. European companies have also become increasingly interested in the possibilities for developing joint ventures in China offered by the European Community Investment Partners (ECIP) facility, which provides a variety of grants and loans to encourage European firms to establish joint ventures in several Asian countries, including China. Over 100 companies or organisations have taken advantage of the ECIP scheme to encourage EU joint ventures in China. China is now proving the most popular destination for ECIP applicants.

Science and Technology Cooperation with China

Scientific cooperation between the Community and China began in 1984. For some years, the programme of cooperation centred on short-term activities including seminars and training. But in recent years, the focus has shifted to the implementation of joint research activities with a high added value scientific content and involving research institutes on topics of mutual interest. More than 70 joint research projects have been funded, notably in biotechnology applied to agriculture and medicine, health, thermonuclear fusion, and environmental sciences, including global change, earth observation and monitoring, which have established firm foundations for cooperation. In addition, several scientific workshops on these sectors have been organised in China, and more than 150 young scientists have received research grants to work in a variety of European institutions and laboratories. Cooperation in the area of biotechnology, one of the core areas for cooperation with China, is coordinated by the **EC-China Biotechnology Centre**, a joint initiative set up in 1991 to act as an information bureau and a catalyst for EU/China interaction.

The onset of the Fourth Framework Programme (1994-1998) has introduced new possibilities for scientific cooperation with China, supporting innovative research, mobilising complementary skills, developing human capital, training young researchers and generally fostering a culture of research.

Other cooperation

Cooperation has been undertaken in sectors of economic significance to EU business. **Industrial cooperation** has been developed in a number of areas of technological importance, with direct industrial projects (such as in the field of computer integrated manufacturing), promotion of the use of European standards and localisation of European products (such as in the field of software), as well as research cooperation in the industrial environment. An important programme of **telecommunications** cooperation has been defined and launched in close cooperation with the State Science and Technology Commission (SSTC), the Ministry of Posts and Telecommunications, the Ministry of Electronics and Industry and the Ministry of Radio, Film and TV, including institutional strengthening of the SSTC's own information network. This programme concerns two major long-term initiatives in areas of advanced technology, to support the use of the GSM standard for mobile communications, and to develop digital audio and video broadcasting technology. **Energy** cooperation began as early as 1981, and has sought to encourage the development of energy policy-making in China, with technical assistance to energy resource development and training in best practice. Amongst specific projects has been support for the gas industry in exploration and extraction techniques. In all of these cases, a genuine mutual interest has resulted from the transfer of technology and know-how to China through the use of European products, making such products progressively more familiar to the Chinese market.

But cooperation has not been limited to areas of interest to business. Following contact between European and Chinese universities in 1986, a small-scale programme in the field of

higher education was organised. This built on a fledgling network of European studies bodies in Chinese universities (the Chinese Society for EC Studies), seven of which are now European Documentation Centres. An annual programme was developed made up of a summer school for Chinese students, with European lecturers teaching European studies, and a number of scholarships for Chinese doctoral-level students. In 1994, an initiative was also launched in the context of the EU's worldwide programme to combat AIDS/HIV and sexually transmitted diseases. The objective is to support the Chinese government's efforts to build up an administrative and medical infrastructure to combat these diseases.