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

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November 9th, 2020
Roadmap to presentation

1. Where do we stand with our trade relations?
2. Why is trade in services falling behind?
3. US-China strategic competition is hurting
4. For China’s outward FDI, it is not about size but about objectives
5. What to expect going forward
1. Where do we stand with our trade relations?
Trade ties between EU and China has strengthened markedly since China joined WTO in 2001, but much more driven by EU imports than exports.

Source: Eurostat, Natixis
Chinese exports to the EU have accelerated steadily recently, especially in 2020 due to pandemic and mainly for electronics, transport equipment and textile (masks). This is not the case of the US.

**The market share of Chinese exports**

(%, 2001 to 2019)

Source: Natixis, Trademap

**Export growth rate differential**

(China minus the average of US/Germany/Japan, 12-month moving average YoY, %)

- Textile: HS 50-63
- Metal products: HS 72-83
- Electronics: HS 84-85
- Transport equipment: HS 86-89

Source: Natixis, Wind, Trademap.

Note: The data for January and February are set to missing and smoothed to avoid the influence of the Spring Holiday effect.
The trade deficit masks a better position for Europe in value-added terms, but the difference is shrinking rapidly as China moves up the ladder.

**Domestic value added in gross exports to world (%)**

- **EU28**
- **China**

Source: Natixis, OECD Tiva
This is clearly seen in China’s increasingly central role in global value chains (GVCs)

• While the size of GVCs is shrinking globally, China is losing much less ground than the European Union.

• The EU’s rapid decreasing size in the global value chain is also true within the single market while China’s role as exporter of intermediate goods in the EU is increasingly important.

Source: UNCTAD-Eora database, Natixis
N.B. Results for 2018 are forecasted by UNCTAD-Eora
2. Why is trade in services falling behind?
In contrast to trade in merchandise, China’s share of trade in services remained low, even when compared to other developing economies.

Source: UNCTAD, Natixis

N.B. 2019 or as of latest
China is the 13\textsuperscript{rd} largest destination for EU exports of services, well behind US and even Switzerland. However, from China’s point of view, the EU is a main source of imports of services, which shows how close the market is.
3. US-China strategic competition is hurting
EU hurt from US-China strategic competition due to trade diversion but also decoupling

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

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

- Tech decoupling is by now a reality:
  - Starting with China’s internet social media/google ban
  - Followed by US on hardware (5G and beyond) through identity list and sanctions.
  - More recently also software and social media (Tiktok)

- All the above increasingly forcing companies into two ecosystems.

- This hampers European companies’ competitive edge as they need to adopt two ecosystems without having control on either of the two.
- This also puts at risk Europe’s long-standing role as global standard setter
4. For foreign direct investment, the size is very low but with clear objectives.
European FDI into China has been stagnating for years and heavily concentrated in manufacturing, especially autos.
There are economic as well as non-economic challenges for the EU companies not to increase their FDI in China

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

- **Non-economic factors**
  - Institutional inefficiency
  - The US-China trade war

Table: Macroeconomic challenges lie ahead for EU companies (from EU chamber of Commerce)
China has been pushing for more investment in the EU but the size remains very small according to both China and the EU’s statistics.

China's direct investment in the EU reported by Chinese Ministry of Commerce and Eurostats (USD bn)

Source: Natixis, CEIC, Eurostats
The EU has been a significant destination for Chinese investors, but the momentum faded, at least temporarily, since the outbreak of the pandemic.

Destination of the overseas completed M&A
Deal value: 2018H1 to 2020H1 (USD bn)

Source: Mergermarket, AEI, NATIXIS
But Chinese companies has kept its interest in accessing the smaller-sized deals in the EU

Source: Mergermarket, AEI, NATIXIS
But most of the deals are going to high-value added sectors, especially industrial one (robotics, etc).

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

- Industrial
- Financials
- Entertainment
- Energy
- Utilities
- Agriculture
- ICT
- Health Care
- Others

Source: Mergermarket, AEI, NATIXIS
Chinese SOE have dominated acquisitions in Europe until 2020. The difference with the US is striking, since SOEs are hardly present.

**Share of SOE by region from 2016 to 2020 H1**

(%, in terms of deal value)

- **US**
- **Europe**
- **Asia Pacific**
- **Other**

Source: Mergermarket, AEI, NATIXIS
5. What to expect going forward
China in a new era: What does it mean for EU-China economic relations

• China is moving into its 14\textsuperscript{th} Five Year Plan with self reliance in mind: dual circulation

• Two main reasons for this:
  1. A hostile and more protectionist external environment;
  2. Readiness to move up the ladder in terms of achievements in innovation and human capital as well as value added in production

• Improved economic relations with Europe are important but not essential
  • The key bottleneck for China to move up the ladder is the semiconductor industry and EU does not rank highest on that (US, Taiwan and South Korea are much more important)
  • Reaching a deal for the Comprehensive agreement on investment (CAI) is especially important as a signal to the US
Should the EU go for CAI by year end?: It is all about how far we are in our economic models

China’s economic model
1. Limited market access
2. Government policy intervention
3. Non-market corporate governance: the SOE

versus

European economic model
1. Much eased market access
2. Free market principle
3. Competitive neutrality
What to do?

• It’s not only an investment treaty, but a coordination and reciprocity of two growth models

• China needs to
  • Move from a **Foreign Investment Law** to a more fair and united **Company law**
  • Quantify its subsidies to Chinese companies before going for negotiation, preparing for more equal treatment of every market participant
  • Narrow negative list to make it reciprocal to the foreign inventors

• The EU needs to
  • A transparent and reciprocal EU-version investment screening framework
  • The complement of the competition policy to pre-entry checks
  • Push for multilateral solutions to coordinate between China and the US