EU-China Hub

Interview Series

CHARLOTTE ROULE

ONE ECONOMY, TWO SYSTEMS: EU BUSINESSES IN CHINA AMID THE PANDEMIC

// JUNE 2020

EU-China Hub

About
EU-CHINA HUB

We are a Brussels-based, private, non-profit initiative pushing forward dialogue on EU-China relations.

Given China's rapidly rising importance on the global stage, it is now more important than ever for EU-China relations to be better understood not only by an inner circle of professionals and enthusiasts, but also by politicians, business people, and the general public.

This is especially true as Europe struggles to embrace the complexity of its relationship with China as a partner, a competitor, and a rival.

We aim to break down this complexity in a digestible format by aggregating the key EU-China news stories and interviewing important players directly involved in EU-China relations.

VISIT OUR WEBSITE AND FOLLOW US TO ACCESS:

- Weekly and Monthly EU-China Briefings
- EU-China Podcast Interviews
- Timely Updates on EU-China Relations

CHARLOTTE ROULE

The Vice President of the European Union Chamber of Commerce in China

She is also an external trade advisor for the French Government and a member of the Jinan Mayor's International Economic Consultation Committee.

We discuss with her the business environment in China and the current standing of European businesses in the Chinese market. We will also cover the Business Confidence Survey recently released by the European Union Chamber of Commerce in China.

But we will go well beyond that, focusing on the impact of COVID-19 on European businesses in China, progress on the Comprehensive Agreement on Investments, and what we can expect from the economic policies that came out of the Two Sessions.

CONTENTS

ONE ECONOMY, TWO SYSTEMS: EU BUSINESSES IN CHINA AMID THE PANDEMIC

Edited by Grzegorz Stec and Michael Durgin

The following interview, from June 2020, is based on an episode of the podcast produced by the EU-China Hub as part of its on-going series. It has been edited for length and clarity.

Grzegorz Stec: In our conversation today, we will refer often to the European Business in China - Business Confidence Survey 2020 that you released on June 10. Can you tell us the idea behind the survey?

Charlotte Roule: Absolutely. The survey is about the business confidence sentiment of the European business community based in China. The European Union Chamber of Commerce in China conducts this survey each year.

The idea is to track progress or lack of progress in market opening, the sense of a level playing field, and all of the concerns that our members have.

We also see BRI as an opportunity for the Chinese government to push Chinese companies to go more global and compete in other markets, using some of the techniques they already use domestically.

GS: A very useful point to understand the findings of your survey would be to know who the members of the European Chamber are. Can you tell us a bit about that?

CR: The majority of our companies, about 53%, have fewer than 250 employees. (Although, among these, some have JVs, and they may not always account for the people they have in JVs.) We also have major companies, about 30%, with more than 1000 employees. The rest are intermediate-size.

In the survey, these groups are well represented. We have people in professional services, such as financial services, IT and telecommunications, legal, media, and publishing. Then we have industry and goods and services, which includes automotive, auto components, aerospace applications, chemicals, civil engineering, environment—including energy—and machinery, transportation, and logistics. And then consumer goods, such as cosmetics, education, fashion and textiles, food and beverages. It's basically 30% professional services, 35% industry and goods, and 21% for consumer goods, in this year's survey. The rest is for specific businesses, such as agriculture.

So, we cover all sectors in China and all sizes of companies.

GS: Thank you. That gives us a good understanding of who we are talking about. Now, the report has a pretty grim subtitle: “Navigating in the Dark”. Is that really the situation? Is it that dark for European businesses in China right now?

CR: I believe so. This might be surprising but I wouldn't say it's very negative, but. it is indeed dark. The survey was conducted when the crisis was still in its early stage in China. European businesses were forced to take something like an extended Chinese new year’s gap, a bit of slowdown, but not much more.

Now we are in a situation where COVID-19 has spread globally and the impact is far larger than we expected at the beginning. One of our members said, ‘We feel like we are in a dark room, looking for the door out.’ Whether positive or negative, we need to find that door, because there are so many questions that it is difficult to find the right answer. So we rely on survey findings to see the underlying trends. And we compare them with later surveys, whether our own or those conducted by national Chambers or by the European Union.

GS: So, this year’s edition of the Chamber’s Business Confidence Survey was conducted before the full force of COVID-19 was known to European businesses, in February 2020. But the report says the situation for European businesses in China was already growing unfavorable in comparison to previous years. You referred to this in the report as a “soft downturn”. Can you tell us about those findings?

CR: Yes, indeed. If you look at the report, the interesting part is to compare year over year.

Looking back to 2018, two-thirds of our members were reporting very positive revenue increases. Since then, the proportion of members reporting a decrease has more than doubled.

But it's a mixed situation, because 17% of our members report that their outlook on the market is pessimistic. For SMEs, the outlook is more pessimistic because they are even harder hit by the crisis.

The survey was conducted in early February, mostly reflecting what was happening in 2019. In late February, we jointly conducted with the German Chamber a survey specifically on the coronavirus. At that time, 48% of respondents reported that they expected a drop in revenue for the first half of 2020. So already the outlook had changed. Later on surveys were conducted by the Italian Chamber, the German Chamber (again), the Australian Chamber, and the French Chamber.

They reported a drop in revenue of 10% or more for the first half of 2020. So you see how much things changed in just one month.

There are definitely specific issues related to COVID-19 that need to be tackled. I want to highlight one of the main findings of the business confidence survey this year: an ongoing trend of one economy, two systems in China. On one side, we see some improvement in terms of market access and opening, a well regulated market. That's very positive, although it differs widely between sectors.

But on the other side, there are sectors where SOEs are predominant and this is not changing. There, there’s very little market opening and no level playing field. That's a growing concern. We believe that there might be a temptation with the COVID-19 crisis to defer to SOEs, which means we don't have the same vision of SOE reform. To us it is about addressing overcapacity and competition or market distortion. But we hear from Chinese authorities that it's about making SOEs bigger, better, and stronger. So we want to address this discrepancy.

Overall, 45% of our respondents are still facing market access barriers, quite a huge number. It’s even more worrying that this number is the same as last year. So while there were some openings, overall, for the European business community in China, this should be happening faster and across more sectors.

GS: Can you tell us more about this concept of “one economy, two systems”?

CR: It’s about SOEs gaining market share benefits at the expense of the private sector. In our report, 48% of our respondents consider that SOE shares will increase, and that will be detrimental to private enterprise.

This percentage is increasing—last year it was 41%—which is worrying, because when you look at all the efforts that are done in terms of reforming and at foreign investment law that has been issued, we should see these SOEs getting decreasing market shares compared to private companies.

The second point is that this is not specific to European businesses. We're trying to call for reform, actually calling on Chinese leaders to use reform to address the current crisis.

We believe that relying on SOEs is probably not the best way to stimulate the economy; they should rely on innovation. There is a vibrant private sector in China, which is hard hit because of the SOEs. These have closer links with authorities, but they also have a sort of preferred access to financing, which is a key issue for our members. SOEs have a de facto warranty from the state, so it is easy for a bank to lend to an SOE, with high confidence that the risk is limited.

In addition, SOEs probably don't have the same profitability requirements that private companies have; it's quite healthy to have profitability requirements. When we surveyed our members about access to financing in China, 40% percent of them have difficulty. Even 43% of their Chinese partners and all of their private partners have difficulties accessing financing.

This issue has been magnified during the COVID-19 crisis, because all companies are facing cash flow issues. The cash needs are not that huge because we are speaking mainly about SMEs. So MNCs have access to cash, deposits in the bank. But with COVID-19 those deposits are drawn because they are needed. And then the banks have less money to lend to SMEs, which are then in a very critical situation.

The silver lining is that Chinese authorities are now saying they will support SMEs, which is relatively new messaging. We hope to see that in terms of facts. We see some genuine efforts to improve the business environment, but this heavy weight of SOEs is distorting competition, not only by their presence but also by what they do in the business ecosystem, most notably to financing.

GS: Over the last few years, have Chinese authorities been leveling the playing field for European companies or are they making it less fair?

CR: It’s a mix, depending very much on the sector. But this year, half of our members don't see a level playing field. And that's where we see one economy, two systems. There were improvements in some sectors, notably in financial services. Since 2017, we've seen continuous improvement in accessing more of the market. There are also some new rules which are very healthy for the market, although they can be difficult to comply with when you are a very small dog. But then we saw some closing, too, in education, ICT, and legal services, so that's quite a concern.

So, is it a level playing field? I have mixed feelings. But when 50% of your members report that they don't see a level playing field, this is high enough to maintain concern and push for it to be addressed.

GS: Moving back to the topic of the pandemic: How has the outbreak of COVID-19 affected European businesses that are active in China right now and those that are dependent on Chinese entities? How did this unfold, from the perspective of European businesses?

CR: For European businesses based in China, the impact was immediate. We thought that the crisis would be quite limited and the experience of SARS was almost not helpful, because it was so different. SARS was quite limited to China, but now we are facing a global crisis.

European businesses saw huge differences from when the survey was conducted in early February to late February and into March. These are businesses that have been here for quite a long time, loyal members who are very committed to China. They have a market in China and when there is no more Chinese demand, when you cannot produce anymore, you are stuck.

Although the crisis started to change a bit and we saw some silver linings, they had to get their whole supply chains up and running. That’s difficult because, for example, if you're an auto manufacturer and you're allowed to start again, you still need your whole supply chain. You need brakes and that kind of thing for your autos. We saw some very local disruptions in the supply chain, because we produce mainly for China as EU Chamber members.

European businesses based in China have their headquarters in Europe, by definition. When the crisis reached Europe, the impact was different. We discussed this with the Chinese authorities, because although we see a very limited number of members considering relocation, at the end of the day, because of the crisis, they just might have no money. And if you don't have a business environment that is welcoming you, you may not consider China as a first choice.

GS: We're going to get back to the topic of supply chains in just a moment. But I'm still curious whether there were any specific European sectors or companies that were particularly hard hit by the outbreak of COVID-19. Can you see any trends when it comes to European businesses in China?

CR: We can see an overall trend. Rather than sectors I would say that it's a question of size of company. We saw a large impact among SMEs, because the cash flow issue was hitting them so hard. It was a question of survival.

In terms of sectors overall, industry was at least operating rapidly compared to goods and services, especially services. This is quite natural. If you think about what the crisis was like and the lockdowns— in Wuhan, in Hubei province, in Beijing, and Shanghai—when everything was basically closed. The services were hard hit because then when you recover, there will be an appetite for consuming but then—to take just a simple thing like restaurants, hairdressers, that kind of thing—you're not going to go three times a day just to just help them recover. You can only do as much as you can. So the hit was there.

In terms of impact, it's quite dramatic. Because, at the end of the day, those SMEs were providing 80% of employment in China, which is very important for the complete ecosystem, not only for employment but also for the supply chains themselves. We identified some weak points on the supply chains, because companies just couldn't manage and it was too hard to have no revenues, but to still have expenses to deal with.

GS: Exactly. Supply chains are one of the key discussions coming out of the outbreak of COVID-19, including their fragility and over-reliance on single providers. In most cases, it has meant overreliance on China. What lessons can be learned from this pandemic in regard to supply chains?

CR: There are several lessons to be drawn. First of all, it is not good to be dependent on only one supplier or only one country. I think that is clear to everybody now.

Changing this is not that easy, though, because you're not talking only about producing, but also having a whole ecosystem of subcontractors, suppliers, and logistics. China is actually quite a good country for that; you have good skills there. You also have a nice logistics organisation. It's obviously been impacted currently, but it still works quite well with industry and certain clusters. In addition, there is a huge market. So when we surveyed our members before the crisis, only 11% of them were saying they were considering relocating. And those were generally producing goods for exports and using low labor skill. The COVID-19 crisis is going to accelerate this movement, but it was there already.

From the perspective of the European Union, some strategic goods will be identified for which you want to have a diversification of supply. The question might be whether it should be in Europe or elsewhere, but for sure it shouldn't be just in one place.

But this is also a political issue, because these companies were originally organized based on business and efficiency issues. Those supply chains were organized to get the best price for the end consumer, so they're rather resilient. We have to consider what it means in terms of cost, because relocating means that you're closing your plant somewhere, and then all of the ecosystems around it will be impacted. Then you reopen another one, which means money to be invested, etcetera. And when you relocate, you need to have all of these ecosystems again.

We heard a lot about Vietnam being considered, but when you identify a country where the infrastructure is lacking, then you haven't sorted out your issues. So this is a clear political issue to be addressed. Europe needs to consider that and to address what strategic supply it wants to secure, whether it should be only partly outside of China, and whether in Europe or not in Europe. And second, it needs to have a real industry and the policy to develop it.

GS: So, those supply chains are actually quite resilient. In your report you said that those European businesses are simply "in China, for China", which suggests there isn't really that much incentive for them to move away. In that context, can you tell us how this discussion in the Commission and the EU about the need for diversification of strategic supply chains is perceived by European businesses in China?

CR: We asked our members this after the survey but, despite all of the discussions currently ongoing in the European Union, we don't see things changing. In addition to 11 percent of our members considering relocation, some investment, rather than being divested, could potentially be delayed due to the crisis.

But the market is in China and it's positive that China supports growth for Europe. So for all sectors of our membership, the mood didn't really change. There is no strong move in terms of leaving China.

This goes also with the attitude of the European Union, which is engaged in a very strong, fruitful, and positive dialogue with China. This is important, because when you look at this figure of 11%, it's much less than our friends from the American Chamber. And Japan is promoting a real form of relocation away from China. The EU is not doing that;

the idea is to maintain dialogue, to understand what is needed, and to propose a constructive but pragmatic answer. Companies need to clearly assess what is key and what they are ready to pay more for.

GS: Let's talk about Brussels' approach to diversification in relation to China. Is there anything specific that you would advise them to keep in mind?

CR: Before I answer, let me just mention that we are liaising about this with the European Union delegation in China. We are also providing some elements to better understand the environment for the EU negotiator of the Comprehensive Agreement on Investment.

Getting back to your question, it is important to keep two things in mind. In terms of diversification, the first point is to clarify what is strategic, what we don't want to be dependent on. This is a natural, methodological question. And I heard a lot in some countries about masks: 'We need to have masks. We need to have a mask supply in Europe.' Maybe, but masks are not that difficult to produce, so this might not be the most strategic element to pursue. Part of the rumor of the crisis is that we were missing things that were becoming strategic. But at the end of the day, they're not that complicated to produce. So that's the first point: Decide what is really strategic and what is not.

The EU is extremely concerned by the place SOEs are taking in the Chinese market. One of the reasons that they are there is to address strategic issues, but when you look at all the fields that are covered, 70% of our members are facing competition with SOEs. It's difficult to understand why cosmetics, for instance, are addressed by SOEs. There is no good reason.

So the selectivity of activity is key. And then the question is: What effort do you want to make and what does it mean in terms of relocation? Is it in Europe so that you will also support employment? This makes some sense but then you need to organize to get the right skills. Or is it just outside of China to diversify a supply chain? Overall, I would argue that diversification of supply chain and of risk, in general, is a healthy strategy that should definitely be addressed.

GS: In the context of the role of SOEs, you already mentioned one very important topic, the Comprehensive Agreement on Investment or CAI. Just in case some of our listeners are not really familiar with this, can you give us a quick recap?

CR: The Comprehensive Agreement on Investment is about how we share market access and the opportunities we can see in terms of investment. This means we are addressing and identifying rules for sectors in which we can reciprocally invest. The EU has a screening mechanism in place and it's very important. We know also that there are elements on the Chinese side. So really it is about where we can go on each side and the rules to access the market. There's also an enforcement mechanism which identifies what we can do if those rules are not respected.

GS: Thank you very much for that. So moving a little bit deeper into the CAI, it comes in the context of discussion on the role of SOEs, the level playing field, and the general opening up of markets. By the end of May, the EU and China had concluded the 29th round of negotiations. While we keep getting positive messages about progress, it seems those key issues still remain to be negotiated, especially the position of Chinese SOEs and whether there is competitive neutrality.

And while the commission is proceeding with the white paper targeting state aided, non-EU actors, Leipzig has been postponed. So, there are a number of things that are affecting progress on CAI. In your view, what is the state of play with the negotiations?

CR: First of all, the dialogue is ongoing, which is very important. The negotiations used to take place face-to-face only. This was obviously sometimes a bit difficult, but we have very active negotiators who are very up to speed. They have the competence to understand the market, both in Europe and in China. So, during the outbreak negotiations have continued on a remote basis without stopping. This is very positive. Leipzig has been postponed due to COVID-19, but we still have a new China virtual summit on June 22. So again, the dialogue continues.

I have had the opportunity to work on the industry projects. When a project is 90% finished, it means that it's not finished and the last 10 percent might be the most painful.

So, you're right to mention points that are still under discussion but I would be cautious. We are not privy to the negotiation. We are naturally commenting on some elements based on what we observe in the market, but we have no idea specifically. There is no communication. We know that state aid or the status of SOEs is the elephant in the room and this is the second leg of one economy, two systems. It's definitely an issue and we have very different views than the Chinese authorities.

A second point is the enforcement mechanism. We don't want an agreement for the sake of an agreement. If Leipzig had been held as originally scheduled, it would have been nice to see something in that moment. Either we have an open market with big changes—what we need currently—or we had better go on without an agreement. It's not about ticking the box. We really want now to see things change.

GS: Regarding SOEs, I want to discuss China's economic response to the corona crisis, coming out of the Two Sessions. We have witnessed historic events in regard to the Chinese economy, first the contraction of the economy by 6.8% in the first quarter of 2020 and then the decision by the party state not to announce an annual growth target, for the first time since 1990.

In your report, you urge the Chinese authorities not to waste a crisis and instead to use it as an opportunity for greater liberalization of the economy as they did during some of the past crises. Keeping this in mind, how do you evaluate the economic policies coming from this year's Two Sessions?

CR: That session is interesting in not setting any GDP target. We thought that maybe we would see something like a GDP target over two years.

We think not setting a target is a very positive signal, because it would have been weird in this time of navigating in the dark to have such a target when we don't exactly know where we will go and how to manage. The Chinese authorities have identified some positive ideas to answer the crisis, such as supporting SMEs. There is also an important element about employment as a priority, creating 9 million urban jobs. And there were no big plans in terms of incentives, such as in Europe, but rather ambitions, which are very well addressed by Chinese authorities. They were sticking to what they had said they would do as support. We will see for SMEs, but typically we might see reducing pressure, delaying taxes, and that kind of thing. But then we also see a new infrastructure plan coming, which is an opportunity to invest and support the recovery, upgrading it even further. So that's all quite positive.

We would be cautious, though, because SOEs tend to have a sort of social room. We believe this conviction is misplaced. You don't support recovery and growth with SOEs. So this is a risk. We definitely need to push for further opening and reforms.

You're very right to refer to the past, actually. When there were crises in China, like under Deng Xiaoping in the late seventies or the early nineties with Zhu Rongji, the response was more opening up and we feel that that's a better answer. China geographically is now more open generally and there is more growth as well.

We think that probably using SOEs would address the crisis imperfectly. Even if they have the social room, they are not the biggest provider of employment. The biggest providers are SMEs, so those are the businesses requiring support. And when we come to innovation and getting more business initiative, we see the private sector, which is very vibrant in China and needs to be supported. This innovation is a positive trend in China and it has been for our members over the years. Now 69% of our members see China as innovative, even significantly more innovative than Europe. This potential should be tapped into, thanks to market opening and further liberalization.

GS: Of course, but at the same time, we have the issue of unemployment. This statistic seems to be becoming politically sensitive in China. Given what's going on with the corona crisis, the message from the Two Sessions seems to be that of stability over growth. Given the circumstances, do you think that the leadership is going to turn to SOEs to make them bigger, better, stronger, or are we going to see a move in the other direction?

CR: It's difficult to say. There might be a temptation to ask SOEs to be a support. To be fair, because they are state owned, they're also an instrument for authorities. (It's the same way for SOEs everywhere; they are not specific to China.) But we see the signals about SMEs and some openings in financial services. So China is becoming more mature, more diversified, proposing more services, including for small businesses. At the end, the question is: How do all of these align? We see measures announced at least to the right place, companies, and people.

GS: Naturally, as you say, we're only going to know what road the Chinese government is taking once we see the implementation of the measures. But what kind of sentiment do you see among European companies based in China? Are they hopeful about the measures from the Chinese government? Or do they really feel that this is going to be navigating in the dark, that things are going to look darker in 2020?

CR: In 2020 we will be navigating in the dark because we don't know exactly how much the crisis will impact us, because we have a Euro basis. Obviously, there is an impact that is wider than China.

I would say that European businesses currently are relatively cautious. Recovery seems to be occurring in Europe. We even see some positive trends in consumption. But the sentiment in terms of business and how much we are welcome is also impacted by a specific point, which is that currently China is banning entry by foreigners onto its territory. The process that allows people to enter is quite complex and not fully successful, I must say currently. There are far fewer flights coming in and out of China and foreigners are, in principle, forbidden to enter unless they have a specific authorization, which is very complicated to get. So we have people currently outside of China, although they are working for our companies, and families that are split. We have some experts that we don't need 100% of the time in China; we need them for a specific operation to upgrade industry installation but they cannot come in.

And this is definitely alongside the financing issue that I mentioned earlier, a topic of great concern, because if China is not opening its territory, if it's closing frontiers, this becomes an issue, so we are cautious with that. We can see and we appreciate the recovery, which is really more and more visible now in China, but it should go further. We are in a global environment and we should be able to exchange again, as much as we can.

GS: In your view, what are three key trends for EU-China business relations that we should be mindful of in 2020?

CR: First, the dialogue is there. This might not be a trend, but it has been ongoing for very long, so it's quite important. And there is mature understanding that continues to grow, which is very positive. So we need to keep that in mind.

Second, we are facing a global crisis. To address that in terms of EU-China business relations, we need to be aware of the overall situation. How does this articulate in terms of having the EU well positioned to discuss with China? There is ongoing thought about whether we should relocate. What is strategic and how do we address those points?

And, thirdly, we, as the European Union, need to be strong. We are strong but we are not seen as strong enough by China. So when we hear that there are ideas about developing 5g IOT but in the EU—which might be perceived as a form of aggressive reaction to China —I would argue that it's not aggressive at all. It's about getting the same level of understanding and competence in order to discuss between peers and to be able to nurture and mutually grow together. There is place for a constructive relationship between the EU and China, and it needs to be worked on right now.

Maybe one last trend: China probably needs to also have a view about how it wants to approach its relationship with the EU. When you see projects around the Belt and Road Initiative now linked to topics like health, this can be interesting. But similarly when we see Belt and Road, it sounds like the Connectivity Project of the European Union. So far, they both seem a bit isolated on their own sides and we need to have them reconnected, if we want to make the most of it. So these are things that we can discuss together.

GS: What recommendations would you give to Brussels and Beijing, to support mutual business cooperation amid the pandemic?

CR: I think cooperation should be based on facts and transparent information. This is very important. We had quite some discussion about masks coming one way, then the other way. How do we communicate that? I think we should get rid of any discrepancy or let's say political noise about that. The cooperation should be focused on a given target, such as fighting COVID-19. But then there should also be further cooperation.

The European Union knows itself very well already, but could actually move the needle a bit further. But China should also have a better understanding of what the European Union can bring and how it is perceived in China.

I'm sure domestic issues are extremely important and relevant to China. But going further in the cooperation, a mature understanding should also bring a kind of awareness of what image to project and how you can show that effective cooperation works and is healthy. Obviously it goes with the market mechanisms that I was mentioning, so in China already there is more opening and transparency and fair access. China should have broader discussions with the EU but also be involved jointly with the EU in multilateral organization institutions, such as the WTO.

EU-China Hub

CLICK TO

VISIT

euchinahub.com

FOLLOW

SUBSCRIBE

CONTACT

info@euchinahub.com