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中国欧盟商会

European Business in China

POSITION PAPER 2023/2024

European Union Chamber of Commerce in China

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The *European Business in China Position Paper 2023/2024* represents the views of the European Union Chamber of Commerce in China. Our working groups, fora and more than 1,700 member companies have together compiled the latest assessments, concerns and recommendations of European businesses operating in China.

We hope that this position paper will promote constructive dialogue between Europe and China, at both the political and business levels. We look forward to continued improvement in business cooperation, to the benefit of both Europe and China.

Message from the President

After the programme of reform and opening up of the late 1970s set China's economy on a spectacular growth trajectory, European companies quickly recognised the country's enormous market potential. With Chinese state planners seeking to ensure growth and stability, pragmatic principles guided the country's economy, and reforms facilitated huge inflows of foreign direct investment (FDI).[1] For decades, European companies thrived in China, benefitting from a stable and efficient business environment.

However, after the turbulent past three years, many have re-evaluated their basic assumptions about the Chinese market. The business community feels that predictability and reliability—core characteristics of China's attractiveness as an investment destination—have been eroded as a result of erratic policy shifts, such as the unexpected disruptions to power supplies that took place in 2021 and 2022, and the sudden mass lockdowns that were imposed in an attempt to contain COVID.[2] Overall confidence in China's growth prospects has deteriorated,[3] and companies are revising down their forecasts. Sentiment is spreading that, with China's economic growth slowing and its focus on 'self-reliance' solidifying, only foreign companies in industries that are directly supportive of China's policy goals—or those that are temporarily needed due to a lack of local suppliers—will be able to prosper the way they did when China's growth was pushing double digits.[4]

The disruptions that took place over the past couple of years were an eye-opener, as they laid bare the fragility of modern supply chains. As a result, many companies are now focussed on making their supply chains more durable and have become increasingly risk averse. Several European companies are either considering shifting or have already shifted investments out of China to increase supply chain resilience, or have onshored supply chains into China, detaching them from global value chains.[5] Geopolitical issues are also pushing companies towards increased caution,[6] with Russia's war on Ukraine amplifying sensitivities in particular.[7]

Mixed messaging from the Chinese Government only adds to the growing sense of uncertainty, further eroding confidence in this important market. The annual work report delivered by China's outgoing premier Li Keqiang at the 14th National People's Congress, held in March 2023, highlighted the government's aim to encourage more foreign investment.[8] However, while businesses are waiting for this pledge to be followed by action, China's push

1 "FDI inflows to China have surged from almost nil at the start of reform in the late 1970s to between $40 billion and $45 billion a year (nearly 5 percent of GDP) in the second half of the 1990s[…]By the 1990s China had become the second-largest FDI recipient in the world, after the United States, and by far the largest recipient among developing countries, accounting for about 25-30 percent of FDI flows to all developing countries." Tseng, Wanda S., *Foreign Direct Investment in China: Some Lessons for Other Countries*, International Monetary Fund (IMF), 24th February 2003, viewed 10th August 2023, <https://www.elibrary.imf.org/display/book/9781589061781/ch005.xml>

2 *European Business in China Position Paper 2022/2023*, European Union Chamber of Commerce in China, p. 12, 21st September 2022, viewed 10th August 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1068/European_Business_in_China_Position_Paper_2022_2023>

3 Confidence in China's growth prospects over the coming two years deteriorated among respondents to the *European Business in China Business Confidence Survey 2023* (BCS 2023), with fewer (-6 percentage points (pp)) reporting optimism than in 2022, despite the fact that companies were surveyed after China's 're-opening'. *European Business in China Business Confidence Survey 2023*, European Union Chamber of Commerce in China, p. 8., 21st June 2023, viewed 10th August 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1124/Business_Confidence_Survey_2023>

4 This includes industries that can provide the technology and expertise China needs to upgrade its value chains, such as chemicals, machinery and semiconductors.

5 Making their supply chains more resilient was selected by 31 per cent of those respondents who are either considering shifting or have already shifted investments out of China in the BCS 2023. *European Business in China Business Confidence Survey 2023*, European Union Chamber of Commerce in China, pp. 10–11, 21st June 2023, viewed 10th August 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1124/Business_Confidence_Survey_2023>

6 According to a recent IMF report, "FDI flows are increasingly concentrated among geopolitically aligned countries, particularly in strategic sectors". *World Economic Outlook: A Rocky Recovery*, IMF, April 2023, viewed 10th August 2023, <https://www.imf.org/en/Publications/WEO/Issues/2023/04/11/world-economic-outlook-april-2023?cid=bl-com-spring2023flagships-WEOEA2023001>

7 Russia's invasion of Ukraine, which saw over 1,000 companies publicly announce that they would be voluntarily curtailing their Russia operations, has acted as a further wake-up call for businesses, and pushed them to evaluate how susceptible their China operations would be to a similar disruption. In a flash survey conducted by the European Chamber in April 2022, a third of respondents reported that the war in Ukraine made China a less attractive investment destination. This indicates that, regardless of whether there is actually a serious dispute between Mainland China and Taiwan, just the threat of wars or blockades is enough to increase the sense of unpredictability. *European Business in China Business Confidence Survey 2023*, European Union Chamber of Commerce in China, p. 21, 21st June 2023, viewed 10th August 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1124/Business_Confidence_Survey_2023>; *Flash Survey: COVID-19 and the War in Ukraine: The Impact on European Business in China*, European Union Chamber of Commerce in China, 5th May 2022, viewed 10th August 2023, <https://www.europeanchamber.com.cn/en/publications-archive/973/Flash_Survey_COVID_19_and_the_War_in_Ukraine_The_Impact_on_European_Business_ in_China>

8 *Full text: Report on the Work of the Government, Xinhua*, 15th March 2023, viewed 28th June 2023, <http://www.china.org.cn/china/2023-03/15/content_85169057.htm>

for technological self-reliance continues to restrict foreign enterprises' market access.[9] In July 2023, Xi Jinping called for a higher level of opening up and efforts to boost foreign cooperation in investment and trade, among others.[10] At the same time, recent legislation, including the amended Anti-espionage Law and the new Foreign Relations Law,[11&12] indicates an increasing focus on national security across a widening scope of areas, which is prompting businesses to exercise even more caution.

At the top of a growing list of questions about the Chinese market is, *what kind of relationship does China want to have with foreign enterprises?* A decisive answer would be for policymakers to begin tackling the fundamental, structural issues hindering China's economic rebound,[13] while taking concrete action to address the challenges faced by private companies, both Chinese and foreign. This would do much to rejuvenate business confidence and restore the appetite of foreign companies to continue engaging with China, and even increase their investments.

Although European firms' perceptions about the Chinese business environment might be changing, they have a shared interest in China's continued success. To this end, the European Chamber stands ready to increase its engagement with Chinese stakeholders and provide constructive recommendations that can boost China's recovery and help to realise its vast potential.

Jens Eskelund
President
European Union Chamber of Commerce in China

9 *European Business in China Business Confidence Survey 2023*, European Union Chamber of Commerce in China, p. 25, 21st June 2023, viewed 10th August 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1124/Business_Confidence_Survey_2023>

10 Yu, Evelyn & Tam, Felix, *Xi Calls for More Economic Opening, Trade as Recovery Falters, Bloomberg,* 11th July 2023, viewed 10th August 2023, <https://www.bloomberg.com/news/articles/2023-07-11/china-s-xi-calls-for-greater-economic-opening-in-charm-offensive#xj4y7vzkg>

11 *A battle against spies in China is spooking locals and foreigners, The Economist*, 4th May 2023, viewed 2nd July 2023, <https://www.economist.com/china/2023/05/04/a-battle-against-spies-in-china-is-spooking-locals-and-foreigners?gclid=EAIaIQobChMIg9LTqMTv_wIV9MZMAh30ewJbEAMYASAAEgLQBfD_BwE&gclsrc=aw.ds>

12 The Law on Foreign Relations of the People's Republic of China, *Xinhua*, 28th June 2023, viewed 2nd July 2023, <https://english.news.cn/20230628/28c7aedd386440ba9c370eb22476d430/c.html>

13 There are many structural issues—both long-standing and recently emerged—that need to be addressed for China to regain momentum for its economic recovery. According to the Rhodium Group's assessment of the second quarter of 2023, key systemic issues that require the attention of Chinese policymakers include "crushing local government debt, an ongoing property sector crisis, continued addiction to investment projects for GDP growth, and falling confidence among both domestic consumers and businesses and foreign investors." Rosen, Daniel H., Salidjanova, Nargiza & Lietzow, Rachel, *China Pathfinder: Will Sluggish Growth Trigger Green Shoots of Reform? Q2 2023 Update*, Rhodium Group, 7th August 2023, viewed 10th August 2023, <https://rhg.com/research/china-pathfinder-will-sluggish-growth-trigger-green-shoots-of-reform-q2-2023-update/>

ABOUT THE EUROPEAN UNION CHAMBER OF COMMERCE IN CHINA

FOUNDED IN
2000
BY 51 MEMBER COMPANIES

35
WORKING GROUPS AND FORA

MORE THAN
1,700
MEMBER COMPANIES

OPERATING IN
9
CITIES

The European Union Chamber of Commerce in China (European Chamber) was founded in 2000 by 51 member companies that shared a goal of establishing a common voice for the various business sectors of the EU and European businesses operating in China. It is a member-driven, non-profit, fee-based organisation with a core structure of 26 working groups, 13 sub-working groups/desks and nine fora representing European business in China.

The European Chamber has more than 1,700 member companies in seven chapters operating in nine cities: Beijing, Nanjing, Shanghai, Shenyang, South China (Guangzhou and Shenzhen), Southwest China (Chengdu and Chongqing) and Tianjin. Each chapter is managed at the local level by local boards reporting directly to the Executive Committee.

The European Chamber is recognised by the European Commission and the Chinese authorities as the official voice of European business in China. It is also recognised as a foreign chamber of commerce by the Ministry of Civil Affairs. The European Chamber is part of the growing network of European Business Organisations (EBOs), which connects European business associations and chambers of commerce from 45 non-EU countries and regions around the world.

Mission Statement

As a member-based organisation, the European Chamber seeks to:

1. Ensure greater market access and a level playing field for European companies operating in China;
2. Improve market conditions for all businesses in China;
3. Facilitate networking and communication among members and stakeholders;
4. Provide specific, relevant information to its members on how to do business in China; and
5. Update its members on economic trends and legislation in China.

Principles

1. We are an independent, non-profit organisation governed by our members.
2. We work for the benefit of European business as a whole.
3. We operate as a single, networked organisation across Mainland China.
4. We maintain close, constructive relations with the Chinese and European authorities, while retaining our independence.
5. We seek the broadest possible representation of European business in China within our membership: small, medium and large enterprises from all business sectors and European Member States, which operate throughout China.
6. We operate in accordance with Chinese laws and regulations.
7. We treat all of our members, business partners and employees with fairness and integrity.

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Executive Summary

Regaining Momentum

How to Restore Business Confidence

After abruptly abandoning its 'zero-COVID' approach in late 2022,[1] China reopened its borders on 8th January 2023. This decision was a welcome surprise, as pandemic control measures were one of the main reasons European companies had had an extraordinarily difficult year in 2022,[2] and the removal of the restrictions gave rise to a belief that a swift economic rebound would follow. International banks revised up their growth forecasts for China, and businesses were expecting a surge in new orders resulting from pent-up Chinese demand.[3]

The political will in China also seemed to finally match businesses' expectations for increased opening of the economy. At the 14th National People's Congress, held in March 2023, China's outgoing premier Li Keqiang delivered the government's annual work report, reviewing the progress made on development plans from 2022, and setting out the key priorities for the coming year. The gross domestic product (GDP) target for 2023 was set at around five per cent, and Li's presentation emphasised economic recovery and stability. The work report also outlined aims to encourage more foreign investment. The business community saw these as positive messages, as they suggested the Chinese Government would shift focus from ideological considerations—and an emphasis on self-reliance and national security concerns—to prioritising the economy and re-engagement with the world.[4&5]

While economic indicators at the beginning of 2023 showed momentum was gathering, as the year progressed, China's recovery began to wane, with many areas of the economy not performing as expected. A key factor in this was that the much-anticipated release of pent-up demand simply did not take place, resulting in an extended contraction of manufacturing activity, producer prices and industrial profits.[6] While services fared somewhat better than manufacturing, growth in this sector showed signs of slowing after an initial strong rebound.[7] On top of this, a host of serious challenges that China's economy had already been facing—including mounting government debt and the unravelling of the real estate

1 China's successful management of the COVID-19 pandemic in the two years following the initial outbreak led to a swift economic recovery relative to the rest of the world, while protecting the health of its population. However, waves of more transmissible variants of the virus throughout 2022 began to exert immense pressure, first on supply chains and then on China's economy overall.

2 A record-high 64 per cent of respondents to the European Chamber's *European Business in China Business Confidence Survey 2023* (BCS 2023) reported that doing business in China become more difficult in 2022. Revenue and profitability took a turn for the worse, as stringent COVID-19 containment measures disrupted operations and slowed China's economic growth, and the contribution of China operations to companies' global revenues decreased for a second year running. *European Business in China Business Confidence Survey 2023*, European Union Chamber of Commerce in China, p. 1, 21st June 2023, viewed 5th July 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1124/Business_Confidence_Survey_2023>

3 Wang, Huiyao, *5 reasons China's reopening is good news for the global economy, SCMP,* 10th January 2023, viewed 28th June 2023 <https://www.scmp.com/comment/opinion/article/3206057/5-reasons-chinas-reopening-good-news-global-economy>

4 *Full text: Report on the Work of the Government, Xinhua,* 15th March 2023, viewed 28th June 2023, <http://www.china.org.cn/china/2023-03/15/content_85169057.htm>

5 *European Business in China Position Paper 2022/2023*, European Union Chamber of Commerce in China, pp. 4–8, 21st September 2022, viewed 5th July 2023, <https://www.europeanchaamber.com.cn/en/publications-archive/1068/European_Business_in_China_Position_Paper_2022_2023>

6 Huang, Eustance, *Weak consumption is a 'major problem' for China's recovery, says analytics firm, CNBC,* 10th June 2023, viewed 29th June 2023, <https://www.cnbc.com/2021/06/10/weak-consumption-is-problem-for-china-recovery-says-analytics-firm.html>

7 *China's services activity softens as recovery falters, Reuters*, 5th July 2023, viewed 7th July 2023, <https://www.reuters.com/markets/asia/chinas-services-activity-softens-recovery-falters-caixin-pmi-2023-07-05/>

sector—are yet to be resolved.[8,9,10&11]

China's demographic dividend is also fading,[12] and urban youth unemployment broke historic records for several months in a row in 2023,[13] adding more pressure to the country's recovery. Official statistics, published until July 2023,[14] suggested that one in five people between the ages of 16 and 24 were out of a job in China's big cities. This data also highlighted the need for targeted policies in order for domestic consumption to live up to its potential as a key driver for the Chinese economy.[15] Rebuilding consumer confidence will also require measures that can improve the outlook for the real estate sector, in which over 70 per cent of Chinese household wealth is tied up.[16]

Some momentum for China's economic recovery could be regained by providing policy support for the demand rather than the supply side. This is particularly important given that supply-side policies have been a contributor to the significant trade imbalances China has accumulated with both the European Union (EU) and the United States (US).[17&18] There is a danger that, if not addressed, this may lead to reactions by overseas governments – the growing trade imbalance and the lack of reciprocal market access are often cited by European politicians as key grievances and reasons for dissatisfaction with the relationship with China.[19]

8 Government debt increased significantly during the COVID-19 pandemic as lending accelerated to help businesses recover, local governments poured money into pandemic control measures—including the building of new hospitals and quarantine centres, and mandating regular testing for the population—and the real estate sector crashed. He, Laura, *Chinese cities are struggling to pay their bills as 'hidden debts' soar, CNN*, 1st February 2023, viewed 2nd August 2023, <https://edition.cnn.com/2023/01/31/economy/china-local-governments-basic-services-debt-crisis-intl-hnk/index.html>; Lee, Amanda, *How China's hidden debt risk 'comes from its system', and why local governments are beholden to Beijing, SCMP*, 30th July 2023, viewed 2nd August 2023, <https://www.scmp.com/economy/china-economy/article/3229284/how-chinas-hidden-debt-risk-comes-its-system-and-why-local-governments-are-beholden-beijing>

9 Cheng, Evelyn, *China's property sales are set to plunge 30% - worse than in 2008, S&P says, CNBC*, 27th July 2022, viewed 2nd August 2022, <https://www.cnbc.com/2022/07/27/chinas-property-sales-set-for-a-worse-plunge-than-in-2008-sp-says.html>

10 Lee, Yen Nee, *These charts show the dramatic increase in China's debt, CNBC*, 13th July 2021, viewed 2nd August 2022, <https://www.cnbc.com/2021/06/29/china-economy-charts-show-how-much-debt-has-grown.html>

11 Ma, Josephine, *How zero-Covid was a costly lesson for China's local governments, SCMP,* 14th February 2023, viewed 1st August 2023, <https://www.scmp.com/news/china/science/article/3210188/how-zero-covid-was-costly-lesson-chinas-local-governments>

12 The 'demographic dividend' refers to economic development that is driven by a high proportion of working-age population. This is being lost in China due to its unprecedented low number of newborns and its rapidly ageing population. Woo, Ryan & Yao, Kevin, *China demographic crisis looms as population growth slips to slowest ever, Reuters*, 11th May 2021, viewed 9th August 2022, <https://www.reuters.com/world/china/china-2020-census-shows-slowest-population-growth-since-1-child-policy-2021-05-11/>

13 "China's youth unemployment rate hit a record in June—marking a third consecutive month above 20%—and the government warned the situation may get even worse as new graduates start looking for work." Disis, Jill Elaine & Siu, Chi Yui, *China Warns Youth Unemployment to Worsen After Hitting Record, Bloomberg*, 17th July 2023, viewed 28th July 2023, <https://www.bloomberg.com/news/articles/2023-07-17/china-warns-youth-unemployment-to-worsen-after-hitting-record?srnd=economics-jobs#xj4y7vzkg>

14 The National Bureau of Statistics suspended the publication of the urban unemployment data broken down into age groups in August 2023. Figures in this series only included young people who were actively looking for work. However, according to an estimate by a professor at Peking University, who has since been censored, the figure may be as high as 46.5 per cent, if those 'lying flat' or relying on their parents were also included. Woo, Ryan & Zhang, Ellen, *Chinese professor says youth jobless rate might have hit 46.5%, Reuters*, 20th July 2023, viewed 2nd August 2023, <https://www.reuters.com/article/china-economy-youth-unemployment-idUSKBN2Z00HN>

15 Youth consumption is important for China's economy, especially in areas such as culture and education, rent, transportation and communication, in which they generally spend heavily. *Why has youth unemployment risen so much in China?*, Goldman Sachs, 31st May 2023, viewed 29th June 2023, <https://www.goldmansachs.com/intelligence/pages/why-has-youth-unemployment-risen-so-much-in-china.html>

16 *China's $16 Trillion Cash Hoard Shows Deepening Household Gloom, Bloomberg,* 23rd May 2022, viewed 7th July, <https://www.bloomberg.com/news/articles/2022-05-23/china-s-16-3-trillion-cash-hoard-shows-deepening-household-gloom>

17 In 2022, the EU's trade deficit with China surged to euro (EUR) 395.7 billion from EUR 250.3 billion in 2021. Huld, Arendse, *EU-China Relations – Trade, Investment, and Recent Developments*, China Briefing, 4th April 2023, viewed 7th July 2023, <https://www.china-briefing.com/news/eu-china-relations-trade-investment-and-recent-developments/>

18 In 2022, the US' trade deficit with China reached US dollar (USD) 382.9 billion, the second highest level on record. Palmer, Doug, *What cold war? U.S. trade with China hits new high, Politico*, 7th February 2023, viewed 7th July 2023, <https://www.politico.com/news/2023/02/07/trade-china-relations-economies-00081301>

19 For example, the Italian Government highlighted its growing trade imbalance with China as a reason behind its intention to leave the Belt and Road Initiative, which Italy joined as the only Group of 7 (G7) country in 2019. Folkman, Varg, *Italy intends to leave China's Belt and Road Initiative, defense minister says, Politico*, 30th July 2023, viewed 2nd August 2023, <https://www.politico.eu/article/italy-leave-belt-and-road-initiative-china-minister-guido-crosetto/>

The role of European business in China's economic development

Shaken by the supply chain vulnerabilities that became evident during the COVID-19 pandemic, concerned about the economic outlook in China and globally, and with geopolitical tensions raising new challenges, European companies' perception of the Chinese market as predictable, reliable and efficient has been steadily eroded.[20] However, while they have come under increasing pressure to mitigate risks stemming from their presence in China, they remain committed to this important market.[21]

Although Beijing is taking steps to increase its technological self-reliance, European businesses historically played an important role in the upgrading of China's domestic industry through both collaboration and competition with Chinese companies.[22] And there is still enormous potential for them to continue making valuable contributions to China's development, particularly if self-reliance efforts are focussed on narrow and precisely-defined national security concerns. If provided with greater market access, 63 per cent of respondents to the BCS 2023 said they would consider expanding their footprint in China. Nearly half of those would likely increase investments by between five to 10 per cent of their annual revenue; 12 per cent would likely increase investments by 11 to 20 per cent of their annual revenue; and one in 10 by more than 20 per cent.[23] European and other foreign companies have also created many new jobs through greenfield investments in China. However, with the value of greenfield foreign direct investment (FDI) having decreased sharply in 2022, even compared to the first two years of the COVID-19 pandemic,[24] China is at risk of losing out on the positive effect that FDI can have on employment.

Implementing policies that can help companies attract and retain foreign talent to work in China is another area that needs to be addressed if China wants foreign companies to optimise the contributions they can make to the country's development. This challenge was exacerbated by the pandemic, during which many companies experienced an outflow of foreign workers.[25]

According to official figures in 2021, the number of foreign nationals in China was already very low. Of the 1.4 billion total population in Mainland China recorded in the 2021 census, only 845,697 were foreign nationals, which represented approximately 0.06 per cent of the total.[26] Furthermore, the number of foreign workers from developed economies that work in international companies was shown to be falling in some key cities. This trend is not beneficial to China's economy, as high-level foreign talent tend to make significant contributions to innovation, efficiency and productivity in areas that are important to the country's high-quality development.

While the 2021 census indicates a total foreign population of 845,697 in Mainland China (or 1,430,695

20 *European Business in China Business Confidence Survey 2023*, European Union Chamber of Commerce in China, 21st June 2023, viewed 5th July 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1124/Business_Confidence_Survey_2023>

21 Ibid.

22 Zenglein, Max J. & Holzmann, Anna, *Evolving Made in China 2025: China's industrial policy in the quest for global tech leadership*, Mercator Institute for China Studies (MERICS), July 2019, viewed 30th June 2023, <https://merics.org/sites/default/files/2020-04/MPOC%20Made%20%20in%20China%202025.pdf>

23 *European Business in China Business Confidence Survey 2023*, European Union Chamber of Commerce in China, p. 32, 21st June 2023, viewed 5th July 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1124/Business_Confidence_Survey_2023>

24 "Inbound FDI for China declined further in 2022, with decreases in the number of announced FDI projects numbers (24%), capital expenditure (44%) and job creation (59%). Compared to 2019, the number of projects into China last year [2022] was down 60% and capital investment was down 68%." *The fDi Report 2023: Global greenfield investment trends*, fDi Intelligence, p. 10, 16th May 2023, viewed 30th June 2023, <https://www.fdiinsights.com/fdi/report2023>

25 Wang, Huiyao, *China's zero-Covid policy has had a severe impact on its stock of global talent, Financial Times*, 18th July 2022, viewed 3rd August 2023, <https://www.ft.com/content/fef5a71d-8a19-4f65-804e-42bfb02af083>

26 By contrast, foreign residents in Japan in 2021 made up about 2.2 per cent of the total population: *Number of registered foreign residents living in Japan from 2012 to 2021*, Statista, 4th January 2023, viewed 7th August 2023, <https://www.statista.com/statistics/687809/japan-foreign-residents-total-number/>; and as of March 2021, foreign residents in South Korea made up around 3.8 per cent of the total population: Yonhap, *Foreign population in S. Korea falls below 2m for 1st time in over 5 years, The Korea Herald*, 27th April 2021, viewed 3rd August 2023, <www.koreaherald.com/view.php?ud=20210427000344>

including residents from Hong Kong, Macau and Taiwan), an increase of 251,865 over the 593,832 recorded in 2010, it is important to put these numbers—and in particular the geographical distribution of international talent—into context. For example, the foreign populations of Beijing and Shanghai—locations that have historically had a higher density of foreign nationals from developed economies relative to the rest of China—dropped from 107,445 (about 0.5 per cent of the total) to 62,812 (about 0.3 per cent of the total) and from 208,602 (about 1.0 per cent of the total) to 163,954 (about 0.6 per cent of the total) respectively from 2010 to 2021.[27] Given China's increased focus on innovation under the 14th Five-year Plan (14FYP), the significance of a decreasingly diverse working population—particularly in cities that are expected to be important drivers of future growth—cannot be overstated.

The outflow of foreign nationals has resulted in reduced transfer of know-how and best practices, as well as increased communication difficulties between headquarters (HQs) and China operations. In some cases, this has led to investment plans being deferred or even companies closing their China operations down.[28] The announcement of the four-year extension of non-taxable allowances for foreign national employees in August 2023 was therefore welcomed by European businesses,[29] as the measure will help them to continue providing more competitive employment opportunities for much-needed foreign talent. Nevertheless, while extending these benefits until 31st December 2027 is seen by the Chamber as a demonstration of China's commitment to both foreign companies and the foreign nationals that are already working in the country, it is likely that more policies that can attract new talent will still be needed.[30]

Would you like to know more?

To learn more about how tax-related issues impact European businesses' operations in China, read the *Finance and Taxation Working Group Position Paper 2023/2024*.

One key challenge that undermines China's attractiveness to international talent is the erosion of the soft infrastructure that is vital for maintaining a vibrant foreign community in China. For example, with international schools and medical clinics finding themselves short of both staff and customers, their service offerings have reduced overall, which makes relocation to China a less attractive proposition, especially for senior-level talent, who are more likely to bring their families.

Once attracting foreign investment became a clear policy priority at the beginning of 2023,[31&32] Chinese interlocutors at all levels of government ramped up engagement with foreign business representatives in a bid to introduce their respective regions as viable investment destinations. There was also a significant

27 Calculations on the proportion of foreign nationals compared to total metropolitan populations of Beijing and Shanghai conducted by the European Chamber. The foreign populations provided for Shanghai and Beijing include residents of Hong Kong, Macau and Taiwan. *How many Foreigners live in China – the seventh national census in 2021*, Registration China, 15th May 2021, viewed 7th August 2023, <https://www.registrationchina.com/articles/how-many-foreigners-live-in-china/>; *Beijing, China Metro Area Population 1950-2023*, macrotrends, viewed 8th August 2023, <https://www.macrotrends.net/cities/20464/beijing/population>; *Shanghai, China Metro Area Population 1950-2023*, macrotrends, viewed 8th August 2023, <https://www.macrotrends.net/cities/20656/shanghai/population>

28 "One in six respondents (16%, +5pp y-o-y) say they do not currently employ any foreign nationals, while foreign nationals make up 10% or less of overall staff for 78% of respondent companies." *European Business in China Business Confidence Survey 2023*, European Union Chamber of Commerce in China, p. 16, 21st June 2023, viewed 2nd July 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1124/Business_Confidence_Survey_2023>

29 *Announcement on the Continuation of the Implementation of Non-taxable Allowances of Individual Income Tax Policies for Foreign National individuals*, Ministry of Finance (MOF) & State Taxation Administration, 29th August 2023, viewed 1st September 2023, <http://szs.mof.gov.cn/zhengcefabu/202308/t20230828_3904329.htm>

30 Some recent measures were aimed at streamlining visa application procedures; however, while welcome, these steps have little impact on companies' ability to attract foreign talent. *The Ministry of Public Security issued 26 measures to ensure high-quality development of services, People's Daily Online*, 3rd August 2023, viewed 3rd August 2023, <http://society.people.com.cn/n1/2023/0803/c1008-40049749.html>; *The State Council's notice on the publication of measures on adopting international standards at conditional pilot free trade zones and free trade ports and promoting structural opening up*, State Council, 29th June 2023, viewed 3rd August 2023, <https://www.gov.cn/zhengce/content/202306/content_6889026.htm>

31 Wang, Orange, *Chinese Foreign Minister Qin Gang assures US business leaders of Beijing's support, SCMP*, 26th March 2023, viewed 2nd July 2023, <https://www.scmp.com/news/china/diplomacy/article/3214870/chinese-foreign-minister-qin-gang-assures-us-business-leaders-beijings-support?module=inline&pgtype=article&module=inline&pgtype=article>

32 He, Laura, *China's new premier rolls out the welcome wagon for foreign companies, CNN*, 28th March 2023, viewed 30th June 2023 <https://edition.cnn.com/2023/03/28/economy/china-development-forum-foreign-companies-welcome-intl-hnk/index.html>

uptick in the number of in-person meetings at the political level.[33,34&35] European Chamber members reported a surge in the number of investment promotion meetings, both in China and at their HQs in Europe. The European Chamber also received many regional investment promotion bureaus since the beginning of 2023, seeking foreign investment.[36] Restarting face-to-face meetings after a three-year gap has been an important step towards rebuilding bridges, as China's isolation from the rest of the world resulted in less understanding of the country and diminished business confidence. This renewed engagement was welcomed by the European business community in China, and it raised expectations that foreign companies would rush back to the table after the country re-opened its doors with a bang. However, despite the warm reception and the apparent attentiveness towards the challenges of businesses, the appetite for investment was not there once business leaders realised they were being served the same old menu.

In segments of China's economy that have continued to open and become better regulated, European companies have increased their investments. This goes to show that when Chinese policymakers follow up on pledges to improve conditions for foreign businesses, it gives a visible boost to investor confidence. At the same time, it is important to institute meaningful government-industry communication before new policies are introduced to ensure they are practical and effective, as inconsistencies and ambiguity over certain requirements can pose barriers.

For example, in the automotive industry, the lifting of ownership restrictions resulted in one large European automotive manufacturer increasing its stake in its joint venture (JV) partner in the first half of 2022, an investment that accounted for over half of the total EU FDI into China during that period.[37] However, despite the removal of equity caps, many foreign-invested carmakers still face regulatory hurdles when trying to optimise their investments in China. These barriers largely stem from approval requirements and processes that are not clearly specified, which does not provide international automotive manufacturers the certainty they need to plan their investments in China.

Would you like to know more?

To learn more about the automotive sector in China, and the concerns and recommendations of the European Chamber's relevant members, read the *Automotive Working Group Position Paper 2023/2024.*

The aviation sector provides another example of an opening promise that has not yet materialised due to prevalent invisible market access barriers. Although China included among its commitments to the World Trade Organization (WTO) in 2001 the liberalisation of its computer reservations system (CRS) market, foreign CRS providers still do not have access in practice. In 2012, China released measures that would allow licensed foreign companies to offer global distribution system (GDS) services in China

33 European Commission chief Ursula von der Leyen accompanied French President Emmanuel Macron to Beijing in April. *Macron and von der Leyen in China: A difficult but useful dialogue, Le Monde*, 8th April 2023, viewed 29th June 2023, <https://www.lemonde.fr/en/opinion/article/2023/04/08/macron-and-von-der-leyen-in-china-a-difficult-but-useful-dialogue_6022150_23.html>

34 Tesla CEO Elon Musk and Microsoft co-founder Bill Gates headed to the Chinese capital in May and June respectively. Chiang, Sheila, *China's Xi tells Bill Gates he's the 'first American friend' he met in Beijing this year, CNBC*, 16th June 2023, viewed 29th June 2023, <https://www.cnbc.com/2023/06/16/bill-gates-visits-china-hot-on-the-heels-of-elon-musk-with-xi-meeting-confirmed.html>

35 Similarly, Chinese stakeholders also resumed their overseas trips, with Wang Yi in his role of foreign minister in February and then Li Qiang, stepping into the role of China's premier, paying visits to several European countries.

36 Some examples of such meetings include: *Meeting with Chairman of China Council for the Promotion of International Trade (CCPIT) Changsha Branch*, European Union Chamber of Commerce in China, 12th July, 2023, viewed 7th August 2023, <https://www.europeanchamber.com.cn/en/lobby-actions/6497/Meeting_with_Chairman_of_China_Council_for_the_Promotion_of_International_Trade_CCPIT_Changsha_Branch>, *Meeting with Vice-Chairman of China Council for the Promotion of International Trade (CCPIT) Tianjin Sub-Council*, European Union Chamber of Commerce in China, 11th July 2023, viewed 7th August 2023, <https://www.europeanchamber.com.cn/en/lobby-actions/6496/Meeting_with_Vice_Chairman_of_China_Council_for_the_Promotion_of_International_Trade_CCPIT_Tianjin_Sub_Council>, *Meeting with China Council for the Promotion of International Trade (CCPIT) Wuhu Delegation*, European Union Chamber of Commerce in China, 9th June 2023, viewed 7th August 2023, <https://www.europeanchamber.com.cn/en/lobby-actions/6400/Meeting_with_China_Council_for_the_Promotion_of_International_Trade_CCPIT_Wuhu_Delegation>

37 Kratz, Agatha, Barkin, Noah & Dudley, Lauren, *The Chosen Few: A Fresh Look at European FDI in China*, Rhodium Group, 14th September 2022, viewed 5th July 2023, <https://rhg.com/research/the-chosen-few/>

to certain sales agencies. However, when agencies choose a foreign-owned service provider, they have to go through a licence verification process that exceeds 50 days, illustrating how the playing field is tilted in favour of domestic competitors. This problem is further exacerbated by the lack of clarity on how certain required authorisation processes apply to foreign GDS providers.

Would you like to know more?

For more information on the aviation sector in China, and the concerns and recommendations of the European Chamber's members in relevant industries, read the *Aviation and Aerospace Working Group Position Paper 2023/2024.*

Some market access challenges in certain sectors are due to 'one-size-fits-all' regulations, and can act as a deterrent to foreign investment across multiple industries. For example, foreign banks in China already have smaller balance sheets compared to their Chinese peers and, on top of that, often face stricter compliance requirements, making it difficult for them to compete on bond-trading turnover and inventory size. However, foreign banks usually have larger overseas client bases that are eager to trade with them via China's investment channel Bond Connect, and to get market updates and recommendations to access the onshore Chinese Interbank Bond Market. Therefore, difficulties in qualifying to become Bond Connect market makers limit foreign banks' ability both to develop business and bring investment into China.

Would you like to know more?

To learn more about the challenges that European banks face in China and their recommendations for improving the business environment, read the *Banking and Securities Working Group Position Paper 2023/2024.*

Research and development (R&D) is one area in which the Chinese Government has clearly signalled its intention to expand the role of foreign investment. Recent measures have been rolled out to create a better environment for foreign-funded R&D activities, facilitate the mobility of overseas talent and strengthen intellectual property (IP) protection, among others.[38&39] It is seen as a positive sign by European businesses that some of their key concerns have been reflected in these documents, but it remains to be seen how effectively these measures will be implemented.

Would you like to know more?

For more information on developments in China's innovation field, read the *Research and Development Working Group Position Paper 2023/2024.*

38 *Several Measures on Further Encouraging Foreign Investment to Establish R&D Centres*, Ministry of Commerce (MOFCOM) & Ministry of Science and Technology (MOST), 11th January 2023, viewed 10th July 2023, <https://www.most.gov.cn/xxgk/xinxifenlei/fdzdgknr/fgzc/zcjd/202301/t20230119_184334.html>

39 *Action Plan for Improving Enterprise Technology Innovation Capabilities (2022–2023),* MOST & MOF, 5th August 2022, viewed 10th July 2023, <https://www.most.gov.cn/xxgk/xinxifenlei/fdzdgknr/qtwj/qtwj2022/202208/t20220815_181875.html>

Executive Position Paper

Time to change the menu

Even though many challenges remain, and economic recovery has shown signs of faltering, China is still widely expected to meet its growth targets in 2023.[1] However, in the coming years, economic growth is projected to decelerate.[2] This is in line with trends seen in most economies as they mature, albeit with some obvious and significant differences,[3] which provides a compelling argument for shifting from growth-at-all-costs to a more sustainable model. European companies have a key role to play in this alignment, as they can bring much needed competition and technology if provided with an open market and a level playing field.

An important part of the shift towards sustainable economic growth is finding ways to increase productivity. This could be difficult for China given its emphasis on increasing self-reliance, and in some cases developing self-sufficiency.[4] China is pursuing this partly as a result of being denied access—for various reasons—to certain types of foreign technology, particularly that which has dual use applications. It is also driven by a desire to achieve self-sufficiency in strategic technologies, an idea that can actually be traced back nearly two decades, and to create dependencies on its own market.[5] Messaging from the Communist Party's 20th Party Congress, held in October 2022, suggests that in the face of growing external risks, the country will further increase its focus on national security.[6]

Three trends stemming from the same root: China's self reliance campaign, the European Union's (EU's) 'de-risking' strategy, and the United States' (US') own version of 'de-risking'

The Trump administration's trade and technology war with China led the Chinese leadership to view their earlier self-reliance efforts as retrospectively vindicated. However, the combination of China's own

1 In April, the International Monetary Fund (IMF) set its gross domestic product (GDP) growth forecast for China at 5.2 per cent; and in June, the World Bank projected that China's GDP will grow 5.6 per cent in 2023. *World Economic Outlook: A Rocky Recovery,* IMF, 11th April 2023, viewed 6th July 2023, <https://www.imf.org/en/Publications/WEO/Issues/2023/04/11/world-economic-outlook-april-2023>; *China Economic Update – June 2023*, World Bank, 14th June 2023, viewed 6th July 2023, <https://www.worldbank.org/en/news/press-release/2023/06/14/priority-reforms-key-for-sustaining-growth-and-achieving-china-s-long-term-goals-world-bank-report>

2 The IMF expects China's GDP growth to slow to 4.5 per cent in 2024; the World Bank forecasts a deceleration to 4.6 per cent in 2024, and then to 4.4 per cent in 2025. Ibid.

3 One obvious difference is that in comparison to other fast-developing economies—particularly the 'Asian Tigers', Hong Kong, Singapore, South Korea and Taiwan—that have seen rapid transitions to higher income levels, China's growth rate is slowing at a time when its relative GDP per capita is much lower. Dieppe, Alistair, Gilhooly, Robert, Han, Jenny, Korhonen, Iikka & David Lodge, (eds), *The transition of China to sustainable growth – implications for the global economy and the euro area*, European Central Bank, p. 10, January 2018, viewed 2nd August 2023, <https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op206.en.pdf>

4 It is important to make the distinction between 'self-reliance'—and its relation to 'de-risking' from an European Union (EU) perspective—and 'self-sufficiency,' and how this is more related to the idea of 'decoupling'. Increasing self-reliance is a strategy that many economies are now pursuing—including those of the EU and the United States (US)—in order to reduce dependency on any one source or country for crucial goods, such as medical devices, pharmaceutical inputs or rare earths. For the EU, this involves taking a carefully considered, analytical approach to identifying which goods can be truly defined as 'critical', and then taking precise, country-agnostic actions that can ensure its continued access to those goods, even in the event of global shocks. This narrow, surgical approach to 'self-reliance' is what the EU terms 'de-risking', in order to differentiate it from a broader self-reliance drive. The aim of becoming 'self-sufficient' is to ensure that you can source and produce everything that you need within your own country, which involves 'decoupling' – in other words, 'self-sufficiency' entails countries developing entire supply chains that are completely insulated from the rest of the world.

5 Although China's drive to achieve self-sufficiency in strategic technologies has recently accelerated due to additional export controls that have been imposed, the origins of this idea predate it by nearly two decades. It can be traced to 2006, with the launch of the National Medium- and Long-term Programme for Science and Technology Development (2006-2020) (MLP), which saw China adopt the concept of "indigenous innovation" as a policy priority. The MLP was introduced to address the fact that most key innovation was taking place outside of China, and was intended to "reduce [China's] dependence on foreign technology by at least 30%". The 2010 Strategic Emerging Industries (SEI) initiative, reiterated the guiding principles of the MLP and was aimed at supporting hand-picked national champions to become leaders in strategic industries. The "comprehensive national security" concept was then formally adopted in 2014, which saw increasing national security explicitly stated as a policy objective. Made in China 2025 (MiC2025), aka China Manufacturing 2025 (CM2025), was published in 2015, and is largely acknowledged as a re-packaging of the SEI. It focusses on China achieving "technological self-assurance". MiC2025 assigns global "market share targets" for 10 key industries and outlines the need to reduce dependence on foreign core technologies.

6 Lin, Bonny, Hart, Brian, Funaiole, Matthew P. & Lu, Samantha, *China's 20th Party Congress Report: Doubling Down in the Face of External Threats*, Center for Strategic and International Studies, 19th October 2022, viewed 7th July 2023, <https://www.csis.org/analysis/chinas-20th-party-congress-report-doubling-down-face-external-threats>

industrial policies and market access barriers aimed at ringfencing strategic areas of its economy largely contributed to the escalation of tensions between the world's two largest economies. It has also had profound consequences for European businesses.[7]

China's self-reliance campaign has a common root with the EU's 'de-risking' strategy and the US' own version of 'de-risking', since all these approaches stem from the realisation that overexposure to any one source can lead to major challenges if that source suddenly becomes unavailable.[8&9] However, one key element that differentiates these approaches is the extent to which they are offensive and aimed at restricting a rival economy's development, or defensive and aimed at ensuring economic and social stability in a player's home market.

The US' version of 'de-risking' from China primarily manifests itself in a series of measures to stop or limit the sale of 'emerging' and 'foundational' technologies to China. While China has also taken some targeted retaliatory measures specifically against the US, it has introduced a broader framework of export and import controls, and formalised its own version of an entity list as well.[10] These tools allow China to introduce blanket export controls and increase the reliance of third countries on its market in certain areas.[11]

One area in which China is increasingly exerting its dominance is in solar panel production. After proposing an export restriction on technologies used in the production of key components of photovoltaic (PV) cells,[12] China's Ministry of Commerce (MOFCOM) imposed export controls on gallium and germanium, two metals used in semiconductors and solar panels.[13] Such moves are in line with China's 'dual circulation' policy, which outlines its plan of tapping into the unexploited potential of its huge domestic market to become a leader in key technologies that will be the drivers of the future global economy. This approach, however, is pushing other players to find ways of diversifying away from the country to reduce their dependencies sooner rather than later.

For its part, the EU has also been working on strategies aimed at reducing critical dependencies and vulnerabilities in its economy. While the fragility of global supply chains was exposed by the COVID-19 pandemic, Russia's war on Ukraine was the event that pushed the issue to the top of the agenda in Brussels. Only two weeks after the invasion of Ukraine, the European Council adopted the Versailles Declaration, setting out the targets for reducing the EU's energy dependency on Russia. Meanwhile, recognising the need to enhance the economic resilience of the Single Market, EU leaders began

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7 Much of China's opening has taken place in non-critical areas, or has been conditional, for example through JV requirements that have kept foreign players as minority stakeholders or by requiring technology transfers that have empowered Chinese companies. Meanwhile, industrial policies, such as the CM2025, set out to advance "indigenous innovation" and "self-reliance" in strategic areas. *Decoupling: Severed Ties and Patchwork Globalisation*, European Chamber of Commerce in China, pp. 10–11, 14th January 2021, viewed 7th July 2023, <https://www.europeanchamber.com.cn/en/publications-decoupling>

8 Ibid, p. 10.

9 The fragility of global supply chains has been exposed and risk management has become a priority due to a host of factors, including COVID-19, Russia's invasion of Ukraine, inadequate logistics infrastructure, and a lack of truck drivers in many markets, as well as freak occurrences such as the container ship that ran aground and blocked the Suez Canal. *European Business in China Position Paper 2022/2023*, European Union Chamber of Commerce in China, p. 21, 21st September 2022, viewed 6th July 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1068/European_Business_in_China_Position_Paper_2022_2023>

10 The entity list is a tool used to deter parties from conducting trade or investment activities with certain foreign entities. China's *Unreliable Entity List* came into effect when the MOFCOM issued its relevant provisions in September 2020. *MOFCOM Order No. 4 of 2020 on Provisions on the Unreliable Entity List*, MOFCOM, 19th September 2020, viewed 31st July 2023, <http://english.mofcom.gov.cn/article/policyrelease/questions/202009/20200903002580.shtml>

11 Ouyang, Shijia, *List of technologies banned from export released, China Daily*, 29th August 2020, viewed 7th July 2023, <https://www.chinadaily.com.cn/a/202008/29/WS5f495f8aa310675eafc56330.html>

12 Yeh, Nadya, *China drafts new export controls to shore up solar dominance*, The China Project, 1st February 2023, viewed 7th July 2023, <https://thechinaproject.com/2023/02/01/china-drafts-new-export-controls-to-shore-up-solar-dominance/>

13 Domonoske, Camila, *China imposes export controls on 2 metals used in semiconductors and solar panels, NPR*, 4th July 2023, viewed 7th July 2023, <https://www.npr.org/2023/07/04/1185940293/china-imposes-export-controls-on-two-metals-used-in-semiconductors-and-solar-pan>

outlining the areas where strategic dependencies need to be addressed.[14]

Discussions about the EU's potential overexposure to China were already ongoing at the time, as part of its re-evaluation of its relations with the world's second largest economy. However, as the EU's critical dependency on Chinese goods is being characterised as limited,[15&16] the bloc's approach to eliminating risks is expected to be narrow and precise, especially since the EU's de-risking strategy—unlike China's push for self-reliance—is not aimed at onshoring production, but rather ensuring that any one supplier does not dominate EU supply chains for a specific product.

The EU's 'de-risking' approach, first put forward by European Commission President Von der Leyen in March 2023,[17] and reaffirmed by the European Council three months later,[18] acknowledges both the need to maintain engagements to resolve key issues and the potential for strengthening cooperation, trade and investment partnerships. The EU's leadership made it clear that its strategy towards China is different from that of the US, primarily in that it "does not intend to decouple or to turn inwards".[19] Current discussions in the EU also indicate that there is an expectation that the depth and breadth of corporate de-risking activities will be significantly more modest in scope and much less restrictive compared to self-reliance initiatives in China, as they are driven by the need to build resilient supply chains rather than achieve self-sufficiency.

Risks and opportunities

To fend off potential risks to operational continuity, an increasing number of firms are creating two separate systems, with one for China and one for the rest of the world – including for supply chains, data and information technology (IT) systems, and staffing. Some are bringing as much of their own production into China as they can, and/or enticing existing suppliers to enter the China market. Others are looking to replace their overseas suppliers with local ones that are more likely to be in line with relevant Chinese regulations and guidelines.[20]

It should be noted, though, that this approach still carries risks. Some European companies already report receiving conflicting requests from Chinese and Western customers to produce goods containing either no China- or no US-made components or software.[21] Should current geopolitical tensions take a turn for the worse, Chinese buyers may well feel pressure to cease using European suppliers altogether.

For certain companies, however, siloing their China operations is simply not an option, either because

14 Critical raw materials, semiconductors, healthcare products, digital technologies and key agricultural products were listed as the most sensitive areas of strategic dependence. *Versailles Declaration*, European Council, 11th March 2022, viewed 7th July 2023, <https://www.consilium.europa.eu/media/54773/20220311-versailles-declaration-en.pdf>

15 MERICS identified 103 such product categories in electronics, chemicals, minerals/metals and pharmaceutical/medical products. Zenglein, Max J., *Mapping and Recalibrating Europe's Economic Interdependence with China*, MERICS, p. 7, 18th November 2020, viewed 7th July 2023, <https://merics.org/en/report/mapping-and-recalibrating-europes-economic-interdependence-china>

16 In May 2021, the European Commission proposed a strategy for reducing dependency on 137 imported products in the areas of raw materials, batteries, active pharmaceutical ingredients, hydrogen, semiconductors, and cloud and edge technologies, which in total account for about six per cent of the total value of goods that the EU imports. While China was identified as accounting for 52 per cent of the imported goods the EU was highly dependent on, its critical dependence on China was for only three per cent of the total value of EU imported goods. *EU unveils strategy to reduce dependency on China*, Economist Intelligence, 18th May 2021, viewed 6th July 2023, <https://www.eiu.com/n/eu-unveils-strategy-to-reduce-dependency-on-china/>

17 *Speech by President von der Leyen on EU-China relations to the Mercator Institute for China Studies and the European Policy Centre*, European Commission, 30th March 2023, viewed 7th July 2023, <https://ec.europa.eu/commission/presscorner/detail/en/speech_23_2063>

18 *European Council conclusions on China,* European Council, 30th June 2023, viewed 7th July 2023, <https://www.consilium.europa.eu/en/press/press-releases/2023/06/30/european-council-conclusions-on-china-30-june-2023/>

19 Ibid.

20 Overall, 79 per cent of respondents to the *Business Confidence Survey 2023* (BCS 2023) reported they had at least partially localised their China supply chains over the past five years—with 67 per cent reporting having done so "significantly" or "moderately"—while 24 per cent reported plans to further onshore their supply chains into China. *European Business in China Business Confidence Survey 2023*, European Union Chamber of Commerce in China, pp. 15–17, 21st June 2023, viewed 7th July 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1124/Business_Confidence_Survey_2023>

21 Ibid, p. 39.

they import components to China that they cannot easily source from elsewhere or, as is often the case for smaller companies, because they either lack the necessary resources to create separate systems for China and the rest of the world or doing so would make their business unviable.[22]

Companies are also facing the risk of being caught between conflicting legal regimes, as recently adopted and forthcoming legislation in the EU and China pose compliance challenges. The EU has recently rolled out laws to ensure that companies operating outside of its legal jurisdiction keep in line with its human rights and environmental standards.[23&24] The US already has legislation in place that requires importers to provide sufficient evidence that goods entering the country have not been produced using forced labour.[25]

It is not clear how companies will be able to comply with such requirements, as independent, third-party audits that could certify them as not using forced labour anywhere along their supply chains are difficult, and in some cases impossible, under current conditions in China.[26] This situation was brought into sharp focus following raids on some American firms that conduct background checks and due diligence as part of their business. According to reports, at least one of these companies was investigated due to its work on “Xinjiang supply chain audits”.[27] As the date for reporting obligations under the new EU legislation draws closer, affected companies may come under increasing pressure to move operations out of sensitive regions in China, on top of the pressure they are already facing from many Western customers to do the same.[28]

As previously noted, China’s current policy agenda and the EU’s targeted approach to mitigating risk still leaves plenty of opportunities for strengthening the EU-China relationship. WTO reform, international standardisation and tackling climate change are all areas where bilateral cooperation can and should deepen. The focus on both sides should be to rebuild the right bridges so that these ties can continue to flourish in the long-term.

China has repeatedly stated its commitment to open its doors wider to foreign investment and foster a world-class business environment. However, meaningful change comes through implementation, not pledges. For example, while the proposed establishment of a ‘unified national market’ was touted as a move towards the creation of efficient, standardised and competitive market,[29] it merely brings together

22 Only a quarter of respondents do not import components or equipment into China that cannot be easily replaced in the event of a supply disruption; and a third of manufacturers (32 per cent) import critical components for which they cannot source alternatives at all. Over a quarter (27 per cent) of respondents are able to source alternatives for equipment/components they currently import into China, but report that the substitutes are of lower quality; another 14 per cent report that they can source replacements but will have compatibility issues; and 11 per cent say the alternative products available come at a higher cost. Ibid, p. 19.

23 The Corporate Sustainability Reporting Directive (CSRD) entered into force on 5th January 2023. It obliges all large and all listed companies operating in the EU to “disclose information on what they see as the risks and opportunities arising from social and environmental issues, and on the impact of their activities on people and the environment.” From 2024, such companies will need to prepare sustainability reports—including information on their sustainability policies, environmental protection policies and actions, social responsibility and treatment of employees, and respect for human rights—for submission in 2025. *Corporate sustainability reporting*, European Commission, viewed 10th July 2023, <https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en>

24 The Corporate Sustainability Due Diligence Directive (CSDDD) was approved by the European Parliament on 1st June 2023. It will require EU-based companies to establish due diligence processes to ensure their entire operations—including subsidiaries, and up- and downstream suppliers—are in line with EU human rights and environmental standards. *MEPs push companies to mitigate their negative social and environmental impact*, European Parliament, 1st June 2023, viewed 10th July 2023, <https://www.europarl.europa.eu/news/en/press-room/20230524IPR91907/meps-push-companies-to-mitigate-their-negative-social-and-environmental-impact>

25 The US Uyghur Forced Labor Prevention Act came into effect on 21st June 2022. *Implementation of the Uyghur Forced Labor Prevention Act*, US Department of State, 21st June 2022, viewed 10th July 2023, <https://www.state.gov/implementation-of-the-uyghur-forced-labor-prevention-act/>

26 In the BCS 2023, 16 per cent of respondents reported the lack of third-party audits as a concern. While this issue is not a concern for 45 per cent of respondents, it should be noted that 38 per cent said they “don’t know”, meaning that there could be many more impacted. *European Business in China Business Confidence Survey 2023*, European Union Chamber of Commerce in China, p. 46, 21st June 2023, viewed 10th July 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1124/Business_Confidence_Survey_2023>

27 *China’s ‘men in black’ step up scrutiny of foreign corporate sleuths, Financial Times*, 2nd May 2023, viewed 10th July 2023, <https://www.ft.com/content/8c21b86d-66de-4c69-8c8d-a0ef270ae3e3>

28 *European Business in China Business Confidence Survey 2023*, European Union Chamber of Commerce in China, p. 39, 21st June 2023, viewed 10th July 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1124/Business_Confidence_Survey_2023>

29 *China's State Council discusses work plan on unified domestic market, Xinhua,* 20th May 2023, viewed 7th July 2023, <https://english.www.gov.cn/news/202305/20/content_WS64680365c6d03ffcca6ed336.html>

under one umbrella many items that have been on China's to-do list for quite some time, which remain unfulfilled.[30] Renaming a list of old dishes will not satisfy the appetite of foreign investors. Instead, China needs to listen to long-standing concerns and take tangible steps to address them. The Chamber's 1,058 recommendations contained in this position paper provide a blueprint for how this can be achieved, with the aim of improving market conditions for all companies operating in China. By following them, China can build on its reopening momentum and give investors the menu they have been craving.

30 "The primary task of last year's guidelines are to encourage competition, lower institutional costs, boost efficiency and productivity, elevate tech innovation and promote international cooperation.[…]Specifically, the government campaign includes plans to implement unified market access standards, fair competition, a social credit system, intellectual property rights protection and the free flow of labour and data." Nulimaimaiti, Mia, *Will a unified domestic market be a trump card to tackle China's economic growth problems and US threats?, SCMP*, 5th June 2023, viewed 7th August 2023, <https://www.scmp.com/economy/china-economy/article/3223011/will-unified-domestic-market-be-trump-card-tackle-chinas-economic-growth-problems-and-us-threats>

Key Recommendations

There is a host of structural issues that need to be addressed to boost economic recovery and satisfy the appetite of foreign investors, especially now that China's economic slowdown is reported as the top challenge faced by European businesses.[31] Below are five broad key recommendations that can improve China's economic outlook and boost business confidence if addressed. Some can be tackled comparatively easily through targeted policies, while others will require a systemic approach.

1. Increase Productivity by Giving Greater Play to Market Forces

Concern

The prioritisation of the public sector is hindering competition and undermining productivity in China.

Assessment

The International Monetary Fund's (IMF's) 2023 report on China identified the advancement of the public sector as a key factor weakening China's productivity growth.[32] The IMF's report also highlights that, as state-owned enterprises (SOEs) tend to be less productive than their privately-owned counterparts, their continued prioritisation might further increase the productivity gap between China and advanced economies.[33]

The need to rebalance the state-owned and private sectors has been acknowledged by Chinese financial experts, including two former People's Bank of China (PBOC) governors, Zhou Xiaochuan and Yi Gang.[34&35] Yi Gang asserted that China should consider applying the principle of 'competitive neutrality' to SOEs as part of a solution to "solve the structural problems in the Chinese economy".[36] At the moment, certain industries are only fully open to SOEs, which hold the advantage in many areas of doing business—including access to financing, licences and public procurement, and the ability to influence policy—and are largely protected from competition. This is to the detriment of the private sector,[37] and small and medium-sized enterprises (SMEs) in particular. Although, as pointed out by former Vice Premier Liu He, "SMEs are the mainstay of the market and the main source of jobs",[38] they still do not receive adequate support in China for financing or basic administrative issues.

SOEs are being pushed to take the lead in sectors deemed strategically important to China's ongoing technological self-reliance drive. To channel financing into strategic sectors, the China Securities

31 Over a third of respondents to the BCS 2023 ranked China's economic slowdown as a top-three challenge that will have the greatest impact on their future business in China. *European Business in China Business Confidence Survey 2023*, European Union Chamber of Commerce in China, p. 9., 21st June 2023, viewed 28th July 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1124/Business_Confidence_Survey_2023>

32 *People's Republic of China: 2022 Article IV Consultation – Press Release; Staff Report; and Statement by the Executive Director for the People's Republic of China, IMF*, p. 5, 3rd February 2023, viewed 30th June 2023, <https://www.imf.org/en/Publications/CR/Issues/2023/02/02/Peoples-Republic-of-China-2022-Article-IV-Consultation-Press-Release-Staff-Report-and-529067>

33 According to the IMF's recommendation, "productivity growth can be bolstered by ensuring a level playing field for all enterprises and rolling back support to SOEs, including by removing implicit guarantees, increasing banks' risk weights on corporate loans to firms with stretched debt-to-earnings ratios, adjusting cost advantages provided to SOEs, strengthening financial reporting, and fostering the orderly exit of unprofitable SOEs". Ibid, p. 23.

34 Miles, Tom, *Ex-PBOC Chief says China Must Address "Loopholes" as Part of WTO Reform, Reuters*, 19th September 2018, viewed 30th June 2023, <https://www.reuters.com/article/us-china-economy-zhou-idUSKCN1LZ0XU>

35 Antonini, Renato, *Comment: Expect More on 'Competitive Neutrality' in WTO Reform Talks*, Borderlex, 12th December 2018, viewed 30th June 2023, <https://borderlex.net/2018/12/12/comment-expect-more-on-competitive-neutrality-in-wto-reform-talks/>

36 Ibid.

37 For example, some formal restrictions have been removed in the financial sector, but only after it had become saturated by dominant domestic players. This left foreign banks to compete in only a few remaining niches, such as cross-border services. In addition, even after formal market access has been granted, many companies struggle due to indirect barriers, such as difficulties obtaining operating licences or certification: *European Business in China Executive Position Paper 2020/2021*, European Union Chamber of Commerce in China, September 2020, viewed 24th July 2022, <https://www.europeanchamber.com.cn/en/publications-archive/865/Executive_Position_Paper_2020_2021>

38 Ma, Jess, *China's SMEs: how important are small firms to the economy, and what challenges are they facing?, SCMP*, 14th November 2021, viewed 2nd August 2023, <https://www.scmp.com/economy/china-economy/article/3155660/chinas-smes-how-important-are-small-firms-economy-and-what>

Regulatory Commission (CSRC) created a 'traffic light system', giving a 'red light' to companies in non-strategic sectors, effectively barring them from listing on domestic stock exchanges.[39&40] This increasing reliance on policy-related rather than market-related factors to attract and allocate funding diverges from the spirit of market reforms. In fact, a May 2023 report, jointly published by two prominent think tanks, found that in terms of competition, China has moved further from market economy norms in the first quarter of 2023, just as it was in the process of 'reopening' to the world.[41]

Over the course of the 2023 summer period, Chinese policymakers gave several signals that they would take steps to advance the development of private businesses and promote private as well as foreign investment. In July 2023, the Central Committee of the Communist Party of China and the State Council jointly released a document containing 31 points that are to be used as key principles in the formulation of new regulations, as well as in the implementation of existing ones, in an attempt to boost the private sector.[42] Some of the requirements include the removal of market access barriers for private enterprises, and consulting with businesses in the policymaking process. In August 2023, China's State Council also released the *Opinions of the State Council on Further Optimising the Foreign Investment Environment and Increasing Efforts to Attract Foreign Investment (Opinions)*.[43] The 24 points listed in the *Opinions* resonate with the foreign business community, as, if implemented in a timely, coordinated and consistent manner, they would go a long way to improving business confidence. Many of them reflect ongoing issues for which the European Chamber has advocated solutions through its *Position Paper* and other targeted actions. Chinese policymakers took swift action with the announcement of the four-year extension of non-taxable allowances for foreign national employees, something the State Council *Opinions* implied would be forthcoming.[44] Businesses are now waiting to see if action will be taken to resolve the other points listed in this important document.

Another key part of boosting confidence in the private sector, especially among foreign-invested enterprises, will be navigating a path that allows for the development of common-sense policies aimed at proportionately increasing self-reliance in areas that are truly related to national security, while avoiding a blanket approach aimed at achieving self-sufficiency. Some European companies have reported having already been pushed to increasingly localise their China operations, separating them from the rest of the world. However, it is an expensive and highly inefficient solution that still carries risk,[45] and will hinder China's economic development.

Recommendations

- Refocus on reform and opening, to address market access and regulatory issues and rebuild confidence in the private sector.
- Continue with reforms that bring SOEs more in line with market forces through the adoption of modern

39 Salidjanova, Nargiza, Lietzow, Rachel & Rosen, Daniel H. *China Pathfinder: Q1 2023 Update*, Rhodium Group, 4th May 2023, viewed 1st July 2023, <https://rhg.com/research/china-pathfinder-q1-2023-update/>

40 Sun, Yu & Cheng, Leng, *Beijing blocks listings of 'red light' companies to steer funding to strategic sectors, Financial Times*, 9th January 2023, viewed 1st July 2023, <https://www.ft.com/content/1fdb223f-49aa-4ccf-9b82-5573554515d9>

41 Salidjanova, Nargiza, Lietzow, Rachel & Rosen, Daniel H. *China Pathfinder: Q1 2023 Update*, Rhodium Group, 4th May 2023, viewed 1st July 2023 <https://rhg.com/research/china-pathfinder-q1-2023-update/>

42 *Opinions of the Central Committee of the Communist Party of China and the State Council on Promoting the Development and Growth of the Private Economy, Xinhua,* 19th July 2023, viewed 28th July 2023, <https://www.gov.cn/zhengce/202307/content_6893056.htm>

43 *Opinions of the State Council on Further Optimising the Foreign Investment Environment and Increasing Efforts to Attract Foreign Investment*, State Council, 13th August 2023, viewed 4th September 2023, <https://www.gov.cn/zhengce/content/202308/content_6898048.htm>

44 *Announcement on the Continuation of the Implementation of Non-taxable Allowances of Individual Income Tax Policies for Foreign National individuals*, Ministry of Finance (MOF) & State Taxation Administration, 29th August 2023, viewed 1st September 2023, <http://szs.mof.gov.cn/zhengcefabu/202308/t20230828_3904329.htm>

45 This includes companies' staff, supply chains, IT systems and data storage infrastructure. For more information see: *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, 20th June 2022, viewed 24th July 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1124/Business_Confidence_Survey_2023>; Some companies are also separating their R&D operations, with core R&D being carried out in EU Member States or other countries, and China R&D functions focussing more on localisation. For more information see: *China's Innovation Ecosystem: Right for many, but not for all*, European Union Chamber of Commerce in China & MERICS, 8th June 2022, viewed 28th July 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1019/China_s_Innovation_Ecosystem_Right_for_Many_But_Not_for_All>

governance structures to make them more efficient, and eventually implement 'competitive neutrality'.
- Establish regulations that can provide a truly level playing field between foreign and Chinese enterprises.
- Address barriers that prevent businesses from attracting and retaining foreign talent.
- Provide SMEs with support for administrative issues and access to financing.
- Increase China's integration with the global economy and steer away from excessive self-reliance and self-sufficiency.
- Develop nuanced strategies for strengthening supply chains that do not err towards trade protectionism.
- Remain committed to globalisation and contribute to the strengthening of multilateral institutions.

2. Reduce Corporate Risk by De-politicising the Business Environment and Removing Ambiguity from Legislation

Concern

The politicisation of business, and ambiguous laws and regulations, make it increasingly difficult to carry out due diligence and meet compliance requirements, which increases risk for companies operating in China.

Assessment

Geopolitical developments have prompted China to expand its toolkit aimed at protecting its national security and development interests, which has resulted in a more politicised business environment.[46] This is being exacerbated by the prevalence of ambiguity in new or updated laws and regulations, with European companies struggling to understand their compliance obligations, a factor that significantly decreases business confidence.[47]

The most recent examples of such ambiguity can be found in China's recently amended Anti-espionage Law and the new Foreign Relations Law.[48&49] While both laws contain references to the broader concept of 'national security', neither provide guidelines on what constitutes a national secret, raising the likelihood of both inconsistent implementation and compliance issues for businesses.

While the purpose of any law is to specify what is allowed and what is not, businesses tend to err on the side of caution in the absence of clear language and well-defined boundaries. This can deter new investments, the planning of which requires a thorough assessment of the destination business environment—including related risks—by carrying out rigorous due diligence. With no clear understanding of what kind of information can and cannot be obtained, what is required to fulfil compliance requirements and what could constitute an act that is "detrimental to China's national interests", conducting business intelligence operations becomes a high-risk activity. This enhances the attractiveness of other markets that can provide more legal certainty.

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46 In the BCS 2023, 59 per cent of respondents reported that China's business environment became more politicised in 2022, a nine per cent increase year-on-year. The Chinese Government is perceived as the main source of increased political pressure. A large percentage of respondents foresee the situation getting worse before it gets better. *European Business in China Business Confidence Survey 2023*, European Union Chamber of Commerce in China, pp. 37–38, 21st June 2023, viewed 2nd July 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1124/Business_Confidence_Survey_2023>

47 According to the BCS 2023, ambiguous rules and regulations ranked as the top regulatory obstacle members face for the seventh year running. Ibid, pp. 27–28.

48 The amended version of the Anti-espionage Law was approved by China's legislature on 26th April 2023 and came into effect on 1st July 2023, expanding the scope of activities that could be categorised as espionage. While the old version of the law, first adopted in 2014, specifically applied to obtaining or sharing state secrets or intelligence, the new version also adds to this list "other documents, data, materials or items related to national security or interests". *A battle against spies in China is spooking locals and foreigners, The Economist*, 4th May 2023, viewed 2nd July 2023, <https://www.economist.com/china/2023/05/04/a-battle-against-spies-in-china-is-spooking-locals-and-foreigners?gclid=EAIaIQobChMIg9LTqMTv_wIV9MZMAh30ewJbEAMYASAAEgLQBfD_BwE&gclsrc=aw.ds>

49 The Foreign Relations Law, adopted by the Standing Committee of the 14th National People's Congress on 28th June 2023, puts an obligation on enterprises and citizens, among others, "to safeguard China's sovereignty, national security, dignity, honor and interests in the course of international exchanges and cooperation". Article 8 of the law also stipulates that "any organization or individual who commits acts that are detrimental to China's national interests in violation of this Law and other applicable laws in the course of engaging in international exchanges shall be held accountable by law". *The Law on Foreign Relations of the People's Republic of China, Xinhua*, 28th June 2023, viewed 2nd July 2023, <https://english.news.cn/20230628/28c7aedd386440ba9c370eb22476d430/c.html>

It was on these grounds that reports in the first half of 2023 about raids by the Chinese authorities on several US-invested consultancies raised concerns among businesses operating in China. The details of these high-profile crackdowns have not been made public, but as the allegations against the companies in question alluded to the obtaining of 'sensitive information', without providing a clear definition of the term, companies were left wondering if they may face a similar outcome if they conduct due diligence.[50]

With the EU's Corporate Sustainability Reporting Directive (CSRD) having entered into force on 5th January 2023, European companies operating in China—particularly those in 'sensitive' regions—will increasingly find themselves torn between two legal regimes. The CSRD obliges all large and all listed companies operating in the EU to "disclose information on what they see as the risks and opportunities arising from social and environmental issues, and on the impact of their activities on people and the environment." From 2024, such companies will need to prepare sustainability reports—including information on their sustainability policies, environmental protection policies and actions, social responsibility and treatment of employees, and respect for human rights—for submission in 2025.[51] The Corporate Sustainability Due Diligence Directive (CSDDD) was approved by the European Parliament on 1st June 2023. It will require EU-based companies to establish due diligence processes to ensure their entire operations—including subsidiaries, and up- and downstream suppliers—are in line with EU human rights and environmental standards.[52] As the date for reporting obligations under the new EU legislation draws closer, affected companies may be increasingly compelled to move out of 'sensitive' regions in China, while being pulled in the opposite direction by Chinese customers applying pressure for them to maintain these operations.[53]

As both the Foreign Relations Law and the revisions to the Anti-espionage Law are relatively new, the ambiguity of some of their contents could be explained by the limited time available for their interpretation. However, these two laws seem to follow a longer trend of designing legislation that is broad and vague to allow room for more flexible implementation. For example, over the past six years, China's regulatory authorities and standard-setting bodies have issued a series of laws, measures, standards and guidelines on the protection of personal information and "important data" that also contain certain terms that are not clearly defined. Despite key regulations—including the Cybersecurity Law (CSL), the Data Security Law (DSL) and the Personal Information Protection Law (PIPL)—having been in force for years, there is still no definition of "important data", and the catalogue of what constitutes important data, which is provided for in the DSL, has not been made public. This makes it impossible for data handlers to comply with China's general requirements.[54]

In the summer of 2023, the European Chamber and its members, along with other industry associations, were invited to government meetings for briefings on some of the key policies that impact them.[55] However, although attendees sought clarity on these topics, to date officials are yet to share any

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50 *China's raids on foreign firms hurt its own interests, Financial Times,* 10th May 2023, viewed 3rd July 2023, <https://www.ft.com/content/f956ab7c-7980-44e4-b2b4-5f101398e2b3>

51 *Corporate sustainability reporting,* European Commission, viewed 10th July 2023, <https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en>

52 *MEPs push companies to mitigate their negative social and environmental impact,* European Parliament, 1st June 2023, viewed 10th July 2023, <https://www.europarl.europa.eu/news/en/press-room/20230524IPR91907/meps-push-companies-to-mitigate-their-negative-social-and-environmental-impact>

53 *European Business in China Business Confidence Survey 2023*, European Union Chamber of Commerce in China, p. 39, 21st June 2023, viewed 10th July 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1124/Business_Confidence_Survey_2023>

54 The CSL came into effect on 1st June 2017, the DSL became effective on 1st September 2021 and the PIPL on 1st November 2021. The DSL prescribed the formulation of a catalogue of 'important data'; however, at the time of writing, no such catalogue has been released by the relevant authorities. *Understanding China's Data Regulatory Regime: What Are Important Data? And Can They Be Transferred Outside Of China?*, Sidley, 11th April 2022, viewed 3rd July 2023, <https://datamatters.sidley.com/2022/04/11/understanding-chinas-data-regulatory-regime-what-are-important-data-and-can-they-be-transferred-outside-of-china/>

55 For example, on 21st July 2023, China's MOFCOM held a briefing session for the foreign business community on recent laws and policies that have raised concerns among foreign-invested enterprises, including cross-border data transfer, the Anti-espionage Law and export controls. *The Ministry of Commerce holds roundtable meeting on policy interpretation and communication for foreign investment associations*, MOFCOM, 21st July 2023, viewed 2nd August 2023, <http://www.mofcom.gov.cn/article/xwfb/xwbldhd/202307/20230703423168.shtml>

information that has not been already publicly available.

Unclear compliance requirements leave a high chance of inconsistent implementation of laws and regulations in general, but this is especially so at the local level, where degrees of industry knowledge and competence can vary significantly across different levels of government. European Chamber members in the petrochemical, chemical and refining (PCR) industries, for example, reported that they were ordered by local authorities to shut down plants within unreasonably short timeframes once the Yangtze River Protection Law entered into force in March 2021. In addition, many companies received conflicting information from different government departments and encountered difficulties establishing direct negotiation channels with the relevant authorities.[56&57]

Would you like to know more?

To learn more about the PCR industries, and the concerns and recommendations of the respective members of the European Chamber, read the *Petrochemicals, Chemicals and Refining Working Group Position Paper 2023/2024.*

When a law appears to be enforced arbitrarily, even if it is due to competence issues, it will result in compliance concerns and increased operating costs. Some members of the European Chamber's Nanjing Chapter, for instance, reported that when undergoing environmental, health and safety (EHS) inspections, different inspectors held conflicting views on how to improve safety. For example, in one case, one expert required installation of a flammable gas warning system only for another expert to subsequently require it be taken down shortly after.[58]

It is worth noting that local governments can also suffer from the lack of clarity in legislation, as their inability to accurately interpret and enforce it can impact their ability to attract foreign investment.

Recommendations

- Engage in dialogue with other governments and key stakeholders to depoliticise the business environment.
- Refrain from punishing companies for the actions of their home governments.
- Improve the predictability and reliability of China's regulatory environment by ensuring laws and regulations are specific and clearly defined.
- Provide the conditions that allow companies to undergo independent, third-party audits of their entire operations, so they can be certified as being fully compliant with global legislation.
- Ensure administrative processes are transparent, consistent and predictable.
- Provide local authorities with proper guidance and training on how to consistently implement laws.

3. Optimise Policymaking by Allowing Space for Discussion and Constructive Feedback

Concern

Narrowing space for discussion on economic trends and policies prevents relevant experts and industry players from providing input that can improve China's business environment.

Assessment

For China to implement necessary structural reforms through policies that are practical and implementable, it will be important for policymakers to be given space to 'make mistakes', openly discuss

56 The law prohibits constructing or expanding chemical parks and projects within one kilometre of the river, with no recognition for projects intended to upgrade plants' safety and ecological protection. *Petrochemicals, Chemicals and Refining Working Group Position Paper 2023/2024*.

57 *European Business in China Nanjing Position Paper 2023/2024*, European Union Chamber of Commerce in China, p. 18, 27th April 2023, viewed 3rd July 2023, <https://www.europeanchamber.com.cn/en/publications-archive/1079>

58 Ibid, p. 17.

ideas and ultimately change course, something that was previously a characteristic of policymaking in the country. However, with China's red lines becoming more blurred, and the scope of issues deemed as 'sensitive' constantly expanding, people's willingness to speak out is bound to diminish.

In late June 2023, China's popular microblogging platform, Sina Weibo, announced that it had blocked the account of a prominent economic commentator, Wu Xiaobo, alongside two unnamed users, for "disseminating negative and harmful information" about China's economy. While the content that the accounts were blocked for was not disclosed, and recent posts by Wu were deleted from his account, in its statement, Sina Weibo accused the three writers of "hyping up the unemployment rate", "smearing the development of the security market", and "attacking and undermining" the country's economic policies.[59&60]

The European Chamber itself has had content removed, with no clarity provided on which red lines were allegedly crossed with regard to China's regulation of online content. Over a one-year period, from May 2022 to May 2023, a total of 10 posts were deleted from the Chamber's official WeChat account.[61] The explanations given by the platform's provider for deleting posts were that the contents violated either relevant official regulations,[62] or WeChat's internal regulations on the operation of public accounts, without further details.

In August 2021, the Cyberspace Administration of China (CAC) launched a two-month-long rectification campaign to remove from the internet information provided by individuals that "misinterpret[s] economic policies and forecast doom and gloom in financial markets".[63] This was at least partly intended to tackle widely acknowledged problems with the Chinese internet, such as curbing the dissemination of fraudulent information used to mislead investors or blackmail stakeholders. However, the campaign also gave rise to fears that an over-reach in its implementation could prevent investors from accessing valuable sources of legitimate information.[64]

Access to important information related to the economy and regulations has already been significantly curtailed for foreign entities. For example, in late 2022, Shanghai-based Wind Information—China's largest financial data provider—restricted offshore users' access to some business and economic data, citing new CAC regulations as the reason.[65] Similarly, researchers outside of China were cut off from the country's largest academic database in April, and some corporate databases have become increasingly difficult to access from overseas.[66&67] In March 2022, the National Bureau of Statistics discontinued the public release of its consumer confidence data, a series which it issued every month for over three decades.[68] In August 2023, it also suspended the publication of the urban unemployment data broken

59 Ji, Siqi, *China censors economic, financial writer Wu Xiaobo for 'hyping up unemployment rate' amid economic slowdown, SCMP*, 27th June 2023, viewed 4th July 2023, <https://www.scmp.com/economy/china-economy/article/3225598/china-censors-economic-financial-writer-wu-xiaobo-hyping-unemployment-rate-amid-economic-slowdown>

60 White, Edward & Lockett, Hudson, *China censors financial blogger as economic recovery falters, Financial Times,* 27th June 2023, viewed 4th July 2023, <https://www.ft.com/content/c3e64c12-cccb-4559-b046-1ea81fbf709a>

61 These included announcements of the launch of some of the Chamber's key publications—such as the *Business Confidence Survey 2022*, and the *Position Paper 2022/2023*—and even a post about the Chamber's president attending an event organised by the China Council for the Promotion of International Trade.

62 互联网用户公众账号信息服务管理规定 *(Provisions on the Administration of Information Services of Internet Users' Public Accounts)*, The State Council Information Office of the People's Republic of China, 22nd January 2021, viewed 4th July 2023, <http://www.scio.gov.cn/32344/32345/44688/46640/xgzc46646/Document/1711132/1711132.htm>

63 Zhang, Jane, *China targets fake news and citizen journalists with new campaign from internet watchdog, SCMP,* 28th August 2021, viewed 4th July 2023, <https://www.scmp.com/tech/policy/article/3146734/china-targets-fake-news-and-citizen-journalists-new-campaign-internet>

64 *Financial blogger crackdown leaves China investors scrabbling for data, Financial Times*, 16th September 2021, viewed 4th July 2023, <https://www.ft.com/content/d5725cb3-169c-442f-953e-077bb926f4c0>

65 *New rules compel leading China financial data provider to limit offshore access, sources tell Reuters, CNBC*, 5th May 2023, viewed 13th July 2023, <https://www.cnbc.com/2023/05/05/new-rules-compel-offshore-china-financial-data-access-limits-reuters.html>

66 Pak, Yiu, *China to slash foreign researchers' access to academic database, Financial Times*, 28th March 2023, viewed 13th July 2023, <https://www.ft.com/content/93051bff-5af8-4841-8e1f-8c9ab0cbd3fe>

67 Wei, Lingling, Kubota, Yoko & Strumpf, Dan, *China Locks Information on the Country Inside a Black Box, The Wall Street Journal*, 30th April 2023, viewed 13th July 2023, <https://www.wsj.com/articles/china-locks-information-on-the-country-inside-a-black-box-9c039928>

68 Bradsher, Keith, *China Is Trying to Make Its Gloomy Consumers Spend More, The New York Times*, 31st July 2023, viewed 7th August 2023, <https://www.nytimes.com/2023/07/31/business/china-economy-consumer-stimulus.html>

down into age groups.[69] Without access to such data and business intelligence, companies will be unable to make well-informed investment decisions and will look to other jurisdictions that offer more transparency.

China has historically had a strong track record of trialling schemes before rolling them out, with the understanding that constructive criticism is an important correction mechanism to ensure that the resulting policies can best serve the country's interests. A narrowing space for discourse and critical voices, from industry and other stakeholders, will lead to Chinese authorities missing out on feedback that can help to shape policies capable of sustaining China through the next stage of its economic development.

Recommendations

- Accept feedback from key government, think tanks and industry stakeholders so that new policies can be developed, and existing ones adapted, to tackle emerging challenges in a way that does not sacrifice other key priorities, such as sustainable economic growth.
- Refrain from erratic policy shifts and allow reasonable transition times before implementing new, or amending existing, policies or regulations.
- Permit access to legitimate sources of data and business intelligence that companies need to make well-informed investment decisions.

4. Address Socio-economic Challenges to Boost Consumption

Concern

Although domestic consumption can play a significant role in China's economic recovery, current socio-economic challenges are undermining consumer confidence.

Assessment

The anticipation that there would be a release of pent-up demand after China's reopening partly stemmed from the fact that household savings in China grew by a record amount in 2022.[70] However, rather than a sign of supressed consumption, a significant proportion of the excess savings were due to a heightened sense among the public that precaution was necessary in the face of uncertainty.[71]

Chinese policymakers have—to some extent—acknowledged the problem of weaker-than-expected consumption recovery, and new measures were rolled out to encourage more spending. However, these measures predominantly target the supply side, and fail to address the issues on the demand side that are inducing Chinese consumers to keep their wallets closed.[72]

While a large proportion of household savings in China is most often primarily tied up in real estate, with the property sector still struggling to bounce back and expectations for a strong recovery waning,[73] Chinese households are increasingly turning to bank deposits. According to the findings of a quarterly survey conducted by the PBOC, Chinese consumers' willingness to spend increased only mildly in the first

69 Chen, Laurie & Zhang, Albee, *China suspends youth jobless data after record high readings*, *Reuters*, 15th August 2023, viewed 15th August 2023, <https://www.reuters.com/world/china/china-stop-releasing-youth-jobless-rate-data-aug-says-stats-bureau-2023-08-15/>

70 "China's household savings surged by RMB 17.8 trillion (USD 2.5 trillion) in 2022, causing many economists to believe that these "excess savings" represent pent-up demand and could lead to a wave of "revenge spending" in 2023." Mei, Qin, *Why China's Long-Awaited "Revenge Spending" Boom Has Not Arrived*, Center for Strategic and International Studies, 1st June 2023, 4th July 2023, <https://www.csis.org/blogs/trustee-china-hand/why-chinas-long-awaited-revenge-spending-boom-has-not-arrived>

71 Zhang, Jun, *China's savings conundrum, China Daily*, 5th March 2023, viewed 4th July 2023, <http://www.chinadaily.com.cn/a/202303/05/WS64040246a31057c47ebb241c.html>

72 Li Chunlin, vice chair of the NDRC, admitted that some Chinese consumers "lack confidence and have many concerns". The NDRC rolled out 20 measures in July 2023 to encourage spending in certain areas, including in new energy vehicles and housing upgrades. Some of the listed measures were reiterating already existing policy initiatives, for example, that older apartment building should install elevators, which is a programme that was set in motion in 2020. Others were vague on specifics, especially about how the cost of these support measures will be covered. Bradsher, Keith, *China Is Trying to Make Its Gloomy Consumers Spend More, The New York Times,* 31st July 2023, viewed 2nd August 2023, <https://www.nytimes.com/2023/07/31/business/china-economy-consumer-stimulus.html>

73 Cheng, Evelyn, *New warning signs emerge for China's property market, CNBC*, 30th May 2023, viewed 4th July 2023, <https://www.cnbc.com/2023/05/31/new-warning-signs-emerge-for-chinas-property-market.html>

quarter of 2023, with over half of surveyed urban depositors reporting they preferred to further increase their savings.[74]

In addition to a more cautious approach, another factor pushing Chinese consumers towards more carefully considered spending is that the cost of living—especially in China's most developed, eastern regions—has been increasing. While consumer price inflation has overall been modest in recent years, the costs of housing, child- and elderly-care have been putting significant pressure on households. With China's demographic dividend fading, this pressure is set to increase, setting in motion a vicious cycle where the willingness to have children decreases because of the potential cost of raising them.[75]

China has already achieved significant progress in building a social safety net, and providing pension insurance and basic medical insurance for the vast majority of its large population.[76] However, in order to tap into the positive impact that consumption can bring to its economic recovery and future growth, more support is needed for its households in the near- to medium-term; for example, through the provision of more affordable housing and welfare programmes that provide financial support for low- and middle-income families.[77]

Recommendation

- Develop and implement demand-side policies that can boost domestic consumption.
- Provide a more predictable policy landscape in order to reassure consumers that they do not need to accumulate large amounts of savings in anticipation of sudden policy shifts.

5. Maintain a Balance Between Economic Recovery and the Low Carbon Transition

Concern

As policy focus shifts towards reviving the economy while ensuring energy security, China's low carbon transition is at risk of decelerating.

Assessment

Since the country's reopening, Chinese policymakers' focus has shifted from carbon reduction goals towards the double challenge of reviving the economy and ensuring energy security.[78&79] With consumption recovery sluggish, more energy-intensive exports and investments present an obvious way to reignite economic growth. Meanwhile, with extreme weather events—such as heatwaves and droughts—putting China's energy supply under increasing pressure in recent years, and although global energy prices have risen, coal was again given a prominent role in guaranteeing energy security.[80]

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74 Zhou, Lanxu, *Income, willingness to spend rallying: PBOC, China Daily*, 3rd April 2023, viewed 4th July 2023 <https://www.chinadaily.com.cn/a/202304/03/WS642ad140a31057c47ebb8235.html>

75 "According to the Seventh National Chinese Population Census, the age dependency ratio in China increased to 46.3 per cent in 2021. It means that for every 100 people of working age, more than 46 elderly people and children had to be supported." Yan, Jing Tian, *For family and country: why China needs more babies, SCMP,* 22nd June 2023, viewed 5th July 2023, <https://multimedia.scmp.com/infographics/news/china/article/3224346/china-population/index.html>

76 *World Social Protection Report 2017/19*, International Labour Organization, 29th November 2017, viewed 4th July 2023 <https://www.ilo.org/beijing/information-resources/public-information/press-releases/WCMS_606868/lang--en/index.htm>

77 Zhang, Jun, *China's savings conundrum, China Daily*, 5th March 2023, viewed 4th July 2023, <http://www.chinadaily.com.cn/a/202303/05/WS64040246a31057c47ebb241c.html>

78 The government work report presented each year at the Two Sessions routinely includes details on the progress of China's green development. However, in 2023, the summary of the progress made in the previous year was shorter than in the 2022 report, and the language about carbon reduction efforts was softened. Song, Ziying, *China's two sessions of 2023: trend for green development, green finance, and Belt and Road Initiative (BRI)*, Green Finance and Development Center, 15th March 2023, viewed 5th July 2023, <https://greenfdc.org/chinas-two-sessions-of-2023-trend-for-green-development-green-finance-and-belt-and-road-initiative-bri/>

79 References to energy intensity reduction targets were dropped altogether from the 2022 and 2023 government work reports. Lu, Sophie & Zou, Chris, *China 30/60: Tracking the Financing of China's Green Transition*, Rhodium Group, 13th March 2023, viewed 2nd August 2023, <https://rhg.com/research/china-30-60-tracking-the-financing-of-chinas-green-transition/>

80 *People's Republic of China: 2022 Article IV Consultation – Press Release; Staff Report; and Statement by the Executive Director for the People's Republic of China*, IMF, p. 8, 3rd February 2023, viewed 5th July 2023, <https://www.imf.org/en/Publications/CR/Issues/2023/02/02/Peoples-Republic-of-China-2022-Article-IV-Consultation-Press-Release-Staff-Report-and-529067>

China has already made significant achievements in its green transition: non-fossil fuel energy sources, such as wind, solar and hydro power, already account for 50.9 per cent of the country's total installed capacity of electricity generation.[81] However, China still primarily relies on fossil fuels for power generation, with coal accounting for more than 56 per cent of total consumption in 2022.[82] According to Greenpeace, in the first quarter of 2023, Chinese provincial governments had already approved more new investments into coal-fuelled power generation than in the whole of 2021.[83] Meanwhile, the country has been falling behind on making progress on its energy intensity targets since 2020.[84]

To ensure it reaches its targets of peaking carbon dioxide emissions before 2030 and achieving carbon neutrality by 2060 (30/60 Goals),[85] China needs to address the challenges companies face in transitioning to green energy. Many European companies have made globally binding pledges to achieve decarbonisation well ahead of China's timeline for its national targets; however, they face barriers that could prevent them from both meeting their corporate pledges and contributing fully to the 30/60 Goals. Key challenges include limited access to renewable energy, a lack of clear policy guidance, a scarcity of necessary technology and issues related to China's emissions trading system (ETS).[86]

As the World Bank has highlighted, China's carbon neutrality challenge is a challenge to the whole world because, "[w]ithout China successfully transitioning to a low-carbon economy, achieving global climate goals will be impossible".[87] The fight against climate change therefore calls not only for a redoubling of global efforts, but also is an area that demands greater EU-China cooperation.

Recommendations

- Deepen EU-China collaboration in the fight against climate change and sustainable development.
- Increase EU-China cooperation in environmental policymaking to facilitate the sharing of best practices.
- Address challenges related to companies' green energy transition:
  - Increase companies' access to reliable sources of renewable energy.
  - Provide clear policy guidance at the local and sectoral level on China's decarbonisation roadmap.
  - Create a fully functioning national electricity market, including developing an ancillary market and mechanisms for renewable energy to be sold nationwide.
  - Communicate clearly to businesses how China's national ETS and associated mechanisms will work in practice during each phase.
- Ensure European companies can fully contribute their expertise and technology to help China achieve its 30/60 Goals:
  - Remove market access and regulatory barriers that prevent foreign companies from investing in renewable energy.
  - Remove market access barriers that prevent green technologies from entering the Chinese market.

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81 *China's installed non-fossil fuel electricity capacity exceeds 50% of total, Reuters*, 12th June 2023, viewed 5th July 2023, <https://www.reuters.com/business/energy/chinas-installed-non-fossil-fuel-electricity-capacity-exceeds-50-total-2023-06-12/>

82 The consumption of coal increased by 4.3 per cent year-on-year in 2022, with coal accounting for 0.3 per cent more of the total energy consumption than in 2021. *Statistical Communiqué of the People's Republic of China on the 2022 National Economic and Social Development*, National Bureau of Statistics of China, 28th February 2023, viewed 5th July 2023, <http://www.stats.gov.cn/english/PressRelease/202302/t20230227_1918979.html>

83 *China has already approved more new coal in 2023 than it did in all of 2021 — Greenpeace*, Greenpeace East Asia, 24th April 2023, viewed 5th July 2023, <https://www.greenpeace.org/eastasia/press/7939/china-has-already-approved-more-new-coal-in-2023-than-it-did-in-all-of-2021-greenpeace/>

84 Lu, Sophie & Zou, Chris, *China 30/60: Tracking the Financing of China's Green Transition*, Rhodium Group, 13th March 2023, viewed 2nd August 2023, <https://rhg.com/research/china-30-60-tracking-the-financing-of-chinas-green-transition/>

85 Farand, Chloé & Darby, Megan, *Xi Jinping: China will aim for carbon neutrality by 2060, Climate Home News*, 22nd September 2020, viewed 5th July 2023, <https://www.climatechangenews.com/2020/09/22/xi-jinping-china-will-achieve-carbon-neutrality-2060/>

86 *Carbon Neutrality: The Role of European Business in China's Race to 2060*, European Union Chamber of Commerce in China, 25th March 2023, viewed 5th July 2023, <https://www.europeanchamber.com.cn/en/publications-carbon-neutrality-report>

87 *China's Transition to a Low-Carbon Economy and Climate Resilience Needs Shifts in Resources and Technologies,* World Bank, 12th October 2022, viewed 5th July 2023, <https://www.worldbank.org/en/news/press-release/2022/10/12/china-s-transition-to-a-low-carbon-economy-and-climate-resilience-needs-shifts-in-resources-and-technologies>

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Recommendations

Recommendations for the European Union

- Continue to proactively engage with China, and reject calls for disengagement.
- Enhance the overall coordination between member states and EU institutional stakeholders in order to foster a united European approach towards China.
- Avoid provoking China unnecessarily, while defending European core interests.
- Ensure that responses are measured and proportionate when EU-China disagreements arise.
- Deepen EU-China cooperation in areas where interests overlap, such as in relation to combating climate change, international standard-setting, sustainable development and WTO reform.
- Ensure that the EU's China strategy reflects both existing and emerging priorities and challenges, and strikes the right balance between collaboration and competition.
- Continue to work towards reciprocity with third countries, including in relation to public procurement.
- Continue to engage with chambers of commerce, China-focussed think tanks, industry organisations and standard-setting bodies when formulating China policy, to ensure that it reflects on-the-ground realities.
- Strengthen the competitive capabilities of European players by developing bottom-up industrial policy that promotes market competition and innovation in strategic industries, without prescribing technological pathways.

Recommendations for European Companies

- Maintain strong communication between company HQs and China operations, to ensure that HQs receive accurate, on-the-ground information in order to make informed investment and operational decisions.
- Continue to integrate foreign staff into China operations—as well as Chinese staff into global operations—to maintain diverse teams and avoid talent silos.
- Establish 'decoupling teams' to evaluate the costs associated with both localisation in China and disconnection from certain global systems.
- Continue to monitor areas of potential political risk or public backlash, or sudden changes in market conditions, and develop proportionate mitigation strategies.
- Prepare for emerging global regulations on supply chains by establishing transparency up and downstream to the greatest extent possible, and determine levels of exposure to current and potential sanctions.
- Invest and participate more in government advocacy efforts through chambers of commerce, industry associations and standard-setting bodies.

Abbreviations

14FYP	14th Five-year Plan
BCS	Business Confidence Survey
CAC	Cyberspace Administration of China
CM2025	China Manufacturing 2025
CRS	Computer Reservations System
CSDDD	Corporate Sustainability Due Diligence Directive
CSL	Cybersecurity Law
CSRC	China Securities Regulatory Commission
CSRD	Corporate Sustainability Reporting Directive
DSL	Data Security Law
EHS	Environmental, Health and Safety
ETS	Emissions Trading System
EU	European Union
EUR	Euro
FDI	Foreign Direct Investment
G7	Group of 7
GDP	Gross Domestic Product
GDS	Global Distribution System
HQ	Headquarters
IMF	International Monetary Fund
IP	Intellectual Property
IT	Information Technology
JV	Joint Venture
MERICS	Mercator Institute for China Studies
MiC2025	Made in China 2025
MLP	National Medium- and Long-term Programme for Science and Technology Development
MOF	Ministry of Finance
MOFCOM	Ministry of Commerce
MOST	Ministry of Science and Technology
NDRC	National Development and Reform Commission
PBOC	People's Bank of China
PCR	Petrochemical, Chemical and Refining
PIPL	Personal Information Protection Law
PV	Photovoltaic
R&D	Research and Development
SEI	Strategic Emerging Industries
SOE	State-owned Enterprise
US	United States
USD	United States Dollar
WTO	World Trade Organization

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