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The Head of Delegation

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Subject: Report of the EU Trade Counselors Meeting on 2 February

Summary

Hiddo Houben opened the meeting by providing an overview of the 2011 trade agenda, which is likely to be quite busy in Congress compared to previous years insofar it will have to vote on the KORUS FTA and possibly on the Colombia and Panama FTAs. Additionally, Congress may need to take up a vote on Russia PNTR if the multilateral WTO accession process moves to conclusion. In addition, there may be a vote on TPA if momentum develops on Doha.

Gabor Szabo gave an overview of the planned Trade Counselors visit to Seattle. The tentative date of the trip would be 23 to 25 May.

The Trade counselors meeting featured two main speakers with two different perspectives on the US-EU-China relations. Deputy Assistant Secretary for Asia Craig Allen from the Department of Commerce outlined the main deliverables from the JCCT and Hu Jintao's visit; Derek Scissors from the Heritage Foundation focused on the issues we should be asking the Chinese to address. Allen considered the recent meetings successful, including notably the Chinese commitment to de-link government procurement from localisation obligations in its indigenous innovation policy. He, however, underlined the need to ensure that the Chinese implement what had been agreed. In this task, he also invited EU businesses to remind China of its commitments. According to Scissors, our main task should be the liberalization of capital account, which will eliminate a large number of macroeconomic distortions and result in diminished subsidization of the Chinese state-owned enterprises (SOEs). He also suggested that the EU needed to create a system, similar to CFIUS, where they would be able to control Chinese investment inflows.

Detail:

Presentation on China trade by Commerce Deputy Assistant Secretary Craig Allen

In IPR, software piracy is a key issue for the United States (for Europe it is more patent infringements). During President Hu's visit, the Chinese finally agreed to ensure that only legal software would be used in government ministries and in 30 major state owned enterprises (SOEs). However, the obligations are only applicable to future purchases (not existing software). In the area of indigenous innovation, China agreed not to link its innovation policies to the provision of government procurement preferences. While Allen

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thought that it was a meaningful accomplishment, he cautioned that China still needs to implement this commitment.

In order to avoid paying royalties, the Chinese have telecom standards which differ from those used in the EU and the U.S. The Chinese government had now agreed not to discriminate against foreign standards (to be "technology neutral"). Allen encouraged EU companies to report on any public announcements promoting Chinese companies to use Chinese standards. On standards in general, China agreed to adhere to international standards where applicable and possible. The Chinese also agreed to consult international bodies when establishing their own standards. Allen urged EU companies and Member States to push for seats on Chinese standards committees.

In government procurement the Chinese had agreed to submit a revised GPA offer which would also cover the sub-federal level. In agriculture, there was no progress. In pharmaceuticals, China would submit legislation next year to protect proprietary data from generic drug makers.

DAS Allen concluded with a list of China's priorities vis-à-vis the US: market economy status (MES), relaxation of export controls, and greater freedom to invest in the US. On MES, Allen noted that the US was statutorily held to follow the WTO criteria but the 2016 MES deadline was not automatic.

Heritage Foundation expert Derek Scissors on China's macroeconomic performance

Scissors started by noting that many forget that Chinese GDP per capita is only about $5000/year. Chinese purchasing power as measured by the World Bank is also exaggerated due to China's high inflation rate. In Scissors' view, China's growth rates are not sustainable and it is very likely that China will hit a wall in the next 5 to 10 years. Even the optimists don't think that such a growth is sustainable, but they believe that the Chinese will adjust when they have to. The problem in China is that no one has the authority to push for economic reforms. Today, the SOEs are the tail wagging the dog as they can go to the Chinese Communist Party and say that they are the ones providing the jobs. The one issue China is facing is whether they "will get old before they get rich". In 2016 China will lose its demographic advantage. In order to sustain its level of growth China must return to an efficiency-driven path.

As to EU and US priorities in China, Scissors argued that the SOEs' grip on the economy must be broken, regulatory protection needs to be lifted so the SOEs would face real competition. Additionally, both the EU and U.S. need to push for the liberalization of the capital account. This would considerably weaken the government's ability to use the banking sector to subsidize half of its industry. The issue of subsidies is one area where the EU and US could work together – coordination on the currency issue would be difficult.

On investments, so far China has had nowhere to put its money except US Treasuries. However, lately China has looked to diversify its portfolio and has poured into the Euro. Scissors argued that if the EU does not have any controls in place for Chinese investment, they will flood the EU market. Therefore, the EU should have an instrument similar to CFIUS to have some control over investment inflows.

On Chinese standards in the telecom sector, Scissors thought that this was a dead issue, since US telecom providers have no market access anyway. The main Chinese telecom providers would not be interested in joint ventures under current circumstances.