THE HAMBURG SUMMIT
China meets Europe

“The Hamburg Summit: China meets Europe”

Keynote Speech
“EU - China: A new growth equation”

by

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- Check Against delivery -

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Ladies and gentlemen,

The rise of China is arguably the most significant economic development of our time. In just 30 years its growth has lifted more than 500 million people out of poverty and transformed global trade and production.

It has also transformed China's relationship with its partners. And the European Union is no exception.

In 1975 Christopher Soames, then Europe's external relations commissioner, travelled to Beijing where he and Chinese Foreign Minister Chou En-Lai agreed to establish diplomatic ties.

On his return he rightly predicted in the European Parliament that the relationship would be of "considerable significance."

That looks like a vast understatement today, even for an Englishman.

At the time, trade flows between our economies were a trickle. Today they are a hundredfold larger and have become torrents.

The streams of investment are not yet as impressive – but they are growing in importance:

And Chinese firms are coming to Europe in increasing numbers. Investment flows from China to the EU amounted to less than one billion euro on average between 2003 and 2008. But last year they were greater than seven billion.

So between us is a vast sea of commerce. And it means, if I may, that Europe and China are now in the same boat.

We will both be affected by how well the other one manages to overcome its challenges.

And we do each face real challenges.

Both China and Europe have long relied on a series of elements to deliver our economic success.

In Europe one of these elements was and is the European Single Market – as well as the economic and monetary union.

But the Eurozone architecture has to be repaired and expanded.

To return to balance and growth, we need more: central oversight of national budgets, solidarity between Member States, unity for the banking system, more flexibility in labour and product markets.

These are not easy problems to solve. But I firmly believe that while Europe still has difficult choices to make, we will put things in order soon.

Europe's difficult choices are different from China's. But the challenges China faces are just as critical.

China’s growth equation has so far been based on the abundance of low-cost labour, state-led investment in infrastructure development, and a financial system geared towards state-owned enterprises.

This model has been incredibly powerful: It has delivered the economic miracle I have been taking about.

But important variables have changed.

Up to now China has been moving from low-income to middle-income status.

The next step in China's development – to become an enduring middle-income country – will need a new growth equation.

High income economies are characterised by mass consumption, by innovation and by technology-intensive production.

- More consumer spending means higher paid workers. Competing on labour costs then becomes more difficult.
- Innovation requires infrastructure, but not just roads and bridges. It needs education, skills, intellectual property rights, business clusters and free access to information. These will not be achieved with the government's raw financial power. They require more nuanced forms of support.
- Technology-intensive production implies heavy investment by the private sector, from within and outside China. But this will only come when companies feel that they are legally secure.

As a result legal and regulatory predictability become more important, as do market-based pricing of capital – via the interest rate. And money – via the exchange rate. A level-playing field between the private sector and state-owned enterprises will also be vital. If incumbents continue to receive advantages that stop creative new companies entering the market then the whole economy will be held back.

Most fundamentally, in this new equation the role of the government needs to shrink and change. It needs to intervene less as a player in the economy and more as a wise referee. The market, not the state, must lead.

The leaders of China are very much aware of these challenges. But the new leaders still face a daunting mission.

I wish them well as they start on that task, which is China's, after all, not Europe's.

But our relationship is relevant, in two ways.

First, as I said at the outset, we are close partners with much to gain from each other. But our relationship has its complications.

A successful reform in China could help to resolve many of them.

A reformed economy should mean less subsidisation of state owned enterprises.

A reformed economy should imply stronger enforcement of intellectual property rights.

A reformed economy should see more market access and equal treatment for foreign direct investors – and for foreign companies tendering for public procurement contracts. But this equal treatment should benefit Chinese private companies as well, who are currently facing similar problems than their foreign peers.

In the meantime, our disputes will not go away. And Europe will continue to take the action we need to combat unfair trading practices, whether through the WTO or our own trade defence system.

But if the Chinese government does move decisively towards reform, I believe that we will have more to agree on than disagree on in future.

The second way our relationship is relevant is because it can support China's sustainable development into the future.

More integration of our economies would itself be significant. The involvement of European companies will speed up the move to a consumption-driven domestic economy in China. Our companies are world leaders in the areas China needs to develop – like services, clean technologies and healthcare for example. Making sure they can participate in the structural transformation of the economy is very much in China's interest.

On top of this, the European Union and the Chinese government work together in a variety of ways, including through our High Level Economic and Trade Dialogue, which I look forward to renewing once the new leadership is fully in place.

Cooperation through fora like that one can help support reform in China in a number of ways:

One piece of work we have before us is to negotiate an investment agreement.

And one of the key elements in any reform strategy will have to be an increased role for foreign direct investment.

Foreign investment brings know-how, expertise and the competition that will drive China's companies forward. Investment abroad by Chinese companies, particularly in competitive markets like ours, also helps them become more efficient and effective.

Our investment relationship is already strengthening, as I have said. But there is considerable room for improvement. Europe's investments in China add up to less than 2% of our total investments abroad. By comparison, 30% of our stocks are in the United States.

China's investments in Europe, while growing, still only account for three and a half per cent of total foreign direct investment here. In comparison, 20% is American.

An agreement would give a boost to investment in several ways:

European investors would have better access to the Chinese market.

Companies operating in both Europe and China would be able to operate on a more level playing field – no matter what their origin or ownership structure.

And investors would have a simpler legal framework to deal with. A new agreement would consolidate all of the 25 current bilateral investment treaties into a single framework.

An agreement will be effective if it tackles all of these issues, be they related to market access or investment protection. And I hope we can begin negotiations on an agreement of that type soon.

A second important area of joint work is on government financing for exports. Export credits are vital for international trade and are an area where many governments intervene in one way or another. So we need a common framework to avoid distortions. In September China joined us in international negotiations with this objective. I hope the new leadership will give its full support to these efforts.

Innovation is another area we can work together to support a new growth equation in China.

We have started a dialogue on innovation that covers important practical cooperation to support innovation. In the future, however, I believe we should also address other elements of a successful innovation strategy: from intellectual property rights to education and the overall regulatory environment. Europe has a lot to offer China on these issues.

The final area where joint work can help is through multilateral cooperation at the World Trade Organisation. Neither China nor Europe will be successful without the system of global trade rules. And we both have a huge stake in a new global trade liberalisation deal.

Unfortunately, the core issues of the Doha Round are currently on hold. However, work has not stopped. We are now beginning to see the outlines of what could be a significant package of measures for the next WTO Ministerial in Bali in December next year. The most important element would be an agreement on trade facilitation, the value of which I don't have to explain to a Hamburg audience. I hope that Europe and China can work closely to move this process forward.

Ladies and gentlemen,

The way that China develops in the coming years is of crucial importance – not only for the Chinese people but also for Europe and the rest of the world.

Continuing "the great renewal of the Chinese nation" – as future President Xi Jinping put it earlier in the month – will not be easy.

It will take time to build a new equation that favours the market over the state and where consumption and innovation play much bigger roles.

But I believe that China's new leaders understand the necessity of this kind of reform to guarantee the sustainable growth of China's economy in the decades to come.

And Europe stands ready to work with them.

Thank you very much.