China-EU FTA

--- A decisive option for deepening China-EU cooperation by 2020

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The *China-EU 2020 Strategic Agenda for Cooperation* released at the 16th China-EU Summit in 2013 declared "broader ambitions including, once the conditions are right, (the one) towards a deep and comprehensive FTA". Due to various factors, such an ambition towards a China-EU FTA has not yet made important progress in the recent two years.

This report holds, the period from now to the year 2020 is critical for establishing a China-EU FTA, and what strategic option to be chosen by both parties will determine the prospects of China-EU cooperation.

(1) Over the next five years: trade in services will remain an important drive for a new round of globalization, a focus on reshaping global trade rules and an important link for advancing economic transformation in both China and the EU through their cooperation based on complementarity.

(2) Over the next five years: establishing a China-EU FTA with trade in services as the priority will have significant impacts on China's economic transformation, on the EU's economic recovery and on the global free trade process.

(3) Over the next five years: China and the EU should comply with the international trend and seize opportunities to formulate a pragmatic roadmap for establishing a China-EU FTA.

Part I – Cooperation between China and the EU in the context of the general trend of global trade liberalization

Economic and trade cooperation between China and the EU over the past 40 years or so has yielded fruitful results. At present, profound changes in the global trade landscape have brought along both serious challenges and important opportunities. And in the context of profound and complicated changes in their internal and external development environments, China and the EU need to proactively comply with the megatrend of the global trade liberalization to continuously deepen their comprehensive and strategic cooperation.

1.1 Megatrend of the global free trade development

1.1.1 "Servitization" of the world economy is gaining momentum

(1) The world is entering an era of service-led economy. In 2011, value added of the service sector accounted for over 70% of the global GDP[1], and the global trade in services accounted for one-fifth of the world's total trade in 2015[2].

(2) Economic servitization in emerging economies is gaining speed. A growing number of emerging economies are entering the middle or late phase of industrialization, and the average share of their service sectors in GDP has exceeded 50%.

(3) The new round of scientific and technical revolution is accelerating the process of economic servitization. Driven by new technologies such as big

[1] National Bureau of Statistics, *International Statistical Yearbook*, China Statistics Press, Beijing, 2014
[2] WTO, *World Trade Report 2015: Speeding Up Trade, Benefits and Challenges of Implementing the WTO Trade Facilitation Agreement,* 2015

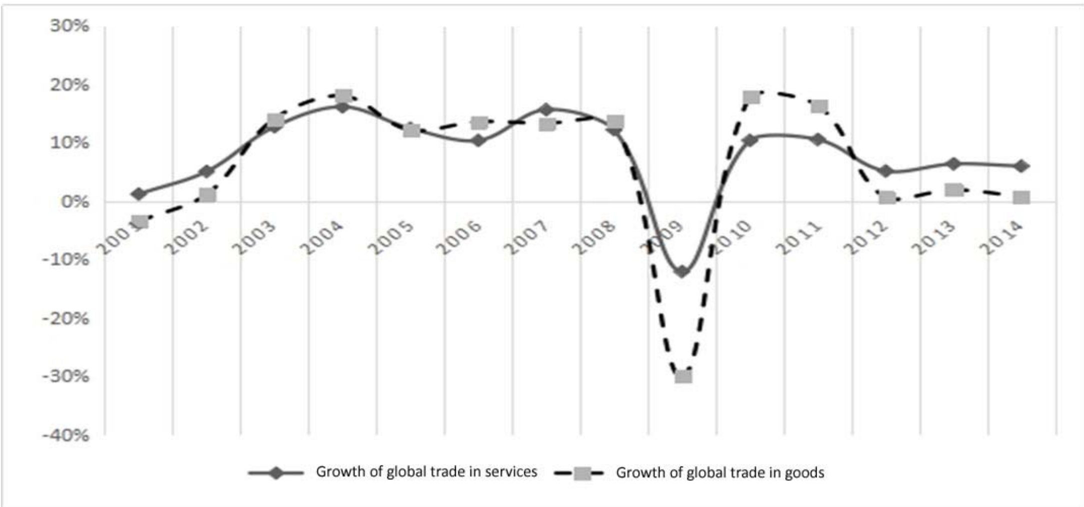
data, intelligentization, cloud computing, internet of things and mobile Internet, either in producer services or consumer services, new business models and new commercial activities are emerging one after another, bringing about profound changes to people's life.

1.1.2 Trade in services has become a major engine for the new round of globalization and global trade liberalization

(1) Global economic servitization has ignited explosive growth of global trade in services. From 2000 to 2014, growth of global trade in services has been higher than not only GDP but also that of global trade in goods in most of the years. According to the World Trade Organization (WTO) statistics, in 2000, the global trade in services (excluding government procurement of services) was only 1.44 trillion US dollars, and it hit 9.8 trillion US dollars in 2014, an increase of almost 7 times in 14 years.

(2) Global trade in services has been growing significantly faster than that of trade in goods. In 2014, for example, the growth rate of global trade in services was 6%, while that of global trade in goods was only 0.8%.

Figure 1.1： Growth of global trade in services and trade in goods (%)



Source: from the WTO *World Trade Report(s)* and *International Statistical Yearbook*

1.1.3 Trade in services has become the focal point for bilateral and multilateral FTA process

(1) Trade in services is a focus for upgrading global trade rules. The "first generation" of trade rules focusing on trade in goods is upgrading to the "second generation" ones focusing on trade in services.

(2) The number of issues in service trade negotiations has been increased. For instance, negotiations for Trade in Services Agreement (TiSA) have already added new issues such as services for e-commerce, information, environment and energy.

(3) Mega-FTAs with trade in services as the focus are emerging. Negotiations for multilateral trade agreements like TPP and TTIP have taken service trade rules as a key issue. Once concluded, these treaties will have great impacts on global trade rules.

1.1.4 Trade in services has become an important driver for reforming the global economic governance

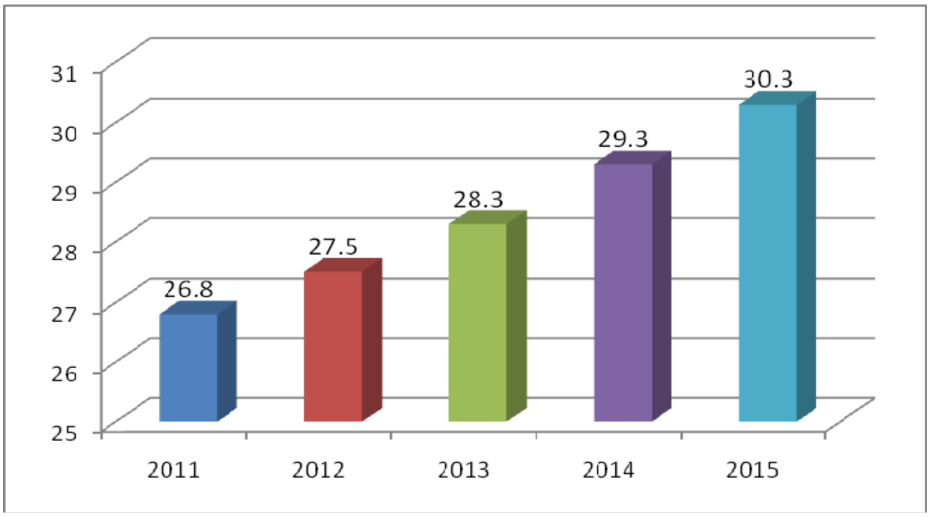
(1) Some traditional service trade rules are not reasonable. For a long time, establishing service trade rules has long been dominated by developed countries. They have imposed many standards out of reach by emerging economies in areas such as intellectual property rights, environmental protection, labor rights, government procurement and carbon emission.

(2) To build a more open and inclusive service trade system has become an important issue in reforming the global economic governance. Since the eruption of the international financial crisis in 2008, the share of emerging economies (the E11[3]) in the world economy has kept growing, rising to 30.3% of the world total GDP and contributing 52.9% of the global economic growth, which was much larger than the 22.9% contribution by G7 and the 12.2% contribution by the EU. Therefore, to build a more open service trade system

[3] E11 refers to Argentina, Brazil, China, India, Indonesia, South Korea, Mexico, Russia, Saudi Arab, South Africa and Turkey, from Boao Forum for Asia, *Boao Forum for Asia Development of Emerging Economies Annual Report 2009*, University of International Business and Economics Press, Beijing, 2010

that emerging economies can participate will create new driving forces for rebalancing the world economy and reforming the global economic governance.

Figure 1.2: Share of economic aggregate of E11 in the world's total (%)



Source: *Boao Forum for Asia Development of Emerging Economies Annual Report 2016*, Boao Forum for Asia, University of International Business and Economics Press, Beijing, March 2016.

1.2 Historic convergence of China's economic transformation with global trade liberalization process

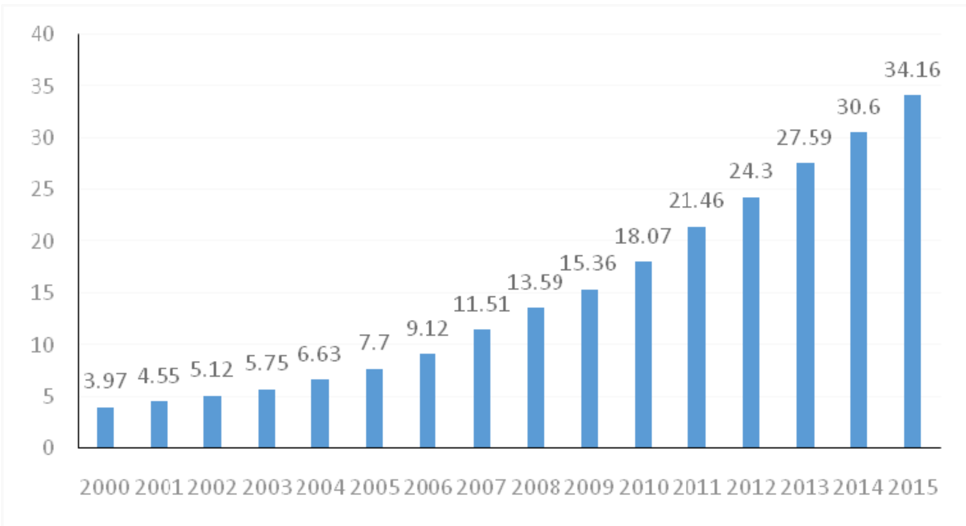
1.2.1 China's industrial structure is transforming from its current manufacturing domination to service domination

(1) The structure of Chinese urban and rural residents' consumption is rapidly changing from one with material consumption as the mainstay towards one with service consumption as the mainstay. Currently Chinese urban residents' service consumption takes about 40% of their total and by 2020 this proportion is expected to reach around 50%.

(2) The rapidly comprehensive growth of service consumption demand by China's nearly 1.4 billion people will drive its service sector to rapidly develop. From 2000 to 2015, the value added of China's service sector grew from 3.97 trillion *yuan* to 34.16 trillion *yuan*, expanding by about 8.6 times with an average annual growth of more than 9%. In other words, the added value of the service sector doubled every 5 years. In 2015, China witnessed growth rates of 6.0% and 8.3% of the value added of its industrial sector and service sector respectively, with the value added in the service sector rising to 50.5% of GDP.

(3) China is moving towards a major service economy. Conservatively estimated, the total size of China's service by 2020 will be over 50 trillion *yuan*, accounting for about 58% of the GDP and enabling China to be a truly major service economy.

Figure 1.3: 2000--2015 growth of value added of the service sector (trillion *yuan*)



Sources: National Bureau of Statistics, *China Statistical Yearbook 2015*, China Statistics Press, Beijing, 2015; National Bureau of Statistics, *2015 National Economic and Social Development Statistics Bulletin*[4]

[4] Via http://www.stats.gov.cn/tjsj/zxfb/201602/t20160229_1323991.html, accessed on 12 May 2016.

Table 1.1: Estimated expansion of China's service sector in its 13th Five-Year Plan period

Year	Value-added of the service sector（trillion *yuan*）（with an annual growth rate of 8%）	Value-added of the service sector（trillion *yuan*）（with an annual growth rate of 9%）
2016	36.88924	37.2308
2017	39.84037	40.58158
2018	43.0276	44.23392
2019	46.46981	48.21497
2020	50.18740	52.55432

1.2.2 The service sector will support China to grow at a medium rate in the next 10 years

(1) The contribution by the service sector to GDP growth will keep growing. By 2020, Contribution by the service sector to China's economic growth is expected to increase from 62.8% in 2014 to around 72-80% in 2020.

(2) The service sector is providing much stronger support for economic growth. In China, every 1% growth in the service sector will boost 0.49% of economic growth. That is to say, 8% of growth in the service sector will bring around 4% of growth. It is estimated that in the next 10 years, China will witness an average growth of 8% in the service sector. This will support China's economy to grow at a medium rate of around 6% in the next 5 to 10 years. Of course, such a growth rate may experience fluctuations.

1.2.3 China expanding the opening-up of its service market has converged with rapid development of global trade in services

(1) China is quickening its step in opening-up of its service sector. In the past few years, China has introduced a series of reform measures to open its service market, which has converged with rapid development of global service trade and enabled its service sector to become a major area for attracting foreign investment. In November 2015, President Xi Jinping made it clear in his speech at the G20 summit that "… (we will) relax market access for foreign capitals with the service sector as a prioritized area…" marking that China's opening up of its service sector, internally to private capital and externally to foreign capital, has entered into a new era.

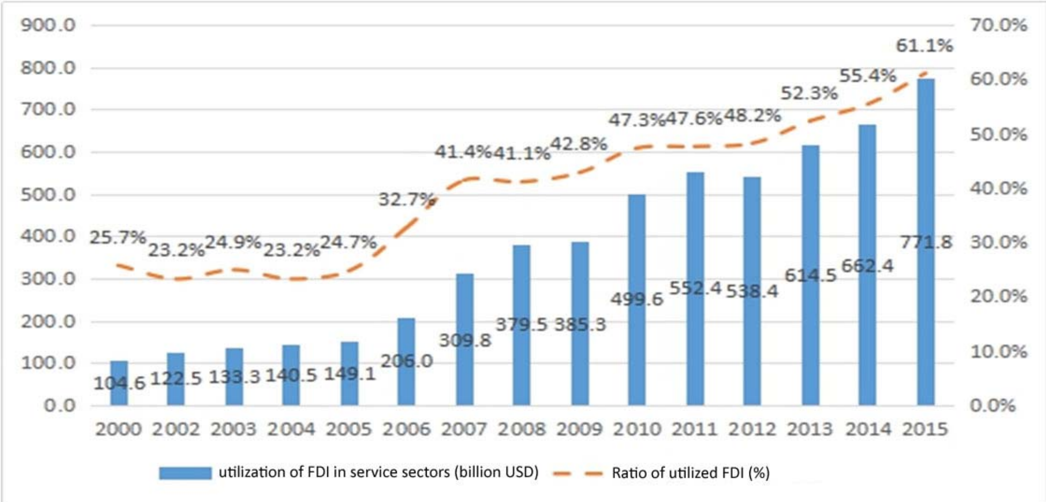
(2) The need to speed up market-oriented reform of the service sector has become more urgent. The current degree in which the service sector has opened up cannot meet the need for attracting private capital. For example, from January to April in 2016, growth of private investment in the service sector was only 3.2%, not only lower than the growth of private investment in other areas (18.1% and 6.1% for the primary and secondary industry respectively), but also well below the average growth of investment in fixed assets of the whole society (10.5%).

(3) New trend of expanding effective supply of services. It has become a major task for China's supply-side structural reforms to enlarge the cake of the service sector by opening up. So, a tendency of expanding effective supply of services by deepening both the internal and external opening up of the service sector is now already taking shape.

Box 1.1: China's service sector attracts more foreign investment than the manufacturing sector

According to statistics, in 2000 China's actual utilization of FDI in the service sector only accounted for 25.7%, but it increased to 47.6% in 2011, for the first time surpassing that of the manufacturing sector. In 2013, China's actual utilization of FDI in the service sector reached 61.451 billion US dollars, accounting for 52.3% of China's total actual utilization of FDI, taking up more than half of the total for the first time and 6.1 % higher than that of the secondary industry. In 2015, China's actual utilization of FDI in the service sector reached 61.1% of the total, nearly twice of that of the manufacturing sector.

Figure 1.4: 2000--2015 Actual utilization of FDI in China's service sector



Source: Data before 2011 is from Li Yongjian, *Strategic thinking on how to attract FDI in Chinese service sector*, Globalization, Vol 10, 2013. Data for 2011 to 2015 is from FDI statistics released by MOFCOM[5].

1.2.4 China is speeding up the implementation of its FTA strategy in order to support the global trade liberalization process

(1) Development of pilot free trade zones is gaining momentum. Since 2013, China has successively established four pilot free trade zones (FTZs) in Shanghai, Tianjin, Guangdong and Fujian to take the lead in experimenting the opening-up of the service market and free trade in services.

(2) Promoting economic transformation through the experiments on the opening-up of the service sector in FTZs. The spreading of duplicable and generalizable experience and practices out of the FTZs is helping the formation of a comprehensive opening-up landscape all over the country and cultivation of new driving forces for transformation and upgrading of the economy.

[5] via http://www.gov.cn/xwfb/2012-01/18/content_2047861.htm, http://www.gov.cn/gzdt/2013-01/16/content_2313210.htm, http://www.scio.gov.cn/xwfbh/gbwxwfbh/fbh/Document/1394281/1394281.htm, http://money.163.com/14/0116/11/9IN5OPQB00255OO9.html, and http://www.mofcom.gov.cn/article/ae/ag/201601/20160101234256.shtml, accessed on 15 May 2016

(3) Contributing to the promotion of the global free trade process by implementing the FTA strategy. China will take more initiatives by speeding up the implementation of its FTA strategy to play an active role in reshaping global trade and investment rules, especially those about service trade.

1.3 General trend of the EU's economic recovery and sustainable growth

1.3.1 The EU's economic recovery is facing increasing challenges

(1) The problem of lacking economic growth drivers has become more serious. By now the euro zone sovereign debt problem and problems in unemployment and credit market have all been eased. Nevertheless, the situation of weak domestic demand, high youth unemployment and sluggish economic recovery has not yet been substantially improved.

(2) Number of non-economic challenges is increasing. There have been an increasing number of new contradictions and new problems such as geopolitical tensions, refugee issue and terrorist attacks. The characteristic of non-economic factors affecting economic recovery is outstanding.

(3) The process of integration is facing challenges. The referendum of “Brexit” increases the uncertainties and risks of the European economic integration. Internal coordination has become one of the biggest challenges facing EU’s economic recovery.

1.3.2 The acceleration of global service trade development has brought the EU new opportunities

(1) The EU has unique advantages in the modern service sector. The EU now is in the post-industrial era, the ratio of the service sector in GDP exceeds 70%[6], and the service sector creates 70%[7] of the total jobs. Thus, modern

[6] GDP data is from Eurostat
[7] China’s Mission to the European Union, http://eu.mofcom.gov.cn/aarticle/sqfb/201210/20121008376896.html, accessed on 2 May 2016.

service sectors are major sources of growth, employment and competitive edge.

(2) The EU has first mover advantages in the new round of industrial revolution. Both the industry 3.0 featuring "Internet plus new energy" and the industry 4.0 featuring intelligent manufacturing started from the EU, in the producer service sector, EU has the first-mover advantages.

(3) Trade in services has been an important driver for EU's economic growth. Trade in services is a major source of the EU's trade surplus and also a power engine for a new round of economic growth in the EU. According to Eurostat, in the 5 years from 2010 to 2014, the EU witnessed significant growth of trade in services, its service exports rose from 568.7 billion Euros to 734.8 billion Euros, an increase of 29% in five years; while its service imports climbed up from 458 billion Euros to 583.4 billion Euros, an increase of 27%, driving the EU's trade surplus to have kept growing.

1.3.3 The EU has an important role to play in the new global economic landscape with its competitive edge in service trade

(1) Trade in services is EU's competitive edge. Trade in services is what EU could rely on to fully utilize its comparative advantages in participating the new round of globalization and to contribute to the promotion of the new round of trade liberalization.

(2) The huge market space of emerging economies will unleash huge demand for trade in services. The rapid development of service sectors in emerging economies, including China, is creating huge market space for the EU to further expand its service trade.

(3) Speeding up the development of China-EU trade in services will make the EU globally more influential. Speeding up the liberalization of trade in services not only will create stronger driving forces for the EU's economic recovery but also will make the EU globally more influential.

Part II – Feasibility of establishing EU-China FTA by 2020

To comply with the general trend of global trade liberalization developments, it is both a practical need and also feasible to establish a China-EU FTA by 2020

2.1 2020: important opportunities for deepening China-EU cooperation

2.1.1 2020: critical period for economic transformation in both China and the EU

(1) China is in a period of forming a large service market. Since the beginning of this century, the structure of households consumption has been changing from one with material consumption as the mainstay to the new one with service consumption as the mainstay, as a result of China becoming an upper middle income country from a lower middle income one. Each of the 8 new types of consumption including information, health care, travel and leisure, education, culture and entertainment, elderly care, sports and green products is promising a market larger than the size of trillion *yuan*. In 2015, China’s GDP per capita exceeded 8,000 US dollars and urban households’ service consumption accounted for about 40% of the total. It is estimated that China's GDP per capita will be over 12,000 US dollars by 2020 and the proportion of urban residents’ service consumption will reach about 50%. In some better developed areas, this rate will be higher than 60%. It is expected that, boosted by service consumption, China’s households consumption will reach 50 trillion *yuan* by 2020.

(2) The EU is in a period of rebuilding long-term growth engines. According to the growth strategy ***Europe 2020*,** the EU has been striving to achieve smart growth, sustainable growth and inclusive growth by 2020, raising the rate of employment of the 20-64 year-olds to 75% and investment in R&D to 3% of GDP, cutting greenhouse gas emissions by 20% with 1990 as the base year, increasing the proportion of renewable energy consumption to 20% of the total, reducing the total energy consumption by 20% and the poor population to about 20 million. To achieve such objectives and targets, the EU needs to speed up transformation and achieve a new balance among growth, social protection and employment.

2.1.2 2020: strengthening of economic complementarity between China and the EU

(1) General trend of the development of service sectors in China. Basically forming a service-led industrial structure by 2020 is an objective tendency of economic transformation and upgrading in China. This service-led economic transformation is designed to largely solve the problem of mismatch between supply and demand structures in general and in particular to make the supply of services to meet the demand of services.

(2) The EU's advantages in service supply. The EU on the whole has entered the post-industrial era. Either in producer service sectors such as electronic technology, aviation, information and communications technology (ICT), life science and technology, energy and environment protection technology, or in consumer service sectors such as healthcare management and elderly care, the EU has unique advantages with advanced technology and mature management expertise.

(3) Strong complementarity in service trade between China and EU. To speed up the development of China-EU trade in services, the EU could fully utilize China's huge service market with nearly 1.4 billion people to speed up its economic recovery and promote its sustainable development; while China could utilize EU's advanced technology and advanced management expertise to develop its own modern service industries to achieve breakthroughs in its economic transformation and upgrade.

Table 2.1: Shares of value added of service sectors in China and some EU members in 2014

Countries	Services, etc., value added (% of GDP)
China	50.50
EU 28 average	74.31
Luxembourg	87.83
Czech Republic	59.34
UK	78.36
France	78.89
Germany	68.99

Source: data about EU member countries from the World Bank[8], data about China in 2015 from China's National Bureau of Statistics

2.1.3 2020: formulation of new rules for global service trade

By 2020, such bilateral and multilateral negotiations including TiSA, TPP, TTIP and China–Japan–South Korea FTA are expected to achieve substantial results. All these put altogether will surely reshape the global service trade rules. The EU is the world's largest developed economy and China the world's largest emerging economy. When the envisaged China-EU FTA with service trade as the prioritized area could become true to form new rules for trade in services that are equally beneficial to both the North and the South, it would have significant impacts on global economic recovery and on forming a new pattern of global economic governance.

8 http://data.worldbank.org/indicator/NV.SRV.TETC.ZS, accessed on June 6

2.1.4 2020: timing for establishing China-EU FTA

(1) China's trade in services enters a period of rapid development. In 2015, China was the second largest service trader in the world, with a total volume of 713 billion US dollars, of which service imports was 424.81 billion, accounting for 9.6% of world total[9]. It is expected that China would possibly soon replace the US as the world's largest importer of services.

(2) China's service trade market is huge and the first movers will enjoy larger bonus. Take China-ASEAN FTA as an example. After the two parties signed the service trade agreement in 2007, the average annual growth of trade in services between them in the period between 2007 and 2014 was as high as 19.6%, 2.72 times of the average annual growth rate of China-EU trade in services, and the total size is now approaching that of the EU-China trade in services[10]. If negotiations for the upgraded version of China-ASEAN service trade agreement or for the Regional Comprehensive Economic Partnership (RCEP) are concluded over the coming years, ASEAN countries will be the first movers to share China's service trade dividends. At the beginning of China's reform and opening-up, Germany was the first mover into China's auto industry, while France was a comparatively slow and late comer. The result was a striking contrast between Germany and France in sharing China's auto market bonus today. Similar situation would be very likely to reappear in China's service market.

No matter which country the EU signs FTA with, it cannot have the same economies of scale in terms of market size as it can from the envisaged China-EU FTA. If the China-EU FTA is put off after 2030, the EU will possibly miss the opportunity when China's huge service market with 1.4 billion people is rapidly developing.

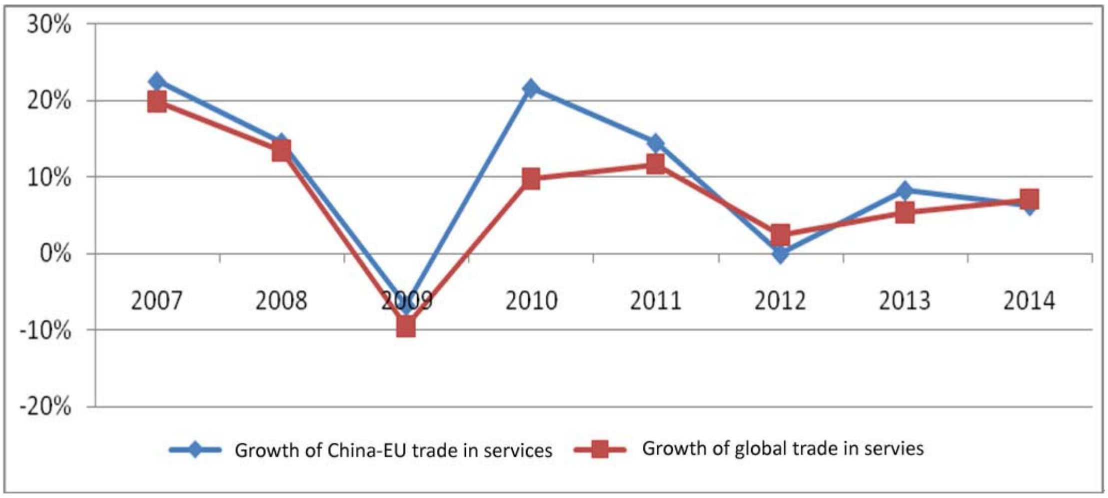
[9] Data is from China's MOFCOM.
[10] Calculated on China's MOFCOM data.

2.2 2020: Starting China-EU FTA process with service trade as the priority

2.2.1 2020: trade in services will become a major driver for the growth of China-EU trade

(1) The trend of rapid growth of China-EU trade in services. Between 2004 and 2014, growth of China-EU trade in services has been higher than the growth of EU's total external service trade and that of the global service trade in most of the years. In the same period, the EU service exports to China registered an average annual growth of 16%, while China's service exports to the EU witnessed an average annual growth of 14%[11].

Figure 2.1: 2004-2014 growth of China-EU trade in services, global trade in services



Source: *China Statistics of Trade in Services 2015*, MOFCOM[12]; data of China-EU trade is from Eurostat.

(2) The space for trade in services between China and EU is huge. In 2014, global trade in services was 20% of the total global trade, while the trade in services between China and EU was only 10.4% of their total trade. Intermediate services provided by one party to the other was only 1.34% of their total service

[11] Calculated on data from China's MOFCOM and Eurostat.

[12] http://tradeinservices.mofcom.gov.cn/a/2016-01-26/284927.shtml, accessed on 23 May 2016

outputs put together, well below the 2.77% in their manufacturing sectors[13]. China is the EU's third largest trading partner in services, but the share of trade in services between China and the EU was only 4% of the EU's external trade in services in 2014, far below the United States' share of 26% and the Switzerland's 14%[14]. The EU is the world's largest service supplier, while China the world's most promising service consumer market. The current volume of trade in services between them is seriously incompatible with their economic development needs.

If China and the EU could initially integrate their service markets by 2020, China's trade in services could become 1.2 trillion US dollars in volume, and its import of services could grow from 424.81 billion US dollars in 2015 to 600-700 billion US dollars, at an average annual growth rate of 7.5-11%. Then, the volume of China-EU trade in services could reach 200-220 billion Euros[15] and the share in China's total service trade would climb up from 13.2% to 20%.

(3) The EU's service export to China has a huge potential. In 2014, six EU member states' service exports to China exceeded 1 billion Euros each: Germany exported 8.85 billion worth of services to China, UK 5.2 billion, France 4.15 billion, Ireland 2.83 billion, Denmark 2.62 billion and the Netherlands 1.36 billion. The EU has very big potentials for exporting services to China such as tourism, transport, patent licensing, insurance and many others. If trade barriers could be substantially lifted by 2020, China's import from EU is expected to reach 109.8-143.2 billion US dollars, an increase of 1.8-2.7 times, and it's share in China's total import will climb up from 10% in 2014 to 18-20% in 2020.

Take tourism as an example, according to a conservative estimation, the number of China's outbound tourists will be over 500 million, which means at least more than 500 billion US dollars in tourism export for other economies. In 2015, the number of China's outbound tourists whose first stop was an EU member state reached 3.4276 million, a year-on-year increase of 23%. According to official

[13] Song Yuhua, Zhang Haiyan (2013), " A study on the strategic challenge to China's FTA system and the role of China-EU FTA", *Nankai Journal Philosophy, Literature and Social Science Edition*, Vol. 4.

[14] Eurostat newsrelease, Almost a third of EU trade in services with the United States in 2014, 102/2015 – 11 June 2015

[15] *"China-EU Reform Agenda" held and research on China-EU FTA initiated*, *Guangming Daily*, 16 March 2015.

statistics of France, China continues to be its largest source of international tourists, with double-digit growth rate for more than 10 consecutive years, which has provided about 2 million jobs and has a contribution of more than 7% to GDP[16]. If China-EU trade in tourism services is further liberalized and supported by visa facilitation, it will create more jobs and make an even larger contribution to GDP for EU member states in tourism, restaurants, hotels, and retails industries.

2.2.2 Promoting China-EU cooperation in trade in services will be a driving force for China's economic transformation.

Through deepening cooperation in trade in services with the EU, China could effectively improve its capacity in providing consumer services such as health care, education, culture, elderly care and others. And drawing the EU's experience in promoting Industry 3.0 and Industry 4.0, China could speed up the development of its producer service sectors and the implementation of the strategy of "Made in China 2025" so as to realize transformation of its production-oriented manufacturing sector to a service-driven one.

2.2.3 Promoting China-EU cooperation in trade in services will have significant positive impacts on the EU's economic growth and employment growth.

The EU's trade surplus from trade in services with China was respectively 12 billion Euros in 2013 and 9.2 billion Euros in 2014[17]. If the proportion of China-EU service trade increases to 20% of their total trade, the EU's export of services to China could be doubled. With the growth of China-EU trade in services gaining momentum, the EU will benefit from the development of China's modern service industries and enjoy the bonus of the first mover into China's service market.

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[16] *Double-digit growth of Chinese outbound tourists for 12 consecutive years, several countries take facilitation measures*, People's Daily (print), 28 January 2016

[17] According to the Economic and Commercial Counsellor's Office of Embassy of the People's Republic of China in Germany, the EU's trade in services surplus increases to 173 billion Euros, http://de.mofcom.gov.cn/article/jmxw/201406/20140600641746.shtml, accessed on 26 April 2016

2.3 2020: important basis for establishing a China-EU FTA

2.3.1 Cooperation between China and the EU for as long as 40 years has led up to extensive political mutual trust between the two sides

China and the EU have established very close economic and trade relations without any conflicts in geopolitical interests. The EU has been China's largest trading partner for 11 consecutive years, and China has been the EU's second largest trading partner and biggest source of imports. They have extensive cooperation in many areas including investment, finance, currencies and industries. Since 2004, China has established comprehensive and strategic partnership with 16 EU member states, while enjoying high mutual political trust with many EU member states like Germany, Britain and France.

2.3.2 Expanding consensus on establishing a China-EU FTA

On November 21st, 2013, during the 16th China-EU summit, Chinese Premier Li Keqiang proposed to "actively promote studies of the feasibility of a China-EU FTA". The "China-EU 2020 Strategic Agenda for Cooperation" jointly released stated "…their willingness to envisage broader ambitions including, once the conditions are right, towards a deep and comprehensive FTA…" China has been very active in promoting the establishment of China-EU FTA, while EU has regarded advancing FTAs with Asian countries and regions as its foreign trade policy priority, and some EU member states including Germany and UK have all clearly expressed their positive attitudes towards a China-EU FTA.

2.3.3 Mutual compatibility between China's "One Belt and One Road" initiative and the EU's "Juncker Plan"

China is the only non-EU country that invests in the "**Juncker plan".** Quite a few EU members including Britain and Germany are founding members of Asian Infrastructure Investment Bank (AIIB). The two sides have been accurately docking their major development strategies to promote pragmatic cooperation, which has created favorable conditions for a China-EU FTA.

2.4 2020: recommended actions to establish a China-EU FTA

2.4.1 Step 1: signing a framework agreement

In the period between 2016 and 2017, TPP may well start its domestic ratification processes in its participating members; while on the other hand, TTIP, EU-Japan FTA and RCEP have all aimed to wrap up negotiations by the end of 2016. The progresses of these negotiations, besides their interactions, all have important impacts on the global economic and trade landscape. The EU is the world's largest developed economy, China the world's largest developing economy; and the EU is China's largest trading partner while China is the EU's second largest trading partner. The establishment of China-EU FTA should not lag behind the process of other regions' economic integration. Within the next two years and as soon as possible, China and the EU should sign a framework agreement on FTA through consultation to specify objectives, issues, time frame and early harvest programs of FTA negotiations.

2.4.2 Step 2: completing negotiations on key issues

Between 2018 and 2019, China and EU should make efforts to complete key negotiations about trade in goods, trade in services and investment. At the same time, early harvest programs should be specified. In view of the differences among EU members in development level and in economic and trade ties with China, the FTA can have differential exception lists of sensitive products and different transitional periods. Regarding certain issues difficult to reach agreements for the time being, a "gradual liberalization" approach could be adopted but with clearly specified time tables for negotiations. This approach of gradual upgrading can help proceed with and finish negotiations in a smooth manner.

2.4.3 Step 3: Official establishment of China-EU FTA

When a comprehensive agreement on China-EU FTA is signed and domestic ratification processes completed, the establishment of China-EU FTA should be officially announced. In 2020, major clauses concerning trade in goods, trade in services and investment should enter into force, and tariff and non-tariff barriers should be substantially lifted. Meanwhile, trade and investment facilitation should be markedly improved, and macro-policy coordination and market supervision cooperation should be effectively strengthened, so as to lay a solid foundation for a large and integrated China-EU market.

Part III – Merging China-EU FTA and CAI Negotiations

If China and the EU agree to sign a free trade agreement by 2020, the path of actions needs major adjustments. Given the current real need of economic development in China and the EU, and in view of the global trend of incorporating investment treaty negotiations into trade agreement negotiations, we suggest that China-EU CAI (Comprehensive Agreement on Investment) negotiations should be merged into FTA negotiation as soon as possible.

3.1 Trend of merging BIT negotiations into FTA negotiations

3.1.1 Clear trend of merging BIT talks into FTA negotiations

On the whole, there has been a global trend for international investment treaties to be merged into international trade agreements. In 2004, 73 BITs were concluded globally,[18] but by the year of 2011, only another 47 new ones were signed. In the first five months of 2012, only 5 new BITs and 2 other investment treaties were inked. More and more issues negotiated for BIT such as investment market access, investment promotion and protection are incorporated into FTA negotiations.

At present, most of mega-regional economic and trade deals are all taking the form of FTA. For instance, the EU is a major global economy. All the on-going economic cooperation negotiations it is conducting with other economies such as Vietnam and India are targeted at FTAs. The BIT (CAI) between China and

[18] Yu Jingsong, Zhan Xiaoning, "Recent development of international investment treaty and the impacts on China", *The Jurist*, Vol.3, 2006

EU is one of the few currently under negotiation.

3.1.2 Negotiating only for CAI without thinking of FTA has proved much more difficult

(1) Negotiating only for BIT cannot meet the need of development of the economic and trade relations between China and the EU. A look at the shares of foreign enterprises, of actually utilized foreign capital, and of their averages between 1978 and 2013 in China's primary, secondary and tertiary industries shows that both the number of foreign funded enterprises and the share of actually utilized foreign capital in the tertiary industry had been growing every year. From January to April 2016, actual utilization of foreign investment in the service sector was 201.4 billion *yuan*, a year-on-year growth of 7.9%, a 3.1 percentage points higher than the average growth rate of foreign capital utilization in the secondary industry. The amount of foreign capital utilized by the service sector accounted for 70.2% of the total foreign direct investment in China, with the service sector becoming the most important area for attracting foreign investment.

Table 3.1: Structure of FDI in China (100 million US dollars)

2013				
Industry	**Number of enterprises**	**Share%**	**Actual utilization of FDI**	**Share%**
Total	221819	100	1239.11	100
First industry	757	3.32	18.00	1.45
Secondary industry	6931	30.37	495.69	40.00
Tertiary industry	15131	66.31	725.42	58.54
1978-2013				
Industry	**Number of enterprises**	**Share%**	**Actual utilization of FDI**	**Share%**
Total	786217	100	30640.65	100
First industry	22766	2.90	710.86	2.32
Secondary industry	519768	66.11	18396.61	60.04
Tertiary industry	243683	30.99	11533.18	37.64

Note: absolute number is the accumulated amount while relative number is the average amount between 1978 and 2013.

Source：National Bureau of Statistics, *Statistics on FDI in China 2014* and *Statistics on FDI in China 2015*, China Statistics Press, Beijing, 2015.

(2) Dividends of a China-EU FTA far outweigh those from a CAI. Without negotiating for FTA, the benefits of China-EU CAI, even if signed, would be rather limited. Now there still exist lots of outstanding disagreements between China and the EU in legal norms, market protection, definition of nature and direction of investment, intellectual property rights protection, government procurement, and proportion of industries being open to foreign investment. Chinese companies are very interested in railway and road construction in the EU but it is not yet open to them. As directly related to the opening-up of service sectors, this type of problem has to be resolved under a FTA framework.

In fact, the ongoing China-EU CAI negotiation already includes some important issues in negotiating an FTA, which makes it substantially different from traditional BIT negotiations. Therefore, to meet practical needs of the two parties, the ongoing CAI negotiation between China and the EU can be upgraded into FTA negotiations without extra efforts.

(3) Being confined to CAI negotiations will let slip the golden opportunity for launching FTA negotiations. The first round of China-EU BIT talks started in January 2014. The EU originally planned to conclude the talks in two and a half years by the middle of 2016. This now appears a little bit too optimistic in view of the progress so far made. As late as in January 2016, the two sides announced to expand the scope of CAI talks and boost substantial negotiation. In 2016 another 2-3 rounds of negotiations have to be conducted. At present, the EU is accelerating its FTA talks with the United States, India and Japan, while China is doing the same for RCEP and China-Japan-South Korea FTA. Comparatively speaking, China and EU have more difficulties in their CAI negotiations. Judging from the progress so far, it may take too long to seal the deal. This may well lead to the situation China and the EU may let slip good timing and golden opportunity to enter each other’s market.

3.1.3 Feasibility of merging China-EU CAI negotiation into China-EU FTA negotiation

(1) China has precedents of merging BIT talks into FTA negotiations with

other parties. Many of the FTAs already sealed by China with its partners are the results of merging BIT talks with FTA negotiations. China-Pakistan FTA was the first one to do so. Investment clauses were put in one separate chapter, covering definition of investment, promotion and protection of investment, investment treatment, expropriation, damage compensation, transfers, subrogation, and settlement of disputes. In fact, this can be seen as direct merge of a traditional BIT into an FTA.

(2) There is also a precedent of the EU directly starting FTA negotiations with a developing country. The EU and Vietnam inked their FTA in December 2015; the treaty covers areas such as tariff elimination, reduction of non-tariff barriers, rules of origin, government procurement, fair competition, trade in services, investment, and settlement of disputes. In terms of economic transformation and development, China has been and is still ahead of Vietnam. China and the EU have conditions for starting FTA negotiations by merging CAI negotiations into FTA negotiations. In this way, the degree of opening up markets towards each other will be no smaller than that stipulated in the EU-Vietnam FTA.

3.2 Action proposal on merging China-EU CAI talks with China-EU FTA negotiations

3.2.1 Expanding the scope of negotiation

(1) Taking service market access and service trade as prioritized issues in China-EU CAI negotiations. Currently, The EU's major concerns include China's market access, fair competition and national treatment, while China's major concerns include investment laws and regulations, investment standards and management mechanisms in the EU. It would be a pragmatic choice for the two sides to include more issues such as service trade into the negotiation framework before the negotiating text is finalized.

(2) Taking the CAI negotiating text as the base and appropriately adding issues concerning trade in services such financial service. This proposed scheme still regards the CAI negotiating text as the base and adding issues in trade in important services such as financial ones. In this way, the negotiation will be better adapted to the general development of China-EU trade in services.

(3) Add FTA issues to the China-EU CAI negotiating text. This requires upgrading CAI talks into BITT (Bilateral Investment and Trade Treaty) negotiations. This BITT negotiating text should look like a standardized FTA one, incorporating all the key issues of concern by both parties.

3.2.2 Gradually expanding the scope of implementation

In its reform and transition process, China has taken the approach of introducing pilot projects in selected areas first to experiment many its opening-up policies before nationwide implementation. This could also be the approach for implementing China-EU FTA. During negotiations, pilot projects can be implemented first in selected areas to explore feasible routes and ways for opening up trade in services. China's pilot free trade zones (FTZs) are ideal areas to launch such pilot projects. As China continues to set up more FTZs and with their coverage continuously expands, China-EU FTA pilot projects could be automatically implemented in larger and larger areas. This will help work out a new way for China and the EU to speed up their two-way market opening up.

3.2.3 Win more EU member states' support for the envisaged China-EU FTA

(1) Bringing the role of EU member states with positive attitude into full play. Germany and UK are quite influential and play important roles in many EU affairs. Securing their greater support can help a lot in accelerating the China-EU FTA process.

(2) Strengthening communication with member states in Southern Europe and Central and Eastern Europe. Countries like Greece, Spain, and Italy have not yet recovered from the sovereign debt crisis and are more susceptible to external impacts. For these countries, China could give more concessions and allow a cushion and transitional period for their structural adjustments. While

EU's new member states from Central and Eastern Europe are economically more vigorous. China needs to enhance communication with them and convince them of the mutual benefits from the economic complementarity so as to ease their doubts on the envisaged China-EU FTA.

3.3 Accelerating implementation of early harvest projects when merging CAI talks with FTA negotiations

3.3.1 Trade facilitation with China-EU customs cooperation as the priority

Under the Strategic Framework for Customs Cooperation 2014-2017, the two sides can explore more reasonable administration approaches on customs clearance in line with the latest service trade characteristics and enhance comprehensive cooperation in trade facilitation, transit efficiency improvement, intellectual property rights protection and trade statistics. It is also suggested that an agreement to be signed between China and the EU as soon as possible to facilitate cross-border movement of people related to service trade, including business visitors, employees transferred within the same company, contracted service suppliers, independent experts and consultants; and to protect the benefits and rights of service suppliers' employees and to ensure transparent visa processing procedures. China and the EU should also enhance cooperation in food security and quality standards, encourage mutual recognition of third party accreditation and testing results, and promote information sharing.

3.3.2 China-EU monetary and financial cooperation with internationalization of RMB as prioritized purpose

China pledged contributions of 50 billion US dollars and 43 billion US dollars to enhance the IMF's resources in 2009 and 2012 respectively to cope with the international financial crisis. Of China's foreign reserves of more than 3 trillion US dollars, close to 20% is in euro assets.[19] Meanwhile, EU member states such as UK, Germany, and France are all AIIB founding members. And China

[19] Chen Zhimin, Peng Chongzhou, *A comparative study of the relationships between China and the EU Member States*, *Chinese Journal of European Studies*, Vol. 2, 2013

joined and became a shareholder of the European Bank for Construction and Development in December 2015. All these have created favorable conditions for deeper China-EU monetary and financial cooperation.

In the next few years, it is of mutual interest for China and the EU to jointly enhance monetary and financial cooperation with internationalization of RMB as the priority. In this, the priorities include encouraging establishment of more subsidiaries of financial institutions within each other's borders and enhancing mechanism building-up to strengthen the interconnectivity of their capital markets in order to jointly build an interconnected Eurasian financial market; boost multi-channeled Eurasian cooperation in investment and financing with AIIB and EIB as bridges and hubs; enhance cooperation in international monetary and financial supervision and regulation; and strengthen macro-policy coordination in improving and reforming the international financial and monetary system as well as in revising and formulating relevant rules.

3.3.3 Technical cooperation with environmental protection technology as the focus

The EU is a world leader in green energy, low-carbon technology and environmental protection technology, while China has the world's largest clean energy market and relatively low manufacturing costs. China is badly in need of the EU's advanced technology and expertise. Increasing free trade in these areas and promoting combination of China's huge market demand with the EU's human capital, production capability and advanced technologies will greatly promote innovation cooperation between companies in China and the EU. Take clean energy technology as an example, China is expected to be the world's largest clean energy market and its market is estimated to reach 555 billion US dollars by 2020. As a world leader, the EU has great advantages exporting environmental protection technology and new energy development and utilization technology. Thus, China should further open up its market to attract the EU's enterprises to enter its environmental protection market.

3.3.4 Cooperation in emerging industries with e-commerce as the priority

China and the EU both need to develop new types of service trade like cross-border e-commerce. E-commerce has become a new trend in global trade. Either in China or the EU, small and medium-sized enterprises are faced with limitations of traditional international trade such as difficulty in identifying buyers' need, long cycle for orders and high risk of exchange rates. Thus, their need for e-commerce is more urgent.

E-commerce is still faced with many trade barriers nowadays and WTO lacks trade rules for e-commerce. Although rules for e-commerce are being incorporated in some regional trade agreements, there are great differences in implementation. If China and the EU, aiming at FTA, start equal consultations about cross-border e-commerce, they will not only unleash the huge potential of China-EU cross-border e-commerce, but also provide valuable references for formulating global and regional rules on cross-border e-commerce. Therefore, China and the EU should jointly explore how to innovate the mode of supervising and regulating special items like e-commerce deliveries so as to facilitate customs clearance.

3.3.5 Enhancing China-EU cooperation on infrastructure investment

Huge amount of investment is needed for the EU to upgrade, expand and renovate its infrastructures such roads, railways, airports and canals. The implementation of the Junker Plan alone will need investment of no less than 315 billion Euros. China possesses state-of-the-art technologies and equipments, strong construction capability, and competitive costs in building high-speed railways, bridges, airports and power facilities. Thus, infrastructure interconnectivity can be an important part of cooperation in the framework of the envisaged China-EU FTA.

3.3.6 Expanding China-EU cooperation in government procurement

The size of China's government procurement has been continuously growing, with a total volume of 1.7 trillion *yuan* in 2014, an increase of 92.424 billion *yuan* compared to that in 2013, a year-on-year growth of 5.6%[20]. In the last few years, China's recent offer to accede to the WTO Government Procurement Agreement has made more commitments in opening up. The first is to include more suppliers, the second to enlarge the number of goods, services and projects for procurement, and the third to lower the threshold for government procurement market access. The potential for enhancing cooperation between China and the EU in government procurement is huge as both parties are seeking to enter each other's markets of large-scale infrastructure construction projects. China and the EU could make it clear by applying negative lists to specify each other's eligible suppliers to stabilize expectations and reduce uncertainties.

[20] *Last year registered a total value of 1.7 trillion RMB in public procurement, 30% of which were procured from small and micro enterprises*, National Business Daily, July 31,2015.

Part IV – 2020: Key issues in deepening structural reforms in China and the EU

Deepening China-EU cooperation by advancing the China-EU free trade process practically need structural reforms in both sides. Though China and the EU are at different development stages and face different structural problems, cracking structural problems by deepening structural reforms has become China and the EU's common choice and also an important condition for establishing China-EU FTA.

4.1 Structural problems in the way of deepening China-EU cooperation

4.1.1 The EU

(1) Trade protection. Although China and the EU are two highly complementary economies, mutually opening up their markets to each other will unavoidably have various impacts, such as giving rise to structural unemployment and temporary difficulties in certain industries. Facing pressures on employment readjustment and temporary difficulties in some industries, the EU has adopted some trade protection measures against China.

(2) Technical trade barriers. In some industries the EU is not competitive; the EU still implements explicit or implicit protection policies and even excludes these industries from the list of market access and national treatment. In recent years, the EU has promulgated a large number of technical regulations, standards, and related conformity assessment procedures, which have directly or indirectly become trade barriers to China.

(3) Rather poor facilitation of trade in services. For instance, Chinese citizens still find it difficult to get visas to EU member states. Their complaints include low facilitation level, complicated procedures, long processing time and high rejection rates.

4.1.2 China

(1) Overcapacity. Overcapacity is a serious problem with Chinese economy and it's even more prominent in some industries as the traditional growth model has not yet been fundamentally transformed. This has become a critical factor not only affecting the short-term economic growth but also leading to short-term economic risks. To tackle this problem, the Chinese government specified cutting overcapacity and excess inventory, deleveraging, reducing costs, and shoring up weak areas as major tasks of supply-side structural reforms. Practices in the past two years have shown that China's structural reforms with the five tasks as the focus is actually a tough battle. To win this battle, it would be no easier than the task of pulling China's SOEs out of difficulties within three years time in the 1990s.

(2) Comparatively lagging behind of the opening-up of service sectors. Since the reform and opening-up, industrial sectors have been prioritized for opening up toward the outside world but the opening-up of service sectors has been lagged behind. In particular, the degree of the opening-up of service sectors to international investors is relatively quite low.

(3) Share of trade in services is relatively low. In spite of its rapid growth over the past several years, the proportion of trade in services in the total of international trade still remains low. In 2014, China's foreign trade in services only took up 12.3% of its total foreign trade, 8.3% lower than the global average in the same year, but much lower than the global average of 19.6%, 22.1% of the United States and 26.5% of India in 2013. In 2015, the total volume of China's trade in services was 713 billion US dollars, less than 1/5 of its trade in goods.[21]

[21] National Bureau of Statistics of China, *Statistical Communique of China on the 2015 National Economic and Social Development*, http://www.stats.gov.cn/tjsj/zxfb/201602/t20160229_1323991.html, accessed on 22 May 2016.

4.1.3 Deepening structural reforms is China and the EU's common choice

(1) The EU. Since 2011, the EU has adopted a variety of measures, including the European version of quantitative easing, to cope with the global financial crisis and the European debt crisis. Though these policy measures have helped easing the crises, they have proved unable to fundamentally solve structural problems in economic and social fields. Therefore, an important choice for the EU is to advance structural reforms to eliminate structural drawbacks, which may well be conducive to unleashing new growth drivers and raising potential growth rates in EU member states.

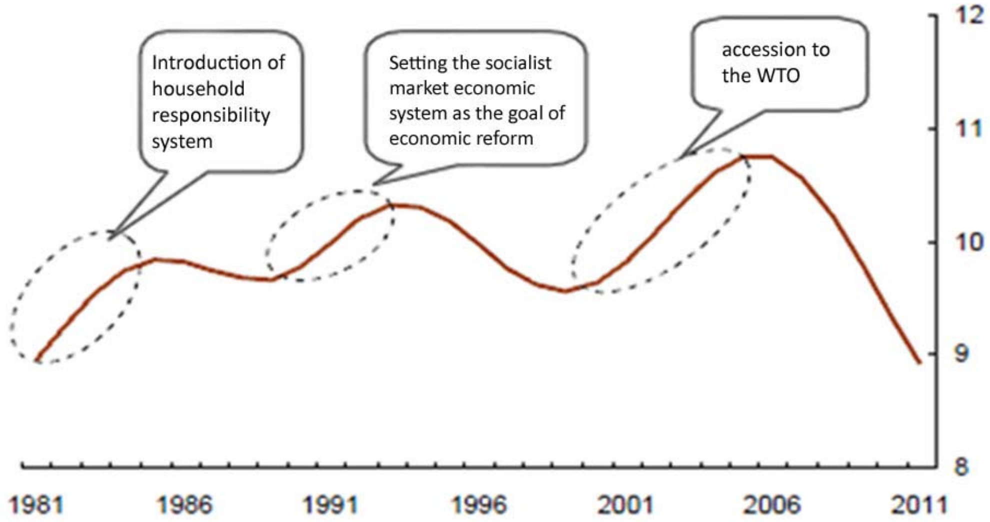
Table 4.1: Recent structural reforms and its impacts on the level of potential GDP growth after 10 years, percent (France and Italy)

	GDP		Via employment growth		Via productivity growth	
	France	Italy	France	Italy	France	Italy
Product market reform	0.3	2.6			0.3	2.6
Labor market reform	1.3	2.4	1.8	2.7	-0.5	-0.3
Tax structure reform	0.4	0.4			0.4	0.4
Public administration reform	1.0	0.9			1.0	0.9
Total	3.1	6.3	1.8	2.7	1.2	3.6
Average annual growth	0.3	0.6	0.2	0.3	0.1	0.4

Sources: OECD, *France – Structural Reforms: Impact on growth and options for the future*, OECD Publishing, 2014; OECD, *Structural Reforms in Italy: Impact on Growth and Employment,* OECD Publishing, 2015.

(2) China. Reform and opening up over the last 38 years have shown that rise of China's potential economic growth rate is directly related to economic transformation. The three occurrences of remarkable increase of economic growth are direct results of breakthroughs in transformation and reform, namely, introduction of the household responsibility system in 1978, setting the socialist market economic system as the goal of economic reform in 1992, and China's accession to the WTO in 2002.

Figure 4.1: China's potential GDP growth rates since the reform and opening-up (%)



Source: China Institute for Reform and Development, *Reform Bonus*, China Economic Press, Beijing, 2013

Currently, China is in a critical period for economic transformation and upgrade. On one hand, the ongoing rationalization of the industrial structure, population urbanization and changes in the consumption structure all promise huge potential dividends. While on the other, releasing these dividends directly depends on breakthroughs in structural reforms. In the next few years, making substantial breakthroughs in structural reforms with economic transformation as the main line is a major task in maintaining a medium-to-high growth rate.

(3) China and EU's common choice to deepen structural reforms. Effective response to the rapid development of trade in services and realizing the basic goal of building a China-EU FTA by 2020, both China and the EU need to push forward structural reforms, increase institutional supply and solve structural problems standing in the way of China-EU economic and trade cooperation. For example, China and the EU should focus on the “painful spots” in investment and trade between them, and strengthen communications and consultations in order to reach consensus in key areas at an early date. They should also focus on the problem of poor mutual understanding between the general public of the two sides to promote social and cultural exchanges by further facilitating people’s cross-border movement.

4.2 Recommendations on deepening structural reforms in the EU

4.2.1 Advancing the reform of the labor market

Efforts to move towards China-EU FTA may unavoidably give rise to industrial transformation and adjustment in the EU, requiring relocation of employees across different industries. CEPS’s study (2016)[22] shows that if the EU makes a successful implementation of structural reforms, impacts on the EU labor market due to a China-EU FTA is still manageable. The quicker the reform of EU’s labor market, the less painful the employment adjustment will be. It requires the EU to increase the flexibility of its labor market, governments to reduce their intervention and give more autonomy to companies in recruiting employees and setting salary standards. The EU should also build a more flexible welfare system so that economic growth and the welfare system could benefit each other.

4.2.2 Relaxing control of high-tech export to China

Take emission reduction technology as an example. The EU has transferred a large amount of carbon emission to China via international trade. Research shows that carbon emitted by producing the commodities exported from China to EU takes up 2.99-8.85% of China’s total annual emission, while carbon emitted by producing commodities exported from EU to China takes up only 0.17-0.73%

[22] Pelkmans, et al, *Tomorrow’s Silk Road: Assessing an EU-China Free Trade Agreement*, Centre for European Policy Studies, Brussels, 2016

of EU's total annual emission[23]. After the envisaged China-EU FTA is established, the amount of carbon emission transferred via international trade from EU to China may well be even markedly larger. So the EU has the capacity and responsibility to expand low carbon technology export to China to help China to improve productivity, reduce carbon emission, and promote green growth and green transformation. While strengthening cooperation between China and the EU in intellectual property rights protection, the EU should remove controls of high-tech export to China as soon as possible. It should also eliminate technical barriers targeted at China, especially technical barriers such as Ecolabel.

4.2.3 Markedly reducing technical barriers to trade

EU member countries have set technical barriers in many areas. Its markets of electronic technology, aviation technology, ICT, life science and technology, and energy & environment technologies have not yet opened to developing countries. Meanwhile, it does not have unified investment approval procedures in its member states. This has led up easy abuse of anti-monopoly investigation and hindered Chinese enterprises' investment in the EU. To unleash the market potential of China-EU trade in services, the EU should give Chinese enterprises equal treatment enjoyed by enterprises from other market economies, cancel and stop setting technical and national security review barriers exclusively targeted at China, and further open up its service market to China, including business services, finance, telecommunications, distribution, tourism, education, transportation, medical and health care, construction, environment, and entertainment. In addition, the EU should prudently resort to anti-monopoly investigation.

4.2.4 Eliminating barriers to movement of persons involved in labor service cooperation

Facilitating movement of persons is a key to deepening China-EU cooperation. EU should further simplify procedures of application for travel, business, overseas study, medical care and work visas, and shorten application

[23] Yan Yunfeng, "The carbon emission leakage by China-EU trade", *Journal of Central University of Finance & Economics*, Vol.4, 2012

procession procedures. To eligible applicants, more convenient visa processing procedure should be applied. Meanwhile, EU should also explore the practice of issuing e-visas; extend the period of validity and duration of stay, and increase issuance of multi-entry visas.

4.3 Recommendations on deepening structural reforms in China

4.3.1 Advancing the opening-up of its service market

(1) Speeding up the anti-monopoly process in service sectors. China should strengthen the basic thinking of developing service sectors by promoting investment of private capital in order to eliminate administrative and market monopoly in the service sector, prevent market fragmentation, break up regional barriers and build up a unified and open service market characterized of fair and orderly competition. Various hurdles to the entry of private capital into such service markets as education, medical care, telecommunications and finance should be removed. And market capacity, quality and efficiency of service supply should be improved through fair competition.

(2) Accelerating the opening-up of the service market to foreign investors. China needs to practice institutions for “pre-establishment national treatment plus a negative list” at a quicker pace and shorten the negative list; pursue foreign investment registration system in service sectors. In general service sectors, the approval system for registration change of foreign-owned companies should be gradually transformed into a registration system. Procedures of foreign-funded enterprises’ information reporting, sharing and disclosure should be introduced. Such service sectors as finance, education, culture, and medical care should be opened up in a manageable manner. Restrictions on the entry of foreign capitals into service sectors including infant caring and elderly care, architecture design, accounting and auditing, commercial logistics, and e-commerce should be removed. Service outsourcing should be developed to upgrade the level of development of service sectors.

4.3.2 Raising the proportion of trade in services

On one hand, China could establish 3-5 more FTZs with a focus on service trade, significantly reduce restrictive measures on service trade in the negative list of each FTZ, and speed up generalization of successful FTZ practices nationwide. On the other hand, China should continue its efforts to launch bilateral and multilateral investment and trade liberalization negotiations with trade in services as a major issue, driving the development of trade in services with two-way opening-up of the service sectors. Thus, in 2020, China may well raise the share of trade in services in its total trade volume from 12.3% in 2014 to 20%, and its share of service trade in the world's total from 6.2% to 10%. This will help form a trade structure that promote balanced development of trade in traditional services and trade in modern services.

4.3.3 Deepening SOE reform

Breakthroughs in cutting SOEs' overcapacity could play an important role in changing industrial structure.

(1) Firmly cutting SOEs' overcapacity in areas with severe excess capacity. SOEs, especially in industries with severe overcapacity such as steel, coal, and non-ferrous metal industries, need to cut their overcapacity by way of optimization and reorganization so as to transform and upgrade themselves.

(2) Promoting strategic adjustment of state-owned capital allocation. China should formulate a classification reform program to readjust the strategic allocation of state-owned capital. This program should stipulate that state-owned capital should exit from general competitive sectors like real estate development and hotel management, that state-owned capital administration and management companies should be set up to push forward readjustment of strategic allocation of state-owned capital by guiding state-owned capital to exit from natural competitive sectors and competitive links of urban public utilities. At the same time, more state-owned capital shall be invested in public services for the goal of generally achieving equalization of urban-rural basic public services by 2020.

(3) Raising the proportion of state-owned capital gains transferred to national social security funds. Taking this as a key measure to reach the target of no lower than 30% of state-owned capital gains be transferred to public finance by 2020.

4.3.4 Raising the share of government purchase of public services in its total spending

Opening up of the public service sectors needs to be accelerated with government procurement of public services as an important measure. Restriction of areas on foreign service providers should be further lifted so that there will be multiple suppliers of public services in the market. Discriminatory policies against domestic private companies and social organizations regarding public services procurement should also be removed. With all these structural reforms, the share of government procurement in the total government spending could rise from 11.4% in 2014 to 15-20% by 2020, the share of government purchase of public services in the total fiscal expenditure could rise from 11.2% in 2014 to about 30% by 2020.

4.3.5 Deepening government reform with market regulation transformation as the priority

In recent years, the Chinese government has intensified its efforts to streamline administration and delegating power. For instance, the government has revised twice the Catalogue for the Guidance of Foreign Investment Industries. The number of investment items subject to central government approval is cut by 76%. More than 95% of foreign investment items and more than 98% of overseas investment items only need to make online registration. To cut costs and improve the effectiveness of market regulation, China has to make further concrete progress in streamlining administration, delegating power and improving services, speed up the process of market regulation transformation, and improve law-based market regulation.

Conclusion: Deepening China-EU cooperation faces a critical choice to make

In view of the new trend of globalization, of the overall China-EU relations, and of the trends and requirements of China and the EU's respective transformation and growth, China and the EU seizing the current opportunity for a China-EU FTA is a critical choice to make for joining hands to promote globalization and trade liberalization, it is a critical choice to make for deepening China-EU comprehensive strategic partnership, and it is also a critical choice to make for promoting their respective economic transformation and growth and for improving the global economic governance.

1. Trade liberalization is still an important engine for the world economic growth. The world economic history shows that growth and jobs created by trade facilitation and liberalization is far more than larger the growth and employment maintained by trade protection. For both developed and developing countries, trade protection may temporarily delay the pains brought by external competition, but would at the same time hold back the process of adjusting its own industrial structure. From a medium and long-term perspective, it will lead up to deep-rooted problems such as declining economic competitiveness and weaker innovation capacity. Since the eruption of the international financial crisis in 2008, trade protectionism, conservatism and populism are rising when external demand keeps slowing down and unemployment is deteriorating. With growing uncertainties in globalization, the growth of world trade has been below 3% for four consecutive years. As responsible major economies, China and the EU should play a key role at such a critical time.

2. Firmly pushing forward market opening-up with service trade as a priority. Trade in services has become an important driver for global trade growth and economic growth. Currently, both developed and developing economies are facing the challenge of different forms of service trade barriers. In the context that global free trade rules for services are still largely absent, China and the EU should push forward two-way opening of their markets with trade in services as the focus, so as to significantly increase the share of service trade, and to promote more inclusive service trade rules.

3. Prioritizing economic and trade cooperation to drive comprehensive cooperation in social, cultural and governance areas. For more than 40 years since the establishment of diplomatic ties, China-EU relations on the whole have been pursuing a pragmatic route by prioritizing economic and trade collaboration. China has become the EU's second largest trading partner, and the EU has become China's largest trading partner and the most important source of high-tech. Based on close economic and trade relations, there has been increasing comprehensive cooperation in social, cultural, environmental, and global governance fields. An FTA based on economic complementarity and win-win, while significantly improving the consumer’s welfare, will also promote China and the EU’s respective industrial restructuring and upgrade, and help both sides in increasing employment and improving social welfare.

4. The "market economy status" (MES) should not become an obstacle to China-EU FTA. From a global perspective, there is no single model for market economy; from a historical perspective, the market economy system is still on the way of continuously improving. Since 1978, China has been keeping on exploration and by sticking to the orientation of socialist market economic reform, has established a socialist market economic system and become the world's second largest economy. This is not only of great significance for China's development, but also a great contribution to the world development. The EU has already signed a free trade agreement with Vietnam, and is negotiating an FTA with India. China and the EU need to eliminate unnecessary political interference and start the China-EU FTA process as soon as possible.

5. China and the EU should take their own responsibilities to deepen their structural reforms. Against the backdrop of slowing global demand with global overcapacity in many traditional industries, both China and the EU should promote their respective economic transformation through deepening economic and trade cooperation with outside world. China has already laid down a clear timetable to cut overcapacity, and the EU also needs to have one for the adjustment of its traditional industries and the corresponding employment. Both parties should take their own responsibilities to solve the structural unemployment problem by deepening structural reforms, but should not simply attribute the problems to free trade.

6. China and the EU should join hands in pushing forward global trade liberalization. The establishment of a FTA between the world's largest developed economy and the world's largest developing economy, if making more open, inclusive, mutually beneficial and win-win cooperation rules for trade and investment, will provide a model for free trade cooperation between other developed and developing economies and make a unique contribution to the rebalancing of the global economy and to the improvement of global governance.

Starting the process of China-EU FTA process to integrate the two largest markets in the world is an extremely important choice for China and the EU to make. With this choice, China and the EU will win at the turning point in the 21st century. This is also an important choice for the sustainable growth of the world economy. China and the EU need to enhance exchanges and dialogues at multiple levels among member governments, businesses, think tanks, societies and public opinions in order to reach consensus on the establishment of a China-EU FTA at an early date.

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