



Swiss representation: <b>Beijing</b>	Ref.: 512.0-2 / BZD/HBD/PIA/HGC/STEYA
Country: <b>China</b>	Last Update: November 2014

# Economic report: China

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### Key Messages

- *The bilateral Free Trade Agreement signed between the two countries on 6 July 2013 entered into force as of 1st July 2014.*
- *President Xi has committed to improving the legal framework and the rule of law during the Fourth Plenum of the 18th Central Committee of the CPC*
- *The third quarter of 2014 confirms the decelerating trend this year with real GDP growth of 7.3%YoY, the lowest since the financial crisis.*
- *The slowdown of the property activity has accelerated since the beginning of this year.*
- *China's headline CPI inflation has been going down since May (2.5%YoY), showing its lowest value this year in September (1.6%YoY).*
- *Chinese consumption has so far failed to offset weaker investment. Not only the total retail sales of consumer goods growth rate slowed, but also real household consumption decelerated.*
- *Local governments have planned trillions of yuan worth of investment projects in railways, energy and water conservancy.*
- *Easing lending rules for second-home buyers through discount on mortgage rates and down payment requirement cuts.*
- *New liquidity was offered to the financial sector by injecting RMB 500 billion to the five biggest banks in September and another RMB 200 billion in October through open market operations and a repo rate cut*
- *On the commercial services imports side, China overtook Germany as the second largest trader, just right after the US.*
- *China has become a source of outward direct investments (ODI) reaching a new record of USD 107.84 bn. in 2013. Compared with the previous year, this is an increase of 22.8%. Looking at this growth rate, ODI is expected to outstrip FDI still in 2014.*
- *China was Switzerland's third most important foreign trading partner.*
- *The Swiss National Bank and the People's Bank of China signed a currency swap agreement, in July 2014. The swap agreement enables renminbi and Swiss francs to be purchased and repurchased between the two central banks, up to a limit of 150 billion renminbi, or CHF 21 billion.*
- *At present, around 600 Swiss firms with over 1000 branches are represented in China, employing more than 200'000 people.*
- *Compared to 2013, sales and profits have slightly improved and Swiss companies tend to be more optimistic than a year ago.*
- *On July 2nd this year, the Sino-Swiss Zhenjiang Ecological Industry Park (SSZEIP) was officially inaugurated by the Swiss State Secretary for Economic Affairs.*

## 1 Appreciation of the economic situation

After decades of rapid growth based on an economic model driven largely by exports and investments, China intends to more evenly share the benefits of its expansion among the population in the long run, filling the wealth gap created by rampant urbanization between rural and urban areas, raising living standards for the masses and lowering poverty and disparity within China. In opting for a more sustainable model led by consumption, innovation and quality, **China's leadership is embarking on a new round of reform which is setting new standards through a significant push towards a more market-based approach, streamlining administration, and delegating power. At the same time, the Chinese leadership also** seems to accept the effects of such structural adjustments on its economy, meaning lower growth rates in the short term, *in fine* sacrificing quantity over quality. "A *new Normal of China's economy has emerged with several notable features*," President XI said in his speech at the Asia-Pacific Economic Cooperation CEO Summit in Beijing in November. "First, the economy has shifted gear from the previous high speed to a medium-to-high speed growth. Second, the economic structure is constantly improved and upgraded." Third, the economy is increasingly driven by innovation instead of input and investment," he added.

As a rising economic superpower and future net investor of capital, now facing the challenges of lower growth dragged by a resilient property downturn, risky shadow banking, and local government debt, China has every interest to avoid the unsustainable path of artificial supports of its domestic economy through old style excessive investment plans and cosmetic policies, but rather to choose the virtuous path of fair market-oriented reforms and unconditional support to the new norm of economic growth. With the application of the anti-corruption law, as well as the central government's strong commitment to the rule of law during the Fourth Plenum of the 18<sup>th</sup> Central Committee of the CPC, China is indeed moving in the right direction, offering more transparent and fairer framework conditions to the markets.

**The third quarter of 2014 confirms the decelerating trend this year with real GDP growth of 7.3%YoY, the lowest since the financial crisis.** While real GDP growth rates in Q1 and Q2 2014 were more or less stagnant with respective values of 7.4%YoY and 7.5%YoY, real GDP growth in Q3 slowed down to 7.3%YoY, the lowest figure since Q1 2009. The weaker figure is to be understood against the persistent property market downturn in the economy, a more pronounced deceleration in industrial production, and the effects of policies addressing financial vulnerabilities and structural constraints through market-oriented reforms. While property sales dropped by 13% in Q3, having a negative drag on the economy as it held back fixed investment and demand for heavy industry products, industrial production growth contracted from 8.9% in Q2 to 8% in Q3. Although China missed its initial growth target of 7.5%YoY, the recent comments from President Xi showed that China now will tolerate a growth range of 7.0-7.5% YoY, as the government intends to put the economy on a more sustainable path putting more importance on controlling employment, price level, and financial vulnerabilities.

Although food price inflation gathered pace in September driven by vegetables and egg prices, **China's headline CPI<sup>1</sup> inflation has been going down since May (2.5%YoY), showing its lowest value this year in September (1.6%YoY).** China's PPI<sup>2</sup>, which has been contracting the whole year, regained some strengths in Q2 with a decrease of only 0.9%YoY in July, before going into free fall, contracting by the higher pace of 2.2%YoY in October. This illustrates both the currently weaker economic activity and the industrial overcapacity. Official unemployment at year end 2013 stood at 4.1%, and despite the obvious overall slowdown, the government announced that in the first nine months of 2014, a total of 10 million new urban jobs were created, hitting the annual target ahead of schedule. However, the unemployment statistics are

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<sup>1</sup> Consumer Price Index

<sup>2</sup> Producer Price Index

notoriously unreliable in China. As employment becomes an important driver of Chinese economic policies, it is crucial that in the future unemployment statistics are shaped in a way that they reflect as closely as possible the working age population in both rural and urban areas.

Lower investment growth reflects the view that the Chinese economy is shifting from its traditional growth model which depends too much on investment on land and buildings towards a more sustainable model driven by consumption, innovation and quality. Chinese policies point in that direction, but **consumption has so far failed to offset weaker investment**. This is clearly visible in this year's figures: fixed asset investments, a hitherto major contributor to the economic performance, dragged down by a further deceleration of manufacturing investment, has slowed down significantly. Monthly figures of fixed asset investments show a slower growth of 16.1%YoY in September 2014, well below the 19.6%YoY in December 2013.

Not only the total retail sales of consumer goods growth rate slows from 12.5% in May to 11.9% in August, and real household consumption decelerated from 7% YoY in Q2 to 6.5% YoY in Q3, but also the negative growth of the total sale of commercialized residential buildings continued accelerating from -9.9% in April to -10.9% in August.

**The slowdown of the property activity has accelerated since the beginning of this year.** The real estate supply has been growing faster than the demand, and investment demand for housing is cooling down while inventories continue to build up. Property sales declined by 10.3% YoY in September and dropped by 12.7% in the third quarter of 2014, while contracting by 7.5% in Q2. The property downturn forced the government to announce new supportive measures. While purchase restrictions in all cities outside Tier 1s (Beijing, Shanghai, Guangzhou, Shenzhen) were relaxed, support for social housing construction increased and cheaper mortgages were proposed. New property construction has increased by 4.7% in Q3 in comparison to the same period last year. Despite this temporary increase, the overall trend is a significant reduction in construction activities, as the Q3 figure follows Q2's contraction of -10.5%. Cumulated growth rate of floor space of commercialized residential real estate started this year shows a decrease of -13.5% in September, while it was growing by 11.6% in December last year, meaning that a construction volume correction is still in progress and supply is adapting to a shrinking demand.

Usually property bubbles are merely analysed from the price correction angle. However in the China context, experts estimate the construction volume correction is more important than the impact of the price correction, as the construction sector is such an important pillar of China's growth. Therefore a drop in the construction volume of 10% could result in a loss of 2.5% in GDP growth given the fact that not only property developers but also heavy industries like metals, construction materials and machineries will be strongly affected. Demand for heavy industry products such as cement and steel has decreased, while industrial production growth contracted from 8.9% in Q2 to 8% in Q3. The financial sector would then suffer most from the worsening of the balance sheets of constructors, corporates, loans collateralized by property, future projects and land. Given that transaction volumes have fallen and prices have been cut, repayment of debts for developers is getting increasingly difficult due to liquidity problems, explaining the easing of restrictions. Whereas increased migration and old housing stock will sustain a demand for new housing, the pace of supply will have to come down markedly as currently there is far too much unused housing on the market. According to the World Bank, home inventory levels have more than doubled since the start of 2013 for the country's biggest cities, Beijing, Shanghai, Guangzhou and Shenzhen. This is likely to be the end of an era when a secular property and construction boom was the main engine driving domestic demand.

However, the likelihood of a crash which would result in a financial crisis or a balance of payment crisis is relatively low, as household balance sheets are strong and could weather a downturn. Furthermore, whereas some local governments see growing liquidity problems, the central government has large firepower to intervene. As a first positive sign that the government is tackling this problem, in October, the State Council announced new rules for local government bond issuance and debt management, which could result in restructuring existing local

government debt stock and reducing systemic risk for the Chinese financial system. Another challenge for the Chinese authorities will be to balance the envisaged liberalization in the market with keeping in check the potentially harmful excesses in the shadow banking sector.

As a consequence of the above, GDP growth could be missing the official target of 7,5% for this year, with an additional weakening in 2015. Bearing in mind the recent policy announcements and the effects of structural reforms towards both a market-oriented economy and a business friendly environment (rule of law, anti-monopoly law, anti-corruption law), China is likely to take a more sustainable path led by consumption and innovation, where private investment could gradually replace public investment in the mid run.

Nevertheless, in the short run, policies aimed at boosting consumption and investment, as well as actions supporting the sluggish property market represent the main priorities. While China's government has now facilitated investment approval procedures, **local governments have planned trillions of yuan worth of investment projects in railways, energy and water conservancy**, opening them to private investment partnership PPP. Besides, Chinese policy makers have relaxed property lending policies, agreeing on a large amount of measures, such as **easing lending rules for second-home buyers through discount on mortgage rates and down payment requirement cuts**. Also due to weak foreign exchange inflows, the PBC has decided to further intervene, **offering liquidity by injecting RMB 500 billion to the five biggest banks in September and another RMB 200 billion in October through open market operations and a repo rate cut**. Among others, these policies aim to counter the downward pressure on the economy and keep the growth rate in the government target range. While these policies should stimulate small businesses, innovative industries, as well as enhancing living standards and consumption, the impact on the economy will be far lower than in 2008 and 2013 where major infrastructure investments led to a rebound of the economy.

On its way to rebalancing the economy, it is clear that should the government be serious about getting the economy away from export-led and investment-driven growth, this will only be possible with lower GDP growth rates in the short run. Reform-induced growth however cannot be expected to reach again levels seen during the 30 years of rapid growth after the first market oriented reforms of the Deng Xiaoping era. Research by the World Bank and the Chinese Development Research Center showed that reforms would increase China's potential growth by about 0.8 percentage points in the first year. Spread over five years, reforms would raise China's growth potential by a total of 3.5 percentage points.

From a political point of view, the **conditions for economic reforms have kept improving since the leadership change, announcing many key reforms**. President XI very quickly managed to consolidate his power with his anti-corruption and mass-line campaigns and keep his adversaries and vested interests opposing reform in check. With the strong application of his anti-monopoly law resulting in an impressive distribution of fines among both domestic and foreign companies, he strongly pledged for more competitiveness in the Chinese economy, while the food safety law which took effect on the 1<sup>st</sup> of May underlined the importance of quality over quantity in the economy. Even though the market agrees that these reforms are truly necessary in the long run, the impact of these reforms was seen as unfair and arbitrary by many foreign companies<sup>3</sup>. Following **President XI's full commitment to the rule of law during the Fourth Plenum of the 18<sup>th</sup> Central Committee of the CPC**, which took place in Beijing on the 20-23<sup>rd</sup> of October, guarantees of a fairer and more trustful implementation of the law for all investors have been offered. After the business sentiment among foreign investors has markedly weakened in the current year due to uncertainties surrounding the implementation of the anti-Monopoly and Anti-Corruption campaigns, the announced judicial reforms are expected to enhance the business climate in China. Eventually a positive impact on private investment and business

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<sup>3</sup> The EU Chamber of Commerce in China: "Position Paper 2014/2015"

developments can be expected, while innovative and high-end companies will be benefiting from greater protection with regards to their intellectual property rights.

## 2 International and Regional economic agreements

### 2.1. China's Policies and Priorities

#### 2.1.1. Protectionism vs. Liberalization

China's leadership is strongly focused on energizing economic reforms balancing between protectionism through strong state intervention, mainly in favor of its SOEs, versus liberalization. Obviously, the diminishing reliance on Western markets for exported Chinese goods implies a strategy geared towards increasing domestic demand and market diversification. One of the most recent examples in this regard is the import tariff on coal between 3-6% that China - as the world's main coal producer and consumer - levied mid-October to protect its own mining industry.

Meanwhile, China is the most important power in terms of trade volume and import growth, hence gaining in influence in international trade policy. Regional and bilateral trade agreements are currently proliferating. China keeps engaging in multilateral trade discussions and protecting its interests within the WTO, while keeping the conclusion of **bilateral and regional trade agreements** with strategic partners at the top of the foreign economic agenda.

#### 2.1.2. China and the WTO

In the WTO accession process, China has been categorized as a developing country, benefiting from special treatments and exclusions within the WTO. It is a classic example of an **emerging economy still benefiting from these advantages**, despite the tremendous economic development. Most industrialized countries claim that emerging economies should make more concessions than other developing countries. China made far-reaching commitments on market opening and liberalization unparalleled in GATT and WTO history. Although China is perceived in many fields as a **constructive partner**, particularly in issues typically affecting emerging markets, it has **not adopted the leading role expected by most countries yet**.

China's recent experience with the **WTO's Dispute Settlement Body (DSB)** suggests that the country is gradually internalizing the non-discrimination principle embodied by the multilateral trading regime, committing to comply with all DSB rulings and redress its WTO-inconsistent policies in a number of cases. In March this year, the WTO confirmed that China had lost a case on rare-earth metals as China's export duties on rare-earth metals were inconsistent with WTO obligations.<sup>4</sup>

By the end of 2013, China had been accused 31 times in 19 different cases of violations of WTO rules or accession obligations, mainly for illegally restricting access to its domestic market through anti-dumping duties or promoting its domestic industry through illegal subsidies. Nevertheless, China faces fewer complaints than the EU or the US during the same period of time.<sup>5</sup>

#### 2.1.3. FTAAP, RCEP vs. TPP, ITA

East Asia and Asia-Pacific are the most dynamic zones for FTA activity in the world with 107 free trade agreement projects and 75 already into force or signed.<sup>6</sup> There was a race between the **US-led TTP (Trans-Pacific Partnership)** and **China-led RCEP (Regional Comprehensive Economic Partnership)** to determine who will shape the architecture of regional trade

<sup>4</sup> <http://online.wsj.com/news/articles/SB10001424052702304418404579463073051039380>

<sup>5</sup> [http://www.swp-berlin.org/fileadmin/contents/products/research\\_papers/2014\\_RP01\\_hlp.pdf](http://www.swp-berlin.org/fileadmin/contents/products/research_papers/2014_RP01_hlp.pdf)

<sup>6</sup> <http://www.imd.org/uupload/IMD.WebSite/EvianGroup/Web/982/Free%20Trade%20Agreements%20in%20the%20Asia.pdf>

liberalization. Both RCEP and TPP are not only trade, but also geopolitical rivals, however the TPP aims rather at creating the next generation of trade rules while RCEP is trying to build a unified market by eliminating the FTA proliferation's 'noodle-bowl'-effect.

With the **FTAAP (Free Trade Area of the Asia-Pacific)** - being a substantial extension of RCEP - China both seized the opportunity to influence trade policy in the Pacific and position the FTAAP as the newest next generation trade policy standards. Although China wanted to use the APEC Summit at the beginning of November as a platform to announce the launch of a feasibility study for the FTAAP (Free Trade Area of the Asia-Pacific), the US and Japan opposed the actual start of negotiations. At the end, all rather agreed on a strategic study, named *the Beijing Roadmap*<sup>7</sup>, which commits APEC economies to advancing the process by 2016 towards the eventual realization of the FTAAP on a later stage. China achieved substantial successes defining TPP as a pathway towards FTAAP and fading the US objective of the TPP setting new trade rules.

China - as host of the APEC - demonstrated how to assume power by leading both regional integration and international trade developments, also announcing with the US a new agreement on lowering tariffs for more than 200 Information and Technology products through an extension of the **WTO's Information Technology Agreement (ITA)**.

The future prospects of RCEP will depend on the maintenance of good diplomatic relations amongst the negotiating parties. The RCEP negotiations should be concluded by 2015, accounting for 27% of global trade with a combined GDP of \$21 trillion, covering a 3 billion people market.<sup>8</sup> RCEP's 5<sup>th</sup> round of negotiations was held in Singapore in June, the RCEP Economic and Trade Ministers met in Myanmar in August and the 6<sup>th</sup> round will be held December 1-5<sup>th</sup> in New Delhi. So far, progress was made in Trade in Goods, Trade in Services, Investment, Intellectual Property, Competition, TBT/SPS, Customs Procedures and Trade Facilitation and Rules of Origin, as well as Standard, Technical Regulations and Conformity Assessment Procedures (STRACAP).<sup>9</sup>

The TPP represents 30% and 40% of global trade and GDP respectively. TPP Ministers met on 27<sup>th</sup> October in Sidney and convened again during APEC early November in China. While the conclusion of the TPP is aimed for H1 2015, it remains unclear when it will be finalized, partially because of domestic reluctance within the US Senate. The original TPP fundament was laid on inclusive, rule-based multilateralism to align and not divide the Asia Pacific in a cohesive pact. Korea has recently completed a comprehensive preferential trade arrangement with the US and aims at joining the TPP, along with India, Taiwan, Thailand and the Philippines.<sup>14</sup> As Chinese Vice-Minister of Finance ZHU Guangyao states, any trade bloc that would not include China would be considered as incomplete.<sup>15</sup> China is the major trading partner for most RCEP and TPP members. The question is not whether China will join the TPP *per se*, but rather whether it will be admitted to actively participate in the shaping process.

The **CEPA (Closer Economic Partnership Agreement)** between mainland China, Hong Kong and Macao was the first regional trade agreement concluded in 2004. In 2010, **CAFTA (China-ASEAN Free Trade Agreement)** came into effect, which was followed by APT (ASEAN Plus Three: China, Japan and South Korea), representing RCEP's base. Since then, China has concluded numerous bilateral FTAs with **Costa Rica (2010), Pakistan (2009), Senegal (2008), Peru (2008), Singapore (2008), Chile (2008) and New Zealand (2008)**, the latter being the first industrialized country to sign an FTA with China. The FTA of **Iceland and Switzerland** both

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<sup>7</sup> [http://www.apec.org/Meeting-Papers/Leaders-Declarations/2014/2014\\_aelm/2014\\_aelm\\_annexa.aspx](http://www.apec.org/Meeting-Papers/Leaders-Declarations/2014/2014_aelm/2014_aelm_annexa.aspx)

<sup>8</sup> <http://mfat.govt.nz/Trade-and-Economic-Relations/2-Trade-Relationships-and-Agreements/RCEP/index.php>

<sup>9</sup> <http://www.mfat.govt.nz/Trade-and-Economic-Relations/2-Trade-Relationships-and-Agreements/RCEP/#negot>

<sup>14</sup> <http://www.eastasiaforum.org/2014/03/20/china-debates-the-tpp/>

<sup>15</sup> <http://thediplomat.com/2014/10/will-china-join-the-trans-pacific-partnership/>

entered into force on July 1<sup>st</sup> 2014. Some amendments to the Agreements with for instance Chile and New Zealand are being renegotiated on certain aspects such as Rules of Origin.

#### **2.1.6. Free Trade Agreements under Negotiation**

The conclusion of the negotiations for an FTA with **Australia** was announced during the G20 summit in Brisbane on 17 November 2014 after 19 rounds of negotiations. This will be followed by a legal scrubbing taking up to 5 months, the signature in April-May 2015 and the entry into force presumably on January 1<sup>st</sup> 2016. China is Australia's largest trade partner and biggest export market, while Australia is China's largest overseas investment destination. The aim for Australia was to reach a FTA which is substantially at least equivalent to the New Zealand FTA. Korea and Australia signed a bilateral FTA in April 2014.

China and **South Korea** announced the **substantial conclusion** of the bilateral FTA at the APEC summit this November after 14 rounds of negotiations since March 2012. The China-South Korea FTA has the widest coverage and biggest trade volume among the bilateral FTAs China has concluded so far, covering e-commerce and government procurement. The tariff modalities are divided in NSI (Non-sensitive Items), SI (Sensitive Items) and HSI (Highly-sensitive items). Seoul and Beijing tentatively agreed to abolish tariffs on 90% of all products and 85% of imports by value.<sup>16</sup> Furthermore, a RMB clearing bank was opened in Seoul by the Chinese Bank of Communications on November 6<sup>th</sup>. China, **Japan and Korea** launched their **trilateral FTA** negotiations in November 2012, with the 5<sup>th</sup> round held in September in Beijing. So far, working group meetings were held on trade in goods, services, IPR and e-commerce. Whether or not to include environmental standards, government procurement and food sectors is high on the agenda.<sup>17</sup> The combined GDP of the three countries represents 70% of Asian and 20% of the global GDP and the combined trade volume accounts for 17.5% of global trade.<sup>18</sup>

China and **Sri Lanka** launched the FTA negotiations during the visit of President XI to Sri Lanka, the first of a Chinese Head of State in 28 years. The conclusion is aimed at June 2015.<sup>19</sup> The trade balance remains significantly in favor of China; the latter is also Sri Lanka's largest loan provider since the end of the war for infrastructure such as roads, railways, airports, ports and coal power plants.

**Norway** and China launched FTA negotiations in 2008, which were halted after 8 rounds because of the Nobel incident in 2010. According to Vice-Minister of Commerce YU Jianhua's statement, which reflects the Chinese status since then, Norway has raised demands deemed difficult for Chinese industries for which neither side has proposed solutions. The negotiations are still halted and Norway would welcome any Chinese initiative to resume them. Norway supported the granting of Arctic Council observer status to China in order to normalize their bilateral relations.

The **Gulf Cooperation Council (GCC)** and China launched FTA negotiations in 2004 and stalled in 2009 after five rounds, as China wishes to exclude services. President XI Jinping called for resuming the negotiations during the visit of King of Bahrain Sheikh Hamad bin Isa Al-Khalifa in September 2013. In January this year, the GCC rotating president - Kuwait's First Deputy Prime Minister - and the Chinese Minister of Foreign Affairs met to sign the 2014-2017 Action Plan putting the resumption of FTA negotiations high on the agenda.<sup>20</sup>

China is also an **APTA (Asia-Pacific Trade Agreement)** signatory, formerly known as Bangkok Agreement, signed in 1975 as an initiative of the UNESCAP (United Nations Economic and Social Commission for Asia and the Pacific). The fourth session on the APTA Ministerial Council

<sup>16</sup> <http://www.asiabriefing.com/news/2014/09/china-nears-free-trade-agreements/>

<sup>17</sup> <http://www.thebricspost.com/china-japan-s-korea-fta-talks-constructive/>

<sup>18</sup> [http://news.xinhuanet.com/english/china/2014-03/04/c\\_133159106.htm](http://news.xinhuanet.com/english/china/2014-03/04/c_133159106.htm)

<sup>19</sup> <http://english.peopledaily.com.cn/n/2014/1029/c90883-8801277.html>

<sup>20</sup> <http://www.kuna.net.kw/ArticleDetails.aspx?id=2355934&language=en>



on tariff concessions is scheduled for 2014.<sup>21</sup> In June 2004, China and **SACU (Southern Africa Customs Union)** announced the launch of free trade negotiations. So far, no negotiations have taken place.

### **2.1.7. Free Trade Agreements under Consideration**

While the Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada is to be concluded, the 7<sup>th</sup> round of negotiations of the **TTIP (Transatlantic Trade and Investment Partnership)** between the US and the EU shows progress in market access, services, investment and agricultural non-tariff barriers.<sup>22</sup> China has expressed strong interest in negotiating a **EU-China FTA** despite the anti-dumping disputes earlier this year. However, from the European side, this option will only be taken into consideration once the EU-China Bilateral Investment Treaty (BIT) is concluded and remedies to obstacles such as subsidies, export credits and cheap loans are found. The BIT negotiations were officially launched in November 2013 and the 1<sup>st</sup> round of negotiations took place at the end of January 2014 in Beijing. China has already separate BITs with every EU Member State except for Ireland; however the new China-EU BIT would supersede the previous individual agreements.<sup>23</sup>

A **US-China** bilateral FTA lies further ahead on the horizon of both most powerful economies, although the US aims first at concluding the TPP and the China-US Bilateral Investment Treaty.<sup>24</sup> Both economies agreed last July to restart stalled negotiations on the BIT launched in 2008; the 15<sup>th</sup> round was held in September in Beijing. Both countries are still of divided views on domains such as SOEs, IPR protection, transparency and formulation of standards and guidelines.<sup>25</sup> While a conclusion initially aimed for the end of 2014 is rather unlikely, the second phase on the negative list negotiations started.<sup>26</sup> The regime created by a China-US BIT could significantly accelerate the reform of Chinese FDI regime, which has slowed down in recent years, and in fact give impetus to China's domestic reforms.

A feasibility study for a **China-India** Regional Trade Agreement was completed in 2007 and President Xi expressed the desire to start FTA negotiations with India to mitigate the Indian trade deficit of no less than \$37 billion. The Indian government and industries however still remain concerned by the influx of Chinese goods and are reluctant to start negotiations in the near future. During the XI-Modi Summit in September, a dozen economic agreements were signed and XI announced investments up to \$20 billion in India in the next 5 years.<sup>27</sup>

China, as Mongolia's main importer of mineral resources, initiated feasibility studies for a FTA with **Mongolia** in 2010. An agreement in economic and technological cooperation was signed during WU Bangguo's visit to Mongolia early 2013, which was the first high-level visit to Mongolia in 16 years.<sup>28</sup> In October 2013, Prime Minister Norov Altankhuyag held talks with Premier Li Keqiang, the latter underlining that China would be ready to discuss the establishment of a bilateral FTA.<sup>29</sup> In August, President Xi visited Mongolia, whereas 26 Agreements on cooperation in finances, commerce, energy and infrastructures were signed, among them an economic cooperation agreement.<sup>30</sup> The internationalization of the RMB is also of highest priority and a swap-agreement was signed. Mongolia seeks an APEC-Membership and Mongolia's President has attended the Summit in Beijing at the beginning of November with

<sup>21</sup> <http://fta.mofcom.gov.cn/topic/enpacific.shtml>

<sup>22</sup> [http://trade.ec.europa.eu/doclib/docs/2014/october/tradoc\\_152859.pdf](http://trade.ec.europa.eu/doclib/docs/2014/october/tradoc_152859.pdf)

<sup>23</sup> <http://www.economonitor.com/blog/2014/01/china-eu-investment-pact-on-the-right-track/>

<sup>24</sup> <http://www.vcc.columbia.edu/content/china-united-states-bit-negotiations-chinese-perspective;http://www.ft.com/intl/cms/s/0/b8b391ec-a634-11e3-8a2a-00144feab7de.html#axzz2z7cnKe5r>

<sup>25</sup> <http://www.aastocks.com/en/stocks/analysis/china-hot-topic-content.aspx?id=200000379028&type=3&catq=2>

<sup>26</sup> [http://www.china.org.cn/business/2014-07/10/content\\_32907444.htm](http://www.china.org.cn/business/2014-07/10/content_32907444.htm) ;

[http://www.paulsoninstitute.org/media/102532/bit\\_by\\_bit\\_pricesmart\\_english\\_final.pdf](http://www.paulsoninstitute.org/media/102532/bit_by_bit_pricesmart_english_final.pdf)

<sup>27</sup> <http://www.nzz.ch/international/geld-und-grenzen-1.18386523>

<sup>28</sup> [http://usa.chinadaily.com.cn/world/2013-01/31/content\\_16188990.htm](http://usa.chinadaily.com.cn/world/2013-01/31/content_16188990.htm)

<sup>29</sup> [http://www.fmprc.gov.cn/mfa\\_eng/](http://www.fmprc.gov.cn/mfa_eng/)

<sup>30</sup> <http://uk.reuters.com/article/2014/08/18/uk-china-mongolia-idUKKBN0GI0SW20140818>

observer status. XI also invited Mongolia to become SCO Member and proposed to launch exploratory talks for a China-Mongolia FTA. Japan and Mongolia signed an Economic Partnership Agreement in July.<sup>31</sup>

Now that the *Foreign Investment Protection Agreement* (FIPA) between **Canada** and China entered into force on October 1<sup>st</sup>, both countries are holding exploratory talks on a potential FTA. Launching a FTA with **Brazil**, **Colombia** or **SCO** (*Shanghai Cooperation Organization*) are also in China's FTA expansion strategy, however this general trend may lead to an increasingly complicated effect where one agreement overlapping another, synergies among them will have to occur sooner rather than later.<sup>32</sup>

## 2.2. Outlook for Switzerland

On July 6<sup>th</sup> 2013, the **China-Switzerland FTA was signed** by Federal Councillor Johann N. Schneider-Ammann and Chinese Minister of Commerce GAO Hucheng and **entered into force on July 1<sup>st</sup> 2014**. The FTA contains chapters on trade in goods, trade in services, rules of origin, customs procedures and trade facilitation, technical barriers to trade (TBT) and sanitary and phytosanitary measures (SPS), trade remedies, intellectual property rights, competition, investment promotion, government procurement, trade and sustainable development, dispute settlement, legal and institutional matters, economic and technical cooperation. Side Agreements on Labour and Employment, on Cooperation in the Area of TBT and SPS, Certification and Accreditation, Telecommunication and on Mutual Recognition of Test Results of Measuring Instruments have also been signed on this occasion.<sup>38</sup> It provides a legal framework including consultations and dispute settlement mechanisms. A **Joint Committee will meet at least every 2 years** and various **Sub-Committees** are set-up to monitor the implementation of the agreement. A first *Expert Meeting on the Implementation of Origin Matters* was held in October and a Sub-Committee on TBT/SPS will be held in early 2015.

The provisions of the FTA improve mutual market access for goods and services, enhance legal security for the protection of intellectual property and bilateral economic exchange in general, contribute to sustainable development and deepen bilateral cooperation. This represents a true window of opportunity for Switzerland, before China's focus could shift to other economies once new FTAs are signed and implemented. While it is too early to assess the exact impact of the FTA after five months of implementation, positive developments can be drawn not only in the area of trade, but in most areas of bilateral cooperation.

## 3 Foreign Trade

### 3.1 Development and General Outlook

#### 3.1.1 Trade in goods<sup>39</sup>

Exports growth increased (+15.3% YoY), while imports growth recovered in September (+7% YoY), following two months in a row of contraction (-1.6% YoY in July, -2.4% YoY in August). Despite weak domestic demand, a significant rebound of processing imports led September's imports growth recovery. In the first nine months of 2014, the cumulated Chinese exports reached USD 1.7 trillion (+5.1% YoY) and imports stood at USD 1.5 trillion (+1.3% YoY), compared to respectively USD 2.2 trillion (+7.9% YoY) and USD 1.95 trillion (+7.3% YoY) in 2013. Total trade volumes were respectively USD 4.16 trillion in 2013 and USD 3.2 trillion during

<sup>31</sup> [http://www.joc.com/international-trade-news/trade-data/asia-trade-data/japan-mongolia-reach-free-trade-agreement\\_20140722.html](http://www.joc.com/international-trade-news/trade-data/asia-trade-data/japan-mongolia-reach-free-trade-agreement_20140722.html)

<sup>32</sup> <http://aric.adb.org/fta/peoples-republic-of-china-colombia-free-trade-agreement>

<sup>38</sup> For all texts of the agreement, please refer to: <http://www.seco.admin.ch/themen/00513/00515/01330/05115/index.html?lang=en>

<sup>39</sup> Data mainly based on China's Custom Statistics

the three first quarters of 2014, leaving a trade surplus of respectively USD 259.73 billion (+12.4% YoY) and USD 231.6 billion. China's share in world merchandise exports account for 11.4%, putting the country in the lead before the US (8.6%) and Germany (7.8%).<sup>40</sup> Combined together with goods imports, **China has in 2013 overtaken the US as largest goods trader (total US trade volume USD 3.88 trillion<sup>41</sup>) and claimed back the position that the Middle Kingdom arguably had in the late Qing Dynasty (1644-1912).** The rise to dominance has been an extremely fast one, with the value of Chinese trade roughly doubling every four years over the past three decades. According to the IMF, imports and exports will in the coming years still grow faster than world trade overall, with China's share of world trade expected to reach 13.7% by 2018 (up from 3.7% in 2000, and 10.6% in 2012).

Between January and September 2014, in terms of traded goods, China exported almost as many high-tech machinery and electronics products (USD 114 billion) as textile garments (USD 116 billion), confirming the emerging shift from exporting textiles, apparel and oil products to high-end products. At the same time, imports of components brought to China for assembly are on the decline, indicating a **move away from the practice of importing cheap components for assembly and re-export.** Official figures show the processing trade made up 32.6% of total imports and exports in 2013, a drop from 34.8% in 2012.<sup>42</sup>

**Hong Kong, which is a separate customs territory,** has lost its rank as the Mainland's main trading partner since the beginning of the year, following political tensions. Indeed Chinese figures show a significant drop of exports to Hong Kong (USD 253.5 billion, -10.9% YoY) for the first nine months of 2014, while exports to the US surged (USD 285.7 billion, +7.5% YoY) during the same period. Nevertheless, as Hong Kong exports recovered a bit in September (USD 37.6 billion) from August (USD 29.5 billion), Hong Kong was once again China biggest exports market in September. Then Japan, which was the third biggest trade partner in terms of exports from China in 2013 (6.8%, -0.9% YoY), has received USD 111.4 billion of exports this year for the three first quarters (6.6%, +2.1%).

While discrepancies often exist between trading nations, the Chinese trade figures have in recent years been subject to distortions through fabricated transactions, especially in its trade with Hong Kong.

**On the import side, South Korea took the lead in 2013** (9.4%, +0% YoY), followed by Japan (8.3%, -9% YoY), Taiwan (8.0%, +18% YoY) and the US (7.8%, +15% YoY). In the nine first months of 2014 South Korea reinforced its leadership (9.6%, +4.4% YoY), still followed by Japan (8.3%, +1.6% YoY). Then the ranking changed slightly: the US is now taking the third place (8.1%, +4.9% YoY) whereas Taiwan is new on the fourth rank (7.6%, -6% YoY). Continent-wise, Asia has been the biggest goods seller to China and got the lion's share of total imports to China (55%, -0.1% YoY) due to its geographical advantage, followed by Europe (17%, +3% YoY) and North America (9.4%, +4% YoY) which have both helped China total imports to recover slightly, while Latin America (6.8%, +5.4% YoY) has displayed the fastest growth of imports to China led by a strong hunger for commodities and agricultural products.

### **3.1.2 Trade in services<sup>43</sup>**

According to the White Paper on China's foreign trade **China's international competitiveness in services trade has been enhanced,** especially since its WTO entry. From 2001 to 2010 **China's total services trade value (excluding government services) witnessed a more-than-five-fold growth from 71.9 billion USD to 362.4 billion USD.**<sup>44</sup> In 2013, commercial

<sup>40</sup> WTO International Trade Statistics 2013

<sup>41</sup> US Department of Commerce

<sup>42</sup> <http://www.ft.com/intl/cms/s/0/7c2dbd70-79a6-11e3-b381-00144feabdc0.html#axzz31eqWFKf7>

<sup>43</sup> Data mainly based on WTO International Trade Statistics 2013 and 2014

<sup>44</sup> Information Office of the State Council: White paper "China's Foreign Trade"; December 7<sup>th</sup>, 2011.

exports accounted for USD 205 billion (+7.7% YoY), while commercial imports stood at USD 329 billion (+17.4% YoY), resulting in a total trade in services of USD 534 billion (+13.5% YoY) and a trade deficit of USD 124 billion.

Worldwide, China stayed the 5<sup>th</sup>-largest exporter of commercial services in 2013, after the US, the UK, Germany and France. **On the commercial services imports side, China overtook Germany as the second largest trader, just after the US.** China's shares of world commercial exports and imports trade were respectively 4.4% (+7% YoY) and 7.5% (+18% YoY) in 2013, closing the gap with the leading nations in services trade. In comparison, the US commercial exports and imports made roughly 14.3% and 9.8% of the world total, while the Swiss ones accounted for 2% and 1,2%.

According to the WTO, China's exports of financial services (i.e. services provided by banks and other financial intermediaries) increased by 52% to USD 3 billion in 2013 in USD terms. Other notable changes include China displacing France to become the fourth-largest exporter of other business services (including engineering services, legal/accounting services, management consulting, advertising and trade-related services).

While the Bali summit early December 2013 saw an agreement in trade facilitation, the summit was overshadowed by the **failure to sign an Information Technology Agreement (ITA)**, an intended update to the 1997 version. Beijing was mainly blamed for this failure. In this environment, the **TiSA (Trade in Services Agreement) talks are slowly progressing.** TiSA not only seeks to open services sectors, but also to develop new rules, like those applied to government procurement of services, licensing procedures or access to communication networks. TiSA talks involve largely rich-world countries around the US and the EU that cover about 70 percent of global services with a value of USD 4 trillion.

**Domestically, China's services sector is on the rise.** While the tertiary sector in 2013 for the first time overtrumped the secondary sector with 46.1% (compared to 43.9% in the secondary sector), a number of industries (healthcare, education, and advertising) have seen a decline in share of GDP since 2005. About one-third of workers in China are employed in services, compared to three-quarters in the US. According to the 12<sup>th</sup> FYP, however, the tertiary sector is expected to contribute 47.2% of GDP by 2015, a tough target if manufacturing activity picks up again. In October, the HSBC China Services PMI showed that Chinese service providers remain optimistic towards the 12-month business outlook. The sentiment remained strong overall and according to the HSBC survey, confidence in the sector is linked to planned company expansions and expectations of improving client demand.

While the market might still not be fully developed in general terms, **one sector has seen a meteoric rise: e-commerce.** China is about to overtake the US as the global e-commerce leader. And with 600 million netizens (up from 2.1 million back in 2000) and an annual growth rate of 70 percent, the sector is forecasted to be larger than those of the US, Britain, Japan, Germany, and France combined by 2020.<sup>46</sup> Asked about the reason for this fast development, Jack Ma, founder of e-commerce giant Alibaba, finds that **"in other countries, e-commerce is a way to shop, in China it is a lifestyle."**<sup>47</sup> While this might be true, the weak existing offline alternatives and retail chains certainly also facilitated this incredible rise. By end 2014, the sector is expected to reach 10% of all retail in China.<sup>48</sup>

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<sup>46</sup> <http://www.chinainternetwatch.com/2007/china-e-commerce-market-2020/>

<sup>47</sup> <http://www.ptl-group.com/blogs/e-commerce-in-china-gain-entrance-into-a-completely-different-world>

<sup>48</sup> <http://www.forbes.com/sites/quora/2014/05/08/how-did-alibaba-capture-80-of-chinese-e-commerce/>

## 3.2 Trade with Switzerland

Between January and September 2014, China was **Switzerland's third most important foreign trading partner**. China was the largest buyer of Swiss industrial products in Asia and the fourth largest worldwide. Together with Hong Kong (where transit happens), China is after Germany (18.5% of total goods exports) and the US (12.3%) the third largest destination for Swiss industrial products (8.3%). Imports from China and Hong Kong are ranked fourth (9.3% of total goods imports) after Germany (28.2%), France (9.8%) and Italy (9.7%).

### 3.2.1 Trade in goods

**In the first three quarters of 2014, bilateral trade accounted for CHF 15.6 billion**, compared to CHF 14.6 billion for the same period in 2013. Switzerland exported goods to the value of CHF 6.6 billion to China (+12.1%YoY, 4.3% of all Swiss exports) with imports from China totalling CHF 8.9 billion (+7.5%YoY, 6.7% of total imports). This resulted in a **trade deficit for Switzerland of CHF 2.2 billion** so far in 2014 (in comparison with 2013 trade deficit of CHF 2.7 billion). At the same time, the Chinese Customs statistics recorded January-September export figures of USD 2.3 billion (-12.4%YoY, 0.14% of all Chinese exports) to Switzerland in comparison with USD 2.6 billion in 2013, while import of goods stood at 26.5 billion (-36.2%YoY, 1.8% of total imports) compared to USD 41 billion in 2013. Several factors play into this huge statistical difference, one of them can be identified as the trade in precious metals, which will be included in the Swiss trade statistics in future years. Discrepancies can also occur when goods are repackaged and/ or repriced or sold in transit (most commonly with processed goods). Finally, conceptual and methodological differences in the collection and processing of the trade data can be another reason.

Compared to last year where the main products exported by Switzerland to China remained watches and jewellery (2.7 billion, -7.8% YoY), machines and instruments (2.4 billion, +3.6% YoY), as well as chemicals and pharmaceuticals (2.2 billion, +43% YoY), exports of chemicals and pharmaceuticals took the lead (1.9 billion, +33.7% YoY) during the first eight months of 2014. Regarding imports, machinery (3 billion, +7.2% YoY), as well as textiles and clothing (1.4 billion, +7% YoY) were the main drivers of our bilateral trade with China. This reveals an interesting feature of Sino-Swiss bilateral trade, which is that the two countries trade essentially the same products, but in different price classes. In 2013, Swiss exports to Hong Kong mainly were comprised of watches, jewellery, precious metals and gemstones (86%) and imported products of the same class (84%).

After completion of the internal procedures on both sides, the **bilateral Free Trade Agreement** signed between the two countries on 6 July 2013 entered into force as of 1<sup>st</sup> July 2014. It is expected to boost bilateral trade in the coming years. More data would be needed to fully understand its impact on Sino-Swiss bilateral trade. In general, statistical data for the period from 1988 to 2008 show that Switzerland's trade with its FTA partners (measured in the first four years after the entry into force of the respective FTA) grew substantially faster than its worldwide international trade (total of exports plus imports). The comprehensive nature of the agreement will therefore create opportunities for the private sector to increasingly engage in bilateral economic activities. The subcommittees in the fields of Technical Barriers to Trade and Sanitary and Phytosanitary Measures (TBT/SPS) that entered into force together with the FTA further strengthened ties and facilitated economic cooperation.

### 3.2.2 Trade in services

Many Swiss service providers operate in China (including banks, insurance companies, logistics companies, goods and quality inspection companies, corporate consultants). For Swiss financial institutions, China is of strategic importance as their clients relocate production facilities to China or expand their investments in the country. Several Swiss banks (UBS, CS, ZKB and Bank Julius Baer) are currently present in mainland China. While market access is still limited, Swiss banks proved to be well positioned to engage in the opening of new business opportunities in

China at an early stage. Conversely Chinese service providers show increasing interest in Switzerland as a business location

The FTA is expected to provide a better framework for service providers on both sides to provide their services in either economy. Compared with the GATS, improvements were achieved for a number of additional areas such as environmental services (waste water treatment, cleaning services of exhausted gases and noise abatement services), financial services (in particular in securities), air transport services (aircraft maintenance and repair, ground-handling), logistics services (customs clearance services) and for suppliers of fixed-term contract services (in particular installers and maintainers of machines, architects and engineers).<sup>49</sup>

## 4 Direct investments

### 4.1 Development and general outlook

China attracted a record USD 117.59 billion in FDI in 2013, up 5.25 percent from a year earlier. In the same time period, newly approved foreign invested enterprises amounted to 22,773. From January to May 2014, newly approved enterprises amounted to 8,744, up by 1.6% year on year.<sup>50</sup>

**According to Chinese statistics of 2013<sup>51</sup>**, the top ten foreign investors in China according to foreign capital input, amounting to 93.15% of foreign investment in the country, were: Hong Kong (78.302 billion USD), Singapore (7.327 billion USD), Japan (7.064 billion USD), Taiwan (5.246 billion USD), USA (3.353 billion USD), South Korea (3.059 billion USD), Germany (2.095 billion USD), Netherlands (1.281 billion USD), UK (1.039 billion USD), and France (762 million USD).

It is noteworthy that the **actual use of FDI in the service sector was US\$61.45 billion, constituting over half of the total FDI in China for the first time.** This is in line with China's FDI policy of attracting foreign business from "quantity" to "quality" and to push its industry up the value chain. The social security service industry, electrical machinery repair industry and the entertainment industry were noticeable standouts.

**In April 2011 a new draft of the "Foreign Investment Catalogue" was released and the final version was published in December 2011, entering into effect on January 30<sup>th</sup> 2012.** Stipulating "encouraged," "restricted" and "prohibited" categories into which specific foreign invested projects fall, the Catalogue has long been a major guideline of China's market openness strategies. The following five investment areas shall be further encouraged: high-end manufacturing industry, high-tech industry, modern service industry, new energy industry and energy-efficient and environmentally friendly industries. Preferential policies for land use and tax breaks shall help attract foreign investment into these encouraged categories. The "negative list" approach piloted in the China (Shanghai) Free Trade Zone will according to the third plenum be the way the Chinese government will handle foreign investments in the future and mark a fundamental shift from the previous dirigiste approach.

**Investors' confidence in China is softening.** According to the 2014 Business Confidence Survey conducted by the European Chamber of Commerce, China will continue to remain a strategic market for European firms, although they are adapting to the new reality by setting more modest expectations for the Chinese marketplace. 68% of large companies stated that business in China has become more difficult over the last two years. Furthermore, European companies still perceive themselves to be discriminated against in the Chinese marketplace. It is

<sup>49</sup> SECO

<sup>50</sup> MOFCOM

<sup>51</sup> <http://english.mofcom.gov.cn/article/statistic/foreigninvestment/201402/20140200498911.shtml>

estimated that European companies that are members of the European Chamber missed out on EUR 21.3 billion in revenues in FY 2013 due to market access and regulatory barriers. Although there is careful acknowledgement of some positive policy developments, European firms remain sceptical and are yet to be convinced that real change is afoot.

Nevertheless, looking at the still fast development trajectory of China, it **is hard to justify not investing in China**. Over the course of the next decade, China's mainstream consumer is expected to explode from 6% in 2010 to 51% by 2020 as a percentage of urban households. The change is even more transformative if one considers the current government push for urbanization and the resulting influx of rural people to cities in the coming years.<sup>52</sup> **China therefore remains a top FDI destination.**

**China has also become a source of outward direct investments (ODI).** According to figures released by the Ministry of Commerce, the flow of outbound investment reached a new record of USD 107.84 bn. in 2013. Compared with the previous year, this is an increase of 22.8%.. From 2004 to 2011, China's outward investment grew substantially from 5.5 billion USD to 75 billion USD a year, and is expected to reach 150 billion USD by 2015<sup>53</sup>. In 2013, the US (13%), Australia (12%) and Canada (8%) were the main beneficiaries of China's growing ODI.<sup>54</sup> Looking at this growth rate, ODI is expected to outstrip FDI in 2014. The US is in the leading position mainly due to the acquisition of the agribusiness Smithfield Foods Inc. that was acquired by Shuanghui for USD 7.1 billion, the biggest Chinese acquisition of an American firm so far. At the same time, investments in Australia have seen a decline, indicating a slowdown of acquisitions in the resource industry also in Africa and Latin America. With its growing foreign reserves, **China's ODI is likely to grow further in the coming years.**

According to MOFCOM, about 90 percent of the total outbound investment went into the following six industries: commercial services, mining, wholesale and retail, manufacturing, construction and transportation.

In a speech after the Third Plenum, Mr. Gao Hucheng, Minister of Commerce, encouraged Chinese companies to **go overseas and set up research and development facilities, learn from advanced production practices, establish marketing and sales networks, develop their own brands, and improve their international competitiveness.** This is to be understood against the backdrop of the government's effort to move the economy up the value chain, one of the cornerstones of the 12<sup>th</sup> FYP. KPMG sees particularly the automobile and high-end equipment manufacturing industry as major beneficiaries of such ODI ventures.

As outward investment steadily increases, the Ministry of Commerce has revised the 'Administrative Regulations on Outward Investment'. Under the revised regulations, the approval procedures for outward investment will be further simplified, the role of enterprises as the main players in outward investment will be further consolidated, and the facilitation of outward investment will be increased. The measures will help minimize the scope of outward investments requiring approval.<sup>55</sup>

**China has been working towards the establishment of an Asia Infrastructure Investment Bank (AIIB).** A memorandum of understanding on establishing the AIIB was signed by China and 20 other Asian countries in October 2014. AIIB is planned to be formally established by the end of 2015 with an authorized capital of USD 100 billion. China is set to be its largest shareholder with a stake of up to 50%. The focus of the new multilateral bank – which is to be

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<sup>52</sup> [http://www.mckinsey.com/insights/asia-pacific/meet\\_the\\_chinese\\_consumer\\_of\\_2020](http://www.mckinsey.com/insights/asia-pacific/meet_the_chinese_consumer_of_2020)

<sup>53</sup> The Economist: "FDI with Chinese characteristics", September 6<sup>th</sup>, 2012.

<sup>54</sup> MOFCOM

<sup>55</sup> Key to Investment, October 2014 (Issue 18), CIEIT, International Investment Forum

headquartered in Beijing – will be to promote regional connectivity and economic cooperation as well as strengthening developing countries' say in international financial institutions.

In parallel with the AIIB, China has also been a driving force behind the envisaged establishment of a BRICS development bank (so-called **New Development Bank, NDB**). In July 2014 the BRICS (Brazil, Russia, India, China and South Africa) signed an agreement on the establishment of the NDB which will be headquartered in Shanghai. The purpose of the NDB will be to finance infrastructure and sustainable development projects in BRICS and other emerging nations. The initial subscribed capital amounts to USD 50 billion, while an amount of USD 100 bn. has been authorized.

Perhaps one of China's biggest long term project of economic integration which will increase its geopolitical role, **the New Silk Road – One Belt One Road** and the **21<sup>st</sup> Century Maritime Silk Road** materialized during the 22<sup>nd</sup> APEC summit in Beijing, where a **Connectivity Blueprint for 2015-2025**<sup>57</sup> was announced. The New Silk Road, both positioning China as the golden end of a belt passing across Central Asia and Russia to Europe and placing China as the master of the South East oceans and seas, became a reality with China's pledge of USD 40 billion allocated to infrastructure, resources and industrial investments. China also promised that half of the USD 50 billion AIIB new capital will be used to build roads, ports, and powerplants across the region.

## 4.2 Investment flows from and to Switzerland

**At present, around 600 Swiss firms with over 1000 branches are represented in China, employing more than 200'000 people.** According to Chinese statistics, Swiss direct investments in China amounted to 310 million USD in 2013.<sup>58</sup>

**The figures on Swiss direct Investments in China published by the Swiss National Bank, differ significantly from the data released by the Ministry of Commerce** as shown by the fact that Swiss direct investments to China amounted to 1.6 billion CHF (1.75 bn USD) in 2012<sup>59</sup> (down from 5.33 bn CHF (5.67 bn USD<sup>60</sup>) in 2011), while the stock of Swiss direct investments stood at 14.81 billion CHF (16.21 bn USD) in the same year according to Swiss statistics, thus making China the 15<sup>th</sup> destination of Swiss FDI.<sup>61</sup>

While the majority of the Swiss companies active in China are still located in the three Eastern economic centers Beijing/Tianjin, Yangtze-River Delta (Shanghai) and Pear-River Delta (Guangzhou, Hong Kong), a number of companies are also already located in the hinterland and inland provinces, where costs for land and labour are lower and the growing purchasing power of a new urban middle class creates market opportunities. Most represented are companies in the IT, Manufacturing, Food Stuffs and Chemicals & Pharmaceuticals industries.

The *CEIBS China Business Survey 2013-2014*<sup>62</sup> provides an updated view on the Swiss Business community in China. The survey found that **compared to 2013, sales and profits have slightly improved and Swiss companies tend to be more optimistic than a year ago.** The broader survey also including Chinese and other foreign companies reveals that the main

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<sup>57</sup> [http://www.apec.org/Meeting-Papers/Leaders-Declarations/2014/2014\\_aelm/2014\\_aelm\\_annexd.aspx](http://www.apec.org/Meeting-Papers/Leaders-Declarations/2014/2014_aelm/2014_aelm_annexd.aspx)

<sup>58</sup> MOFCOM

<sup>59</sup> 2013 data for Swiss FDI in China have not been obtained by the time the report was finalized.

<sup>60</sup> The currency conversion was done with Oanda Currency Converter, taking the 31.12. of both years 2012 and 2011 as conversion dates.

<sup>61</sup> *Data on FDI are always collected on two sides, in the country that places the direct investment and the country where the direct investment takes place. Since the institutions collecting the data in both countries cannot exchange information on investments due to reasons of confidentiality, the figures issued by different countries cannot be aligned and may therefore vary substantially as it is the case for Swiss and Chinese data on FDI.*

<sup>62</sup> A survey supported by Swiss Center, SwissCham Shanghai, Swissnex and China Integrated.



challenges for doing business in China besides the economic slowdown remain HR related (finding and retaining talent and rising labor costs), followed by the fierce competitive environment and the legal environment. Innovation capability has newly emerged as an internal challenge, this being particularly the case for state-owned enterprises (SOEs). Besides, survey respondents mentioned a perceived reduction in corrupt government activities. Despite a growing tendency towards investments in China's southwest, the great majority of respondents still plans to invest in the coastal area.

So far, **Chinese direct investment in Switzerland is still modest** but started to increase significantly in the past years. As of today there are about 70 Chinese companies established in Switzerland.

While the Chinese investments appear to be scattered over most of Switzerland's larger economic centres (mainly within the Greater Zurich Area and the Greater Geneva and Berne Area), the reason for an investment in Switzerland is to acquire **technology** or a **brand** and making use of its existing **distribution network**. At the same time, the high education level and the central location seems to be of striking importance when choosing to set up a R&D centre or a European HQ in Switzerland. These investments generate employment, as around 90 percent of the staff is locally hired. Investments in the ICT and solar industries are to be mentioned in particular. Most Chinese companies present in Switzerland are of considerable size, whether private or state-owned. The acquisition of the trading firm Addax (based in Geneva) by Sinopec remains to date one of the most important Chinese investments in Europe.

## 5 Trade, Economic and Touristic Promotion

### 5.1 Foreign economic promotion instruments

Given the market potential and the resulting increasing interest of the Swiss industry, it is not surprising that a growing number of Swiss institutions engage in activities facilitating market entry to and business in China, promoting the Swiss industry by various means. This goes in line with the conviction of the Swiss Federal Council, who considers it sensible to provide an effective commercial diplomacy for the Swiss economy.<sup>63</sup>

The **Embassy together with the three Consulate Generals in Shanghai, Guangzhou and Hong Kong** plays a pivotal role in ensuring a favorable environment for Swiss businesses interested or active in doing business in China. Owing to a privileged access to the Chinese government institutions, the Embassy together with the respective Swiss Federal authorities engages in a number of government to government dialogues. At the moment, Switzerland is having such regular dialogues in a variety of fields, among them in Intellectual Property, Financial Services, Technical Barriers to Trade and Sanitary and Phytosanitary Measures, Social Security, Health. Other cooperation activities resulting either from the Free Trade Agreement or other agreements further contribute to a preferential access to government institutions, providing a platform to bringing problems of Swiss companies to the attention of the respective Chinese authority. Furthermore, the Embassy as well as all three Consulates engage in networking, high level promotional activities, company openings and the organization of economic delegations to China. Therefore, in facilitating and supporting negotiations on various agreements on various levels, the Embassy together with its regional outposts actively contributes to improving the framework conditions for bilateral trade and investment.

Within our diplomatic representations, the Swiss Business Hub is fully integrated into the operations of the Swiss Embassy and Consulate Generals. The **Swiss Business Hub China (SBH)** as part of the worldwide "Switzerland Global Enterprise" network (formerly named OSEC)

<sup>63</sup> For more information on Switzerland's position towards commercial diplomacy, please refer to The Foreign Economic Policy Report 2013.

is operational in Beijing, Shanghai and Guangzhou. The specially trained Swiss and local SBH-staff offer services to Swiss SMEs in their endeavours of strengthening and developing their business relations with China. Services include: market and product analyses; search of distributors, representatives and import partners; individual consulting and coaching; industry reports, presentations and trade fairs.

Since the beginning of 2009, the SBH assumes the mandate for investment promotion. The SBH China now also manages the promotion of Switzerland as a business location for potential Chinese investors. The aim is to inform and build on the firm Sino-Swiss relationships which have been established and raise awareness of Switzerland as a first-class business location for setting up regional and European headquarters among the Chinese business owners, entrepreneurs and investors.

Besides the Swiss Business Hub, the **cantons** as well as certain regional clusters have their own **investment promotion representatives**. The Swiss Business Hub, which carries out systematic market analysis and development has organised some high-level seminars, elaborated brochures, manuals and presentations and assists cantons and regions in their own endeavours in the very demanding Chinese market. With a number of recent Chinese investments in different parts of Switzerland the joint efforts of the SBH, the cantons as well as the service sector have already generated results. Like in other Asian countries, Switzerland is perceived as a prime location in the heart of Europe, but high living-costs and barriers for entry of Chinese workforce are on the flip-side.

The **Swiss-Chinese Chamber of Commerce** and **SwissCham China** are private organisations registered in Switzerland and China respectively. Among their members are the leading Swiss companies in the trade, industry and financial sectors. The network consists of about 800 companies and individual members. Their purpose is to promote and support the global success of the Swiss business community in China.

**Cleantech Switzerland** is the official export platform for the Swiss Cleantech sector and was developed as one part of economic stabilization measures (2009) by Switzerland Global Enterprise. In China, the Swiss consulting firm Generis acts as the service partner of Cleantech Switzerland and as such provides services on site for Swiss companies in the field of environmental technologies.

In this regard, the **Sino-Swiss Zhenjiang Ecological Industry Park (SSZEIP)** has in 2013 received particular attention with a number of Swiss companies providing their know-how. The concept of a Sino-Swiss Eco-Industrial Park was first initiated in August 2010 by then Chinese Minister of Commerce Chen Deming and Swiss Federal Councillor for Economic Affairs Doris Leuthard with the objective to promote cooperation among companies from both sides in establishing an eco-friendly industrial park. On July 9<sup>th</sup>, 2012 a Memorandum of Understanding between the same Minister Chen and Swiss Federal Councillor Johann N. Schneider-Ammann on the Joint Establishment of the Sino-Swiss Zhenjiang Ecological Industry Park (SSZEIP) was signed. On July 10<sup>th</sup>, 2012 a Framework Agreement between Zhenjiang Economic and Technological Development Zone Administrative Committee (ZETDZ) and CTS followed to implement the project on operational level. In January 2013, the official Groundbreaking Ceremony took place and on **July 2<sup>nd</sup> this year, the Park was officially inaugurated by the Swiss State Secretary for Economic Affairs, Ms. Marie-Gabrielle Ineichen-Fleisch**. SECO-supported organizations such as the *United Nations Industrial Development Organization* (UNIDO) or the *International Institute on Sustainable Development* (IISD) are carrying out projects in cleaner productions and voluntary sustainability standards in the Park.

In order to strengthen **bilateral cooperation in the field of higher education, research and innovation**, a **swissnex** office was opened in Shanghai in August 2008. swissnex China's mission is to create and promote awareness of Swiss excellence in science, technology,

innovation and culture, to connect academia and business and to facilitate cooperation between the two countries.

## **5.2 Interest for Switzerland as a location for tourism, education and other services, potential for development**

The National Brands Index 2013 study revealed that **Switzerland ranks 5th for the Chinese in terms of national image**, behind Germany, the US, France and the UK. The perception of Switzerland seems to be better than the average of the 20 countries participating in the survey. While the governance system, the location for investment and work as well as the innovative products under the “Swiss made” label are considered as positive as among the occidental countries, the Swiss population and tourism are regarded even a bit more positively in China than in other countries.

Switzerland is very attractive as a tourism location for Chinese travelers. **The one-million barrier for overnight stays by Chinese visitors in Swiss hotels will be surpassed for the first time in 2014.** For 2015 Switzerland Tourism expects more than 1'100'000 overnight stays, an increase of 7%. Alongside France, Switzerland is the most sought-after European destination. To a growing extent, our country is also becoming a destination for individual travelers, small groups and mono Swiss tours with longer stays and in-depth touring. Shopping is vital to the Chinese destination choices. The expectation for 2015 is that Chinese tourists will purchase more luxury goods while traveling abroad than all other tourists combined.

There is in China a **rising interest in winter sports** with an estimation of 5 million active skiers (at least 1x/year). A Canadian study suggests that among the surveyed group of skiers 30% are likely to go on ski holidays in a foreign country. That being said, we assume that this target group of 1.5 million people is growing fast. Switzerland is well positioned in the eyes of Chinese skiers and it becomes an important option for the Chinese travellers. In the winter 2013/2014, 135'333 overnights of Chinese guests were registered in mountain regions. This is a growth of 34.0% compared to the previous season. The overall growth in Switzerland in the winter season 2013/2014 was 16.2%, so an above-average increase in overnights was registered in mountain regions. We estimate that the Chinese overnights in mountain regions will grow up to 260'000 until 2017 and up to 400'000 until 2022. Switzerland Tourism is developing specific business plan and communication for skiers and winter activities.

The **Swiss public education sector and its institutions have become increasingly attractive among Chinese students.** Despite the fact that Switzerland is mostly known for its hotel management education and that it is considered as one of the most expensive countries, the number of Chinese students in Switzerland has been growing steadily. In 2012/3 there were 1'335 Chinese nationals enrolled in Swiss education institutions.<sup>64</sup> The good positions of our institutions in various rankings and the fact that more and more programmes on the Master level are taught in English contribute to this growing interest in China. The Swiss representations are actively involved in promoting Swiss education opportunities throughout China. Identification and selection of the top students is increasingly becoming the main challenge.

## **5.3 Interest for Switzerland as a location for investment, potential for development**

A large majority of decision makers and business people have a very good perception of Switzerland as a tourism destination. Most of them, however, have **little idea of what Switzerland could offer them as a place for doing business.** Nonetheless, awareness has been increasing since Premier Li Keqiang's visit to Switzerland in May 2013 and the entry into force of the FTA on July 1st 2014. Therefore, a lot of awareness building has to be done as the

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<sup>64</sup> Bundesamt für Statistik

image of Switzerland is still dominated by chocolate, watches and nice landscape, however positive an image those clichés may convey.

Chinese entrepreneurs and companies currently predominantly focus on investments which are still largely based on M&A in terms of value (in Europe only for the year 2011 USD 1.22 billion were invested in 54 greenfield projects vs. USD 8.59 billion in 37 M&A) with a focus on the biggest markets (Germany, France and the UK). The main reason for this trend might be the fact that M&A remains the quickest and easiest way to step foot overseas. In such manner, they can acquire brands, technologies and knowledge in order to apply them to the Chinese market where growth is still substantially higher than in Europe. Besides, Chinese investors will rather choose a country or region where they have existing business relationships (e.g. traders, distributors, etc) and where a certain number of Chinese citizens are already present.

#### 5.4 Interest for Switzerland as a financial location, potential for development

China is catching up in positioning its RMB as internationally used currency and steadily increases its place on the SWIFT list of most-used payment currencies worldwide. In January 2014, the RMB surpassed the Swiss franc and got on place 7 of the SWIFT list. **While the absolute market share of the RMB is still relatively low with 1,64% as of August 2014, in relative terms the RMB has managed to get a fix place in the top ten of the internationally used currencies.** The RMB payments are concentrated in Hong Kong with a share of over 70%, followed by the UK, Singapore, Taiwan, the United States, France and Australia. Data from China's central bank show that from January to July 2014, cumulative cross-border RMB settlements under the regular business of national banking financial institutions reached 3.77 trillion yuan, an increase of 55.9 percent against 2013.<sup>65</sup>

In 2014, efforts of various Asian and European financial centres to position themselves as offshore-RMB-hubs have continued. After Singapore and London were granted a 'Renminbi Qualified Institutional Investor' (RQFII) Quota of RMB 50 bn. and RMB 80 bn. respectively in October 2013, further quotas were given to Paris, Frankfurt and Seoul in 2014 (each amounting to RMB 80 bn.) and to Canada in November (RMB 50 bn.). Direct trading of the RMB and the British pound in the inter-bank foreign exchange market was officially launched in June 2014, following the direct trading of the RMB against foreign currencies including the Japanese yen, Australian dollar, and New Zealand dollar<sup>66</sup>. This year, China has also signed eight RMB clearing and settlement arrangement cooperation MoUs covering London, Frankfurt, Paris, Luxembourg, Qatar, Toronto and Sydney and has set up an RMB clearing service in Seoul.

**Switzerland is ideally placed to becoming a RMB-hub.** The Swiss authorities and the private sector have been taking a number of measures to strengthen Switzerland's position in the process of RMB internationalization.

The Swiss National Bank and the People's Bank of China signed a **currency swap agreement**, in July 2014. The swap agreement enables renminbi and Swiss francs to be purchased and repurchased between the two central banks, up to a limit of 150 billion renminbi, or CHF 21 billion. This allows liquidity in renminbi and Swiss francs to be made available to the relevant markets as required.<sup>67</sup> With the conclusion of the swap agreement, a key prerequisite for the development of a renminbi market in Switzerland has been fulfilled.

Furthermore, in 2013, a regular **Financial Dialogue** between the Swiss and the Chinese authorities has been established. Among others, this forum aims to explore ways how

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<sup>65</sup> MOFCOM

<sup>66</sup> MOFCOM

<sup>67</sup> SNB

Switzerland and its financial industry can support a growing international role for the renminbi. The first two rounds took place in December 2013 and June 2014 in China and Switzerland respectively. The third round of the Financial Dialogue is envisaged to be held in China in 2015.

Also, with the **Chinese – Swiss Financial Round Table**, a private sector platform was created, which provides financial sector leaders from China and Switzerland with the opportunity to discuss relevant topics of common interest and to find new forms of bilateral collaboration. The first round of the Financial Round Table was launched in the greater Zurich area in June 2014. Representatives of both countries' authorities also participated in the event. On this occasion, Finance Minister Eveline Widmer-Schlumpf, Swiss National Bank Chairman Thomas Jordan and China's central bank Governor Zhou Xiaochuan agreed on further collaboration in the field of renminbi internationalisation.