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Executive Summary

- *After 30 years of growth, China has now reached a crucial turning point in the country's development trajectory. The country has exhausted the benefits from its demographic dividend, costs are rising and the export-led growth model cannot be sustained any longer. Innovation and a stronger focus on domestic demand will be the future emphasis of the current government in the pursuit to a moderately well-off society by 2020.*

- *After the first half of 2013 had seen a widespread downward adjustment of economic forecasts on China for the year, economic activity has somewhat rebounded in Q3. It is a consequence from the shift towards an economic model focusing on quality rather than quantity as was done in the past.*

- *Early June, the Chinese financial market was troubled by a shortfall in liquidity. Unlike before, PBoC let the banks pay the price for not planning ahead until a peak of 15% overnight rate on the interbank market (in April it was at 2,7%).*

- *The second half of 2013 was marked by the anticipation of the third plenary session of the 18th CPC central committee that convened between 9 and 12 November 2013.*

- *Already three days after the third plenary had been concluded, a 60 point statement was released that provides a deeper insight into the envisaged reforms. The document emphasizes the importance of the role of the market in allocating resources efficiently. Most probably the most important economic reform plan written since 1978, the coming years will show how determined the current government is and how well they manage to overcome obstacles such as the often mentioned "vested interests".*

- *China is the world's second largest economy after the United States and one of Switzerland's most important foreign trade partners. In the first three quarters of 2013, bilateral trade stood at CHF 14.6 billion (excl. HK), which corresponds to an increase of 9.2% from the same period in 2012.*

- *At present, around 600 Swiss firms with over 1000 branches are represented in China, employing several tens of thousands people. The west of the country is becoming of increasing importance. So far, Chinese direct investment in Switzerland is still modest but started to increase significantly in the past years.*

- *Throughout 2012, sales and profits have continued to increase for Swiss companies in China. The potential for further developments of SMEs in China remains enormous.*

- *The bilateral Free Trade Agreement signed between the two countries on 6 July 2013 will further strengthen investment ties between the two countries. It will 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.*

- *Switzerland's attractiveness as a tourism location is still on the rise. The one-million barrier for overnight stays by Chinese visitors in Swiss hotels could be surpassed for the first time in 2013.*

- *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 an investment location. Since the visit of permier Li Keqiang visit to Switzerland in May and the signature of the FTA, this perception is however changing.*

- *China's declared objective is to make the RMB a widely used alternative reserve currency to the existing ones. China expands its SWAP-Agreements in a noteworthy pace. By now it has 23 SWAP-Agreements amounting in total to 2,6 billion RMB (427 million USD), alone the 8 Agreements concluded in 2013 are worth 1 billion RMB (164 million USD) and are mainly within the European region.*

- *Meanwhile, further steps in interest rate liberalization have been taken. Chinese banks continue to expand their presence onshore abroad.*

- *In May 2013 the Memorandum of Understanding regarding the establishment of a Financial Dialogue has been signed. The first round of the annual Financial Dialogue will take place in Shanghai early December.*

1 Appreciation of the economic situation

China has reached a crossroads. The times of double-digit GDP growth figures belong to the past and the future of China's economic development depends to a great extent on government reforms. Premier Li Keqiang himself stated that "reform is the biggest dividend for China", indicating that the road for the economic development is clear.[1] Fostering the role of the market shall allow for a more innovation-driven and productivity-centered economy and unleash not yet tapped potential, helping the country on its way to a moderately well-off society (*xiaokang shehui*).

Growth has therefore slowed substantially and will remain in the single digits for the coming years. **After the first half of 2013 had seen a widespread downward adjustment of economic forecasts on China for the year, economic activity has somewhat rebounded in Q3**. GDP growth stood at 7.8% YoY compared to 7.7% in the first and 7.5% in the second quarter. For Q4, the economy is expected to moderate again to 7.6% YoY (UBS), which puts the country's economy on track to the set annual growth target of 7.5%, that while stronger than other major economies is still the worst performance in 23 years.

China is trying to shift or "restructure" the economic mix so that activity is geared much more to consumption. But **the latest figures show investment accounted for over half of the expansion** so far this year. Consumption accounted for 46% of growth in the first nine months, compared with 56% taken up by investment. **The government has sped up projects in infrastructure to support growth**, although it has stayed away from more aggressive measures to avoid undermining its efforts to steer the economy in another direction. Overall investment in infrastructure expanded at a pace of 29% between January and September.

While the numbers for 2013 are stable, they don't give reason to euphoria. Industrial production grew in September by 10.2% YoY, and thus only slightly slower than in August. Retail sales climbed by 13.3% YoY and illustrate a somewhat robust domestic demand. Fixed Asset Investments grew by 20.2% in the first nine months of 2013. This is also a stable figure and chiefly to be attributed to infrastructure projects in the railway sector.

China's consumer price index for September **rose 3.1%** compared with a year earlier, accelerating from August's 2.6% y-o-y increase. **Most of the increase was attributed to loftier food prices**, which were up 6.1% in the month compared with a year earlier, driven by fresh vegetable prices that jumped nearly 19% and fresh fruit prices, up 12.5%. **Producer prices** fell by 1.3% on year in September, a slight improvement over the 1.6% decline in August.

An episode in summer has demonstrated the unpredictability of monetary policy in China. **Early June, the Chinese financial market was troubled by a shortfall in liquidity.** A tightening up of speculative ("hot") money inflow in May, a less bright than expected economic forecast in June as well as a relatively high amount of government debt due to be sold at the same time contributed to this temporary shortfall. These factors would not have had such an impact as they are rather small for a well positioned economy with the size of China with relatively low government debts (compared to the US or Europe). What made the big difference was that this time, the PBoC for the first time abstained from helping out with liquidity to soften the effects. So far the Chinese market was used to a liquidity injection whenever necessary, which prevented them to do a proper liquidity planning and risk assessment. This time, PBoC let the banks pay the price for not planning ahead until a peak of 15% overnight rate on the interbank market (in April it was at 2,7%)[2]. The short term winners were the foreign banks that helped out the Chinese banks with liquidities. At the long run the whole financial sector in China will benefit as investing in a reliable liquidity planning to avoid losses as in early June.

[1] http://news.xinhuanet.com/english/china/2013-03/17/c_132240248.htm

[2] See Annexe „Short of Cash“

While the **rhetoric** since taking office in March 2013 has been **positive with regards to reforms** and allowing the economy to grow at a slower pace ("Talking the talk is not as good as walking the walk," Li Keqiang), no concrete measures or a master plan have been initiated so far. President Xi's mass-line and anti-corruption campaigns were seen as a way to consolidate his political power before the third plenary, where wide-ranging economic reforms were to be expected. And such **reforms are in dire need**: the economy is increasingly challenged with its own maturation and is still burdened by inefficiencies and lower productivities in the public sector, overcapacities, regional and rural-urban inequalities, weak domestic consumption, weaknesses in the financial system and an ageing population.

1.1 The third plenum

The **second half of 2013 was marked by the anticipation of the third plenary session of the 18th CPC central committee** that convened between 9 and 12 November 2013. Historically, such third plenary sessions of a newly installed central committee have acted as a springboard for key economic reforms, most prominently the one in 1978, which was followed by the transformative opening and reform policies under Deng Xiaoping.

In the wake of the meeting, a research paper called the "**383 plan**" by the research team of the China State Council Development Research Center outlined the potential agenda and named three overarching reform principles (improve the market system, transform the government functions, innovate the enterprise system), eight key areas of reform (cutting red tape, breaking up monopolies, reforming land ownership, liberalizing finance, reforming the public finances, reforming state-owned enterprises, promoting innovation and opening up to foreign investment) and three broad strategies for achieving them.

In the aftermath of the meeting, a first reform blueprint, the **"decisions on Major Issues Concerning Comprehensively Deepening Reforms"**, were published. The focus lies on the redefinition of the relationship between the state and the economy. Although the blueprint emphasizes the decisive role of the market in the allocation of resources (previously just a 'basic role'), at this moment, no plans seem to have been included to radically reduce the role of the state in the economy, as was requested by many. This however might be a natural development given the gradual reduction in SOEs share in total output (1998 50%, 2011 26%).[3]

The blueprint announced the establishment of **a *Comprehensive Deepening Reform Leading Small Group***, which according to Xinhua news agency will "be in charge of designing reform, arranging and coordinating reform, pushing forward reform and supervising the implementation of plans"[4]. It points at the need for reform, mentions that "the country is standing at a new starting point of development", and acknowledges the market's "decisive" role in allocating resources (compared to its "basic" role as it used to be called). Other than that, a more service-oriented government, a deepening of fiscal and tax reform (including liberation for investments), the establishment of a unified land market in cities and the countryside, more property rights for farmers and the development of a sustainable social security system were mentioned.

The **State Security Committee** is the second new body to be established according to the document. Although its name may suggest that the committee will be a counterpart to the US National Security Council, it seems that it will focus on domestic affairs, since its creation is mentioned in the context of food and drug safety, and public security.

According to the outcomes of the Third Plenary of the 18th Communist Party Congress, China will accelerate interest rate reform and capital account opening while setting up a system of

[3] http://www.piie.com/blogs/china/?p=3545&utm_source=feedburner&utm_medium=email&utm_campaign=Feed%3A+ChinaEconomicWatch+%28PIIE+China+Economic+Watch%29

[4] http://news.xinhuanet.com/english/china/2013-11/12/c_132882325.htm

deposit insurance. A deposit insurance scheme would help guard against the risk of financial instability if banks recklessly promise ever-higher interest rates as they compete for customers.

While many things are still rather vague, the common opinion is in line with David Dollar, former US Treasury's top official in China, who says the document shows "an intention on the part of the new leadership to accelerate reform, and that is good".[5]

2 International and Regional economic agreements

1.1. China's Policies and Priorities

1.1.1. China and the WTO

The anti-dumping disputes on solar-panels between China and the EU could be solved in a way to prevent a more serious trade dispute and all eyes are now turned on the upcoming 9th WTO Ministerial Conference in Bali December 3-6th. On this occasion, the WTO's credibility after the long-stalled Doha negotiations needs to be restored. The three key deliverables shall converge around **development, trade facilitation and food security.**

In the WTO accession process China has been categorized as a developing country, benefiting of special treatments and exclusions within the WTO. It is a classic example of an **emerging economy still benefiting from these advantages** although they have reached a unique economic development. Most industrialized countries claim that emerging economies should make more concessions than other developing countries. At the wake of the 9th Ministerial Conference, this dilemma stands clearly at the front, as further commitments are expected from China, especially in terms of tariff-rate quotas in the agricultural sector.

Although China is perceived in many fields as a **constructive partner**, particularly in issues typically affecting emerging markets, and seeks to perform actively in view of the 9th Ministerial Conference. China however is often substantially put under pressure and has **not achieved to adopt a leading role yet.**

The **service sector in China is still protected** and the existing regulatory framework is not in line with the principles of market economy: market access often remains discriminatory against non-Chinese domestic companies. **Foreign partners would like to see China join the WTO Government Procurement Agreement (GPA).** In December 2007, China officially applied at the WTO in Geneva for joining the GPA with a disappointing initial proposal. In July 2010, a revised proposal was presented deemed insufficient by the GPA members. **China has committed to provide a third revised accession offer by the end of 2013.**

The **reforms announced after the 3rd Plenary of the 18th CPCCC** which took place at the beginning of November could be read as a step forward in reducing the involvement of the State in the private economy, liberalizing the service sector, reducing the monopoly of the SOEs (State-owned enterprises), tackling local protectionism and unfair competition, increasing transparency and openness of market rules and promoting public procurement. The specific timeframe and means of implementation of the reforms however have not been clearly defined.

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.

While China keeps engaging in multilateral trade discussions and protecting its interests within the WTO, it is also actively exploring trade opportunities through bilateral and regional trade

[5] http://online.wsj.com/news/articles/SB10001424052702304644104579193202337104802

agreements with strategic partners. The financial crisis led to a lower reliance on western markets for exported Chinese goods and made China adjust its development strategy towards increasing domestic demand and market diversification, resulting in heightened attention to regionalism in East Asia.

1.1.2. China towards RCEP vs. TPP

China aims at playing a more active role in the ASEAN-lead RCEP (*Regional Comprehensive Economic Partnership*)[6] negotiation process formally launched during the 2012 ASEAN Summit in order to counterbalance the US-lead TPP (*Trans-Pacific Partnership*). RCEP's 3rd round is planned in January 2014 in Malaysia and the negotiations shall be concluded by 2015, creating the world's largest trade bloc, accounting 40% global trade, a combined GDP of $20 trillion and covering a 3 billion people market.[7]

While China is aware that it may not leading the RCEP process, it is eager to accelerate it while the US aims a conclusion of the TPP by the end of 2014, representing 30% of world trade, and of which China is not a Party as it does not meet certain requirements. TPP's fast progress obliges RCEP's upgrade and opening up to more sectors challenging China to reform its services and foreign investment policies.

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 in eliminating the FTA proliferation's 'spaghetti bowl'-effect. RCEP will be weaker than TPP with lower standards and excluding labor and environmental protection. Seven RCEP countries are TPP parties and one day TPP and RCEP may be integrated, if linked to the EU it would lead to 80% of the global trade.

1.1.3. Bilateral Free Trade Agreements Concluded

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**. Iceland** signed an FTA in April while **Switzerland** signed on July 6th this year.

1.1.4. Free Trade Agreements under Negotiation

China, **Japan and Korea** launched their **trilateral FTA** negotiations in November 2012, with the 3rd round held November 26-29 in Japan. So far, working group meetings were held on trade in goods, services, IPR and e-commerce. Whether to include environmental standards, government procurement and food sectors are high on the agenda.[8] The combined GDP of the three countries represents 70% of Asian and 20% of the global GDP amounting $15 trillion.[9]

China and **South Korea** launched negotiations for a bilateral FTA in March 2012, which is aimed to be concluded ahead of the trilateral FTA. Both sides completed the first phase in August after seven rounds during which the tariff modalities of NSI (Non-sensitive Items), SI (Sensitive Items) and HSI (Highly-sensitive items) were defined. Requests and offers, as well as the content of the chapters will be discussed in the second phase.

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[6] ASEAN+6: Australia, China, India, Japan, New Zealand and South Korea.

[7] http://www.ft.com/intl/cms/s/0/07d739c2-3556-11e3-952b-00144feab7de.html#axzz2kW7tnAJs

[8] http://www.thebricspost.com/china-japan-s-korea-fta-talks-constructive/

[9] http://www.asianewsnet.net/Korea-China-Japan-see-progress-on-trilateral-FTA-49849.html

During the APEC Summit in October 2013, **Australian** Prime Minister Tony Abbott and President XI Jinping agreed to set a deadline to conclude the FTA before the end of 2014 after 19 challenging rounds of negotiations.

Norway and China launched the FTA negotiations in 2008, which were halted after 8 rounds after 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 difficult to Chinese industries for which neither side has proposed solutions. The negotiations are still halted and Norway would welcome any Chinese initiative to resume them. At the beginning of May, 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 the King of Bahrain Sheikh Hamad bin Isa Al-Khalifa at the Great Hall of the People.

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 on tariff concessions is scheduled for early 2014.

In June 2004, China and **SACU (Southern Africa Customs Union)** announced the launch of free trade negotiations. So far, no negotiations have taken place.

1.1.5. Free Trade Agreements under Consideration

As the negotiations on a TTIP (*Transatlantic Trade and Investment Partnership*) are progressing, China has shown strong interests in negotiating a China-EU FTA despite the anti-dumping disputes earlier this year. Negotiations on a **bilateral investment agreement** will be launched as communicated at the EU-China Summit in Beijing on November 21st, the first EU investment talks not linked to a trade deal. According to EU Commissioner De Gucht, China-EU FTA negotiations will not start as long as obstacles such as subsidies, export credits and cheap loans persist.[10]

A feasibility study for a China-**India** Regional Trade Agreement was completed in 2007 and earlier this year, Premier LI Keqiang expressed the desire to start FTA negotiations with India to mitigate the trade imbalance. The Indian government and industries however remain concerned by the influx of Chinese goods and are reluctant to start negotiations in the near future.

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, being the first high-level visit to Mongolia in 16 years.[11]

A **US**-China bilateral FTA lies farsightedly in the horizon of both most powerful economies, although the US aims first at concluding the TPP. Launching a FTA with **Canada** 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 may overlap another, synergies among them may thus occur sooner than later.

[10] http://www.reuters.com/article/2013/10/18/us-eu-china-investment-idUSBRE99H0O320131018

[11] http://usa.chinadaily.com.cn/world/2013-01/31/content_16188990.htm

1.1.6. Relations between China and Taiwan

Relations between China and Taiwan have drastically improved since President MA Ying-Jeou took office in 2008 and renewed his mandate in 2012. Former Chinese Minister of Commerce CHEN Deming became President of ARATS (*Association for Relations Across the Taiwan Straits*), a symbolic step to boost the economic and trade relations across the strait.

Taiwan established a direct yuan-clearing system in January 2013, representing one of the four main Offshore RMB-hubs besides Hong Kong, Singapore and London. Furthermore, the People's Bank of China granted the **RQFII (*Renminbi Qualified Foreign Institutional Investor*)** licenses to onshore Taiwanese financial institutions, hoping to increase flexibility for local lenders in their yuan-product offering.

The **ECFA (*Economic Cooperation Framework Agreement*) Service Trade Pact** was signed in June 2013, allowing Taiwanese companies to take controlling stakes in JVs with China, streamline approvals and expand geographic operations in sectors including banking, hospitals, construction or tourism. However, numerous administrative hurdles exist and critical voices thus state that it is mainly symbolic. MA Ying-Jeou would like each side to establish representative offices in each other's capital and to relax strict and outdated rules affecting the interactions. Some fear that the Taiwanese industry and services are disappearing as investments and jobs shift to the mainland.

The numerous FTAs that China is signing with other countries may have a negative impact on Taiwan, as the latter has a strong trade dependence on the former. China's transformation from labour-intensive manufacturing also represents a strong dip for Taiwanese intermediate goods as Taiwan is the leading producer in ICT products. In order to not be singled out of the international trade liberalization trend, President MA Ying-Jeou has committed Taiwan to join the TPP by 2020, wishes to join the RCEP and to resume talks with the US for the TIFA (*Trade and Investment Framework Agreement*).[12]

ANZTEC (*Agreement between **New Zealand** and the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu on Economic Cooperation*) was signed in July and will enter into force on December 1st 2013. ANZTEC includes substantive chapters on trade and labour, environment and indigenous people. Similarly, ASTEP (*Agreement between **Singapore** and the the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu on Economic Partnerhip)* was signed on November 7th 2013. Taiwan hopes that the two agreements may allow an entry point into the TPP as both New Zealand and Singapore are its founding members.

Agreements on e-commerce and patent protection were signed with **Japan** on November 5th and agreements on financial supervision, taxation, customs and trade in services are sought to be signed as a next step towards a free trade agreement. End of October, the European Parliament called on the European Council and the European Commission to facilitate negotiations for a Taiwan-**EU** Economic Cooperation Agreement.

1.2. Outlook for Switzerland

On **6th July 2013, the China-Switzerland FTA was signed** by Federal Councillor Johann N. Schneider-Ammann and Chinese Minister of Commerce GAO Hucheng. 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

[12] http://www.taipeitimes.com/News/taiwan/archives/2013/11/06/2003576258

this occasion.[13] The FTA is currently in the procedure of ratification. It provides a legal framework including consultations and dispute settlement mechanisms. A **Joint Committee meets every 2 years** and various **sub-committees** are set-up to monitor the implementation of the agreement.

The provisions of the FTA will 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.

3 Foreign Trade

3.1 Development and General Outlook

3.1.1 Trade in goods[14]

In 2012, Chinese exports reached USD 2,048.5 billion (+7.92 % YoY) and imports stood at USD 1,817.8 billion (+4.26% YoY), resulting in a total trade volume of USD 3,866.8 billion (+ 6.2% YoY) and leaving a trade surplus of USD 231.1 billion (+49.1% YoY). In the first three quarters of 2013, China's import and export totaled USD 3,060.37 billion with a year-on-year growth of 7.7%. China's export was USD 1,614.86 billion (+8.0% YoY), and its import was USD 1,445.5 billion (+7.3% YoY), with trade surplus of USD 169.36 billion.

China's top trading partners for exports remain the US (16.47% of overall export from China (Jan-Sept 2013, +3% YoY) and HK (17.64%, +27% YoY). On the import side, South Korea takes the lead (9.32%, +11% YoY), followed by Japan (8.29%, -12% YoY), Taiwan (8.2%, +36% YoY), Hong Kong (8.07%, +16% YoY) and the US (7.83%, +16% YoY).

As of **1 May 2014**, China's AQSIQ will have **stricter regulations in force with regards to imports of dairy products and in particular infant formula**. As certain points are still subject to consultation, the definite regulations are expected to be communicated in the coming weeks. This is part of a general trend of the current government towards increasing food security and food safety, an issue that in the past has not received enough attention.

3.1.2 Trade in services

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.**[15] China's share in world total exports is 4.61% with 170.2 billion USD and its share in world total imports is 5.47%, worth 192.2 billion USD.[16]

In the second half of 2013, **China has stated its ambition to join the TiSA (Trade in Services Agreement) talks**, a talk of largely rich-world countries around the US and the EU that covers about 70 percent of global services with the value of USD 4 trillion. Were China to join, it would mark a significant change of strategy, abandoning the exclusive focus on the WTO framework for multilateral negotiations on trade issues. The US fears that an accession of China might water down the agreement, as has been the case with the Information Technology Agreement.

[13] For all texts of the agreement, please refer to:

[14] Data mainly based on China's Custom Statistics, October 2011, see Appendix 3 and Mofcom: Regular Press Conference of the Ministry of Commerce on November 16th, 2011.

[15] Information Office of the State Council: White paper "China's Foreign Trade"; December 7th, 2011.

[16] WTO: "Country Profile China"; October 2011.

The Chinese leadership announced in its communication after the third plenum the **intention to further open the services sector for international investors**. Based on the model of the China (Shanghai) Free Trade Zone that operates with a “negative list” approach, investments in the field of finance, education, culture and health shall be further opened.

3.2 Trade with Switzerland

China is the world’s second largest economy after the United States and **Switzerland’s third most important foreign trade partner**. China is the largest buyer of Swiss industrial products in Asia and the third largest worldwide (after the EU and the United States).

3.2.1 Trade in goods

In the first three quarters of 2013, **bilateral trade stood at CHF 14.6 billion, which corresponds to an increase of 9.2% from the same period in 2012**. Switzerland exported goods to the value of CHF 6.4 billion to China (+8.6% YoY, 4.2% of all Swiss exports), with imports from China totalling CHF 8.2 billion (+9.4% YoY, 6.29% of total imports). This results in a **trade deficit of CHF 1.9 billion** in the first three quarters (2012 trade deficit of CHF 1.68 billion in the same period, CHF 2.5 billion for the entire year 2012), representing the stronger growth of Chinese imports to Switzerland.[17]

The main products exported by Switzerland to China in the first three quarters 2013 remain machines and instruments (26.22%, +4.6% YoY), watches (27.68%, -3.5% YoY) as well as chemicals and pharmaceuticals (28.23%, +26.3% YoY). Imports include machinery (41.55%, +19.9% YoY), textiles and clothing (18.77%, +4.9% YoY), as well as watch making components (10.08%, +3.4% YoY) and chemical products (7.79%, -0.4% YoY). 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 the same period, Swiss exports to Hong Kong mainly comprised of watches, jewellery, precious metals and gemstones (86%) and imported products of the same class (83.5%).

As for Hong Kong, even under the new calculation method of geographic origin, Switzerland still records trade surplus which in the first three quarters of 2013 stood at CHF 4.67 billion at a trade volume of CHF 7.36 billion. Therefore, regardless of the trade deficit vis-à-vis mainland China, it is worth noting that **Switzerland still has a positive trade balance vis-à-vis Greater China,** with a surplus of CHF 2.78 billion for the first three quarters of 2013.

The **bilateral Free Trade Agreement** signed between the two countries on 6 July 2013 is expected to boost bilateral trade in the coming years. 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 shall therefore create opportunities for the private sector to increasingly engage in bilateral economic activities. The subcommittees in the fields of TBT/SPS that will enter into force together with the FTA will further strengthen ties and facilitate economic cooperation.

3.2.2 Trade in services

Also trade in services is of importance. Many Swiss service providers operate in China (including banks, insurance companies, logistics companies, goods and quality inspection companies, corporate consultants) and conversely Chinese service providers show increasing interest in Switzerland as a business location.

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[17] As of January 1st 2012 the Swiss Federal Customs Administration adapted its calculation concept with the aim of harmonizing its foreign trade statistics with international standards, newly taking into account the country of geographic origin, other than the country of production. The regulation substantially impacts on the Swiss trade balance with certain countries. See Economic Report June 2013.

4 Direct investments

4.1 Development and general outlook

China attracted USD 111.72 billion in FDI in 2012, down 3.7 percent from a year earlier. The first half of this year saw foreign investors establishing 10,630 companies in the country, down 9.18 percent year-on-year, while FDI inflow rose 4.9 percent year-on-year to USD 61.98 billion, according to the Ministry of Commerce.[18]

According to Chinese statistics the top ten countries investing in China, accounting for 92.4% of foreign capital input in H1 2013 (January-July) were: Hong Kong *(45.989 billion USD)*, Japan *(5.181 billion USD),* Singapore *(3.760 billion USD)*, Taiwan *(3.405 billion USD)*, USA *(2.184 billion USD)*, South Korea *(2.167 billion USD)*, Germany *(1.516 billion USD),* Netherlands *(724 million USD),* France *(577 million USD)* and Thailand (*469 million USD*).

Since 2006, China's FDI policy has shifted from export led growth to quality investment supporting domestic led growth. The shift is a result of the general economic policy adopted in the 11th Five Year Plan which set out in detail the Utilization of Foreign Investment. Therewith, **China has decided to shift its policy of attracting foreign business from "quantity" to "quality" and to push its industry up the value chain**.

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 30th 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. In order to **continue the promotion of "quality over quantity"**, 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.

Investors' confidence in China has taken a slight downturn in 2013. European companies reported a diminished financial performance (tighter margins), which was mainly attributed to a slower economic growth in Europe and China, to rising labor costs as well as increasing competition from privately-owned Chinese companies. Market access and regulatory barriers are still considerable, pointing at the need for significant economic reforms. As a consequence, future revenue growth optimism among European companies has shrunk to a four-year low of just 71%. None the less, despite the relatively difficult times, China is still perceived as the best of a challenging global situation, which is why **foreign companies will remain committed to this market**. Growth and profit outlooks are most expected in the pharma & healthcare, retail & hospitality as well as the consulting and food & beverage sectors. In line with this development, the share of European companies' revenue from China continues to rise and continues to contribute significantly to the proportion of global sales. While earlier motivations were cheap exports, European companies increasingly provide goods or services for the Chinese market – i.e. in China for China.

Looking at the fast development trajectory of China, it **becomes increasingly 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

[18] http://www.china.org.cn/business/2013-07/26/content_29534521.htm

urbanization and the resulting influx of rural people to cities in the coming years.[19] **China therefore remains a top FDI destination**.

When looking at expansions, **foreign companies particularly seem to favor Western China** (Sichuan and Chongqing). The Chengdu-Chongqing area has emerged as region that clearly stands out. It is as a gate to the west not only a historical trading hub and a cultural center, but has also developed several industry clusters thanks to strong Central Government support, which wants the area to become the important economic centre of West China by 2015. The strong government support, the favorable business conditions, the cost structure as well as a potential consumer market of over 300 million people are among others the reasons why in recent years so many countries have established a national representation in either of the two cities.

Besides the foreign investment coming into the country, **China has also become a source of outward direct investments (ODI)**. By the end of 2012, the total stock of Chinese offshore investment stood at about 502 billion USD, roughly on par with Italy and double Taiwan's stock[20]. 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[21]. According to MOFCOM statistics, the accumulated non-financial overseas direct investment amounted to 58.17 billion USD between January and October 2012, which is an increase of 25.8% in comparison to 2011[22]. With its growing foreign reserves, **China's ODI is likely to grow further in the coming years**.

A shift is under way in China's ODI. The first wave largely involved state-owned firms, and was directed at acquiring energy, minerals and land in poor countries. **Resource insecurity lingers but it is no longer the driving force**. New motives propel the second wave. **China is now encouraging state firms to invest in property in prime locations, and in infrastructure and other assets in mature markets.** As a result, the share of Chinese ODI going to rich countries has shot up from just a tenth in 2002 to two-thirds last year. Likewise, even though the data on China's ODI show that Europe accounts only for a relatively small portion of the country's stock of such assets[23], this share is growing at a fast pace. For instance FDI flows from China increased from about 130 million USD in 2009 to 900 million USD in 2010[24]. The EU is China's largest global trading partner and like the United States, European trade with China remains persistently imbalanced. However, Europe is likely to feel the force of China's outward expansion earlier than the US as European firms arguably have a greater need for cash than American ones and China's huge holdings of US Treasuries give it an incentive to diversify away from its dollar assets, whereas the euro zone is the natural alternative. Surprisingly, China's ODI in the EU fell by 21% year on year to 1.58 billion USD between January and October 2012[25].

In that regard, in particular state owned enterprises benefit both from favorable conditions with regards to financing as well as a network of institutions that help them in their undertakings in foreign markets.

4.2 Investment flows from and to Switzerland

At present, around 600 Swiss firms with over 1000 branches are represented in China, employing several tens of thousands people. According to Chinese statistics, Swiss direct

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[19] http://www.mckinsey.com/insights/asia-pacific/meet_the_chinese_consumer_of_2020

[20] The CIA World Factbook: "China" (data retrieved June 11th, 2013).

[21] The Economist: "FDI with Chinese characteristics", September 6th, 2012.

[22] MOFCOM: "Brief Statistics on China's Non-financial Direct Investment Overseas in January – October 2012"; November 23rd, 2012.

[23] The Economist; "Capital and companies from China are sidling into Europe"; June 30th, 2011.

[24] Economist Intelligence Unit: "Country Report China", December 2012.

[25] Xinhua: "China's ODI surges 25.8% Jan.-Oct.", November 20th, 2012.

investments in China in 2010 amounted to 260 million USD, a decrease of 13% from 300 million USD in 2009. The cumulative Swiss investment in China grew to 878 million USD in 2012, leaving Switzerland on the 4th rank among European countries and 10th overall.[26]

The **figures on Swiss direct Investments in China published by the Swiss National Bank, differ significantly from the data released by the MOFCOM** as shown by the fact that Swiss direct investments to China amounted to 1.824 billion CHF in 2010 and 5'293 billion CHF in 2011, while the stock of Swiss direct investments stood at about 13.134 billion CHF in the same year according to Swiss statistics.[27]

While the majority of the Swiss companies active in China is 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 is also already located in the hinterland and inland provinces. Most represented are companies in the IT, Manufacturing, Food Stuffs and Chemicals & Pharmaceuticals industries.

The *2013 Swiss Business in China Survey*[28] sheds light into the Swiss Business in China. Throughout 2012, **sales and profits have continued to increase for Swiss companies in China**. Similar to other foreign companies, Swiss companies present in China plan to increase investment in China and a large number of companies consider China as a top 3 investment location. In 2012, 23% of the Swiss companies in China already estimated that 30% or more of their global expected revenue would be generated in China, compared to 13% for both European and American companies. As MNCs are likely to have a more balanced distribution of revenue from various countries, it is to be assumed that SMEs are drawing an even larger part of their sales from their China operations. Therefore, the **potential for further developments of SMEs in China remains enormous.**

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. However, numbers of the Swiss National Bank show a net outflow of Chinese FDI to Switzerland, from CHF -23.7 milllion in 2011 to CHF -52.6 million in 2012, corresponding to an investment stock of CHF 80.3 million in 2011.

While the Chinese investments appear to be scattered over most of Switzerland's larger economic centres, the reason for an investment in Switzerland is can be to acquire **technology** or a **brand** and making use of its existing **distribution network**. On the same level, 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.

The bilateral **Free Trade Agreement** signed between the two countries on 6 July 2013 will further strengthen investment ties between the two countries. It will 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.

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[26] MOFCOM

[27] *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.*

[28] http://www.swisscenters.org/download/studies/2013/2013_Swiss.business.in.China.pdf

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.

The **Embassy**, as the official representation of Switzerland to China due to its privileged access to the Chinese government institutions, plays an important role in bringing problems of Swiss companies to the attention of the Chinese authorities. In facilitating and supporting negotiations on various agreements, the Embassy actively contributes to improving the framework conditions for bilateral trade and investment.

The **Swiss Business Hub China** as part of the worldwide “Switzerland Global Enterprise” network (formerly named OSEC) is operational in Beijing, Shanghai and Guangzhou. The specially trained Swiss and local SBH-staff offer services to Swiss SME 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 the **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 has in 2013 received particular attention with a number of Swiss companies providing their know-how.

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 last representative survey in China (2006) revealed that Switzerland gets rated best by Chinese people in terms of national image, before France and Germany. Attributes like political stability, environmental care, top level education and research, friendly citizens, the high quality of life as well as the overall global image complete the picture of the average Chinese.

Switzerland is also getting more attractive as a tourism location. The **one-million barrier for overnight stays by Chinese visitors in Swiss hotels could be surpassed for the first time in 2013.** Alongside France, Switzerland is the most sought-after European destination. By 2014, about 4.6 million Chinese will have the financial resources and the need for a trip to Europe. Of this number, Switzerland has potential for about 1.5 million Chinese. To a growing extent, our country is also becoming a destination for individual travellers, small groups and mono Swiss tours with longer stays and in-depth touring.

The demand for new Swiss routes and tourism products (destinations, experiences) is also picking up. The biometric Schengen visas are likely to be introduced in 2015. The application centers of the outsourcing partner in Beijing, Shanghai and Guangzhou are technically prepared for the introduction of the biometric processes early 2015. However, application centers in other locations throughout China need to be opened in future in order to cope with the growing large numbers of visa applicants.

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 1'228 Chinese nationals enrolled in Swiss education institutions.[29] 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.** Although awareness has been increasing since premier Li Keqiang's visit to Switzerland in May and the signature of the FTA in July.

Chinese entrepreneurs and companies do **not always make decisions purely based on business rationale,** and 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 of this trend might be the fact that M&A remains the quickest and easiest way to step foot overseas. 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. These soft factors are important in the decision making process of the first overseas investment and as a consequence the perception of Switzerland as a business place might suffer because of its small size and rather confidential Chinese community. However, **Switzerland becomes of interest as a business hub (HQ, operational center) once a first settlement was made and when the company seeks to develop and structure its European activities.**

[29] Bundesamt für Statistik

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

China's declared **objective is to make the RMB a widely used alternative reserve currency** to the existing ones. By now Russia, Japan and South Korea use already RMB as reserve currency. Each five years the IMF is evaluating the basket of reserve currencies, which are so far the USD, Euro, British Pound and Yen. One of the criteria the IMF is deciding upon is the importance of the currency in international trade. Beginning of 2013 RMB became number 13 on the list of the most used currencies in international trade. By October 2013, SWIFT declared RMB already at place 8, a year ago it was still on place 20.[30]

As safeguard to guarantee liquidity and prevent an unhealthy speculation in case of temporary currency shortage, SWAP-Agreements come into play. **China expands its SWAP-Agreements in a noteworthy pace.** By now it has 23 SWAP-Agreements amounting in total to 2,6 billion RMB (427 million USD), alone the 8 Agreements concluded in 2013 are worth 1 billion RMB (164 million USD). This year the focus of the Chinese government regarding the RMB trade expansion has been on Europe with 5 SWAP-Agreements (UK, Hungary, Albania, Iceland and EU) worth 566 billion RMB (93 billion USD).[31]

With the launch of the **China (Shanghai) Pilot Free Trade Zone (SFTZ)**, it was first time announced by when the government expects Shanghai to be a global financial center, namely in 2020. For the liberalization of the finance sector – the precondition for an international financial center – Chinese officials speak about a timeframe of 5 years. The SFTZ should serve as test zone to start liberalization policies that afterwards could be applied for the rest of the country.

Meanwhile Chinese banks continue to expand their presence onshore abroad. The 4 biggest Chinese banks[32] are at different stages of building up their international presence. Agricultural Bank of China (ABC) and China Construction Bank (CCB) are respectively in 8 and 11 countries present; in Europe they are since some years in the UK and Germany. CCB opened in November after Bank of China (BoC) and Industrial and Commercial Bank (ICBC) as third Chinese bank its European Headquarters in Luxembourg. BoC is in 31 countries active, in Europe they are in Luxembourg, UK, Germany, France, Italy, Hungary and Russia. ICBC as biggest Chinese bank and largest company worldwide has a presence in 60 countries, in Europe this means in Luxembourg, UK, Germany, France, Italy, Spain, Belgium, Holland, Poland and Russia.

On the 25th September 2013 the **revised Double Taxation Agreement (DTA) has been signed** between China and Switzerland. After the ratification process it is expected to be in force from the 1st January 2015 onwards. In addition to the OECD conform article on information exchange in case of tax avoidance; the revised DTA brings also improvements in terms of the withholding tax rate on dividend and royalty income.

In May 2013 the **Memorandum of Understanding regarding the establishment of a Financial Dialogue has been signed**. The first round of the annual Financial Dialogue will take place early December in China. Bilateral issues as market access, financial sector reforms and international organizations will be discussed.

[30] SWIFT, 8th October 2013.

[31] See Annexe „SWAP-Agreements“

[32] ICBC, ABC, CCB, BoC