The EU-China Investment Deal and Transatlantic Investment Cooperation

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Rarely has an investment agreement received so much bad press so quickly; or even so much press at all. Since it was announced in late December, the EU-China Comprehensive Agreement on Investment (CAI) has proven controversial. We now have a draft text of parts of the agreement; the result of 35 negotiation rounds over seven years. Changes may be required to get it through the European Parliament and critical details have yet to be released, but we know the agreement includes obligations on the establishment of foreign investment together with obligations on subsidies, technology transfer, state-owned enterprises, and sustainable development (environment, forced labour, and climate change).

The agreement will be important for aspects of the EU-China investment relationship and have implications beyond Brussels and Beijing, as reflected in the eyebrows raised not just by former US trade negotiators but also the incoming Biden Administration suggesting the agreement spells trouble for transatlantic investment cooperation on China.

The timing and optics of the announcement were awkward, of course, but December marked the end of Germany's Presidency of the European Council and the CAI is a legacy agreement of Angela Merkel due to leave office shortly. In substance, however, both critics and proponents should be under no illusion: the agreement is limited in nature and will only be relevant for a small minority of European firms operating – or seeking to operate in - China. This is not because EU negotiators are weak or naive (they are not), but because they could never have hoped for more. This will not appease those who find *any* trade deal with China ethically objectionable, but it is worth keeping in mind when sorting through the inevitable noise around the CAI in the coming months.

Binding, not opening

The CAI is more comprehensive than previous Chinese deals, but it does not crack open the Chinese market for European firms. Investment agreements never do.

Compare with the more familiar case of goods trade. Free trade agreements change tariffs between the parties resulting in actual preferential access. The US-China Phase I deal went further by, uniquely, committing China to expand purchasing of US goods. By contrast, obligations on investment establishment very rarely result in new access on the ground. With a few exceptions, they almost solely lock in *existing* access driven by unilateral reform processes as reflected in domestic law.

The CAI is no different. China has agreed to further openness in a couple of sectors (the EU didn't have to as it is much more open), and the agreement may have resulted in a few valuable side-deals (as reported here). But it will not translate into major new investment opportunities for a considerable number of European firms. It does not give access to the Chinese procurement market either. Instead, the core impact of the CAI will be to lock in aspects of China's domestic investment catalogue.

In fact, even some of the commitments presented as providing new market access largely reflect existing domestic rules in China, or rules that were already underway – such as removing joint-venture requirements on private hospitals in major Chinese cities (piloted since 2014), opening up to 50% foreign ownership in cloud services (initiated in 2019), or allowing auto manufactures to invest without joint ventures – including for electric and hybrid vehicles (liberalisation began in 2018).

Negotiations may have sped up, or deepened, some of these domestic initiatives – which would be important. Also, binding is not without value, even without further openness. German auto-makers deeply invested in the Chinese market, for instance, will welcome greater hurdles should the Chinese government be inclined to lower foreign equity caps or reintroduce joint venture requirements in the future. Binding can also help domestic reformers within China, who are known to use trade and investment agreements when engaging with vested interests within China. These impacts can have real value for some European firms in some contexts, but they do not create new access to the Chinese market.

No protection

The CAI includes no obligations on investment protection or investor-state dispute settlement (ISDS). If the EU succeeds to add these on a later date, as is the plan, that would have knock-on effects for the broader investment protection regime and could prove controversial in Europe, where ISDS has become a political poison pill. For the EU-China investment relationship, however, the direct effects will be limited.

China already has investment protection treaties with a range of EU member states. (The US, by contrast, tried to negotiate one with China during the 1980s and then again during the Obama administration). Some of these have outdated provisions, but others are more recent and can play a role when disputes arise. The day after the CAI was announced, for instance, Huawei initiated an ISDS claim against Sweden for banning the company from its 5G rollout.

A similar avenue is available for many European firms operating in China today, but the European Commission's own survey found that few are familiar with their investment treaties. This is not surprising, as few firms can afford the ISDS mechanism or have any appetite to bring such claims in the fear of permanently burning relations with the Chinese authorities. The CAI may end up consolidating these agreements one day – possibly with EU's revised ISDS model. This could prove to be an important focal point for the EU's informal engagement with Beijing on investment protection, for instance through the CAI's institutional oversight committee at the level of the Chinese Vice-Premier and Executive Vice-President of the European Commission. It will not, however, make the prospect of ISDS claims against China any more attractive for European firms than it is today.

Labour rights and state-capitalism

If the CAI is unlikely to change China's investment policy in any material way, its impact on other substantive policy-areas is going to be even less. Critics have charged that CAI will do little to reign in Beijing's human and labour rights violations or the most distortive effects of Chinese state capitalism. This is true, of course, but when was an investment agreement *ever* going to change the structure of the Chinese economy or materially influence Beijing's human rights record (a point also made here)?

With the CAI, China has agreed to neutral and open examination of labour abuses, which is a first and could prove meaningful. The Biden Administration should be interested in securing similar commitments from China as well. In addition, the soon-to-be-released panel report in the EU-Korea labour dispute is expected to show that CAI's commitments to respect the principles of the eight fundamental ILO conventions could have real value (and more so than promises of future ILO ratifications, which has been the subject of most attention).

Equally, while the agreement will do little to restrain Chinese subsidies (which are carved out from the state-to-state dispute settlement mechanism), its transparency obligations go beyond the WTO baseline, where members are not required to notify subsidies to services firms, and could benefit non-parties as well. The agreement also seeks to promote more predictable and efficient licensing and authorisation procedures, which could be used as a building block in WTO debates on an investment facilitation agreement and responds to a core ask by multinationals.

More broadly, the structural provisions of the CAI are either similar to the US-China Phase 1 deal (eg. on technology transfer) or go beyond what the US achieved (eg. on regulatory transparency). None of this will change the Chinese economy or revolutionise how European firms do business there, but no bilateral investment deal ever well and the obligations could help some firms at the margin.

Binding Europe?

Concerns that the agreement would prevent European governments from using unilateral measures against China are also overblown. CAI makes it harder for European governments to scale back openness towards Chinese investment in the future, but the main defensive instrument against unwanted acquisitions – investment screening – is carved out. Nor will the CAI prevent European governments from continuing to impose anti-dumping duties on Chinese products or continue with their plans to sanction human rights abusers. The CAI is also unlikely to prevent restrictions on Chinese firms with questionable labour or human rights practices (as feared here); nor would that pass ratification by the European Parliament.

If the agreement ends up tying the hands of European policy-makers, the constraints will be political rather than legal. In particular, Washington's concerns would be justified if the need to ratify the CAI and make it look like a success ends up constraining EU engagement with China on labour and other issues (a concern raised here). Selling the CAI as a major economic breakthrough would therefore not just be inaccurate, but also a strategic mistake. By contrast, if the agreement is seen for what it is – a meaningful, but limited, ratchet – it does not have to frustrate a joint transatlantic approach towards China. It could even help facilitate it.