

The strategic logic behind the EU's investment deal with China

Blog post by Director Gregor Irwin, 11 January 2021

In late December, the EU concluded a comprehensive agreement on investment (CAI) with China. The deal is controversial, not so much because of its economic content, but because of what it says about the EU's priorities and because of its potential geopolitical implications. Are these concerns valid?

The text has not been published as it is still being legally “scrubbed”, but it is expected to ease investment in China for EU firms, particularly in the automotive, healthcare, and tech sectors. However, that may not amount to much more than binding existing reforms (such as China's negative list for investment), or the formalisation of measures already planned (such as doing away with the requirement for auto manufacturers to enter joint ventures), or matching the liberalising measures in the US-China [phase one deal](#) reached in January 2020, which were in any case non-preferential. In sum, from an economic perspective, the deal may be useful as it will give investors in China some reassurances about market access and the policy environment, but it is unlikely to be ground-breaking.

The controversy is on the political side. Some critics say that reaching any deal right now gives China a free pass for recent bad behaviour, ranging from the treatment of Uighurs to suppression in Hong Kong or the bullying of Australia. Others say it is geopolitically naïve and badly timed, potentially undermining the [EU's plans](#) to work with the US just as a new administration is taking office and promising closer collaboration with its allies. But the hasty conclusion of the deal has more to do with the ending of Germany's six-month presidency of the Council of the EU, which allowed Chancellor Merkel to drive it through. For her, this is a legacy issue, as it helps German industry in China and comes shortly before she is expected to leave office.

The CAI is not without costs, which is why it faces a rocky path to ratification in the European Parliament. But few international agreements are. So, does it stack up from a strategic perspective? Arguably it does, on balance. Here are three reasons.

First, rather than damaging US-EU cooperation, it will make it more likely that the new US administration will take the EU seriously. It is easy to forget what it is like working with a normal US administration, but it is not much fun, even for allies. European foreign ministries will recall their frustration from being blindsided by the Obama administration as it drew down troop levels in Afghanistan, or their suspicions that billion-dollar fines against European banks for breaching Iran sanctions were driven as much by commercial as foreign policy interests. The ability to act alongside the US, but without being wholly dependent on the US, is one of the rationales for the EU's new doctrine of “strategic autonomy”. The CAI is, arguably, that doctrine in practice.

Second, there is nothing in this deal that means the EU must now go easy on China or which will constrain the EU from using its new “defensive toolkit”, as noted recently by the European Commission’s Director General for Trade, [Sabine Weyand](#). That toolkit includes screening foreign investment that is potentially damaging from a security or a strategic perspective and measures to target foreign companies that benefit from state subsidies. The CAI cannot be both a “win” for China and a new source of leverage for China over the EU, as some critics are suggesting. And being more assertive in using the toolkit could help the European Commission to secure the support it needs among MEPs for the ratification of the CAI.

Third, no single deal can completely unlock market access in China or resolve political differences overnight. Negotiations with China are a process rather than an event. The CAI, like the phase one deal struck by the US, ratchets up commitments on both sides. The EU and the US now have an interest in working together to get China to stand by its commitments. They could also seek to capture any new disciplines on labour standards, state subsidies and industrial policy in a revised WTO rule book, which would tighten the ratchet further, as well as applying it to other countries.

This process has a long way to run. But any process is better than no process. The CAI is a positive track for engaging China at a time when relations risk becoming ever more strained. Both the EU and the US will need that, if they are to seek to address the fundamental problems in their relationships with China, without descending into a deeper diplomatic conflict.