Global Counsel

The China angle to the EU-China investment deal

Blog post by Senior Associate Jens Presthus, 4 March 2021

The conclusion in principle of the EU-China Comprehensive Agreement on Investment (CAI) has been controversial. Many have wondered why the EU wanted to hastily finalise negotiations less than a month before Joe Biden could attempt to revive transatlantic cooperation, including on China. Questions about Beijing's intentions have received less attention because there has been an implicit consensus that China saw the CAI as a means to drive a wedge between the US and the EU. But this omits important points that European businesses need to understand. Beijing's own industrial policy priorities, including on renewable energy, technology, intellectual property and financial services, mean that European and Chinese interests are increasingly converging in sectors covered by the agreement. This allowed China to agree to this seemingly one-sided deal because it does not require far-reaching commitments that will negatively impact Beijing's own industrial policy agenda.

The European Commission has lauded unprecedented Chinese concessions and commitments related to market access and the environment. But a closer look at recent policy developments in China shows that the deal mostly locks in previous commitments on market access, including in the financial services and automotive sectors. While these are important for foreign companies, this is likely not something Beijing was planning to reverse. China's leaders know very well that they will need to continue to open up to achieve their development goals.

The financial sector is a case in point. Foreign financial services providers are now being allowed to play a larger role in the Chinese market because it is necessary for RMB internationalisation and integration into the international financial system. It also allows Chinese companies, who dominate domestically and now want to expand internationally, to further learn and improve. The interesting question is therefore whether effective implementation of the agreement will lead to changes to post-entry market access hurdles. Provincial expansion is for instance a complicated matter for most foreign businesses, and the agreement seeks to address this by making clear that licensing requirements and procedures should not act as barriers to investment. Any improvement here would not only go further than Beijing's existing commitments, but significantly improve the operating environment for European businesses.

Commitments related to sustainability, including to effectively implement the Paris Agreement on climate change and not to lower environmental standards to attract investment, also fit neatly in with China's own agenda. Environmental threats have become a top concern in Beijing, partly because they have sparked discontent among the country's citizens and threatened the party's hold on power. China has therefore set itself a target of becoming carbon neutral by 2060, launched an emissions trading system and under new guidelines from the Ministry of Ecology and Environment made climate action part of local government performance evaluation – adding pressure on provincial and regional leaders to take the issue seriously.

President Xi Jinping recently also said strong IP protection is key to building a modern Chinese economy and what he calls a “high-standard market system” - aligning with the agreement’s rules against forced technology transfers. China has for instance made efforts to strengthen IP protection through amendments to the country’s patent laws and commitments to work more closely with the World Intellectual Property Organisation. Importantly, this is not the result of external pressure, but because Beijing is concerned that Chinese entrepreneurs will stop innovating if they do not believe that their government is able to protect their IP from domestic rivals.

The problem, of course, lies with enforcement. While China likely will be able to meet its obligations under the Paris Agreement, perhaps even exceed existing targets, local leaders are under constant pressure to deliver on pre-determined economic growth targets – which count far more towards their evaluation than adhering to environmental standards. Lowering standards to attract investment will therefore remain tempting, at least if it is viewed as necessary to counter economic headwinds and meet job creation targets. After all, that is what will get local leaders their next job promotion.

And while the agreement has a way of dealing with non-compliance, European companies and their home governments are unlikely to make much use of the state-to-state settlement mechanism unless the case bears significant political importance, given time, cost and low probability of achieving a meaningful outcome. It is therefore doubtful that the agreement’s dispute resolution framework will be effective in the event of weak implementation of, for instance, rules against technology transfers.

The big unknown is if opposition in the European Parliament becomes too strong and the deal ends up not being ratified. While this would be a defeat for the European Commission, Beijing won’t shed tears should European lawmakers reject it after all. This is partly because China’s leaders are confident that European businesses will continue to pursue opportunities in China with or without the deal, having been encouraged by recent decisions by companies such as Volkswagen to invest billions more and by uplifting surveys on future investment plans conducted by the German Chamber of Commerce in China, which showed that 72% of companies are planning to increase investment in 2021 and that 96% have no plans to leave the Chinese market.

After all, most European companies are in China for the Chinese market and have responded to speculation about “decoupling” of certain supply chains, such as technology, by localising more R&D and production in China rather than fleeing to perceived safer harbours. For these companies, an agreement in principle is still important symbolically. It confirms that China does not plan to reverse the opening of its economy, that it wants to work with the EU to improve commercial relations, and that it wants European companies to take part in its future development.