Economic Watch

China | EU-China Comprehensive Agreement on Investment: a game-changer to superpower game

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China and EU announced the accomplishment of Comprehensive Agreement on Investment at end-2020

The most prevailing global economic news recently is the EU and China announced the accomplishment of a long-awaited EU-China Comprehensive Agreement on Investment (EU-China CAI) on December 30th 2020, in a move to open up more investment opportunities between two economies. The draft was officially confirmed by European Commission president Ursula von der Leyen, President of Council of the European Union Charles Yves Jean Ghislaine Michel, and the Chinese president Xi Jinping on December 30th's video conference, a moment that would finally bring seven years long-haul to a successful close. In the final stage, the accord needs to be ratified by the European parliament, a process that may not begin until the second half of 2021.

Actually, the China-EU negotiations on the bilateral investment treaty started early in November of 2013. Till now, both sides have already gone through 35 rounds of arduous negations on the contents. In July 2018, amid the trade war between China and the US, the China-EU summit was seeking for the acceleration of the negotiations of the agreement and put it as the first priority in the bilateral cooperation. Recently, in 2019, several factors indeed speeded up the process: the EU side wanted the deal to be done before the end of 2020 amid the pandemic raging and economic stumble; while from China's side, amid the lingering and unsettled China-US hardship, in the countdown to the inauguration of Joe Biden as new US president, China is pulling out the stops and offering concessions, catching the deadline to achieve a successful accomplishment.

In a general sense, the EU-China CAI will guarantee an unprecedented level of access to EU investors in China, allow EU companies to buy or establish new companies in key sectors, help level the playing field for EU companies in China and commit China to rules on state owned enterprises and transparency in subsidies. The necessary substantive commitments from China had been achieved on the three key pillars of the negotiations: market access, level playing field and sustainable development. The negotiated result is the most ambitious outcome that China has ever agreed with a third country or economy.

The contents of the comprehensive investment agreement in details could be summarized as follows. There are two main categories of the agreement: market access commitments by China and commitments on fair competition (Reference: European Commission: EU-China Comprehensive Agreement on Investment factsheet):

Market access commitments by China:

- Manufacturing: More than half of EU investment in China is in the manufacturing sector and this is the first time China has committed to market access in this sector with a trade partner. China's commitments in this sector include cars (traditional and new energy vehicles), production of transport and health equipment, and production of chemicals, among others.

- Services: Significant, binding commitments in financial services, international maritime services, environmental, construction and computer services. Further opening in services related to auxiliary air transport services, cloud services, and private health services.

Commitments on fair competition:

- State-owned enterprises: China to ensure that SOEs active in the market take decisions solely based on commercial considerations and do not discriminate European companies when they buy goods or services from them or sell goods or services to them. In addition, China to share information and consult if the behavior of SOEs affects EU investors.

- Transparency in subsidies: (i) Obligations on transparency as regards subsidies provided in the services sector. (ii) Commitment to share information and to consult on specific subsidies that could have a negative effect on the investment interests of the EU.

- Forced technology transfers: (i) Clear prohibition of investment requirements that compel transfer of technology. (ii) No interference in contractual freedom in technology licensing. (iii) Protection of confidential business information.

- Standard setting, authorizations, transparency: (i) Equal access to standard setting bodies for EU companies. (ii) Enhanced predictability in authorizations. (iii) Stronger legal certainty through transparency rules for regulatory and administrative measures.

- Sustainable development, effective implementation and dispute settlement: (i) Obligations on transparency as regards subsidies provided in the services sector. (ii) Commitment to share information and to consult on specific subsidies that could have a negative effect on the investment interests of the EU. (iii) Commitments to respect core ILO principles and to effectively implement the ratified ILO Conventions. (iv) Specific commitment on the ratification on ILO fundamental Conventions on forced labor. (v) Commitment to effectively implement the Paris Climate Agreement. (vi)Transparent resolution of disagreements by an independent Panel of experts and with the involvement of civil society.

What are the economic implications behind EU-China CAI?

Economically, the meanings of the EU-China CAI are multi-faceted, from alleviating China-US tensions to constructing an EU-China reciprocity investment relation, from prompting China's domestic structural reform and opening-up policy to stimulating economic growth in both regions.

First of all, the EU-China CAI provides China a way to alleviate the hardship with the US gracefully. Amid the escalating confrontation with the US in multiple issues starting from 2018, China is reaching out to other important trade partners such as EU and Asia to defend against the US. (See our recent Economic Watch: China | What is the implication of RCEP to Chinese and regional economy?) Actually, the EU has very similar requests for China as what Trump had in the phase-one deal, intrinsically. Therefore, among these requests from the US, almost all of them are covered through EU-China CAI. Thus, it will set an example for the US to negotiate with China to end the lingering tensions in past years. More importantly, it will add enormous pressure to the Biden administration because the European firms, with EU-China CAI in place, are likely to enjoy advantages in accessing to China's domestic market over their US peers. The US will have the urgency to solve the disputes with China soon to get equal treatments. (See our previous Economic Watch: China | What is our expectation of Bilateral Investment Treaty with the EU?)

Second, the EU-China CAI will promote reciprocity in China-EU investment relationship and re-invigorate the bilateral investment which largely lags behind the bilateral trade. The China-EU economic linkages have the long-lasting bias that the bilateral investment volume has been far less than that of the bilateral trade. In particular, in 2019, EU has already surpassed the US to become China's largest trade partner with bilateral trade volume reaching EURO 559.6 billion. However, bilateral investment volume was barely EURO 19 billion, only counted for around 3% of the total trade volume. The reason behind, citing the OECD research, is that China has the most stringent FDI policies for foreign investors in the world. Thus, the accomplishment of CAI will definitely help to expand the bilateral investment in many sectors in the future, helping to healing post-Covid economy in EU.

Third, it will also catalyze structural reforms and opening-up policy in China as well as boost China's domestic economic growth. Providing more market entry to the EU corporate investment could press ahead the SOE reform in China. By introducing free competition of foreign peers, especially the competition neutrality requirement of the state-owned enterprises, the agreement might lead the Chinese SOEs to participate in the international contests and to circumvent over-protections and soft budget constraint problem. Moreover, it will also have positive impact on China's private enterprises, as they might have more global investors and receive more fair competitions with their SOE peers. In the long run, China's opening-up policy will enhance the competitiveness of China's enterprises in the world arena. Regarding the economic impact, as the agreement significantly promotes bilateral foreign direct investment in and out of China, it stimulates China's growth in the medium to long term. In the short term, the new agreement improves market sentiment of China's investors, which is a positive signal to lead a buoyant Chinese financial market and RMB exchange rate etc.

Some caveats are still noteworthy

First, the agreement may create conflicts with the incoming US President Biden, who has emphasized the multilateralism for rallying with the traditional transatlantic allies to put pressure on China, disparaging EU-US relation to a certain degree. Considering the EU's own interests and discarding the Cold-war concept, the EU would like to take the first mover advantage to cooperate with China, urging to stimulate post-Covid economy taking use of the new investment agreement. On contrast, the Biden team has made clear that it wants a multilateral alliance with the EU and other partners to put pressure on China, ending the Trump era of going it alone. Some US foreign policy researcher deemed that the sudden China-EU rapprochement snubs the incoming administration of Biden, just three weeks before his inauguration. (See our recent China Economic Watch: China | The impact of Biden's victory on Chinese economy and the Sino-US relationship)

Second, regarding the scope of the EU-China CAI, it only covers a subset of a possibly future free trade deal between the two sides. The agreement is far narrower in scope than a free trade deal, and issues including public procurement and Chinese overproduction of steel fall outside its scope. Moreover, if measured against original European hopes for a "fundamental rebalancing of the EU-Chinese economic relationship", it might not be regarded as a very good deal in favor of the EU. However, the deal does commit China to uphold sustainable development goals and the Paris climate agreement. Thus, the EU-China CAI is deemed to be a major step towards negotiations on a free-trade agreement which has no timeline yet between the two economies.

Third, the true success of the EU-China CAI hinges on the implementation. The CAI comprises dispute settlement procedures, with the possibility that the EU can withdraw market-access opportunities if China does not meet its obligations. That means, if China does not deliver what it promises in practice, then the EU must also have options to deviate from the agreement and to close its market. Especially when it comes to the issue of Chinese state capitalism and the distortion of competition, this situation might happen in the future, making the CAI fraught with uncertainties. Thus, some perseverance is indeed needed to witness a reciprocity bilateral investment relationship to be completely constructed under the EU-China CAI framework.

In summary, it is tempting to conclude that the EU-China CAI will become a game-changer to the superpower's game in the aftermath of the pandemic world. It is beyond the US imagination that, under Trump's political heritage of "American First" policy and comprehensive trade war with other regions, China will be trotting ahead towards an ever-tightening relationship with the EU and Asia (indicated by RCEP); it is also beyond the US imagination that the EU, traditional transatlantic ally of the US, already abandoning Cold-war stereotypes, will come closer to China to take the first mover advantage of achieving the bilateral investment agreement; it is again beyond the US imagination that with the hope to rally other allies to curb China's tech sector and decoupling with China, it finally makes itself more isolated. Altogether, the previous priority of China-US economic relationship from the perspective of China might give way to China-EU relation in the foreseeable future. However, in the post-Covid world, perseverance is still needed to facilitate global recovery under the framework of these new bilateral or multilateral agreements.

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