



The EU–China Bilateral Investment Agreement: Between High Hopes and Real Challenges

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In 2012, negotiations over an EU–China bilateral investment agreement were launched to fully tap into the potential of bilateral investments. This policy brief gives an overview of the current negotiation process and argues that the high hopes advanced politically and economically in the agreement must be weighed against the many challenges and obstacles the negotiations face, regarding current events in EU–China relations, in global trade and investment regimes, and the limits of EU competencies. Strategically, the agreement could be important, as it offers the potential to strengthen the EU’s global economic relevance. This brief concludes that there is much to gain if the EU follows a coordinated approach and remains mindful of these (potential) obstacles.

A NEED FOR INCREASED INVESTMENT

In January 2016, representatives of the European Commission and the Chinese Ministry of Commerce met in Beijing for the ninth round of negotiations over a bilateral investment agreement (BIA) between the EU and China. Negotiations over the BIA were initiated after the eurozone crisis erupted in

2008. The need for liquidity in European countries served as an impetus to enhance the possibilities of acquiring investments from outside Europe, while China pursues secure and predictable environments for its investments. The EU–China BIA is one of the priorities of the EU’s new trade and investment strategy ‘Trade for All’, as a means to deepen relations with China. According to optimistic estimates, the negotiations could be concluded within one year.

Historically, EU–China relations have been focused to a large extent on trade in goods, and recently trade in services has also been growing rapidly. The field of investments is still seen as holding vast untapped potential for European and Chinese economies. While China is the EU’s second largest trading partner, investments from the EU in China amount to a mere 5% of European investments abroad and only a fraction of the overall trade volume. In turn, Foreign Direct Investment (FDI) from China represents less than 3% of the total FDI inflow into the EU.¹ The BIA is under negotiation to increase the market access of European companies in China as well as facilitate Chinese investments into European countries, thereby increasing the overall investment flows between the EU and China.

HIGH HOPES FOR THE BIA

In addition to the anticipated economic gains from increased investments, European policy-makers and businesses alike have placed high hopes in the conclusion of this agreement. Following recent stagnation in the EU–China relationship, the BIA is seen as a realistic opportunity to rekindle relations on a substantial level. On the political side, EU–China relations have lost momentum since the negotiations on a Partnership and Cooperation Agreement – conceived as the next step in enhancing the EU–China relationship – stalled in 2011. The Comprehensive Strategic Partnership concluded in 2003 remains rather vague in its language, prompting many to doubt its significance. Similarly, the large number of dialogues the EU maintains with China (over 70 in total), convened in varying intervals, does enhance exchange on different levels, but is criticised for its lack of concrete and visible output. The conclusion of the BIA would hence represent the first major agreement between the EU and China since 2003.

On the business side, China’s strategic importance to the global investment plans of European companies remains unparalleled. However, while 76% of the respondents in the annual business confidence survey of the European Chamber of Commerce described China as their top or top three destination for new investments in 2012, this number dropped to 58% in 2015.² This fall is due to the difficult regulatory environment in China. Despite reform initiatives by the Chinese government, many remain unconvinced that the situation will improve soon. For instance, the European business sector had high hopes that the Shanghai Free Trade Zone (SFTZ), an experimental arrangement, would include currency liberalisation, market-determined interest rates and free trade. Yet, reforms have been slower than anticipated, the list of industries off-limits to foreign investors remains too long, and, overall, the

expectations for the SFTZ have hardly been met. The inclusion of substantial market access in the BIA, however, would ease and expand the possibilities for European companies operating in China.

DIFFERING OBJECTIVES

Investment agreements are designed to establish the terms for investment between the participating countries, determine the level of protection of investments, as well as the number of guarantees, procedures and opportunities available to investors in the event of conflict with the state. The EU and China, however, differ in their specific objectives regarding the BIA.

The objectives of the EU include improving the legal certainty regarding treatment of EU investors in China, improving the protection of EU investments, reducing investment barriers and increasing the bilateral investment flows. Market access – the largest impediment to EU investment in China – remains the most salient issue. A study by Copenhagen Economics on behalf of the European Commission found that the existing BIAs between individual Member States and China already provide investment protection – although most of these BIAs are no longer reflective of economic realities since they were agreed in the 1980s and 1990s. The study concludes that a mere consolidation of current BIAs with China into a single EU-wide agreement would be unlikely to significantly increase FDI flows from the EU to China, but this assessment changes and includes substantial benefits through increased FDI flows when considering the reduction of current investment barriers.³ Hence, the impact of a BIA with China for the EU depends on the inclusion of substantial market access.

Existing restrictions to foreign investors in China include pre-establishment treatment of investors such as market entry and government approval, equity and technology transfer (joint

venture obligations), as well as limited access to financial support and government procurement and unfair competition practices of Chinese State-Owned Enterprises post-establishment.

In contrast, market access is less urgent for China as the European market is already relatively open to foreign investments. For China, the consolidation of existing BIAs into a single regulation providing more clarity would already be of great benefit. The BIA also provides an opportunity for China to prove its reliability as a partner, especially in light of its interest in negotiating a Free Trade Agreement (FTA) with the EU in the long run. The EU has indicated consent to FTA negotiations under the condition that the BIA be successfully concluded and that China demonstrates progress in its internal reforms, especially regarding the role of the market and creating a level playing field for foreign investors. China's specific objectives for the BIA are to consolidate the status quo and create EU-wide uniform protection for Chinese investments, to increase the legal certainty regarding the treatment of Chinese investors in the EU, to safeguard the existing openness of EU economies to investments, and to increase the overall investment flows.

The changing commercial and business motives of Chinese companies and the diversification of Chinese investments increase China's need to find secure places for investments. Chinese investments are increasingly moving away from energy and raw materials in developing countries and into energy distribution, infrastructure, mergers and acquisitions for brand names, high technology and market shares in advanced economies.⁴ In line with this development, the Chinese government is encouraging companies to invest overseas through its 'Going Out' policy, and pursuing negotiations on investment treaties.

LIMITS TO EU COMPETENCIES?

The EU and China formally announced the launch of the BIA negotiations during the EU–China Summit in February 2012. This is the first negotiation of a stand-alone investment agreement under the new Lisbon Treaty (2009), which makes FDI an EU competence. Hence the European Commission negotiates on behalf of the Member States. However, the Treaty does not provide a definition of FDI and therefore does not define the exact scope of the EU's competence in this area, which is contested regarding the protection of foreign investment, transport services, intellectual property, transparency and sustainable development.

The EU's approach to solving this problem has so far been to await the decision on a different case, namely the EU–Singapore FTA, which was referred to the European Court of Justice in 2014.⁵ However, the Court has not yet reached a conclusion. If the Court decides that the competencies of the EU Institutions do not reach sufficiently far, this could greatly delay the ratification of the BIA – and other trade agreements, for that matter – as each will need to be ratified by each Member State's parliament. This could increase the weight of individual Member States in the negotiation process. National parliaments could also block the agreement, although to date few Member States' parliaments have exercised this scrutiny in mixed agreements. The extended ratification process would, however, prolong the already rather lengthy process of negotiating a market access agreement and delay its implementation.

The concluded agreement must in any case pass through the Council and the European Parliament (EP). However, especially in the EP, there has not been much debate over the BIA until now. This might prove dangerous, as the negotiations will already be concluded by the time of voting in the EP and the likelihood of incorporating changes would be very low.

The power of the EP should not be underestimated as it has proven that it can and will deny consent when it deems this appropriate.⁶ On current trade and investment relations, the EP has been very vocal on existing Investor–State Dispute Settlement Schemes (ISDS), prompting the Commission to present a possible new model. This proposition would, if agreed by China, also be included in the BIA.⁷

REACHING A VIABLE AGREEMENT

Since 2012, nine rounds of negotiations have been held. During the latest round, in January 2016, an agreement was reached on the scope of the agreement, meaning that the negotiations can move into a more substantive phase, negotiating on a common basis and specific content. EU officials see this as a very important step that was anticipated by the President of the Commission Jean-Claude Juncker and the Chinese Prime Minister Li Keqiang during the EU–China Summit in Summer 2015.

However, doubts are raised that an effective and viable agreement can be reached in the near future. Indeed, in addition to the possible difficulties in the ratification process outlined above, there might be further impediments to the negotiations. In December 2016, a provision in China’s accession protocol to the WTO from 2001 expires, prompting a debate on how to deal with this change. China sees it as its legal right according to the WTO protocol to be granted Market Economy Status (MES) at the end of this year. This view is not supported by most in the EU institutions, as China does not fulfil the EU’s criteria for MES. However, the current legislation allowing the EU to impose anti-dumping measures against Chinese goods with distorted prices will most likely need to be adapted by December, in order to further protect European steel, chemical and ceramic industries. Any decision of the EU regarding China’s MES might impact the negotiations on the BIA if China

feels wrongly treated. However, even if China were to link MES to progress on the BIA, this does not imply that the EU needs to be susceptible to Chinese pressure, as the leaked decision of the Commission’s legal service from June 2015 suggests. In any case, China’s incentives to keep the negotiations going are very strong.

Even though the EU is very keen on attracting Chinese investments, for instance, through its participation in the European Fund for Strategic Investment (EFSI),⁸ China is also in need of increasing its investments abroad and securing its place in global and regional trade and investment regimes. Most notably, China has been excluded from the Trans-Pacific Partnership (TPP), a free trade agreement concluded with 12 Pacific-Rim countries under the lead of the United States. With the United States simultaneously negotiating Trans-Atlantic Trade and Investment Partnership (TTIP) with the EU, trade and investment infrastructure is being built up globally. China could increase its role in these global dynamics by negotiating an FTA with the EU. Yet this will only happen after the successful conclusion of the BIA.

At the same time, the United States is also negotiating an investment agreement with China. The negotiations differ from the EU’s as European countries already have BIAs in place with China, hence a baseline on investment protection already exists. Already launched in 2008, the negotiations between Beijing and Washington have not been at the top of the political agenda. While both governments remain positive, business has voiced disappointment over the progress made. In September 2015, reduced ‘negative lists’ were exchanged, outlining the sectors China seeks to exclude from the agreement. This is a positive sign for the EU–China BIA, given that the EU has been urging for the use of a negative list as well to ensure market access for European companies. As the negotiations are

going on in parallel, a comparison of both agreements, when finalized, will surely be interesting.

The challenge for the EU will be to strike a balance between the short-term economic interests of its Member States, possible pressures from China, and ideally positioning the EU in global trade regimes. To be sure, the global trade picture is becoming more complex with the increase of overlapping regional trade and investment agreements. In this context, it is paramount that the EU retains a central place as leading trade region, and strengthens its economic relevance through the conclusion of state-of-the-art trade and investment agreements. To this end, an overview and coordination between the many different projects, initiatives, platforms and agreements is essential.

In contrast, lack of coordination among Member States, as was seen in early 2015 when European countries rushed to join the Asian Infrastructure Investment Bank individually, significantly impairs the EU's negotiating power. Sustained lack of coordination could negatively affect the EU's decision-making abilities on MES, its coordination with the 16+1 forum between China and Central and Eastern European countries, its participation in China's One Belt, One Road (OBOR) initiative, and, of course, the negotiations over the BIA – resulting in poorer outcomes for the EU.

The relationship between the EU and China has long been driven by Member States rather than by following a concise EU-led strategy. Against this background, Member States have followed different trade strategies towards China, many of which focussed more on trade in goods than attracting FDI. Given that in the current economic situation investments are seen as the main contributor to economic growth – creating jobs and increasing productivity – the Commission welcomed

China's announcement that it would invest in the EFSI. However, previous Chinese investments have come under criticism in many European countries for misconduct, lack of quality, social dumping, as well as targeting sensitive industries and even sparking fears over national security risks. In these cases, the BIA may serve as a tool to ensure a high standard of Chinese investments in the future.

CONCLUSION

The need for investments in Europe and China alike is driving the negotiations. From this outset it is likely that the different objectives in the negotiations can be consolidated. In addition, as OBOR on the Chinese side and the EFSI on the EU side are already under way, they can serve as tools to increase bilateral investments in the short-term and bridge the period of time until the BIA comes into effect. In contrast, even though negotiations on the BIA may be – by optimistic calculations – concluded within one year, the agreement would only come into effect after several years, depending on the possibly extended ratification process. The BIA therefore serves as a long-term tool to enhance investment between the EU and China, rather than promising short-term benefits.

Another factor to be kept in mind are the economic developments in China and worries about a significant slowdown of the Chinese economy. As undecided as economists are in predicting what might happen in China in the next year and to what extent the Chinese Communist Party has the tools to mitigate a possible hard landing, the long-term effects on European economies also remain to be seen. However, due to the overall slow-down of the Chinese economy, China's interest in increasing its investments abroad, and its ambition to progress towards an FTA with the EU are all strong indications of China's willingness to finalize the negotiations in the near future.

To conclude, successful negotiations have the potential to not only increase investment flows and contribute to economic growth, but also to strengthen the EU's overall relationship with China. They can further serve to demonstrate the effective implementation of the EU's trade and investment strategy internally and strengthen the EU's economic relevance in global trade and investment regimes. However, policy-makers on both sides of the negotiations need to remain aware of the potential obstacles. In order to obtain the best outcome, the EU needs to follow a coordinated approach and ensure that the implementation of the agreement actually significantly improves the situation for

European companies in China. As the example of the Shanghai Free Trade Zone has shown, all that glitters is not gold.

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ENDNOTES

¹ European Commission (2015): *Trade Policy – Countries and Regions – China*. Available at <http://ec.europa.eu/trade/policy/countries-and-regions/countries/china/>

² European Chamber of Commerce in China (2015): *European Business in China*. Business Confidence Survey. Available at http://www.eurochamber.com.cn/en/publications-archive/334/Business_Confidence_Survey_2015

³ Copenhagen Economics (2012): *EU–China Investment Study. Final Report*. June 2012. Available at <http://www.copenhageneconomics.com/dyn/resources/Publication/publicationPDF/3/313/1435826144/44-24-eu-china-final-report-11jun2012.pdf>

⁴ Godement, F., Stanzel, A. (2015): *The European Interest in an Investment Treaty with China*. ECFR Policy Brief. Available at http://www.ecfr.eu/page/-/ECFR127-The_European_interest_in_an_investment_treaty_with_China_%28both_graphics%29.pdf

⁵ European Commission (2014): C(2014) 8218 final. Commission Decision of 30.10.2014 requesting an opinion of the Court of Justice pursuant to article 218(11)TFEU on the competence of the Union to sign and conclude a Free Trade Agreement with Singapore. Available at <http://www.statewatch.org/news/2015/feb/eu-com-fta-cjeu-com-8218-14.pdf>

⁶ For instance, in 2012, the EP rejected the Anti-Counterfeiting Trade Agreement (ACTA), which could henceforth not become EU law.

⁷ European Commission (2015): Commission proposes new Investment Court System for TTIP and other EU trade and investment negotiations. 16.09.2015. Available at: <http://trade.ec.europa.eu/doclib/press/index.cfm?id=1364>

⁸ The EFSI is part of the EU's Investment Plan, an initiative to increase investment in the EU. The goal of the EFSI is to address market gaps and mobilise private investment in key areas such as infrastructure, education, research and innovation. In 2015 China announced its intention to invest into the EFSI.



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