

EU-China Comprehensive Agreement on Investment

Levelling the playing field with China

OVERVIEW

Lack of reciprocity in access to the Chinese market and the absence of a level playing field for EU investors in China have posed major challenges for EU-China investment relations in recent years, with the negotiation of a comprehensive agreement on investment (CAI) being considered by the EU a key instrument to remedy this state of play.

The CAI negotiations aimed at establishing a uniform legal framework for EU-China investment ties by replacing the 25 outdated bilateral investment treaties (BITs) China and EU Member States had concluded prior to the entry into force of the Lisbon Treaty in 2009 when the EU gained competence for most investment issues. The CAI was intended to go far beyond traditional investment protection, also covering market access, investment-related sustainable development, and level playing field issues, such as transparency of subsidies, and rules on state-owned enterprises (SOEs) and forced technology transfer.

On 30 December 2020, negotiators reached an agreement in principle which is now undergoing legal scrubbing and will subsequently be translated into all official EU languages – which may take up to one year – before it will be formally submitted to the Council for approval and to the European Parliament for consent.



Comprehensive Agreement on Investment between the European Union and its Member States, of the one part, and the People's Republic of China, of the other part

Committee responsible: International Trade (INTA)
Rapporteur: Iuliu Winkler (EPP, Romania)

Lack of reciprocity in market access and a level playing field

The EU has a [principled policy of openness](#) of its market to foreign direct investment (FDI) as a major source of growth and innovation, while China's FDI framework is regularly [gauged](#) by the Organisation for Economic Co-operation and Development (OECD) as one of the most restrictive of the countries investigated. From a legal point of view, however, China is largely free to restrict market access for FDI as it seems fit. First, there is no multilateral investment agreement setting out binding rules for market access or investment protection; an [initiative](#) launched in 1995 for negotiations on a multilateral investment agreement (MAI) failed in 1998 owing mainly to incompatible positions on investment protection standards between developing and developed countries. Second, China made limited commitments under the General Agreement on Trade in Services ([GATS](#)) (establishment of commercial presence in the partner country (mode 3) with the objective of providing services) and the Agreement on Trade-Related Investment Measures ([TRIMS](#)) (which [does not regulate](#) investment, but rather addresses investment measures that may distort trade) when it joined the World Trade Organization (WTO) in 2001.¹

In the past few years, China has proceeded to selective liberalisation (e.g. removal of [ownership limits](#) in the financial sector or the gradual [phasing out](#) of the joint venture requirement for certain sectors) and sector-specific market openings, by shortening the restricted and prohibited sectors on the various '[negative lists](#)' applicable to foreign investors or to all investors in China. In December 2020, a revised national market-access negative list for private investors, both Chinese and foreign, was [released](#) that cuts the number of prohibited or restricted sectors from 131 to 123. Relaxed rules [concern](#) sectors such as oil and gas, resource management, and trading and financial services. At the same time China [expanded](#) its catalogue of encouraged industries for FDI which may have contributed to China [surpassing](#) the US in 2020 as the world's largest FDI destination. In 2019, China [adopted](#) a [new Foreign Investment Law](#), which entered into force in January 2020. The law prohibits forced technology transfer (FTT) as a precondition for investment, a [long-standing issue](#) for foreign businesses operating in China. The implementing rules for the new law [emphasise](#) equal treatment of domestic and foreign-invested firms with regard to land supply, government procurement, licensing formalities and protection of intellectual property, among others.

Recent reforms notwithstanding, China's domestic laws [differentiate](#) between rules for foreign companies, domestic private companies and domestic state-owned or state-controlled companies, with an inbuilt logic of discrimination against the former to the advantage of the latter. This sharply contrasts with EU company law and EU competition law which do not distinguish between foreign and EU companies, be they private or public, under a concept of '[competitive neutrality](#)' currently [not embraced](#) by China. The lack of a level playing field for EU companies in China as compared to Chinese firms in the EU – where the latter benefit from the non-discrimination principle enshrined in EU law – has become a major bone of contention in EU-China relations. EU state aid rules are not applicable to foreign companies, including Chinese ([state-owned](#)) enterprises benefiting from domestic subsidies to pursue strategic government goals, notably industrial policy objectives. In addition to the CAI talks, much [more EU action](#) is [needed](#) in various policy areas to [tackle](#) these challenges.

Moreover, in recent years China has enacted a series of [security-related](#) laws (the [National Intelligence Law](#) and the [Cybersecurity Law](#)) and [regulations](#) that may hamper the operation and freedom of investment of foreign firms, in addition to the existing FDI restrictions, thus potentially offsetting past gradual steps towards liberalisation. In late 2020, China adopted new [export control rules](#) and new [foreign investment security review](#) measures, largely mirroring US legislation but with a significantly broader definition of national security; their impact in practice still remains to be seen. These rules typically remain unaffected by liberalisation provisions of international agreements such as the CAI, based on exception clauses on national security grounds, and thus can unfold their full legal impact. China also published a [draft](#) Data Security Law with [enhanced](#) extraterritorial application compared to the Chinese Cybersecurity Law. In January 2021, China issued a [Blocking](#)

[Statute](#) to Counteract Unjustified Extraterritorial Application of Foreign Legislation and Sanctions which, unlike the [EU Blocking Statute](#), allows for significant [discretion](#). Since subsidiaries of foreign companies incorporated in China are deemed Chinese firms required to comply with the Blocking Statute, the latter is [assumed](#) to entail compliance challenges to companies that are subject to both foreign legislation and the Blocking Statute.

This trend is compounded by China's state-sponsored industrial strategy [Made in China 2025](#) aimed at reducing the country's reliance on foreign technology by replacing it with indigenous technology in several strategic high tech sectors in line with its [dual-circulation economic model](#). Other restrictions, such as the country-wide rollout of a [corporate social credit system](#), are set to further complicate the investment climate for EU business in China. The EU [considers](#) the CAI a major tool to address these issues and rebalance EU-China economic relations. However, while the EU has been calling for reciprocal market access and equal treatment for EU firms in China, China has regularly [dismissed](#) these calls on the grounds that its developing country status justifies the lack of reciprocity. As China boasted the world's second largest economy at [US\\$14.3 trillion](#) in 2019, its self-declared developing country status is increasingly [contested](#).

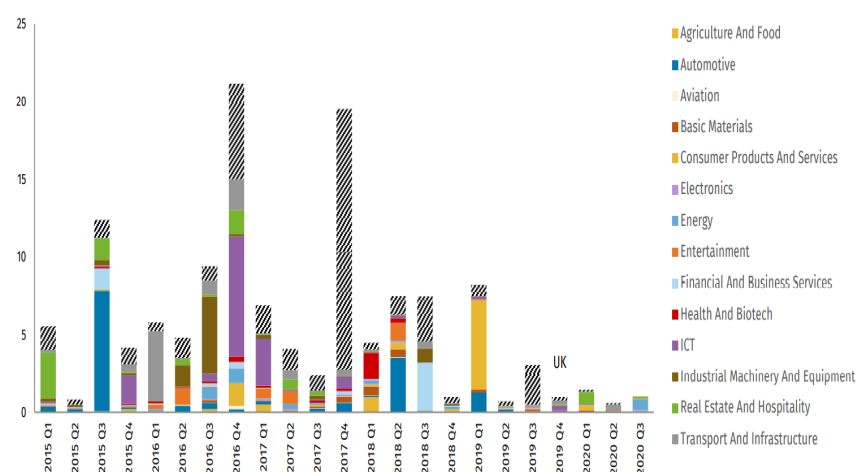
EU-China legal framework for investment

At present, the EU-China legal framework covers only investment protection based on the 25 bilateral investment treaties (BITs) that EU Member States (MS) signed with China before the EU gained competence for FDI under the 2009 Treaty of Lisbon, within the boundaries set by the 2017 [Opinion 2/15](#) of the Court of Justice of the European Union (CJEU). There are no bilateral provisions on investment liberalisation in force, since the [1985 EU-China Agreement on Trade and Economic Cooperation](#) does not contain market access provisions for investment.² As a result, the current EU-China legal framework does not cover market access and the 25 BITs in force covering 26 EU Member States are outdated and reflect neither recent developments in the EU's and China's investment policy, nor major shifts in the bilateral and international investment relations or geopolitical changes. (For an analysis of these BITs please see the [first edition](#) of this briefing.)

EU-China FDI stocks and transaction-based FDI flows

China's footprint in the EU as a foreign investor has changed significantly in quantitative and qualitative terms over time. According to the European Commission (data as of May 2019), the EU-28's FDI stock in China in 2017 [totalled](#) €176 billion, accounting for only 4 % of the EU's global FDI, and China's FDI stock in the EU stood at about €60 billion corresponding to 2 % of overall FDI inflows in the EU. While traditional investors such as the US, Canada, Switzerland, Norway, Japan, and Australia [remain](#) by far the EU's top investors, accounting for 80 % of all foreign-owned assets across all sectors of the EU economy, 'China, Hong Kong and Macao' is catching up: It has gone from controlling just 5 000 firms in the EU in 2007 (2.5 %) to more than 28 000 (9.5 %) in 2017. However,

Figure 1 – Value of completed Chinese FDI transactions in the EU by industry, US billion*



Source: [Rhodium Group](#). *Data cover EU-27, with the UK displayed separately.

'China, Hong Kong and Macao' has only increased its controlled assets of all EU-based companies very moderately from 0.2 % in 2007 to 1.6 % in 2017.

China's efforts to transition to a more service and domestic consumption-driven growth model and its [ambitious](#) Made in China 2025 goals have been the main drivers of the country's FDI flows to the EU. However, stricter [controls](#) of capital outflows from China for 'irrational' FDI have [curbed](#) FDI flows to the EU and the US. The ramping up of the US [FDI screening mechanism](#) and [export controls](#) as well as the [adoption](#) by the EU of a new [FDI screening framework](#) on grounds of security and public order have led to a [downward trend](#) in Chinese FDI inflows into the EU (note the different values on the horizontal axes of Figures 1 and 2). What has distinguished Chinese FDI in the EU from

EU FDI in China oftentimes is that the former has focused on technology- and market-seeking acquisitions, while the latter has emphasised job-creating [greenfield investment](#) in China. In Q3 2020, 50% of Chinese deals involved SOEs, confirming a distinctive feature of Chinese FDI – a large share of SOEs among Chinese acquirers. Research [shows](#) that private Chinese investors are distinct from other investors in several respects.

EU and Chinese negotiating practices

Investment-related agreements the EU and China have negotiated or concluded in the recent past suggest that there is a wide gap between the parties' diverging levels of ambition as regards the granting of pre-establishment market access, post-establishment equal treatment, investment protection and trade and sustainable development provisions.

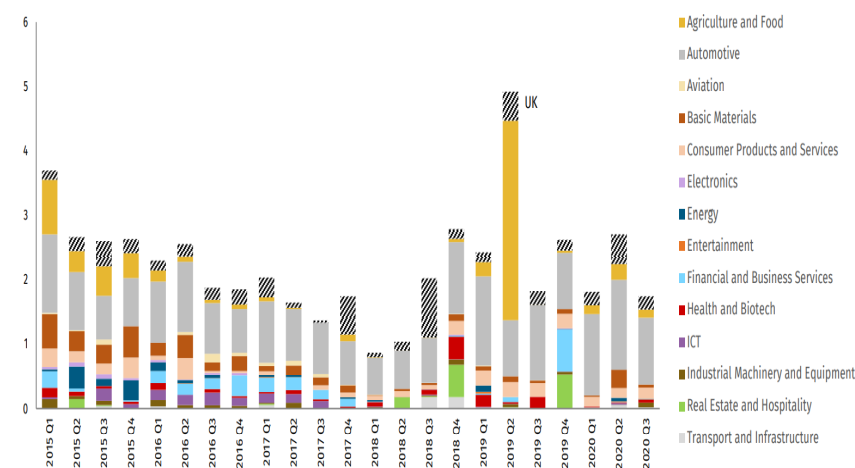
The EU's recent investment negotiating practice

In recent years, the EU has negotiated state-of-the-art free trade agreements (FTAs) and IPAs with various countries, including with Canada, Japan, Mexico and Vietnam. An important objective of post-establishment protection has been to convert the patchwork of BITs EU Member States had bilaterally concluded with them into a uniform legal framework for investment protection and market access.

The [reformed approach](#) taken by EU investment policy features four major elements:

- first, the EU has replaced the traditional investor-state dispute settlement (ISDS) with a new two-instance investment court system ([ICS](#)), which it seeks to substitute with a [multilateral investment court](#) (MIC);³
- second, the EU uses a distinct provision on the [right to regulate](#), which reaffirms the capacity of states to adopt measures in pursuit of public policy objectives including national security. These provisions provide a safeguard for states against investor claims whenever public policy initiatives protecting citizens or the environment clash with the interests of investors;

Figure 2 – Value of completed EU FDI transactions in China by industry, US billion*



Source: [Rhodium Group](#). *Data cover EU-27, with the UK displayed separately.

- third, the EU has systematically mainstreamed its ambitious sustainability agenda, including environmental and labour provisions, into its agreements;
- fourth, clearly defined protection standards that make them less susceptible to interpretation.

China's recent investment negotiating practice

China has signed or concluded close to [130 BITs](#) both with developing and developed countries at various stages of its development but has [no consistent](#) negotiating practice. Changes in the BITs' substantive provisions mirror China's shifting interests from formerly being an exclusive capital-importer to becoming a growing capital-exporter. In the recent past, China has also concluded FTAs with investment provisions. A case in point is the agreement with Australia (ChAFTA).

China has borrowed some features of the '[NAFTA](#)' ([North American Free Trade Area](#)) [template](#) for the BIT template it uses with developing countries (for instance language such as 'in like circumstances' to narrow the scope of protection standards). Some other features are borrowed from the European model BIT and some from the US model BIT, used since 2008 by the Obama Administration for the since stalled [negotiations](#) on a US-China BIT, including the US '[negative list](#)' approach to market access, which sets out restricted or prohibited sectors for FDI as opposed to a 'positive list' approach including all sectors open to FDI.

However, as regards the scope of provisions of key interest to the EU, such as pre-establishment and post-establishment national treatment (NT) and regulatory issues, in recent negotiations China has not moved very much beyond its conservative stance, preserving policy space for discriminatory practices at home. In its [IPA](#) concluded with [Canada](#), in force since 2014, and in the investment chapter of its [FTA](#) with [Australia](#), in force since 2015, China [has not granted](#) pre-establishment NT to investment from Australia and Canada and it has made NT in the post-establishment phase subject to its domestic law, with carve-outs for existing non-conforming measures. China has granted most favoured nation (MFN) treatment in the pre-establishment phase, but that does not apply to agreements previously concluded and would only be meaningful if a country were first to be granted unqualified pre-establishment NT.

The departure from [Australian](#) and Canadian negotiating practice in respect to China has postponed unresolved issues (such as rules on performance and local content requirements or technology transfer) to a future review exercise as regards Australia and overall has led to an asymmetric outcome characterised by [non-reciprocal elements](#) in terms of market access, to China's advantage.

Potential impact on the CAI negotiations

China's gradualist approach to negotiating investment provisions with Australia and Canada, the consequent absence from the China-Australia and China-Canada agreements of reciprocal investment rules that would level the playing field, and the lack of a solution for crucial issues such as rules on performance requirements going beyond TRIMS, licensing and authorisation procedures, subsidies, rules for SOEs, labour and environment standards, and transparency, does not bode well for the ambitious agenda of the EU-China CAI negotiations. China has so far not entered trade and investment agreements with robust provisions on labour rights, and has only ratified four of the eight core conventions of the International Labour Organization (ILO) that the EU typically expects its partners to have ratified or at least to be willing to ratify. Missing are Conventions 29 and 105 on forced labour, Convention 98 on the right to organise and collective bargaining, and Convention 87 on the freedom of association. It remains to be seen whether the EU FTA with Vietnam, which thanks to the pressure from the European Parliament led to a time-bound roadmap for ratifying missing ILO conventions, could be a model for the CAI.

Since the US-China BIT negotiations based on the comprehensive approach of the US model BIT have led nowhere and it is too early to judge whether the [systemic issues](#), notably as regards the protection of intellectual property rights tackled in the Trump Administration's 2020 [US-China Phase](#)

[One Deal](#) but [lacking](#) monitoring indicators will actually be enforced, obtaining far-reaching and truly enforceable concessions from China in the CAI negotiations may be a tall order for the EU.

EU negotiation objectives

The EU-China CAI has been conceived as a stand-alone investment agreement that does not include trade issues and therefore will not tackle issues concerning EU firms' access to the Chinese procurement market. Its scope [extends](#) beyond the usual investment protection dimension to [cover](#) market access for investment as well as regulatory issues and investment-related sustainable development. According to the European Commission's 2013 [impact assessment report](#), the CAI is set to address the following challenges in the EU-China investment relationship:

- the major **discrepancy** between the overall EU-China trade relationship and investment;
- the **lack of a level playing field** for prospective and existing EU investors in China owing to the lack of a predictable and secure regulatory environment in China, leading to a growing imbalance, given the relative absence of barriers in the EU to Chinese investment;
- **market access limitations** for EU investors in China (licensing requirements and procedures, foreign ownership limitations, regulatory approval procedures, prohibition to invest/limited scope of business, joint venture requirements);
- **discriminatory treatment** of established EU investors in the form of more burdensome administrative rules and requirements for foreign investors, insufficient protection of intellectual property rights and key technologies, subsidies to Chinese competitors and the conduct of SOEs in China;
- **lack of a comprehensive framework** to remedy shortcomings in EU-China investment ties;
- a **patchwork of BITs** concluded between China and 26 Member States, resulting in an uneven playing field between investors from different Member States and China.

These challenges have translated into [specific objectives](#) for the negotiations on the CAI, to:

- enhance **legal certainty** as regards the treatment of EU investors in China,
- improve the **protection of EU investments** in China,
- **reduce barriers** to investing in China, and
- foster and facilitate **bilateral investment flows** to unlock untapped potential.

Owing to developments in EU policy since 2013 as a result of the Commission's 2015 [Trade for All](#) strategy and the EU's shift from the ISDS to a new ICS, the EU's specific objectives also include:

- supporting **sustainable development** by encouraging responsible investment and promoting core environmental and labour standards, and
- allowing for the effective **enforcement of commitments** through investment dispute settlement mechanisms available to the contracting parties and to investors.

The Sino-US Phase One deal struck in January 2020 and in force since February 2020 obviously has an impact on the CAI talks, since the EU seeks to obtain at least the same [concessions](#) from China.

Counterpart's position

According to the European Commission's 2013 [impact assessment report](#), China's specific objectives can be summarised as follows:

- establishing **uniform EU-wide protection** for Chinese investments in the EU,
- improving **legal certainty** regarding the treatment of Chinese investors in the EU,

- **preserving the existing openness** in the EU to Chinese investors,
- increasing Chinese **investment flows** to the EU, and
- pushing **more favourable consideration of visa**, work permit and intra-corporate transferees in the EU for Chinese investors.

China's key interests [focus](#) more on seeking uniform treatment and protection for its investors than on bigger access to the EU market, since the EU is already open to a high degree for FDI. However, on the Chinese side concerns have been growing over the increasing backlash against Chinese investors in the EU and increasing calls for [action](#) to [control FDI inflows](#) on grounds of national security or public order. As such, China seeks to safeguard the existing openness of the EU.

Parliament's position

In its 2013 [resolution](#) on the EU-China negotiations for a bilateral investment agreement Parliament:

- stressed the need for the highest possible level of **transparency** in the negotiations as one of the preconditions for its consent to the outcome of the negotiations;
- urged the Commission to negotiate an **ambitious and balanced** CAI that would seek to improve market access for EU investors in China and vice versa, in order to increase reciprocal capital flows, and guarantee transparency regarding the governance of state-owned enterprises and private companies;
- pointed to the need to **address Chinese interventionist industrial policies**, ambiguities in the substance and application of laws and regulations;
- called on the Commission to complement its impact assessment by also evaluating the **CAI's impact on human rights**.

In its 2018 [resolution](#) on the state of EU-China relations, Parliament called on both parties:

- to renew their efforts to advance the negotiations, with a view to achieving a genuine **level playing field** for EU businesses and workers and at ensuring reciprocity in market access;
- to include specific provisions on SMEs and a **sustainable development** chapter with **binding commitments to international labour and environmental standards**.

Individual MEPs submitted [parliamentary questions](#) to the Commission in 2020 on matters including: the impact of issues raised by the pandemic on the CAI's [substance](#), the CAI's coverage of [climate change provisions](#), the EU's [economic leverage](#) in the face of national security legislation for Hong Kong, whether the CAI is a [stepping stone](#) to an FTA, and [market access restrictions](#) in China.

Human rights

In its [resolution](#) of 21 January 2021 on the crackdown on the democratic opposition in Hong Kong, the European Parliament regrets 'that the decision on a political conclusion of the CAI has not reflected Parliament's requests in previous resolutions on Hong Kong to use investment negotiations as a leverage tool aimed at preserving Hong Kong's high degree of autonomy, as well as its basic rights and freedoms'. It regrets 'that, by rushing to reach this agreement while not taking concrete action against ongoing grave human rights violations, for example in Hong Kong, Xinjiang province and Tibet, the EU risks undermining its credibility as a global human rights actor'. It announces that 'Parliament will carefully scrutinise the agreement, including its provisions on labour rights and reminds the Commission that it will take the human rights situation in China, including in Hong Kong, into account when asked to endorse the investment agreement or future trade deals with the PRC'.

The latter statement echoes the EP's earlier [resolution](#) on the national security law for Hong Kong and on the [implementation](#) of the Common Foreign and Security Policy – annual report 2020.

In its November 2020 [resolution](#) on the EU-China geographical indications agreement, the EP called for the creation of a parliamentary dimension with regard to the CAI's implementation.

Advisory committees

In its [opinion](#) of 19 March 2015 on the place of sustainable development and civil society involvement in stand-alone EU investment agreements with third countries, the European Economic and Social Committee (EESC) stressed, inter alia, the importance of including a sustainable development chapter in such agreements.

Preparation of the agreement

In May 2010, the EU Commissioner for Trade, Karel De Gucht, and the Chinese Minister for Trade, Chen Deming, [agreed](#) to launch a Joint EU-China Investment Taskforce to evaluate potential negotiations of an EU-China investment agreement. The Commission's international [investment policy](#) of July 2010 had identified China as a potential candidate for a stand-alone investment agreement. From May to July 2011, the European Commission conducted a [public consultation](#) on the future EU-China investment relationship so as to include stakeholders' interests in the policy decision making process. EU investors [reported](#) substantial market access barriers, discriminatory treatment and legal uncertainty in China, which could be best addressed through a CAI.

On 7 February 2011, a special session informing and consulting social partners on the [impact assessment](#) connected with the potential EU-China investment agreement was held in the context of the regular liaison forum with social partners. A first civil society dialogue on the future EU-China investment relationship took place on 20 June 2011. A second civil society dialogue [was held](#) on 7 March 2012 to update stakeholders on the state of play of EU-China investment relations ([report](#)) and solicit further feedback.

In June 2012, an [external study](#) on the costs and benefits of the various policy options was published. In May 2013 the European Commission published the report on its own [impact assessment](#) and made [recommendations](#) to the Council regarding negotiating directives for a CAI with China.

Negotiation process and outcome

On 18 October 2013, the Council [adopted](#) a mandate for the Commission to negotiate a CAI with China on behalf of the EU and in November 2013 the launch of negotiations was announced at the 16th EU-China Summit, which adopted the [2020 Strategic Agenda for Cooperation](#). The latter states that, once in place, the CAI may ultimately be a stepping stone to a deep and comprehensive FTA.

The first round of talks took place in January 2014. After [agreement](#) on the CAI's comprehensive scope in January 2016 the parties [moved on](#) to specific text-based negotiations. The joint text [was not](#) published. Since the [12th negotiating round](#) of September 2016, the Commission published succinct notes to the file on the talks as agreed with its counterpart. In November 2017, the [report](#) on the sustainability impact assessment (SIA) accompanying the negotiations was made public, followed by a Commission [position paper](#) on this report in May 2018. At the 20th EU-China Summit in July 2018, the parties [had](#) a first exchange of market access offers against the backdrop of persisting [policy divergences](#) on core investment provisions, such as NT and fair and equal treatment (FET) and slow progress on dispute resolution and sustainable development.

At the 21st EU-China Summit in April 2019, the parties [committed](#) to conclude the CAI in 2020. Major topics discussed at the 20th to 24th rounds include rules on financial services, capital transfer, NT-related commitments, state-to-state dispute settlement, and investment-related issues concerning sustainable development. At the [25th round](#) in December 2019, the second exchange of market access offers took place. While the 26th to 30th rounds of negotiations made some progress at technical level,⁴ [covering](#), for instance, level playing field issues, notably rules for SOEs, transparency rules for subsidies and rules tackling forced technology transfers, there was a consistent [lack](#) of engagement at the highest political level on the Chinese side, with China instead repeatedly calling for the EU to meet China '[half way](#)'.

The virtual 22nd EU-China Summit in July 2020 [ended](#) without the usual joint statement and press conference, with Commission President Ursula von der Leyen [stating](#) that there was need for 'more ambition on the Chinese side in order to conclude negotiations on an investment agreement'. Commission [officials](#) and [business representatives](#) were [sceptical](#) about the [chances](#) of concluding the deal by the end of 2020. However, the [report](#) on the 31th round, held from 20 to 24 July 2020, referred to significant progress on all aspects of level playing field rules. This was confirmed in the [press release](#) on the 8th EU-China High-level Economic Dialogue of 28 July 2020, which highlighted that much work remained to be done on market access in the telecommunication sectors, health, biotechnology and new energy vehicles and on [sustainable development](#).

The 32nd round focused on sector-specific market access and the mechanism for addressing differences on sustainable development. Agenda items of the 33rd round were competition-related issues, capital movements and transfers, entry and temporary stay of business visitors for establishment purposes, and intra-corporate transfers. During the 34th round, talks broadened to taxation matters and horizontal exceptions. On 30 December 2020, during a prolonged 35th round of negotiations, the EU and China reached an agreement in principle on the CAI.

The Commission held dialogues with civil society on the CAI negotiations in [December 2018](#), [October 2019](#) and [July 2020](#). In October 2019, it [emphasised](#) that telecommunications, information and communication technology, manufacturing, engineering, biotechnology and finance were key sectors where the EU was seeking better market access and a level playing field in China.

The changes the agreement would bring

What was originally supposed to be a 'comprehensive' agreement has become a 'partial' agreement, since the CAI does not cover investment protection and the related dispute settlement mechanism. The EU and China will continue negotiations on these issues during the next two years. This means that the fragmented investment protection landscape will remain in place. The [agreement in principle](#), the text of which was published on 22 January 2021 has the structure outlined in Box 1.

China has made **market access** commitments under a positive list approach whereby sectors subject to commitments are listed both in **manufacturing sectors** (for example, electric cars, chemicals, telecoms equipment and health equipment) and in **services sectors** (cloud services, financial services, private healthcare, environmental services, international maritime transport and air transport-related services). The CAI both [locks in](#) existing commitments made by China during the past 20 years – to avoid backsliding – as well as new commitments (elimination of quantitative restrictions, equity caps or joint venture requirements, although some of these appear to have been made by China earlier in other contexts). The binding of the commitments is done in a dynamic way referred to by the Commission as 'ratcheting', i.e. future relaxation by China of restrictive measures included in the schedules – to be published in February 2021 – will be automatically bound. Owing to the current asymmetry in market access conditions and levels of commitment in the area of services, China has made GATS plus commitments. The European Commission has stressed that the services sector commitments enshrined in the CAI would not only benefit the EU but also others, based on MFN rules in the WTO (GATS).

Box 1: Structure of the CAI

- [Preamble](#)
- Section I: [Objectives and general definitions](#)
- Section II: [Investment liberalisation](#) (market access)
- Section III: [Regulatory framework](#) (level playing field issues)
 - [Transparency in subsidies](#) (in services)
- Section IV: [Sustainable Development](#)
- Section V: [State-to-State Dispute Settlement Mechanism](#)
 - [Rules of procedure](#) (Annex I)
 - [Code of conduct](#) (ongoing discussions) (Annex II)
- Section VI: [Institutional and final provisions](#)

Source: [European Commission](#).

The regulatory framework section contains **level playing field issues**. It includes provisions on **SOEs** (to act in accordance with commercial considerations and not to discriminate in their purchases and sales of goods or services), on **transparency of subsidies** (to complement the transparency requirements as set out in multilateral rules on subsidies related to goods by imposing transparency obligations on subsidies related to services), and on **forced technology transfer** (in the form of the prohibition of several types of investment requirements that compel the transfer of technology, as well as prohibitions to, directly or indirectly, interfere in contractual freedom in technology licencing) that, if implemented, would fill important loopholes in WTO law.

On **sustainable development**, China has made commitments in the areas of climate change, corporate social responsibility, the environment and labour rights, for instance by pledging to 'effectively implement' the Paris Agreement and to 'make continued and sustained efforts on its own initiative' to ratify the ILO core conventions on forced labour and to 'work towards' the ratification of ILO Conventions 87 and 98, which it has not yet ratified and which appear to clash with China's political system. However, there does not seem to be a time-bound roadmap attached to China's ILO-related commitments (as ultimately requested for the EU-Vietnam FTA).⁵ A panel [report](#) of 20 January 2021 on the EU's dispute with South Korea relating to labour rights commitments as regards the EU-[South Korea](#) FTA – whose Article [13.4.3](#) carries identical language: 'make continued and sustained efforts' – appears to confirm concerns that this wording is 'aspirational' and 'non-enforceable' and therefore not necessarily susceptible to leading to the outcome expected by the EU.⁶

The **implementation and enforcement** of the CAI would be monitored by an Investment Committee as well as a working group at the political level of Executive Vice President on the side of the EU and Vice Premier on China's side. Disagreements would be governed by a state-to-state dispute resolution mechanism. Another working group would monitor the implementation of sustainable development commitments for which different dispute resolution rules (consultations as a first step, and the involvement of a panel of experts as a second step) would be applied than are typically applied for the trade and sustainable development chapters in EU trade deals.

Stakeholder views⁷

The agreement in principle has divided stakeholders⁸ into advocates and opponents, with the CAI's timing, substance as well as its geoeconomic and geopolitical context drawing broad criticism.

The European Chamber of Commerce in China, the European Services Forum and Business Europe have [welcomed the deal](#), highlighting the new opportunities that would result from the CAI's market access and level playing field provisions in the dynamic Chinese economy. Their stance is in line with the position that the CAI is a win for the EU's strategic autonomy and a tool to ensure that EU firms enjoy similar opportunities in China as US firms under the US-China Phase One deal.⁹

A group of **NGOs**, by contrast, has launched a [joint appeal](#) to the EU for the inclusion of a human rights clause in the CAI, deemed an essential element, and the requirement, among others, for China to ratify four ILO core conventions before 'entering' the agreement. It points to reports on forced labour schemes in China that 'may pose a direct risk for European investors of direct or indirect exposure to such schemes, rendering them complicit and vulnerable to possible legal liability.' It argues that the CAI would send a signal that the EU pushes 'for closer cooperation regardless of the scale and severity of human rights abuses carried out by the Chinese Communist Party [CCP], even when Beijing is in direct and open violation of international treaties'.

Bruegel analyst Alicia García-Herrero [considers](#) the CAI disappointing and lists examples of its limited scope in terms of market access. She also points to potential negative implications for EU-US ties and the EU's ability to protect itself from unfair competition. Bruegel analyst Maria Demertzis [stresses](#) that the CAI 'is also a vote of approval that demonstrates that China is a global player capable of cutting deals with the developed world, a fact that legitimises what it does also at home'.

Clingendael analysts Maaïke Okano-Heijmans and Ingrid d'Hooghe claim that the EU would lose leverage vis-à-vis China owing to the CAI, and that it would be drawn into greater dependence on China at a time when the latter pursues a dual circulation economic model that seeks a high degree of reliance on indigenous technologies at home and mercantilist expansion abroad. They also criticise the vagueness of the sustainable development provisions.

François Godement of the **Institut Montaigne** [argues](#) that 'there are three wins for China. One is to obtain what it often calls "certainty", an implicit commitment against economic decoupling by limiting the grounds on which restraints on Chinese FDI in Europe can be based. Given the CCP's fear of a front on this issue, this is important. In terms of public diplomacy, separating the EU from the US ... is also a win, at least in the short term. The third win is that China can build on Europe's claims to have advanced its values while escaping enforcement and remedies on the issues that are at the heart of current public debates - environment and labor.' 'Given China's track record, it is impossible to rely on goodwill to implement commitments and unwise to believe that on key issues, a top-down political process between both parties can be substituted to legal arbitration.'

Carnegie Europe analyst Judy Dempsey [argues](#) that the deal with China may be a mistake, as it 'robs the bloc of leverage, contradicts its policy of working closely with the United States on Beijing, and makes a mockery of Europe's commitment to values'.

Claude Barfield of the **American Enterprise Institute** (AEI) [emphasises](#) the deal's potential negative impact on the reset of transatlantic relations with the Biden Administration which would have [preferred](#) to be consulted prior to the conclusion of the negotiations of the CAI.

James Andrew Lewis of the **Center for Strategic & International Studies** (CSIS) [argues](#) that the 'agreement itself is vulnerable' in terms of China's compliance with it, as 'some parts of the deal run counter to long-standing Chinese economic policy and practices' and China might be willing to live up to its commitments only to the extent this could 'prevent stronger transatlantic cooperation'.

Noah Barkin of the **German Marshall Fund** (GMF) [argues](#) that the CAI 'exposes the transatlantic divide in three ways. First, it shows that the EU ... still believes that economic and broader strategic interests can be neatly separated – an idea that is no longer accepted in Washington. Second, the deal shows that European capitals still see value in Chinese promises, despite evidence in recent years ... that they are often tactical and empty. Third, after four years of Trump, the deal is a clear signal that the EU is embracing "strategic autonomy."

Signature and ratification process

The text agreed upon in principle now undergoes legal scrubbing and after that will be translated into all official EU languages prior to being submitted formally to the Council of the EU for approval and to the EP for consent. This process is estimated to take up to one year.

EP SUPPORTING ANALYSIS

A.-A. Georgescu and A. Carney, [European Commission proposal on EU-China Investment Relations. Initial appraisal of a European Commission Impact Assessment](#), European Parliament, 2013.

OTHER SOURCES

EU-China Comprehensive Agreement on Investment (CAI), [list of sections](#), European Commission, 22 January 2021.

EU-China Comprehensive Agreement on Investment (CAI), [The Agreement in Principle](#), European Commission, 30 December 2020, [fact sheet](#) [DE], [FR].

European Commission services' [Position Paper](#) on the Sustainability Impact Assessment in support of negotiations of an Investment Agreement between the European Union and the People's Republic of China, European Commission, 2018.

[Impact assessment report on the EU-China investment relations](#) accompanying the document Recommendation for a Council Decision authorising the opening of negotiations on an investment agreement between the European Union and the People's Republic of China, SWD(2013) 185 final, European Commission, 2013.

[Recommendation for a Council decision authorising the Commission to open negotiations on an investment agreement between the European Union and the People's Republic of China](#), COM(2013) 297 final, European Commission, 2013.

[Sustainability Impact Assessment \(SIA\) in support of an Investment Agreement between the European Union and the People's Republic of China](#), Final report, Ecorys, 2017.

ENDNOTES

- ¹ The TRIMS 'prohibits local content requirements, trade-balancing requirements, foreign exchange restrictions related to foreign exchange inflows attributable to an enterprise, and export controls'. [Investment provisions in preferential trade agreements: evolution and current trends](#), WTO, 2018, p. 8.
- ² The agreement even predates China's WTO accession. Against the background of China's 2003 [EU Policy Paper](#) and the EU's 2006 [EU-China strategy](#) the parties [decided](#) at the 9th EU-China summit in 2006 to adapt the outdated agreement to their rapidly broadening and deepening relationship, which since 2003 has been referred to as a comprehensive strategic partnership. In 2007, negotiations for a partnership and cooperation agreement (PCA) were [launched](#). A trade sustainability [impact assessment](#) for the [PCA](#) was published in 2008. However, a [mismatch](#) between the two partners' levels of ambition led to the PCA talks becoming [deadlocked](#) and they have not been revived.
- ³ In the United Nations Commission on International Trade Law (UNCITRAL) talks on a new multilateral investment court system (MIC), [China](#) is in favour of setting up a MIC with an appellate body. However, it also emphasises the right of the parties to appoint arbitrators, contrasting with the [EU's](#) position favouring full-time appointed arbitrators.
- ⁴ For a regular update of the CAI negotiations please see the respective [entry](#) in the EPRS Legislative Train schedule.
- ⁵ In its [Q&A section](#) on the CAI the Commission states as regards the question: 'How long do you give China to ratify and implement this Conventions, and what retaliation measures will you take if it doesn't? Ratification is a sovereign act of each member of the ILO expressing the State's intention to be bound by the terms of an International Labour Convention. This process is in the hands of China; **we cannot put a firm deadline to it.**' The Financial Times in January 2021 [cited Shi Yinhong](#) an advisor to China's State Council as saying: 'On labor it's impossible for China to agree.'
- ⁶ The panel report states on p. 79: 'Taking account of Korea's efforts in this regard, particularly those taken since 2017 as acknowledged by the EU, the Panel finds that Korea has not acted inconsistently with the last sentence of Article 13.4.3 by failing to 'make continued and sustained efforts' towards ratification of the core ILO Conventions.'
- ⁷ This section aims to provide a flavour of the debate and is not intended to be an exhaustive account of all different views on the agreement. Additional information can be found in related publications listed under 'EP supporting analysis' and 'other sources'.
- ⁸ For stakeholder views prior to the agreement in principle, please see the [first edition](#) of this briefing.
- ⁹ For a very useful brief comparative analysis of the Phase One Deal's and the CAI's substance by [Wendy Cutler](#) please see the [webinar](#) of 3 February 2021 on the CAI hosted by the Peterson Institute of International economics (PIIE).

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Second edition. The 'International Agreements in Progress' briefings are updated at key stages throughout the process, from initial discussions through to ratification. The [previous edition](#) was from September 2020.