BRIEFING

International Agreements in Progress

European Parliament

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CAI negotiations are aimed at establishing a uniform legal framework for EU-China investment ties by replacing the 25 outdated bilateral investment treaties (BITs) China and EU Member States concluded prior to the entry into force of the Lisbon Treaty in 2009 when the EU gained competence for most investment issues. The CAI is intended to go far beyond traditional investment protection to also cover 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.

Although leaders at the 2019 EU-China Summit jointly committed to concluding the CAI talks in 2020, lack of engagement at the highest political level on the Chinese side has raised doubts as to whether a breakthrough can be reached in time, with China more focused on navigating the uncertainties of its relations with the United States from January 2021.

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

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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 sees 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) agreement (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 reforms (e.g. removal of ownership limits in the financial sector) 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. It adopted a new Foreign Investment Law in 2019, which entered into force in January 2020. The law for the first time prohibits forced technology transfer, a long-standing issue for foreign businesses operating in China and which has given rise to two WTO cases, brought against China by the EU (DS549) and the United States (US) (DS542). The implementing regulations 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, but only time will show whether the law will make a difference for EU firms on the ground.

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 Cyber Security 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. This trend is compounded by China's ambitious state-sponsored industrial strategy Made in China 2025, aimed at significantly reducing the country's reliance on foreign technology by replacing it with indigenous technology in several strategic high tech sectors. Other restrictions looming on the horizon, such as the country-wide rollout of a corporate social credit system, is 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 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 are outdated and reflect neither recent developments in the EU's and China's investment policy, major shifts in the bilateral and international investment relations or geopolitical changes.

The 25 BITs are applicable to 26 EU Member States, since Belgium and Luxembourg share one BIT and Ireland has no BIT with China, as it concluded only one BIT with a foreign country, the Czech Republic, in 1996. The 25 BITs share a similar structure of substantive and procedural protection standards, largely following the Dutch 'gold standard' model BIT. Eight older BITs were replaced by slightly updated BITs, while some older BITs were selectively upgraded by a protocol and again others have never seen an update. The 25 BITs can be classified into **two generations** of BITs (Table 1 below displays them in grey and blue). The more recent BITs (blue) can be distinguished from the older BITs (grey) by two major changes:

First, post-establishment **national treatment** (NT) is granted, which is generally aimed at equal treatment between domestic and foreign investment and is not included in older BITs or if so only as a vague 'best effort' clause; however, the scope of application of most recent NT clauses is limited asymmetrically for EU companies by grandfathered Chinese non-conforming measures or by a general reference to overriding Chinese law which typically discriminates against foreign investors.

Second, after China acceded to the International Centre for Settlement of Investment Disputes (ICSID) Convention in 1993, it gradually granted access to **investor-state dispute settlement** (ISDS) for **any** dispute under certain conditions (e.g. completion of a Chinese administrative review and prohibition on pursuing claims both via national courts and ISDS – 'fork in the road' clause). In older BITs access to international arbitration is often constrained to disputes about the **amount** of the compensation for expropriation, and the state parties' mutual consent or the exhaustion of local remedies are required. It is worth noting that despite China's embrace of ISDS, EU firms' significant investment stock in China, and China's low rule of law ranking, the 2017 Hela Schwarz vs. China case is the only case known to have been brought against China by an EU company.[3]

A general feature of the BITs is that protection standards are drafted with considerable vagueness which leaves ample room for interpretation. The **fair and equitable treatment** (FET) clause is a case in point. In all but the French-Chinese BIT the clause is unqualified, i.e. it is not clear whether it refers to the minimum standard of treatment under customary international law or to an autonomous meaning in the sense of legitimate expectations. The latter interpretation has led to a proliferation of international arbitration cases against host states' 'right to regulate' on public policy grounds.

Moreover, all BITs contain a **most favoured nation (MFN) clause** whereby the host state extends to investors or investments from the other signatory state the most-favourable treatment that it would have granted to investors or investments from a third party to the BIT.

All BITs set out four criteria to define direct **expropriation** and **compensation** (the 'Hull formula'). More recent BITs also include a judicial review clause on expropriations, but all BITs lack a definition of 'measures tantamount to expropriation' – indirect, creeping, or de facto expropriation. Furthermore, most BITs make the **free transfer of funds** by investors linked to their investment in the host country conditional upon the Chinese foreign exchange control regime. Some BITs mention exceptions such as balance of payments difficulties. However, almost all BITs fail to provide clear deadlines for such capital transfers, which implies a lack of legal certainty for EU investors in China. All BITs provide for similar provisions on **state-to-state dispute settlement** (SSDS).[4]

Table 1 – Comparison of the 25 BITs' substantive and procedural protection standards

EU MS	BIT / protocol (p) in force since	fair and equitable treatment (FET); unqualified FET, i.e. no reference to customary international law	post-establishment national treatment (NT)	NT limits: Chinese law/non-conforming measures	post-establishment most favoured nation clause (MFN)	national judicial review of expropriations	exceptions to the free transfer of funds	ISDS access for any dispute	ISDS access after Chinese administrative review (law of 1999)	provisions on local content and export performance	transparency
AT*	1986	✔	no	no	✔	✔	✔fec	no**	no	no	no
BE / LU	2009	✔	✔	no	✔	no	no	✔	no	no	no
BG	1994 p2007	✔	✔	✔	✔	✔	✔nl	no	no	no	no
CY	2002	✔	✔	no	✔	no	no	✔	✔	no	no
CZ	2006	✔	✔	✔	✔	✔	✔fec	✔	✔	no	no
DE	2005	✔	✔	✔	✔	✔	✔fec	✔	✔	no	no
DK	1985	✔	no	no	✔	✔	✔nl	no	no	no	no
EE	1994	✔	no	no	✔	no	✔nl	no	no	no	no
EL	1993	✔	no	no	✔	no	✔nl	no, mutual consent	no	no	no
ES	2008	✔	✔	✔	✔	✔	✔fec+bp	✔	✔	no	no
FI	2006	✔	✔	✔	✔	✔	✔bp	✔	✔	✔	✔
FR	2010	✔***	✔	✔nl	✔	no	✔fec+bp	✔	✔	no	no
IE	–	–	–	–	–	–	–	–	–	–	–
IT	1987	✔	no	no	✔	✔	✔nl	no	no	no	no
HR	1994	✔	no	no	✔	no	✔nl	no	no	no	no
HU	1993	✔	no	no	✔	no	✔nl	no	no	no	no
LT	1994	✔	no	no	✔	no	✔nl	no, only agreed disputes	no	no	no
LV	2006	✔	✔	✔nl	✔	no	nl	✔	✔	no	✔
MT	2009	✔	✔	✔nl	✔	no	nl	✔	✔	no	no
NL	2004	✔	✔	✔	✔	✔	✔fec	✔	✔	no	no
PL	1989	✔	no	no	✔	✔	✔nl	no	no	no	no
PT	2008	✔	✔	✔	✔	✔	✔fec	✔	✔	no	no
RO	1995 p2007	✔	no	no	✔	✔	✔nl	✔	no	no	no
SE	1982 p2004	✔	no	no	✔	no	✔nl	✔	✔	no	no
SI	1995	✔	✔ttep	✔nl	✔	no	✔nl	no	no	no	no
SK	1992 p2005	no	✔	✔	✔	✔	✔fec+bp	✔	no	no	no

Source: EPRS based on the UN Conference on Trade and Development (UNCTAD) International Investment Agreements Navigator, with additional China-specific features.

Key: blue shading = more recent; grey shading: older; p = protocol; * = AT-China BIT available only in German and not mapped by UNCTAD; ** = no means ISDS limited to the amount of the compensation for expropriation; *** = FR-China BIT refers to customary international law; ttep = to the extent possible, fec = capital transfer subject to Chinese foreign exchange controls; bp = balance of payments difficulties; nl = national law, de facto meaning fec for China.

As for issues that are routinely part of modern investment agreements, Table 1 shows that only the Finnish-Chinese BIT contains a prohibition of unreasonable or discriminatory measures on investment concerning **local content** or **export performance requirements** and a **transparency**

clause (also contained in the Latvian-Chinese BIT), while the others do not. The French-Chinese BIT reserves the **right to regulate** investments to preserve cultural and linguistic diversity. Neither BIT incorporates investment-related sustainability issues, rules on state-owned enterprises (SOEs) or transparency rules on subsidies that are priorities on the EU agenda with China today. Overall, the 25 BITs established an **asymmetric investment protection framework** between capital-exporting developed (EU) countries and a then capital-importing developing country, China, whose restrictive investment regime, which has been gradually evolving ever since, was fully accommodated.

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, '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.

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

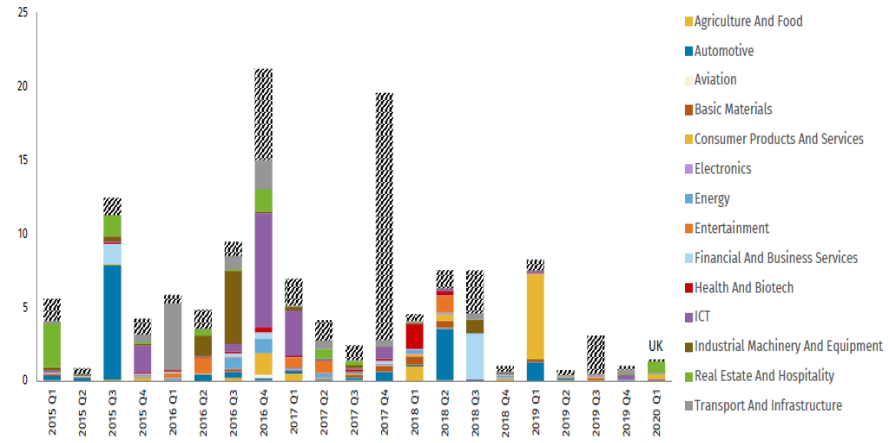
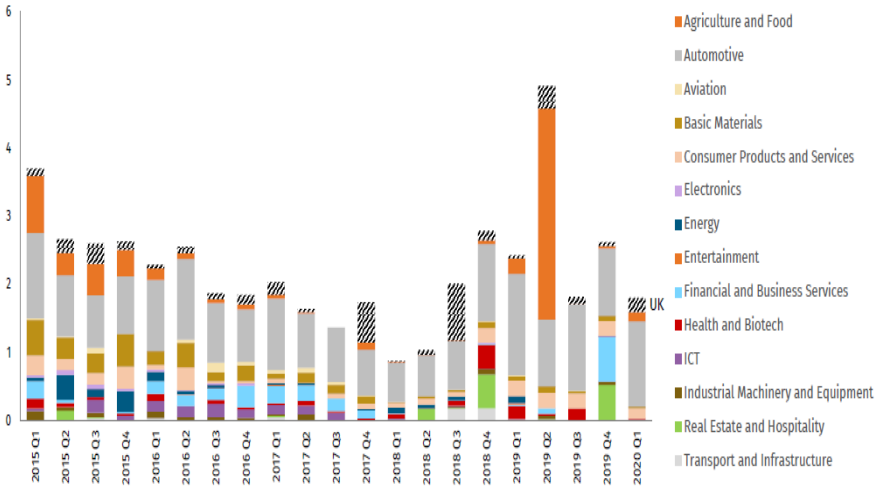


Figure 2 – Value of completed EU FDI transactions in China by industry, US billion*



Source: Rhodium Group. *Data covers EU-27 with the UK displayed separately.

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 is that the former has focused on technology- and market-seeking acquisitions, while the latter has emphasised job-creating greenfield investment in China. Although data show that in Q1 2020, 96 % of Chinese deals involved private investors, a permanent departure from a distinctive feature of Chinese FDI – a large share of SOEs among Chinese acquirers – would be at odds with China's reliance on globalised SOEs. Research shows that private Chinese investors are distinct from other investors in several respects.

EU and Chinese negotiating practices

Since the text proposals of the EU for individual articles of the CAI are not in the public domain, unlike in other ongoing EU negotiations, comparisons with articles of the investment chapter of the EU-Canada Comprehensive Economic and Trade Agreement (CETA) or of the investment protection agreements (IPAs) with Singapore or Vietnam are not possible. However, investment-related agreements the EU and China have negotiated or concluded in the recent past suggest that a wide gap has to be bridged between the parties' diverging levels of ambition as regards the granting of pre-establishment market access, post-establishment equal treatment and protection provisions before negotiations can be concluded.

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 those mentioned above. 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 ISDS with a new two-instance investment court system (ICS), which it seeks to substitute with a multilateral investment court (MIC);[5]
- 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;
- third, the EU has systematically mainstreamed its ambitious sustainability agenda, including environmental and labour provisions, into its agreements;
- fourth, clearly defined protection standards make them less susceptible to interpretation.

It remains to be seen to what extent China will embrace these innovations in the negotiations on the CAI, as Vietnam has done in the context of its agreements with the EU by already ratifying International Labour Organisation (ILO) Convention 98 on the right to organise and collective bargaining and by committing to ratifying Convention 87 on the freedom of association by 2023.

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 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 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 outcome of the more ambitious agenda of the EU-China CAI negotiations. Considering that the US-China BIT negotiations based on the comprehensive approach of the US model BIT have led nowhere and that it is too early to judge whether the systemic issues tackled in the Trump Administration's 2020 US-China Phase One Deal will actually be enforced, it will be a tall order for the EU to obtain far-reaching concessions from China in the CAI negotiations.

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**.

In its June 2020 resolution on the national security law for Hong Kong, Parliament stated that it 'will take the **human rights situation** in China, including in Hong Kong, into consideration when asked to endorse a comprehensive agreement on investment or future trade deals' with China.

MEPs have submitted several 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.

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. Following agreement on the CAI's comprehensive scope in January 2016 the parties moved on to specific text-based negotiations. The joint text is not in the public domain. Since the 12th negotiating round of September 2016, the Commission has published succinct notes on the substance of 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 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 during 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,[6] covering, for instance, level playing field issues, notably rules for SOEs, transparency rules for subsidies and rules tackling forced technology transfers, there has been 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 have been sceptical about the chances of concluding the deal by the end of 2020. However, the report on the 31st 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 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

The EU-China CAI would be the EU's first-ever stand-alone investment agreement covering both market access and investment protection. The CAI would replace the existing 25 BITs with a uniform legal framework with modern protection standards and dispute settlement arrangements.

As for market access, locking in the market openings China has made since its 2001 WTO accession would be an important achievement in order to avoid any backtracking. Beyond that, the CAI is set to address the asymmetry in market access for EU firms in China by obtaining more substantial concessions in sectors which are not part of particularly sensitive sectors for China, such as the media, or for which China is pursuing offensive interests, such as for the transport sector.

As for the regulatory environment, the CAI is expected to address behind the border challenges, such as discriminatory practices, by means of robust transparency provisions and licensing rules to ensure that the Chinese authorities' current discretion with respect to administrative decisions on national and local approval and licensing requirements is reduced and subject to effective administrative and judicial review. The CAI is likely to contain provisions on investment-related sustainable development, including climate change, and on corporate social responsibility. It remains to be seen whether the CAI will ultimately include strong rules on SOEs and transparency provisions on industrial subsidies in line with the EU's agenda for reforming the WTO rules book.

Stakeholders' views[7]

The Business Confidence Survey 2019 of the **European Chamber of Commerce in China** states that in 'addition to market opening, the international business community is increasingly focussing its attention on other issues, such as regulation, equal treatment and SOE reform. Nearly half of survey respondents report that they believe regulatory obstacles will continue to increase over the next five years, with the top three being ambiguous rules and regulations (48 %), the unpredictable legislative environment (33 %) and administrative issues (29 %). … Unequal treatment is reported by 45 % of respondents, with the most frequently cited areas of discrimination being market access (43 %), administrative issues (28%) and communication with the government (26 %)'.

BusinessEurope in a 2020 report stresses that in the CAI talks both sides should strive to liberalise all sectors substantially, eliminate pre- and post-establishment restrictions on investment and tackle

both *de jure* and *de facto* barriers to investment. The CAI should also include provisions on industrial subsidies and SOEs (for example by opening up markets that are currently only open to SOEs and by considering how to handle SOEs in investor-to-state disputes relating to the CAI). The resulting negative list for FDI in China should be as short as possible since many sectors are still completely or partially restricted to foreign investment. For the CAI to deliver concrete results for business, it is essential that it include ambitious clauses not only on market access for goods and services, technology transfer and free movement of capital, but also on fair and equitable treatment, investor-to-state and state-to-state dispute settlement and sustainable development.

In 2015, law firm **Covington & Burling LLP** suggested incorporating affirmative market access commitments into the CAI to ensure that it protects against changes in Chinese laws and policies.

A 2015 policy brief by the **Kiel Institute for the World Economy** concluded that the 'starting position for these negotiations is characterised by strong asymmetries. ... It is therefore only natural that a CAI will demand more 'concessions' and more far-reaching reforms from China than from the EU and its member states'. It notes that 'with respect to several key issues, most notably the liberalisation of market access and the less restrictive and more symmetric implementation of the national treatment standards, … [the CAI] must be substantially more comprehensive than China's recent BITs with other developed countries'.

In their recommendations for the incoming EU Commissioner for Trade, Bruegel analysts **Alicia García Herrero** and **André Sapir** argued that the CAI negotiations 'hinge on finding a workable solution to the structural economic differences between the two' partners and that, [g]iven the prominence of the role of SOEs in such negotiations, talks could actually serve as a basis to negotiate China's better adherence to WTO principles in a future reform of the system'.

The analysis of Institut Montaigne researcher **Mathieu Duchâtel** of the recommendations for the CAI negotiations made by several Chinese stakeholders reveals the huge gap in perspectives between the EU and China, most importantly with respect to what a fair competition environment means. Wang Haochen from the State Information Centre of China's National Development and Reform Commission, for instance, advocates standing firm in demanding that the EU reduce its FDI screening mechanism and negotiating a deal that replaces EU and Member States' FDI screening mechanisms, while progressively opening the Chinese market on the basis of a thorough evaluation of the risks for China.

EP SUPPORTING ANALYSIS

C.-C. Cîrlig, EU-China bilateral investment agreement, European Parliament, 2013.

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 investment study, Copenhagen Economics, 2012.

The EU's response to China's state-driven investment strategy, European Court of Auditors, 2020.

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, op. cit., 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 There are only two cases in Italaw, and three cases in the UNCTAD database. One case was settled (Malaysian company), one decision was in favour of China (Korean company). Some academics explain China's limited exposure to investor-state-arbitration (ISA) by 'the reluctance of foreign investors to lodge claims against China for fear of jeopardizing their future dealings, including wishing to avoid the review of ISA proceedings before Chinese courts'. L. Trakman, 'Resolving the Tension Between State Sovereignty and Liberalizing Investor-State Disputes: China's Dilemma', in J. Chaisse (ed.), *Handbook of International Investment Law and Policy*, Springer, 2019, p. 6. A European Commission presentation for a civil society dialogue on the CAI talks refers to EU business input expressly mentioning 'fear of retaliation'.

4 For an overview of investment standards: J.-A. Crawford and B. Kotschwar Investment Provisions in Preferential Trade Agreements: Evolution and Current Trends, staff working paper, WTO, 14 December 2018.

5 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.

6 For a regular update of the CAI negotiations please see the respective entry in the EPRS Legislative Train schedule.

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'.

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