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REPORT
The EU-China Investment Deal

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On the eve of 2021, the EU and China agreed on a preliminary Comprehensive Agreement on Investment (CAI) that paves the way for a greater European presence in the Chinese market. The deal may mark a China-first foreign policy for the EU, even as the new American administration under US President Biden has called for multilateralism and cooperation in containing China. The US-China Series hosted a recent talk on the broad implications of the CAI deal, featuring:

Philippe Le Corre — research fellow at Harvard Kennedy School and non-resident fellow at the Carnegie Endowment for International Peace

While foreign direct investment flows are comparable, the backdrop to this deal is an unequal one. China has considerable access to European markets while reciprocity is absent. While the CAI addresses some of the concerns regarding market access, it is difficult to argue that the deck is not still skewed in favor of China.

Philippe and I discuss the background of the deal, Germany's influence, the sectors that will gain, and the prospect of implementation versus the intent of the agreement. China has a long history of making statements on the opening of its markets, and yet practically, regulation makes it difficult for western companies to compete with Chinese incumbents.

We chat about the economic imperatives for Chinese FDI, the growing influence of Chinese companies as they compete for European contracts, and the inherent contradictions between the CAI, and issues that have been historically important to Europe, such as human rights, forced labor, and climate.

The public's perception is that the deal was rushed through at the end of the year, and while the EU promotes European values, it has also struck a deal that is quite unbalanced and still may gain little market access to China. Couple this with concerns amongst the EU's left, especially the Greens in Germany, over human rights, forced labor, and the environment, and the deal's passage is not assured.

I have been concerned that the decline of American influence will continue into the Biden Administration. All in all, it remains to be seen how the CAI will be finalized by all the countries and the European parliament in the next two years. In the meantime, the current US administration is trying to define its own China policy, which will emerge in the next few weeks and months. The door will not be closed between Brussels and Washington. That said, EU criticism of China will be difficult in the shadow of the CAI, and this could leave the United States isolated yet again.

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The Comprehensive Agreement on Investment: Some Background

Philippe Le Corre: The Comprehensive Agreement on Investment (CAI) between the EU and China shares similarities with the deal that the US and China discussed five years ago. Its timing came at an unusual moment at the conclusion of 2020, coinciding with the end of Germany's rotating presidency of the European Council and a transfer of power in Washington, D.C.

The CAI s not a trade deal, nor is it bilateral, and it comes as investments from both sides in each bloc are reaching parity: about 140 billion euros of European FDI in China, versus 120 billion euros of Chinese FDI. The detailed document covered numerous strategic sectors:

- The automotive industry, including new energy vehicles and market access for Europeans in China, will not have joint venture requirements.
- European banks, insurance companies, and financial services will also have greater access to the Chinese market.
- Healthcare, including private hospitals and elderly care facilities, a sector in which France has a strong vested interest.
- Cloud services, although given national security concerns, China may be hesitant to give away market share to foreign companies.

The most important one is automotive, especially for the German car industry, as it is highly dependent on the Chinese market, whether for manufacturing or sales.

However, the big issue at stake is that Europe's unfettered market stands in contrast to restrictions in China. The financial crisis of 2008 saw an influx of Chinese companies, particularly state-owned enterprises, investing in tech and infrastructure, mainly in southern Europe and other parts of the continent.

Discuss the political backstory of how this deal came about, given the end of the German presidency of the EU and the transition of presidential administrations in the US.

Philippe Le Corre: Few would have guessed that the 7-year negotiation would see a sudden breakthrough at the end of last year when many issues were still unsettled. The groundwork was laid in 2019 when the strategic white paper, *The EU China Strategic Outlook,* stated that China would be a partner, competitor, and controversially, a systemic rival.

It explained the features and discrepancies of the Chinese system, such as state subsidies, forced technology transfers, and other aspects. In terms of its politics, the past year also demonstrated the Chinese regime's policy towards Hong Kong, Xinjiang, and opponents, so this context made it all the stranger.

The EU is a complex entity with many different interests. As the continent's two largest economies, Germany and France have the most significant say in policy-making. The effects of this deal highlight the unequal benefits, as Germany took the lead in this process and is certainly a winner, and Portugal, which is taking over the chair of the European Council, has a slew of

Chinese-backed infrastructure projects. Yet other countries stand to benefit less, considering that European multinationals are concentrated in the large countries.

Of those interested in investing in China, companies from smaller countries such as the Czech Republic and Poland may not see the same results in access to the Chinese market as German firms. At the same time, countries in Eastern and Central Europe in the 17+1 mechanism were a link to China, which European powerbrokers found uneasy. These countries may now question Germany's stance, which has both cautioned doing business with China yet led the signing of this deal.

Moreover, there is an increasingly negative perception of China across Europe. The European Council and Parliament will look at this deal with China, and Members of the European Parliament (MEPs) from different countries may reflect their country's public opinion in evaluating the CAI deal. This comprehensive investment agreement is very technical in nature, which many are still attempting to understand. But, it shows that China has become a real player in FDI.

Public and Political Opinion Towards the CAI

How will European MEPs sell this deal to the EU population, given China's increasingly unpopularity across the continent?

Philippe Le Corre: It seems to be the case that there will be little of an attempt. The public's perception is that the deal was rushed through at the end of the year, and while the EU promotes European values, it has also struck a deal that is quite unbalanced and still may gain little market access to China. At the end of the day, China may change its foreign investment regulations at any time.

This deal will face scrutiny in both the European and national parliaments. Germany will be one to watch: within German politics, The Green Party has been very critical of China in many ways, not just on the environment but also on human rights and forced labor. If the next German chancellor in September requires a coalition that includes the German Green Party, that may present problems for the CAI deal.

The deal also raises questions of the European Commission's general direction: Ursula von der Leyen pledged a 'geopolitical' commission, but it appears that it encompasses geo-economics that secures business deals. From a Chinese point of view, this deal is a symbolic statement from Brussels and Berlin, and it's not by chance that the deal was signed under the German presidency. The US also played a role, as Europe's attempt to engage Trump on China was rejected. The new administration and its officials are hoping to rekindle alliances to counter China, whereas, in Asia that may be Japan, India, and Australia, the US will also want to talk to the EU and the UK.

Finally, the EU is an important strategic player. Its real asset is its market as a 500-million consumer market. It's important to note that the Belt and Road Initiative had been targeting

Europe from the very beginning, before expanding into an all-encompassing grand plan, but in the EU's case, its strength as a large consumer market has not been leveraged well so far.

China's Vested Interests

As Chinese inward FDI has been decreasing over the last few years, how much was the Chinese's economic imperative to continue to receive FDI as part of the deal-making process?

Philippe Le Corre: China is very much integrated into the world economy, as a manufacturing place first and foremost, and many multinationals use China for subcontracting. At the same time, China needs the world. Its economy, which performed relatively well throughout the pandemic — about 2.3% growth in 2020 — benefited substantially from medical supplies orders from the US and Europe. While the latest Five Year Plan is promoting a more domestically oriented China, the export sector remains of vital importance as the transition continues,

China and the Asia Pacific region are drivers to the world economy, while Europe will struggle for the next few years as it continues to deal with chronic unemployment, weak productivity, and poor demographics.

China has been building national champions over the past few years in fields in which it could not compete before. For instance, in the railway sector, whereas companies such as Siemens and Alstom were competing for shares of the Chinese high-speed train market, China Railway now sells its products worldwide, including in Europe. Telecom is another example, where Huawei now has at least 40% of the market in Europe, in contrast to a time when companies such as Eriksson and Alcatel had shares in the Chinese market.

While the debate rages about China's need for FDI, Chinese firms have to potential to compete on the world stage like never before. Chinese firms now have more to offer than merely capital.

With regulatory hurdles and national security issues surrounding business in China, could this deal be implemented as written, or will bureaucratic difficulties render these deals mostly ineffective?

Philippe Le Corre: Among several improvements, the CAI deal seeks to discipline the behavior of state-owned enterprises. Its execution is unclear because investments are a prerogative of member states — the Italian government, for instance, deals with Chinese SOE investing in Italy, and decisions will not be made in the EU. Meanwhile, an Italian company's investment in China ends up being decided by the Chinese central government.

Other issues include compelled technology transfers and forced labor, the former which may involve national security considerations in China, and the latter on enforcement upon the Chinese government (a questionable prospect). In principle, China has agreed to an enforcement mechanism in the form of arbitration, but it remains unclear how that will be done — one senses that it will be dependent on the goodwill of states. In the EU's case, that falls upon powers at both the EU and national levels, especially for national governments who will be handling investments.

5G Infrastructure and Security

Given the apprehension of Western governments towards Huawei's 5G equipment, will we see similar restrictions implemented, albeit unevenly, as standards are set across EU governments?

Philippe Le Corre: The European Commission's stance is that CAI forms a larger part of the EU's China strategy in the following ways:

- In the case of 5G, a so-called toolbox leaves individual countries to decide whether to allow Chinese manufacturers to build their infrastructure. The big question is Germany's acceptance of Huawei, and it is possible that an unwritten part of the CAI deal allows China to access a small portion of 5G infrastructure.
- Overall, other efforts defining the EU-China economic relationship have come into play, such as an FDI screening mechanism in place since last October. That mechanism, as a counterbalance to the open-door of investments in the EU market, came about as a result of Chinese state-owned enterprises taking over sectors such as the shipping industry and electricity grid.
- This CAI deal is not a completely open door. China will be very cautious, opening to the Europeans in the same way they are opening to the Americans. While I believe this move was correct, the timing was off, as it took place as US President Biden was just about to come into power.

Discuss if the EU will be less likely to use this toolbox against China in light of the CAI and fear of retribution, particularly regarding new and expanded EU investment in China and expected under the CAI.

A preliminary glance at the EU-China relationship would yield the conclusion that the CAI deal was unbalanced in the EU's favor because China is opening its market much more than Europe. Yet keep in mind that the EU is a very open free market and that Chinese companies could pursue whatever business they wanted.

However, the deal comes at a moment of a slowdown in Chinese FDI to Europe for the past two years. Some major investments, such as the Piraeus Harbor in Greece, controlled by Chinese state-owned enterprises, are experiencing problems with labor unions and shipping companies. This slowdown may be attributable to the screening mechanism, but the main reason is internal to China. There has been a restriction to capital outflow and reorganization of state-owned companies that proliferated abroad in the early 2010s. Now, they're being asked to focus on the domestic economy.

It's possible that this year – a political one that will see the Chinese parliament reaffirm a five-year plan as well as the centenary of the Chinese Communist Party – there will be a new direction this summer. China wants to focus on technology and the digital economy, and Europe is aware that China wants to sell its products to Europe. Nevertheless, sectors such as railway and energy plants are a concern.

Multilateralism and Investment

From a Chinese perspective, has this deal effectively hamstrung the Americans and their pursuit of multilateral pressure on human rights and democratic values? Is this deal a symptom of continued American isolation?

Philippe Le Corre: Politicians in Brussels certainly thought they could make their own decisions on issues such as trade and investment, climate, and tech. The idea behind the Comprehensive Agreement on Investment was that Europe would cement its strategic autonomy – given that the US had its phase one trade agreement under Trump, which it did not consult Europe. However, this is not a free trade agreement, and the European parliament would not approve a deal with China as the latter does not have a free market economy. It's mainly about opening the door to investment.

American isolation should not be assumed, given the team assembled by the Biden administration to handle foreign affairs, including Janet Yellen (Treasury Secretary) and Katherine Tai (Proposed US Trade Representative). The President himself has a lengthy diplomatic history and will engage.

The EU market is the prime target, and China wishes to play a bigger role in areas such as 5G, despite Trump's partial success in convincing some countries to avoid Chinese manufacturers.

The EU possesses a reach beyond its market: several countries have launched Indo-Pacific strategies, especially France, which has a naval presence in the Indian Ocean, and the support from Europe is not neglecting issues such as Taiwan and the South China Sea. The EU's legal aspect had come into play, for instance, when Europe-based international arbitration courts made rulings against China's presence in the South China Sea.

Climate change is another issue, and as the US withdrew and now is re-entering the Paris Agreement, climate change is agreed to be at the top of priorities, along with COVID-19, which both are areas that could see collaboration with the Chinese. When it comes to carbon emissions, China has committed to eliminating its emissions by 2060, and as the US has not set a target, Europe has taken the lead.

Does the CAI deal continue or accelerate a China-first foreign policy for the globe? Is America's declining influence allowing an era where the Chinese can pick and choose to lead the issues that used to matter to the West?

Philippe Le Corre: Divide and rule has always been part of the China strategy, and Europe has a history of internal division. Yet China remains as a systemic rival to Europe, and the CAI's assessment will not change that fact. Europe is attempting to balance this business deal with its values of law and order at the international level. On the rhetorical point, this uneasy reconciliation is shadowed because Europe cannot afford to block China's role in the global economy.

In addition, European companies have been doing poorly due to the pandemic and have influenced this deal. German Chancellor Merkel is listening to companies in different sectors with interests in China. I hope the European parliament will be vocal on issues such as Hong Kong and Xinjiang, and indeed, the MEPs representing different political leanings will make themselves heard on these issues.

All in all, it remains to be seen how the CAI will be finalized by all the countries and the European parliament in the next two years. In the meantime, the current US administration is trying to define its own China policy, which will emerge in the next few weeks and months. The door will not be closed between Brussels and Washington.

Conclusion

With the CAI unlikely ratified by the European Parliaments until late 2022 at the earliest, the investment narratives around the agreement are hardly urgent. That said, divide and rule has always been part of the Chinese strategy, and it is difficult not the see the CAI as a wedge between the US and the EU regarding multilateral cooperation against China.

While military might remains America's key strategic advantage, without the moral authority to justify its use, the United States will continue to find itself more and more isolated. Even America's most ardent supporters, such as the European Union, are looking towards China, firstly for its economic future but increasingly for the great challenges facing the globe. While China remains unpopular with the citizens of the E.U., the fast-tracking of the E.U./China Investment Treaty has shown that countries around the world will focus on a "China First" foreign policy. Increasingly, U.S. allies will prioritize the economic advantage of aligning with China. The prospect of placating China and ignoring U.S. criticism of human rights, unfair trade practices, and anti-democratic values will be standard procedure for G20 and emerging economies as they pivot to Asia.

Like many agreements with China, the devil is not in the details of the agreements that tend to be light on substance but in the practical implementation. For me, the prospect of a more inward-looking China remains entrenched, and while the CAI appears to contradict this notion, China will only accept competition and capital as and when it suits their agenda. While foreign direct investment flows are comparable, the backdrop to this deal is an unequal one. China has considerable access to European markets while reciprocity is absent. While the CAI addresses some of the concerns regarding market access, it is difficult to argue that the deck is not still skewed in favor of China.

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