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The Case for an EU-China investment agreement

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Trade and investment volumes between the EU and China will continue to grow – but they will also be a source of friction and disputes. Are there ways for the two sides to improve policy conditions for economic integration in order to avoid new tensions and the risk of protectionism escalating? In the absence of other vehicles to improve policy, an investment agreement between the EU and China is the best current strategy for the EU to improve its access to China's market and resolve sources of tension. China also stands to gain from a strong investment agreement, containing both provisions on market access and protection. Its investment into Europe will increase considerably in the future and Chinese investors will need protection from arbitrary and discriminatory actions by European governments.

The proposed EU-China investment agreement will be the first time that the EU negotiates an investment-only agreement on the basis of the new powers granted by the Lisbon Treaty. The common investment tool gives the EU more power to protect investment and negotiate market access with countries such as China. Not all Member States share the European Commission's enthusiasm for centralising investment policy in Europe. Some are concerned that a common bilateral investment treaty (BIT) with China will water down protection provisions already granted to Member States under their individual BITs. This seems, however, to be a foregone conclusion. The intention with a common BIT is to achieve protection, and market access, that is better than what has been attained in each of the 26 BITs with China.

A critical part of the negotiations with China is the market access component. It is an attempt to establish symmetric market relations – meaning that European and Chinese firms should have equivalent access to each other's markets. The EU also wants to operate on the basis of equitable and reciprocal rules with China. And such symmetry should come by improving access to China's markets – not, as some suggest, by decreasing Europe's openness. As Chinese firms increasingly compete head-to-head with EU firms in high-end sectors, symmetry in market openness has grown more important. EU firms cannot fully participate in sectors such as transport, telecommunication, healthcare, distribution and business services in China. The lack of reciprocity has prompted the EU to resort to protectionist or confrontational approaches to China, not least visible in the discussions around the trade defence case against solar panels from China (and the potential case against Chinese telecom equipment). Even if full symmetry is not achieved, a good EU-China investment agreement that opens new market access in China helps to disarm those in Europe that want to see a hardened EU stance.

Yet, observers ask, why would mercantilist China open its own sectors when all EU sectors are already open? The answer is: because it is in China's economic interest. China is indeed a country that tends to view its foreign economic policy through the lenses of mercantilism. In the nineteenth century, Emperor Qian Long claimed he had everything he wanted and discarded British merchants by saying: 'I set no value on strange and useless objects and have no use for your country's manufacturing'. At that time, China accepted only silver as payment for sales, which is why a few merchants started to trade opium as a payment method, not exactly leading to good outcomes. But China has proved several times in recent history that it could liberalise on an autonomous basis – again, because it has been in their economic interest to do so. Recent developments in Beijing suggest that new steps will be taken to free up markets for greater competition. It remains to be seen how far Chinese leaders are willing to go, but an interesting sign came recently when China expressed a desire to join the talks in Geneva to over a new plurilateral agreement on trade in services, the so-called TISA.

China is an inconsequential country today for Foreign Direct Investment. Its role in global FDI does not correspond with its role in trade. China is the EU's second biggest trading partner, but only 2% of the EU's investment goes to China. Chinese investment accounts for only 1.5% of inward Foreign Direct Investment (FDI) in the EU. The World Bank's (STRI) and the OECD's FDI restrictiveness indexes point to China's joint venture requirements, equity caps, administrative barriers, local content requirement and regulatory requirements such as technology disclosures, as particularly burdensome to investors. A conservative estimate by the European Commission suggests that elimination of these barriers can increase the EU's FDI stocks in China by 2% and add €2 billion of EU's exports yearly. The export figure captures largely intermediate inputs for the EU's affiliate sales in manufacturing (less so for services).

Since 1978 China has modernised its agriculture and manufacturing sectors through liberalisation. Structural change is now needed again – especially economic reforms to push China towards a consumption-driven growth model. China intends to develop its capacities in services, and R&D-based and high-end manufacturing sectors. Currently, these are sectors heavily dominated by entrenched state-owned and state-run enterprises. These sectors need reform if they are going to usher China into a different growth model. Furthermore, it is commonly acknowledged that reduction of investment barriers increase productivity, employment and capital formation in sectors previously dominated by monopolistic players. To reach its goals, China needs to improve services inflows. Better access to foreign banking, transport, distribution, and telecommunication services enhances business performance.

Opening up to new further investments also benefits China's outward interest. By 2020, China's FDI flow to the EU is estimated to have increased by ten times, reaching approximately €250-€500 bn. This will make China one of the major foreign investment stakeholders in Europe. China now has an interest in ensuring that markets in Europe will be open for Chinese investments and that they are not going to be subject to discrimination. Europe is not as open for foreign FDI as its prides itself on being. There are restrictions in several sectors and the more a sector is dependent on political decisions, or influenced by state-owned enterprises, the greater the FDI restrictions. As China has a record of making investments in such sectors (energy, infrastructure, public utilities, airport management, telecommunications, etc.), the greater its interest should be to secure market access and good protection of investments against discrimination.

Furthermore, all the BITs that China has with EU countries are not of top standard. Provisions in these BITs vary and vague language makes them susceptible to different interpretation. Both sides need to get agreements with improved legal clarity and precision – binding agreements rather than rehearsals of ambiguous and broad legal concepts. The latter invites confusion and unpredictability – and prompts firms to test the limits of an agreement through investor-state litigation, adding yet more tensions. Inevitably, Chinese businesses will expand and increasingly operate in the EU. A uniform set of regulations will drive down costs to manage these investments. Investment conditions will get more predictable.

Investment agreements are typically signed to protect investments. Adding a market access component is a new undertaking, but it is an important one to establish market symmetry. EU-China commercial policy relations have been fraught by disputes and tensions – and there has to be constructive and cooperative ways for the two to defuse tensions and improve the policy conditions for further integration. A Free Trade Agreement between the EU and China is currently not on the cards. The talks around updating the Partnership and Cooperation Agreement have lost traction. The High-level Trade and Economic Dialogue has failed to establish a good platform for business-like negotiations to resolve problems. EU-China summits are more often than not inconsequential. Negotiations over a new investment agreement can give purpose and direction to bilateral policy cooperation. Leaders on both sides would be wise to use this opportunity.