

ASG Analysis: EU-China Comprehensive Agreement on Investment (CAI)

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Key Takeaways

- On December 30, leaders of the European Union and China concluded preliminary negotiations for a Comprehensive Agreement on Investment (CAI). The agreement – seven years in the making – promises greater market access and a more level playing field for European businesses in China.
- The proposed EU-China agreement is an opening salvo in discussions between the incoming Biden administration and its European allies about how to approach China. The EU is signaling its intention to protect its substantial commercial interests in China (and thus not de-couple) while starting to lay down rules that it expects China to follow. The precise balance Europe strikes between its economic and human rights interests will be decided in the coming months by EU officials with input from the Biden administration.
- In addition to commitments to discipline the poor behavior of Chinese state-owned enterprises, the EU secured Chinese pledges on environmental policies, climate change initiatives, and labor standards. Several EU members, however, have lamented that these commitments are not legally binding and noted the continued repression of pro-democracy activists in Hong Kong. Germany, having held the Council of the EU presidency at the time of the agreement, is under fire for pushing through the CAI.
- Finalizing the CAI by the original 2020 year-end deadline is a major political victory for China, allowing Beijing to create a wedge in the transatlantic partnership on the eve of President-elect Biden's inauguration while simultaneously flexing its global geopolitical muscle. Europeans, according to a survey by the European Council on Foreign Relations, believe China to be the world's rising power and thus may seek to exact a price from the U.S. in exchange for signing on to a relationship with what many see as a declining power.
- While officials in the incoming Biden administration were likely displeased by Europe's eagerness to sign this agreement, the U.S. and EU are still expected to work together on a multilateral approach to China. A key factor in Europe's decision-making will be the extent to which China threatens to become a competitor to Europe's high value industries in the near term.
- This EU-China CAI is not a "done deal;" member states must approve before it is finalized and implemented. It will likely face challenges both with European Parliamentarians and some national parliaments. The ratification process is unlikely to be completed before 2022.

Timeline of the Agreement

The seven-year-long CAI negotiation process reached a controversial conclusion when an agreement was quickly finalized on December 30 after minimal discussion among EU member states and during a time when many were preoccupied with the coronavirus, Brexit, and the holidays. Germany – a major proponent of the agreement – was set to lose its presidency of the Council of the EU on January 1, likely explaining the rushed process. The agreement comes weeks before a significant political transition in the U.S. and as the incoming Biden administration continues to signal its plans to rebuild a transatlantic relationship focused on coordination to counter competition and threats emanating from China.

Despite the rushed negotiations, the CAI is unlikely to be ratified before 2022. The ratification process will be a telling sign of the current state of EU-China relations, in contrast to the closed-door negotiations which took place over the past month; Germany is already under fire from Belgium, Italy, Poland, and Spain for not legally binding China to higher human rights standards. The CAI ratification process will also be a harbinger of EU-US relations during the Biden administration.

Economic Implications

The European Union is poised to make significant economic gains under the CAI; if ratified, the agreement would provide European investors greater market access to 1.4 billion Chinese consumers and a more level playing field in China. China has committed to opening to foreign investment in automotive, financial, health, cloud, computer, maritime transport, air transport, business, environmental, and construction services under the agreement.

The CAI seeks to make investment fairer by disciplining the behavior of Chinese state-owned enterprises (SOEs) and imposing transparency obligations on subsidies in the services sectors, filling an important gap in the World Trade Organization (WTO) rulebook. The agreement also clearly outlines rules against the forced transfer of technology and for equal access to standard setting.

Reciprocally, the EU would allow China greater access to its renewable energy sector, an area in which China already has a large footprint. The EU did not, however, approve a greater Chinese presence in its critical nuclear energy infrastructure, strategic shipping, security technology, and military industries.

China, in a potentially significant concession, agreed to bolster its labor and environmental standards. The CAI includes China's commitment to implement the [International Labor Organization's eight fundamental Conventions](#), including on forced labor, and the Paris Agreement, with the goal of reaching net zero carbon emissions in Europe by 2050 and in China by 2060.

Despite these promises, critics of the CAI note China's lackluster track record on labor protections and the absence of legally binding concessions to hold China accountable for its commitments; China will only be required to *attempt* to implement changes. For context, the Chinese government agreed to join the WTO's Government Procurement Agreement "as soon as possible" when it joined the WTO in 2001 and is still not a signatory.

"THIS AGREEMENT IS OF MAJOR ECONOMIC SIGNIFICANCE AND ALSO BINDS THE PARTIES INTO A VALUES-BASED INVESTMENT RELATIONSHIP GROUNDED IN SUSTAINABLE DEVELOPMENT PRINCIPLES."

PRESIDENT OF THE EUROPEAN COMMISSION
URSULA VON DER LEYEN & PRESIDENT OF THE
EUROPEAN COUNCIL CHARLES MICHEL

Internal EU Politics

With the preliminary outline of the CAI championed by the European Commission President, European Council President, France, and Germany, it remains to be seen whether the deal will be ratified by the European Parliament and member states.

Parliament members hesitant about the CAI fall into two camps:

- 1) Those who do not believe there are strong enough legally binding commitments on human rights and labor standards, especially given China's actions in Hong Kong and Xinjiang. These members of parliament will not sign unless legally binding terms on forced labor and human rights are added.
- 2) Those who are concerned about the impact of the CAI on the transatlantic partnership with the incoming Biden administration.

Given these concerns, the controversy over the agreement is not likely to dissipate quickly. Poland and the Netherlands have criticized the negotiation process while some member states are reportedly considering vetoes.

Impact on the Transatlantic Relationship

On December 21, Jake Sullivan, the National Security Advisor-designate for U.S. President-elect Joseph R. Biden, tweeted that "the Biden-Harris administration would welcome early consultations with our European partners on our common concerns about China's economic practices." While this request seems to have been sidelined by the German-led EU Council in its decision to push forward with the CAI, Sullivan has signaled that the Biden administration's plans to rebuild trust and a working relationship with its European allies remain largely unchanged.

Sullivan also has suggested that the EU's rush to finalize the CAI is because the Trump administration has damaged ties and alienated U.S. allies in its unilateral approach to China. In contrast, Sullivan has signaled that the incoming Biden administration will seek to build a new transatlantic alliance and approach towards China centered around deep shared concerns on trade, technology, human rights, and military aggression.

Unfortunately for the incoming administration, President Trump's unilateral approach to foreign policy and the U.S. government's difficulties dealing with the Covid-19 pandemic have severely undermined confidence in the U.S. as a partner on the global stage. While talk about the need for democratic countries to wage a "values battle" with China abounds, the signing of the CAI is a clear sign that European leaders in Germany and France do not have sufficient confidence that the U.S. will quickly emerge from its "America First" policy stance. Instead, according to European diplomats, the EU wanted "strategic autonomy" to make its own trade deal with China, akin to the Trump administration's Phase One trade agreement, before starting to work with the new Biden administration on common concerns over China.

Despite the inopportune timing of the EU-China Comprehensive Agreement on Investment, ASG expects the EU and U.S. to collaborate on their approach to China under the incoming Biden administration.

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