

Politically controversial, but weak in content: The China-EU Investment Agreement



Introduction

The investment agreement between China and the EU is highly controversial – and its future uncertain. Whether and when it will be ratified by the European Parliament is unclear.¹ Nevertheless, the Comprehensive Agreement on Investment (CAI) and its context is worthy of deeper analysis. The political dispute over CAI is emblematic of the challenges that the EU faces in its China policy. While tensions between the People's Republic of China (PRC) and the United States are intensifying, the EU is searching for its own approach. In the public and parliamentary debate, aspects related to climate, labor, and human rights politics are frequently addressed. At least as often, however, the EU Commission and other relevant actors decide in favor of economic interests. For a critical civil society, it is important to be prudent here. By taking a differentiated stance, this briefing aims to contribute to this endeavor. It briefly outlines the political context of the tense EU-China-U.S. triangle and looks at the contents of the agreement: What liberalizations in the investment sector does the agreement provide for? What environmental and labor law requirements are there?

China's economic and political strength is increasingly perceived as competition and

sometimes even as threat. Liberal ideas of “change through trade” have finally become outdated. Since 2019, this change in assessment also is reflected by official EU vocabulary: In its “strategic perspectives” on China, the EU Commission characterizes the PRC as a “systemic rival”.² The search for a differentiated approach to the Chinese government and a corresponding EU-China policy represents a major challenge. Not only must the different economic and political interests of the EU member states, their industries and civil society organizations be considered, but also the tense relationship between China and the United States. The Biden administration is pushing for a more unified position on China – both in terms of economic policy and foreign policy issues. NATO's 2021 Final Communiqué states: “China's growing influence and international policies can present challenges that we need to address together as an Alliance.”³

The Chinese government should not be belittled, but neither should it be demonized. The fact that criticism of it is becoming harsher is clearly linked to the struggle to shape global trade relations. It would be wonderful if this struggle were primarily about a socially and ecologically sustainable transformation of the





The EU Parliament plays a central role in the dispute over CAI. Photo: Jorgen Hendriksen, Unsplash

current economic mode of production. As the editors of this publication are committed precisely to this social-ecological transformation, they have long levelled considerable criticism at the EU's trade and investment policies. In the name of *'free trade'* and supposedly *'fair competition'*, global inequalities are exacerbated while the power of corporations and investors is strengthened against democratic control. Environmental, labor, social, data, health and consumer protection standards are being eroded. This is the context in which CAI should be viewed – and its ratification rejected.

CAI in the political context

On December 30, 2020, at the end of a year marked by multiple crises, the image of a video conference went around the world: it showed Chinese President Xi Jinping, EU Commission President Ursula von der Leyen, EU Council President Charles Michel, German Chancellor Angela Merkel, and French President Emmanuel Macron after the conclusion in principle of the CAI negotiations. For nearly eight years, the EU Commission's Directorate General for Trade (DG Trade) and the Ministry of Commerce of the People's Republic of

China (MOFCOM) had negotiated in secret. Contrary to the EU Commission's promise to create more transparency about the trade and investment negotiations, the official draft texts were not published until three weeks after negotiations had been concluded in principle.⁴ After the surprising agreement in principle, which was not coincidentally concluded in the last days of the German EU Council Presidency, the EU Commission expressed satisfaction: CAI is *"an important landmark"* in the relationship with China and part of the EU's *"values-based trade agenda"*.⁵

However, for many, CAI does not fit into the picture of *'values-based trade policy'* that the European Commission likes to paint. *"China deal damages EU's human rights credibility, MEPs to say,"* headlined the British Guardian in January 2021.⁶ Two months later, on March 22nd, the European Parliament voted to sanction four senior Chinese officials, which are linked to the Xinjiang Autonomous Region Public Security Bureau, for their role in the mass internment in Xinjiang. *'China'* was thus subjected to human rights sanctions for the first time since the 1989 Tian'anmen massacre. The Chinese government responded immediately and imposed sanctions in turn. The EU *"must stop lecturing others on human rights and interfering in their internal affairs,"* said the Chinese Ministry of Foreign Affairs. The *"hypocritical practice of double standards"* must be ended.⁷ The Chinese countersanctions affect five Members of the European Parliament, three Members of national parliaments, two academics, as well as the European Council's Political and Security Committee, the European Parliament's Subcommittee on Human Rights, the Mercator Institute for China Studies (MERICS) in Germany, and the Alliance of Democracies Foundation in Denmark. They, their families, and companies and institutions associated with them are prohibited from traveling to the PRC, Hong Kong, and Macao, and from doing business *"with China"*.

A low point in diplomatic relations – and for some, the end of CAI. On May 20th, the European Parliament put a temporary stop to any debate on the investment agreement: With a large majority, the parliamentarians voted to not discuss CAI until the Chinese government has lifted sanctions against EU institutions, members of the European Parliament and national parliamentarians. The EU Commission is expected *"to consult with Parliament before taking any steps towards the conclusion and signature of the CAI"*.⁸ This conclusion includes the *'legal scrubbing'*, that is, the formal legal review and the translation of the agreement into the EU's 24 official languages. It is unclear to what extent the EU Commission is currently suspending these activities, or

whether it is pressing ahead with them. In response to a request by PowerShift, a spokesperson of DG Trade replied in October 2021: “The ratification process should be seen in the wider political context. The Chinese retaliatory sanctions targeting members of the European Parliament and an entire parliamentary sub-committee are regrettable and do not create the required favorable environment. Prospects for the ratification will depend on how the political situation evolves. What is clear is that economic interests will not prevent the EU from standing up for human rights – including, where necessary, through sanctions.”

CAI in the context of economic competition

For the EU, the conflict between the USA and China, “its most powerful ally and most important trading partner” poses a major dilemma.⁹ In the competition for power and capital accumulation, ‘technological sovereignty’, which is closely associated with national security, plays a significant role. At the same time, the deep interdependence and thus co-dependence of the respective economies poses major challenges for all governments and companies. All players are striving to identify vulnerabilities in their supply chains and to promote industrial as well as technological research and development that is independent of each other, for example in semiconductor and microchip technology, 5G and 6G networks, or cloud computing. With the Made-in-China-2025 strategy and the new concept of dual circulation, the Chinese government is articulating its plans and efforts to strengthen domestic demand, develop and produce high-tech goods, and maintain high export rates. In the EU and the USA, on the other hand, discussions on ‘resilient’ supply chains, ‘decoupling’ and ‘reshoring’ are ongoing. In September 2021, the newly appointed U.S.-EU Trade and Technology Council (TTC) met for the first time to discuss strategic technologies.

There is increasing concern in China that European companies and investors will turn away, also due to pressure from the USA. But for many European companies and investors, this would be neither easily feasible nor particularly attractive. Chinese suppliers are deeply integrated into global production networks. At the same time, the Chinese market still offers great growth opportunities for many European companies, such as the export-oriented German industries. In this context, the conclusion in principle of the CAI negotiations should be understood as both a political safeguard measure and a diplomatic gain for the Chinese government.

From the point of view of the EU Commission, CAI is intended to create a more balanced ‘level playing field’, that is, competition on equal terms. The economic systems of China and the EU differ in many respects. This also includes a varying degree of openness to foreign investors. In the spirit of catch-up industrialization, the PRC has pursued a gradual, sector-specific liberalization policy since its Reform and Opening under Deng Xiaoping beginning in 1978. At the same time, many Chinese companies have received state support, for example in the form of subsidies, or have otherwise been protected from foreign competition. Closed markets for public procurement, specifications for the use of local (sub)products or technology transfers from foreign to Chinese companies are also among the measures of domestic economic promotion. Partly because of these fundamental characteristics of the Chinese economic system, the PRC is one of the few countries worldwide that has succeeded in achieving massive economic development in recent decades. However, from the perspective of many foreign investors and companies, including those from the EU, these and other characteristics of the Chinese economic system prevent the ‘level playing field’.

What does the agreement say?

CAI is intended to ‘balance’ economic relations and create more legal certainty. It promises sectoral (partial) openings for EU companies in China, such as in manufacturing and financial, environmental, health and other services. More than half of EU investment in China goes into manufacturing, with 28 percent of that in the automotive sector alone.¹⁰ The investment agreement addresses issues such as transparency of subsidies, improved access to Chinese standardization bodies for European companies, liberalized transfer of capital and payments for investments, as well as the elimination of quantitative restrictions, ‘joint venture’ requirements (the condition that European companies must join forces with Chinese partners), technology transfers or ‘equity caps’ (caps on foreign ownership). In particular, the ‘forced transfer of technology’ has been a point of contention between the EU and China time and again. However, some of these liberalizations are also promised by the Foreign Investment Law (FIL) that came into force in the PRC in 2020.¹¹ From the perspective of foreign investors, it is an improvement because the ‘negative list’ has been shortened (i.e., the list of those protected sectors in which foreign investment is prohibited or restricted). Unless an investment is directed to a specific sector of that ‘negative list’, the FIL now grants so-called ‘national treatment’ to foreign investors and their investments in China.

Dispute over dispute settlement

Investor-State Dispute Settlement (ISDS) is included in many trade and investment agreements. It gives foreign investors the right to sue states for compensation before arbitration courts on the basis of vague, broadly defined property rights – for example, if they see their profits endangered by laws to protect the environment or health.¹² A recent report by the Business and Human Rights Resource Centre examines how ISDS lawsuits could jeopardize new legislation on human rights due diligence for businesses.¹³ Due to the high compensation sums that states may have to pay to investors, the mere threat of an ISDS lawsuit can prevent or weaken legislation (*regulatory chill*). At the same time, regional, democratically legitimized legal systems are undermined, as corporations can use an ISDS claim to challenge their decisions or circumvent these legal systems.

Public criticism and massive protests have led to a slight reform of the EU's investment chapters and the introduction of an Investment Court System (ICS). But these do not break with the logic of granting unilateral special rights of action to foreign corporations, but rather continue it. This also applies to the EU Commission's further project to turn the ICS into a multilateral investment court (MIC) in the long term. The MIC is to be located at the United Nations Commission on International Trade Law (UNCITRAL). Here, too, the structural inequality of the ISDS system remains untouched: Legal action only applies to foreign investors.¹⁴ At the same time, the Chinese government is working on its own variants of arbitration with the establishment of international commercial courts in Shenzhen and Xi'an in 2018 (China International Commercial Courts; CICC).¹⁵

CAI does not currently include an ISDS mechanism. However, this is envisaged by the contracting parties: Negotiations in this regard are to be continued and fully completed no later than two years after ratification of CAI by China and the EU. Progress on the structural reforms of investment dispute settlement at UNCITRAL is also to be considered in this process.¹⁶ The editors of this briefing demand that corporate rights of action remain outside the scope of the agreement. As is the case for other investment agreements, the inclusion of ISDS poses the risks that regulations in the social, environmental and health sectors, for example, will be prevented, slowed down or become very expensive due to compensation payments to companies.

Even regarding less prominently debated components of the agreement, such as the clauses on technical standardization, the changes for EU companies remain limited. According to a study commissioned in October 2021 by MEP Reinhard Bütikofer (The Greens), the easier access to Chinese standardization bodies partially promised in CAI has already been promised under the new FIL. In addition, the study states: *“Furthermore, the recent release of the FIL and its provisions on technical standardisation are indicative of China's general willingness to gradually open its technical standardisation regime to foreign invested companies, at least selectively. It is likely that the improved access under the CAI will be granted to European firms with or without the ratification of the agreement.”*¹⁷

CAI's greatest potential gain here is attributed to the fact that some changes through CAI would no longer be tied to the FIL or other legislation in China but tied to an international treaty. With CAI, the terms of market access for EU firms would be independent of Chinese internal policies. If the Chinese FIL were to be partially or fully withdrawn again, the liberalizations agreed in CAI would – theoretically – remain enforceable. Neoliberal investment lawyers describe this as *'locking-in'*: Economic liberalization is anchored in international law and can only be reversed by national legislation if a state – in a process that is often politically difficult to enforce – cancels an agreement.

Whether this would be the case with CAI and how effective possible dispute resolution mechanisms would be is another matter. In any case, many industry representatives, including the Federation of German Industries (BDI), are not euphoric in their assessment of the agreement: *“In the areas of market access and level playing field, the commitments made by the Chinese side largely codify a status quo already achieved over the last few years. The CAI would improve the situation for European companies in China in some areas, but not fundamentally change it.”*¹⁸ At the same time *“the EU is assuring China of the openness of its own market for an indefinite period”*.¹⁹

What does the agreement not say?

Following the agreement in principle on CAI, the EU Commission did not exercise rhetorical restraint: the agreement was *“an important landmark in our relationship with China and for our values-based trade agenda,”* said Commission President Ursula von

The controversial entry on “Non-Profit Organizations”

In the attached schedules of trade and investment agreements, the respective contracting parties list those economic and political sectors which remain unaffected by the provisions of the agreement, thereby remaining within the autonomy of the contracting parties (the so-called ‘*negative schedules*’). As a rule, these are economic sectors that are particularly sensitive for the respective states – for example, for reasons of national security or to protect certain industries from foreign competition or foreign investment. The principles of ‘*national treatment*’ or other aspects of the agreement do not apply in these cases.

Entry 9 in Annex II of China’s schedules is causing a stir. This provides for a deviation from Article 6 of the chapter on investment liberalization, which states that none of the contracting parties may require companies to appoint natural persons of a certain nationality to senior management or the board of directors.²⁰ Entry 9 in Annex II claims an exception from this requirement, as well as the basic requirement for “*national treatment*”:

Unless approved by the Chinese government: foreign investors and covered investments may not invest in non-profit organizations within the territory of China; non-profit organizations established outside of China may not set up representative offices or branches in China. To conduct activities temporarily in China, foreign non-profit organizations shall cooperate with domestic entities, and the term for such temporary activities shall not exceed one year. The senior executives of non-profit organizations which have been

approved to be established within the territory of China shall be Chinese citizens.²¹

This passage is largely in line with the Law on the Management of Foreign Non-Governmental Organizations, which came into force in 2017 and restricts contact between Chinese and non-Chinese civil society organizations to a narrowly selected range of topics.²² However, the addition found in the last sentence, namely, that senior executives of non-profit organizations must be Chinese citizens, is new. This „*must be interpreted as an attempt by the Chinese side to further move the borders of securitization of civil society spaces*”.²³ Since business associations and political foundations could also be affected by this provision, the BDI is sharply critical of this passage and states: “*The federal government and the EU must take action here and prevent this potential restriction. The relevant section should be deleted from the agreement.*”²⁴

The pivotal question is why these conditions are to be found in an investment agreement at all – and why the European Commission has accepted this. Following a meeting with civil society organizations on this topic, the EU Commission’s representation in Germany published a communication in May 2021, which unfortunately can no longer be accessed online. It said: “*The frequently cited Annex II (entry 9) is a unilateral Chinese offer that is not binding on the EU.*”²⁵ This does not dispel the concern about whether even stricter legislation for international NGOs is imminent in China and whether there is a lack of competence in this regard at the EU Commission.

der Leyen.²⁶ Indeed, the preliminary fourth chapter of CAI is entitled “*Investment and Sustainable Development*”²⁷. In the first article, the two contracting parties refer to “*relevant international documents*”, including the United Nations 2030 Agenda for Sustainable Development. However, this is followed by legally non-binding vocabulary in the form of “*to commit*”, “*to recognize*”, and “*to agree to promote*”. In non-binding language, the two parties to the agreement recognize “*the important contribution of Corporate Social Responsibility or Responsible Business Conduct to strengthening investment’s positive role in sustainable growth.*”²⁸ China and the EU commit to various international frameworks to which they already belong and promise their “*effective implementation,*” for example regarding the Paris climate agreement. No new commitments are made, and no concrete measures are mentioned. Instead, the “*right to regulate*” mentioned in relation to “*Investment and Environment*” and “*Investment and Labor*” is illuminating:

*The Parties recognise the right of each Party to determine its sustainable development policies and priorities, to establish its own levels of domestic labour and environmental protection, and to adopt or modify its relevant laws and policies accordingly, consistently with its multilateral commitments in the fields of labour and environment.*²⁹

Yet the PRC has not even entered all relevant “*multilateral commitments*” in labor. The following are the four fundamental principles and rights at work of the International Labor Organization (ILO): “*freedom of association and the effective recognition of the right to collective bargaining; the elimination of all forms of forced or compulsory labor; the effective abolition of child labor; and the elimination of discrimination in respect of employment and occupation*”. They are set out in eight “*fundamental Conventions*”.³⁰ Of these eight fundamental conventions, the PRC has to this date ratified only four.³¹ This is also criticized by the Hong Kong-based NGO

Globalization Monitor. It highlights that the “*Agreement will not demand China to ratify other ILO fundamental conventions such as ‘Freedom of Association and the Right to Organize Convention’ (ILO C087) and ‘Right to Organize and Collective Bargaining Convention’ (ILO C098)*”, which are key enabling rights.³² Trade unions are not mentioned at all in the draft agreement so far. Instead of making ratification of basic ILO conventions a prerequisite for CAI, only the two ILO conventions on forced labor (ILO 29; 1930) and abolition of forced labor (ILO 105; 1957) are mentioned. The current text draft states: “*In particular, in this regard, each Party shall make continued and sustained efforts on its own initiative to pursue ratification of the fundamental ILO Conventions No 29 and 105, if it has not yet ratified them.*”³³ The PRC is left to decide for itself whether, when, and how to ratify these conventions.

Ratification of other relevant ILO conventions, none of which is specified, is to be “*considered*”. If the EU had been genuinely concerned to provide an impetus for improving labor standards in China, it could have made the entry into force of the agreement conditional on the ratification of fundamental ILO conventions. Alternatively, the EU could at least require changes to national laws, as was the case with the trade and investment protection agreement with Vietnam.³⁴ Of course, the extent to which the implementation of conventions and laws is effectively carried out, reviewed and, if necessary, sanctioned must always be observed. The use of trade sanctions or the suspension of the treaty in case of disregard of environmental and labor standards is not mentioned. The chapter also lacks specific enforcement and sanction mechanisms: the use of state dispute settlement is explicitly excluded; instead, only the possibility of consultations and the convening of an “*expert panel*” that can prepare a report on violations is mentioned. In contrast to the Trade and Sustainable Development (TSD) of the more recent EU trade agreements, CAI does not provide for the establishment of Domestic Advisory Groups (DAGs) in which trade unions, environmental and business associations are represented. A missed opportunity. At the same time, the DAGs can hardly exert any political influence. Yet rather than strengthening the DAG mechanism, CAI leaves it completely on the sidelines, which effectively means a further weakening of civil society participation.³⁵ This gives the impression that the EU has significantly undersold the claim of its “*2values-based trade agenda*”.

Conclusion

The ratification of CAI was originally scheduled for the first half of 2022 under the French Council Presidency. It now has been postponed indefinitely. In September 2021, the European Parliament adopted a “*Report on a New EU Strategy on China*” by a large majority.³⁶ The Parliament calls for nothing less than a reorientation of the European Union’s China policy and maintains its rejection of CAI. This is justified, among other things, by the sanctions still in place against MEPs – and by the fact that trade relations “*do not take place in a vacuum*”. The overall political situation should therefore be considered. This realization comes in late. For years, European investors and companies have benefited from the growth opportunities of the Chinese market, but also from the low environmental and labor standards in China. These always have been and continue to be embedded both in global production networks and in a local political system. The restriction of liberal basic rights, including the massive repression of civil society activities, is anything but new. One thing is clear: The Chinese government should not be played down, but it should not be demonized either. European civil society must critically accompany the reorientation of EU-China policy in cooperation with its partners in the PRC, Hong Kong, and Taiwan and, in doing so, be a perceptible but differentiated voice.

Our criticism of CAI does not primarily refer to the fact that the agreement has been concluded with the PRC’s government, but that it further codifies economic liberalization in favor of export-oriented, transnational companies and investors. We welcome the critical position of most EU parliamentarians on the investment agreement with China. However, this commitment of MEPs and EU member states to the protection of climate and environment, human rights and labor rights must not only come to the (rhetorical) fore when dealing with the PRC and CAI, but also apply to all other trade and investment agreements. Many of the politicians who are critical of CAI have made uncritical statements on other trade and investment agreements or voted for their entry into force.

The commitment to protect climate and environment, human and labor rights must be an anchor for the EU’s trade and investment agreements with third countries. Hence, it must be enshrined with legally binding commitments. We reject the ratification of CAI because climate and environmental protection, human rights, labor, and social standards remain far too vague in the agreement. They refer primarily to multilateral agreements and commitments already made, whose effective implementation must still be fought for politically.

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