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POLICY PAPER

CAI: China is ready, how is about Europe

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Abstract
The China-EU Comprehensive Agreement on Investment (CAI) is a balanced, high-level, and mutually beneficial investment agreement. It not only sets up a new legal framework for China-EU economic and trade relations, but also provides stability for China-EU bilateral relations in an uncertain world experiencing major changes.

CAI as a milestone in the history of China-EU relations

The year of 2020 marks the 45th anniversary of the China-EU relationship. When China and the European Economic Community (EEC) established diplomatic relations in 1975, the annual trade volume was 2.4 billion USD. The average daily trade in goods was about 2 billion U.S. dollars between China and the EU in 2019. The bilateral investment also started from almost nothing, and the capital flows based on one track from the EU to China turned to two tracks between China and EU in the past decade. According to China's statistics, the stock of direct investments from China to the EU was 93.91 billion USD in 2019, and the EU is the biggest destination of China's investment in developed economies. The stock of EU's investment in China reaches 136.38 billion USD in 2019, which becomes 110.99 billion USD with excluding the stock of UK investment in China. Obviously, the current scale of capital flows between China and the EU is still relatively small. The EU's investment in China only accounts for about 5% of China's foreign investment, and China's investment in Europe only accounts for 3.4% of the EU's total foreign investment. These figures do not match with the status of both China and the EU as two major economies and their will for cooperation.

One reason for this mismatch is lack of legal framework. In the following 3 years after the establishment of diplomatic relations, China and the EEC singed a trade agreement based on the principles of equality and complementary advantages. In 1985, the two parties updated the trade agreement and signed the Agreement on

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Trade and Economic Cooperation (TEC), which not only pepped up trade, but also facilitated economic cooperation. The Article 12 of the TEC reflects the investment relations. Both parties agreed to improve investment environment and advance investment promotion. 20 years later, during the Ninth China-EU Summit in Helsinki in September 2006, the two sides agreed to launch negotiations on a new "Partnership and Cooperation Agreement" (PCA) and to revise the "Trade and Economic Cooperation Agreement" (TEC). The negotiations started in 2007, but unfortunately China and the EU did not make much progress due to their different approaches to negotiations. The existing legal framework of China-EU economic and trade relations remained at the level of the 1985 TEC, which cannot reflect the actual needs and requirements of the bilateral relations.

In 2013, China and the EU started new negotiations on the Bilateral Investment Treaty (BIT), which was changed to the Comprehensive Agreement on Investment (CAI) in 2018. CAI tries to not only cover the aspects of traditional investment protection and dispute settlement, but also deal with market access, regulation and sustainable development. The wording of *Comprehensive* reflects the ambitions of the parties and the quality of the agreement. The conclusion of the CAI negotiations at the end of 2020 is a milestone, which would provide a new legal framework for China-EU economic and trade relations.

CAI could promote global trade and investment

China and the EU are leading trading partners in the world. The EU had been China's No. 1 trading partner for over a decade. Nevertheless, due to the Brexit, ASEAN replaced the EU in 2020, and their trade volumes with China are 4.74 trillion RMB and 4.5 trillion RMB respectively. At the same time, China replaced the USA and became the EU's biggest trading partner in 2020. Either the EU's export to or import from the rest of the world decreased around 10%, in context, EU-China trade grows 5.3%. The stability of China-EU trade can contribute to the European recovery from the pandemic.

Against the backdrop of pandemic impact, China managed to boost its economic growth with 2.3% in 2020, and its growth target is 6% for 2021. China's economy exceeded 100 trillion RMB for the first time, which is roughly equivalent to 14.7 trillion USD. According United Nations Conference on Trade and Development (UNCTAD), China replaced the USA and became the biggest FDI receiving country in 2020.[1] The inflow capital was 163 billion USD, with 11% increase in Hi-Tech and 54% increase in mergers and acquisitions (M&A). The market size and potential facilitate capital flows into China. European companies are part of these capital inflows. The CAI will further enhance the trade and investment relations between China and the EU.

China itself is a part of the global production chain. Any Chinese trade and investment agreement will exert its impact on the global trade and investment flow.

[1] https://unctad.org/webflyer/global-investment-trend-monitor-no-38

For example, China together with other 14 Asian-Pacific countries had signed the Regional Comprehensive Economic Partnership (RCEP) in 2020, and the world's biggest free trade area is emerging. Now, the China-EU CAI is in the making.

The CAI will have spill-over effects on the global trade and investment. The CAI adopts a negative list approach. It is not only related to the manufacturing industries, but also to service sectors. According the European Commission's estimation, half of EU investment in China goes to manufacturing sectors, such as transport and telecommunication equipment, chemicals, health equipment, etc. The CAI will give market access of some areas only to EU investors. At the same time, it is the first time for China to adopt a negative list in service sectors. Investors from countries sharing the Most Favored Nation (MFN) can also enjoy the benefits provided by the negative list of the CAI in service sectors, especially in financial sector. The CAI will attract investors from non-EU countries to China as well.

The CAI, to certain extent, is a new generation investment agreement. It sets up high standards for liberalization of investment, regulatory framework, sustainable development, etc. China is a developing country, its opening process is based on a theory of "learning by doing," and its reform agenda is based on general systematic design. The year 2021 is the first year of China's 14th Five Year Plan and the start of a new development period for China, which indicates that China is pursuing a high-quality development, namely, not only in economy, but also in social areas. The CAI will provide a good opportunity for China to adapt itself to the new and emerging standards on investment and trade. China expressed its interest and showed its ambition towards the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTTP). Through the CAI practices, China can promote investment and trade negotiations with other parties and blocks and become a contributor to the global investment and trade system.

CAI as a touchstone for the EU's open strategic autonomy

Today, the world is facing profound changes. According to OECD estimation, the real GDP of China in the world economy between 2000 and 2030 will increase from 8 to 27%, that of the USA will decrease from 25 to 16%, and that of EU-27 will decrease from 24 to 14%.[2] Power game is back to the stage of world politics. Geopolitical and geo-economic structures are in reshaping. Strategic autonomy became the choice for Europe.

It is interesting that US-China trade conflicts to certain extent had induced European companies to move some of their production capacities from the USA to China. For example, German car industry relocated some SUV and Luxury cars and components production from the USA to China, to minimize the loss. Capitals are the first ones to react to the policies.

Another example is the geographical indications (GI) protecting agreement. There is always an US influence upon the GI negotiations between the EU and

[2] https://data.oecd.org/gdp/real-gdp-forecast.htm

China, due to the well-known reason. China and the EU made efforts to eliminate interferences and overcome difficulties, and they successfully concluded the negotiations and presented it to the China Import Expo in Shanghai in November 2019. Within less than one year, the two parties overcome the inconvenience caused by the COVID-19 pandemic and signed the GI Agreement online in September 2020. The agreement came into force since 1st March 2021. It is interesting that this time there was neither voice against the agreement in EU, nor voice in EU asking to wait for the USA. According to EU Delegation in Beijing, in value terms, the market for EU geographical indications is around 75 billion EUR, or 7% of EU food and drink market. GI exports with about 17 billion EUR account for over 15% of total EU food and drink exports.[3]

Now, the CAI is on the way, which is a different story. When there was hardly any hope to conclude the negotiation, the argument was why negotiation process was so slow. When the negotiation was reached by the very end of 2020, the argument was why the negotiation needed to be concluded in haste. Why was it concluded during German Presidency? Why did French President Macron attend the video conference of celebrating the conclusion? Why did not the EU wait for the new US administration? There was even a funny conspiracy theory circulating and accusing why China agreed at the last moment, and people think it is for sure that the EU lost and China won. After posing so many whys, the general impression is why there is no confidence in Europe. Back to the beginning, why did the EU initiate the negotiation on investment?

A Chinese motto says: don't let vision be blocked by floating clouds. The CAI is a touchstone for the EU's open strategic autonomy. Otherwise, the EU's open strategic autonomy will turn into an awkward situation, where the EU will get lost in strategic thinking, having no confidence in autonomy building and being narrow thinking.

CAI as a test for EU's credibility

European integration has a history of more than 70 years since the Schuman Declaration on 9th May 1950. Great achievements have been made, but various challenges remain ahead. A Union with 27 members is not easy to deal with the differences, including the different development levels, variant economic structures, fragmented political spectrum and preferences of interests. The old "question" remains valid: what is the telephone number of Europe?

Everybody knows that if Europe desires to gain its credibility, EU countries need to speak with a single voice and take concerted action. However, if we look at concrete cases, the reality is totally different. Europeans say it is exactly the European way. Ironically, even EU members think about "American First" instead of putting EU interests in the first place. Therefore, speaking with a single voice would be a vision impossible.

[3] https://eeas.europa.eu/delegations/china/93961/eu-china-agreement-protecting-geographical-indications-enters-force_en

There are some voices from EU member states who have smaller trade volume and weak economic relations with China, but their focus is not on how to use the opportunity to enhance and expand the trade and economic exchanges. Instead, they are questioning about the speed of the negotiation and the mandate of the negotiation. Their focus is even on how Americans are thinking. Likewise, there are opinion makers, whose focus is on making opinions. It is like the game that when we talk about money, they talk about politics; when we talk about politics, they talk about values; when we talk about values, they talk about standards; when we talk about standards, they talk about business, just to name a few. The problem is that they just keep talking. Meeting all the interest needs is a mission impossible.

On 22 March 2021, the Council of the European Union had announced sanctions against China on issues of Xinjiang. On the same day, Chinese Ministry of Foreign Affairs (MFA), accusing that the European decision was based on fake news, immediately announced anti-sanction measures, including the human rights committee of the European Parliament (EP). The EP had published non-binding conclusions on 20 May 2021, "blocking" the review of CAI in the EP. The dramatic changes have brought the CAI approval process into uncertainty in the EU. The new situation caused by the EP would further damage the credibility of EU's capability.

The bureaucratic complexity makes the EU itself difficult to be understood on decision-making process. This is why the USA prefers to dealing with capitals of EU member states instead of Brussels as EU capital.

China is a strong supporter of European integration as well as a partner for cooperation. The GI Agreement and the conclusion of the CAI negotiations have showed China's sincere willingness for enhancing the China-EU relations. The will should be respected, and basic trust should be built. In this regard, the CAI is a test for EU's credibility.

China is on the way of further deepening reform and opening up. By signing RCEP and concluding the CAI negotiations, China would like to introduce further competition in domestic market and more actively gets involved into international competition. The CAI is an opportunity for both Chinese and European prosperity. China is ready. The question is whether the Europeans are ready.