

CAI REACHED BETWEEN THE EU AND CHINA IN 2020

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Abstract: *The study is about to compare the CAI between the EU and China in 2020 with its predecessor, the EU-China 1985 Bilateral BIT, and the Germany-China 2005 BIT in order to assess the effects of the CAI on FDIs and economic reciprocity. To fulfil this purpose, a comparative analysis of the three mentioned treaties is performed using the BMWK protection standards as comparison criteria. The new research aspect of this methodological proceeding is its assessment of the 2020 CAI on the basis of a comparison with prior treaties to evaluate the scope and meaning of the achieved agreement. The results of the comparative analysis elucidate that the 2020 CAI ameliorates marginally the framework for investments and market access between EU and China. Nonetheless, it is insufficient for facilitating FDIs of EU companies in China. China agreed to make relevant concessions in terms of environmental and labour standards, however, these do not compensate the persisting structural imbalance regarding market access between both parties.*

Keywords: *CAI, foreign investment, China, EU, bilateral treaty agreement*

1. INTRODUCTION

1.1. Background and Regulatory Framework for Direct Foreign Investments (FDIs)

To contextualise the findings of the comparative analysis performed later in this paper, it is paramount to first illuminate the background as well as the economic and legal framework of FDIs. From an economic perspective, it can be stated that FDIs are substantiated on three economic concepts:

- Michael E. Porter's competitive strategies;
- Ronald H. Coase's transaction costs theory;
- Kenneth Arrow's impossibility theorem.

Especially, Porter's (Porter 1985) research on the field of corporate governance is a relevant economic tenet for FDIs. According to Porter's theory, companies gain advantage over rivals when they master the competitive forces, he termed as the "Five Forces Model" (Mietzner 2009, 81). Identifying these five forces permits a given company to gather a detailed overview over relevant competitors and market players (Mietzner 2009, 81). The five forces determine industry attractiveness, as the rivalry among market players generates a competitive force, i.e., a competitive intensity. The efforts of individual actors aiming to improve their own competitive position (market share) occurs at the expense of its competitors (Bode 2009, 59 f).

Coase's transaction costs theory thematises the transfer of disposal rights over goods and services (Hornych 2012, 36). The transfer of disposal rights permits cooperating companies to benefit from specialisation advantages. In fact, cooperative ventures give rise to long-term

relationships that strengthen trust and thus reduce transaction costs (Hornych 2012, 37). Nevertheless, these cooperation agreements merely last until the market offers more favourable conditions (Hornych 2012, 37).

Arrow's impossibility theorem illuminates how decisions are adopted in markets environments (Arrow 1951; Kern/Nida-Rümelin 1994, 27). The impossibility theorem developed by Arrow is a social-choice paradox in the field of welfare economics and collective decision theory. It explicates the impossibility of yielding an ideal decision-making structure (Kern/Nida-Rümelin 1994, 27). It illuminates why collective decision-making processes do not lead to more beneficial decisions (Kern/Nida-Rümelin 1994, 27). If there are at least two individuals and at least three alternatives, no mechanism exists that can derive a collective decision from the individual decisions that satisfies all five parties involved Arrow, 1951).

Regarding the legal foundations of FDIs, three regulatory levels must be considered: the international, European, and national one (in this case, Germany). On international level, the manuals of the International Monetary Fund (hereinafter: IMF) and the Organization for Economic Cooperation and Development (hereinafter: OECD) prescribe the basic international framework of FDIs (Bundesbank 2022). One of the main functions of the IMF is to grant loans to countries that lack sufficient currency reserves (Bundesfinanzministerium 2022). The IMF publishes guidelines (Balance of Payments and International Investment Position Manual, hereinafter: BPM6) that must be observed by FDIs (IMF 2007). BPM6 regulates is the standard presentation of FDIs. The IMF stipulates that the concept of "assets and liabilities" is to be applied instead of the equity ratio (European Commission 2022, 5).

A gross presentation of FDI is specified, in which assets and liabilities should be explicated separately. Another source in this regard is the fourth edition of the reference definition of direct investment issued by the OECD (OECD Benchmark Definition of Foreign Direct Investment; hereinafter: BD4), which provides guidelines for elaborating statistics on FDIs (European Commission 2022, 1).

On European level, there are a series of requirements that constitute the legal framework for FDIs such as the EU Regulation 2019/452 of March 19, 2019. Regulation aims to establish a framework for the review of FDIs on European level to protect security and public order (Art. 1(1)) (Rusche 2020, 144). This Regulation equally requires member states to maintain, amend, or establish review mechanisms for FDIs (Art. 3(1)) and mandates that the rules and procedures of these review mechanisms are transparent and non-discriminatory (Art. 3(2)). The review mechanisms aim at determining whether an FDI is likely to jeopardise security or public policy (Art. 4(1)). Member states send annual reports to their national FDI commission (Art. 5(1)) and all FDIs subject to review must be reported (Art. 6 (1)). This European regulation was implemented mainly on the initiative of Germany in order to better regulate foreign takeovers and shareholdings of Chinese investors in Germany but also worldwide (Rusche 2020, 144).

The national legal framework for the examination of FDIs has been significantly tightened (Stompfe 2021), regulated by the Foreign Trade and Payments Ordinance (hereinafter: FTPO) and the Foreign Trade and Payments Act (hereinafter: FTPA). The FTPA regulates certain restrictions affecting the movement of goods, services, capital, payments, and other economic transactions with foreign countries (Section 1 FTPA). Restrictions can be adopted if an FDI threatens the protection of public security or foreign interests (Section 4(1) FTPA). The FDI review structure, provided by the FTPO and the FTPA, stipulates that the Federal Ministry of Economic Affairs has comprehensive review authority with respect to the acquisition of shares in German companies by foreign investors from non-EU countries (Stompfe 2021). The review process is triggered when 10 percent of a German company that belongs to a strategic sector (military, encryption, critical infrastructure) is acquired (Stompfe 2021).

1.2. Research Objectives

Objective of this paper is to perform a comparative analysis of the bilateral investment treaty (BIT) signed between Germany and China in 2005, the previous agreement between the EU and China of 1985, and the Comprehensive Agreement on Investment (hereinafter: CAI) signed between Europe and China in 2020. Research methodology will be described in more detail in the following section. Subsequently, the results of the analysis and comparisons of BITs will be described and assessed. Main findings will be synthesised in the conclusion sections as well as future research recommendations.

2. RESEARCH METHODOLOGY

To fulfil the formulated research objectives, a comparative analysis of a series of different BITs signed between different nations or organisations and at different moments in time, namely the Germany and China BIT in 2005, the previous CAI between the EU and China in 1985 and the CAI signed between Europe and China in 2020 is performed. This comparison is performed using the protection standards described by the German Federal Ministry for Economic Affairs and Climate Action (hereinafter: BMWK) as comparison criteria, namely the protection against expropriation, fair and cheap treatment, full protection and safety, Most-favoured-nation (MFN) treatment of residents, the breach of government commitments, and the transfer of capital and earnings. Once the comparative analysis of the content of the CAIs is performed, the effects of the CAI on FDIs are examined and the 2020 CAI is assessed from the perspective of economic reciprocity.

3. RESULTS

3.1. Content Overview of the 2020 CAI

The EU-China 2020 CAI is assessed as the most ambitious agreement China has ever agreed with a third country (WKO 2022). The agreement ensures China grants EU investors better market access that goes significantly beyond previous Chinese commitments in international trade agreements (WKO 2022). In broad terms, the CAI regulates three aspects:

- Market access;
- Conditions of competition;
- Sustainable development.

China has for the first time agreed to a commitment against forced labour, the ratification of the conventions of the International Labour Organization and the Paris Climate Agreement. The CAI also aimed at eliminating issues hindering competition, i.e., China's non-transparent approval procedures, preferential treatment of state-owned companies, discriminatory subsidies, and market access restrictions in certain sectors (WKO 2022).

Content of the CAI can be divided in six sections. **Section I** defines the objectives and formulates general definitions. Art. 1 defines the objective of the CAI as the “commitment to create a better climate to facilitate and develop trade and investment.” Art. 2 defines the key terms of the agreement, such as economic activities, enterprise, or measures. **Section II** thematises investment liberalisation. Art. 1. defines the scope of application, while Art. 2 stipulates the market access. Art. 3 regulates prohibitions on certain performance requirements, while Art. 4 and 5 prohibit unequal treatment. **Section III** contains the regulatory framework and provisions on licensing requirements, processes, or qualification provisions (Art. 1).

Section IV stipulates the provisions on investments and sustainable development and the obligation to comply with international standards (Art. 1). In addition to minimum labour standards, the commitment to corporate social responsibility is equally included (Art. 2). This section also ensures the sovereignty of both contracting parties regarding certain aspects of the agreement. **Section V** contains more detailed provisions on dispute resolution (Art. 3 and 5). The parties can

agree to a voluntary mediation at any time (Art. 4). If this is not expedient, an arbitration tribunal may be called upon (Art. 6). Decisions are based on the provisions of the CAI and the rules of public international law according to the Vienna Convention on the Law of Treaties (Art. 11). **Section VI** regulates in sub-section 1 the creation of an Investment Committee (Art. 1). It is prescribed that the committee meets once a year for reviewing various aspects of the CAI and the adequate compliance with all provisions (sub-section 1, Art. 3).

3.2. Comparison of the previous BITs and the EU-China Investment Agreement (2020)

The investment agreement between Europe and China will be compared with two prior BITs: The investment protection treaty between Germany and China, which came into force on November 11, 2005 (BMWK 2022) and the trade and economic cooperation agreement between the EU and China, which dates back to 1985 (WKO 2022). This BIT forms the basis of trade relations between the EU and the Asian nation. For performing the comparative analysis, the protection standards formulated by the BMWK (BMWK 2022) are used as comparison criteria:

Table 5. Comparison of various agreements

BITs:	Germany-China (2005)	EU-China (1985)	EU-China (2020)
Protection against expropriation	Article 4	no	Indirectly in Section V & Art. 16
Fair treatment	Article 3	Indirectly in Article 8	Indirectly in Section IV, sub-section 4 & Art. 6
Full protection and safety	Article 4	Indirectly in Article 12	Not wide-ranging in the sense of full protection and security (BMWK 2022a); not related to capital; indirectly in: Section III, Art. 2; Section IV, Art. 2; Section IV, Art. 2; Section VI, Art. 3.
MFN	Article 4	Article 3	Section II, Art. 5
National treatment	Article 2 & Article 5	Indirectly in Article 1	Section II, Art. 3bis; Section II, Art. 3ter; Section IV, sub-section 2, Art. 2, Section IV, sub-section 3, Art. 2, Section VI, Art. 4; Section VI, Art. 7; Section VI, Art. 9
Protection against the breach of government commitments	Indirectly in Art. 8 & 9 (Dispute resolution)	Indirectly in Article 15	Section V
Transfer of capital and income	Article 4 & 6	Indirectly in Article 12	Section II, Art. 3; Section II, Art. 6bis; Section VI, Art. 5; Section VI, Art. 6.

The comparative analysis of the three agreements elucidates that only the BIT between Germany and China contains all relevant provisions. The first agreement between China and the EU of 1985 contains hardly any regulations and, in the best case, merely hints at them. The agreement refers to trade between both parties but does not refer to investments. Only Article 12 alludes to the necessity of intensifying efforts regarding FDI.

The regulations of the 2020 CAI between EU and China are more far-reaching. Nonetheless, many of them only indirectly relate to the BITs' protection areas. The MFN clause (with exceptions), national treatment, dispute settlement, and the transfer of capital and income are comprehensively regulated. In contrast, protection against expropriation, fair and equitable treatment and full protection, or full security are only vaguely regulated. This hesitant tone is especially recognisable compared to the BIT between Germany and China.

3.3. Effects of the CAI on Foreign Direct Investments

The influence of the CAI on reciprocal FDI must be assessed considering that China is not a country open to foreign investments (Mildner/Schmucker 2021, 88). Hence, a relevant accomplishment of the 2020 CAI is gaining market access for FDI, abolishing thus the existing restrictions and limits (Mildner/Schmucker 2021, 88). Concessions regarding investments are made for specific sectors, some of which are still subject to restrictions though. This is in line with China's policy of only making concessions for certain sectors (Mildner/Schmucker 2021, 88).

When evaluating the CAI against the background of the EU's expectation of opening up the Chinese market to investments through this agreement, the progress made can be assessed as rather marginal. The EU explained that this CAI would constitute a sort of disciplinary framework for Chinese state-owned enterprises (Hamilton 2022, 67). While this can be agreed with in principle, in practice this is not sufficient to facilitate European FDI in China. Nevertheless, the CAI can be seen as a "new generation investment agreement" with regard to FDI (Chen 2022, 11). It contains high minimum standards for the liberalisation of investments, creates a regulatory framework, and focuses on sustainable development (Chen 2022, 11). In this sense, the CAI provides marginal but measurable improvements for investments and market access (Chen 2022, 11). In addition, the CAI fills a previous gap in the investment relationship between the EU and China as it contains legally binding provisions (Wuttke 2022, 22).

3.4. Assessment of the CAI from the perspective of Economic Reciprocity

Initially, the CAI was fiercely criticised as it was considered too China-friendly (Mildner/Schmucker 2021, 87). However, this criticism must be seen in the context of the EU's objective of strengthening its own geopolitical position, for which China is a paramount market (Mildner/Schmucker 2021, 87). Accordingly, the assessment of the CAI must be made considering that China is a closed market economy and, consequently, following the credo "better than nothing" (Mildner/Schmucker 2021, 87). The CAI does not create an open investment climate nor does it gain new market access opportunities for European companies. However, it ensured a relevant objective, namely the establishment of fair competitive conditions (Mildner/Schmucker 2021, 88).

Essential points of foreign trade reciprocity are addressed and accomplished with the concessions on equal treatment of nationals and MFN treatment. However, there are no clauses protecting against expropriation without compensation or unfair treatment (Mildner/Schmucker 2021, 89). Since both of these exist on the EU market even without this CAI, but not on the Chinese market, an imbalance remains here. Important concessions made by China are the commitments to comply with environmental and labour standards (Mildner/Schmucker 2021, 89 f.; BDI 2021). Equally relevant is China's commitment to provide access to Chinese standard setting bodies for

European companies (BDI 2021). However, these concessions do not compensate the fundamental problem. This CAI does not resolve the structural imbalance when it comes to market access. The Chinese authorities still have numerous possibilities to intervene and block access, whereas the EU assures China an open market for an indefinite period of time (BDI 2021).

CONCLUSIONS

Summary of Findings

Put succinctly, the performed comparative analysis reveals that the BIT between Germany and China is the only agreement containing all relevant provisions. The EU-China CAI achieves marginal improvement for investments and market access compared to previous agreements but falls short for facilitating FDIs in China. It was accomplished, though, that China agreed to make relevant concessions such as complying with environmental and labour standards (Mildner/Schmucker 2021, 89 f.; BDI 2021). However, these concessions do not compensate the fundamental issue of the structural imbalance in market access.

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ПОСТИГАНЕ НА САІ МЕЖДУ ЕС И КИТАЙ ПРЕЗ 2020 Г.

Резюме: Проучването има за цел да сравни САІ (Цялостно споразумение за инвестиции) между ЕС и Китай през 2020 г. с неговия предшественик – двустранния ВІТ (Двустранен договор за инвестиции) между ЕС и Китай от 1985 г., и ВІТ между Германия и Китай от 2005 г., за да се оцени въздействието на САІ върху ПЧИ и икономическата реципрочност. За да се изпълни тази цел, е извършен сравнителен анализ на трите споменати договора, като са използвани стандартите за защита на ВМВК (Федералното министерство на икономиката и климатичните действия) като критерии за сравнение. Новият изследователски аспект на тази методологична процедура е нейната оценка на СИП от 2020 г. въз основа на сравнение с предходни договори, за да се оцени обхвата и значението на постигнатото споразумение. Резултатите от сравнителния анализ показват, че Споразумението за партньорство от 2020 г. подобрява незначително рамката за инвестиции и достъп до пазара между ЕС и Китай. Въпреки това той е недостатъчен за улесняване на ПЧИ на дружествата от ЕС в Китай. Китай се съгласи да направи съответните отстъпки по отношение на екологичните и трудовите стандарти, но те не компенсират продължаващия структурен дисбаланс по отношение на достъпа до пазара между двете страни.

Ключови думи: САІ, чуждестранни инвестиции, Китай, ЕС, двустранно договорно споразумение

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