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China-EU Bilateral Investment Treaty: Can it be Achieved?

By Hong Yan

Synopsis

China and the European Union have officially launched talks on a bilateral investment treaty. How does Beijing expect to benefit from such an agreement and what would be the prospects for the negotiations?

Commentary

THE SIXTEENTH China-EU Summit held in Beijing on 21 November 2013 marked the tenth anniversary of the Comprehensive Strategic Partnership between the People's Republic of China and the European Union. The inaugural summit between the new Chinese leadership and EU leaders aimed to set the roadmap for China-EU cooperation in the next decade.

To this end, both parties agreed to launch negotiations on a new bilateral investment treaty (BIT) to address the evident discrepancy in China-EU investment. This new BIT is expected to replace the existing BITs between China and 26 of the current 28 EU member states. Despite China's clear international and domestic incentives to conclude the treaty, it is unlikely, however, to accept any conditions that will hinder its national development. Prospects of the negotiations will also be subject to the overall climate in the bilateral relations.

Mutual investment lagging behind trade

The EU has been China's biggest trading partner for nine consecutive years while China remains the EU's second biggest trading partner after the United States for the 10th year. China is also the EU's single largest source of import. The bilateral trade volume has increased from US\$ 125 billion in 2003 to US\$ 546 billion in 2012. Both parties aim to increase bilateral trade to US\$ 1 trillion by 2020.

The mutual investment between the EU and China, however, lags far behind the burgeoning trade. Despite the rapid growth of European investment to China over the past two decades, China's share in the EU's outward investment is less than two percent. Although in 2011 the EU emerged as the biggest investor in China, EU foreign direct investment (FDI) into China amounted to only five percent of overall FDI inflows into China. FDI from China to the EU only accounts for approximately 0.2 percent of total inward FDI stocks in the EU, even though Europe is the main destination for Chinese FDI.

Both China and the EU would like to see the BIT reduce the apparent discrepancy between their trade and investment, thus upgrading their commercial relationship.

Why China should secure a deal with EU

There are clear incentives at both international and domestic levels for China to secure a BIT with the EU. Internationally, the US is actively promoting two inter-regional trade and investment agreements: the first is the Trans-Pacific Partnership (TPP) with Australia, Brunei, Chile, Canada, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam. The second is the Trade and Investment Partnership (TTIP) with the EU, which potentially represents the largest-ever free trade area in the world.

The US push for these two grand initiatives is driven by the goals to revive American economic competitiveness which is vital to the country's leading status in the international system, to stimulate the domestic economy, and to shape standards-setting in the Asia-Pacific while deepening shared norms between the US and EU. The TPP and TTIP may also strengthen diplomatic relations between the US and the countries involved.

US intentions cannot be neglected by China. Economically, as the world's largest trading country, China can hardly stay indifferent to the formation of any major inter-regional trade and investment groups which exclude Chinese participation. Politically, today's China would not easily accept US dominance in shaping the norms of Asia-Pacific trade and investment.

However, the chances of China's entry into the TPP so far remain slim because its multiple sectors still fall short of the requirements. Should China be able to conclude the BIT with the EU, it would be better prepared for future negotiations on TPP accession, a key component of which is investment.

China's domestic motivations

Negotiating a BIT with the EU is also driven by China's domestic interests. The BITs China signed with individual European countries in the 1980s and 1990s were mainly intended to attract FDI and are no longer suitable for the new economic realities facing China.

The rapid growth of the Chinese economy and the Chinese government's policy of encouraging domestic enterprises to "go global" have resulted in the accelerated expansion of overseas investment by Chinese companies. Chinese official data showed that China's FDI outflow hit a record US\$ 87.8 billion in 2012, making it the third largest country-supplier of outbound FDI. China's outward FDI is expected to reach US\$ 500 billion in the next five years.

Investing in developed countries to gain access to market, advanced technology, management experience and brands has become an important means for the transformation and upgrading of the Chinese economy. However, due to the lack of legal regulations provided by updated international investment agreements, Chinese enterprises often encounter various barriers in their global activities. A BIT with the EU would better protect Chinese investors in Europe, especially considering that around one quarter of the total Chinese outward FDI between 2010 and 2020 will go to the EU.

Prospects for negotiations

It is too early to predict whether the China-EU BIT negotiation will be successful and how long it will take. Observers often compare it with the China-US BIT talks which started in 2008 but were stalled the following year. Negotiations only resumed in July 2013 when Beijing relented on the issue of the exemption of certain industries (the services sector in particular) from the treaty. As this was the first time that China agreed to include all sectors and all stages of investment in a bilateral pact, it was widely interpreted as a sign of China's willingness to open its market for foreign competition.

As the basic principles of the China-EU BIT are similar to the China-US BIT, it would be reasonable to expect China to adopt a similar position in its negotiations with the EU. Nevertheless, China is unlikely to make any compromise that it deems detrimental to its economic development goals. Besides, the prospects for the bilateral negotiations will be affected by the general climate of China-EU relationship in the years to come.

That said, negotiating BITs with the EU and the US is in line with China's national policy. The resolution to deepen reform that was passed by the recently-concluded Third Plenum states that China will accelerate the signing of investment agreements with relevant countries and regions. China will also establish fair and transparent market regulations for foreign investors. Therefore, we can expect China to demonstrate a flexible posture throughout the negotiations.

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