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A European investment treaty with China: limited effect, but global significance

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Bonn, 7 October 2013. In the debate regarding the transatlantic free trade agreement one issue has remained below the radar: the European Union (EU) is shortly to also commence negotiations with China. On 18 October the EU member states are set to pass the mandate for the negotiation of an international investment agreement with China. Beijing hopes that this treaty will result in the harmonisation of the patchwork of bilateral treaties that China has concluded with the EU member states. For the EU, the opening of new markets for European investors is the key issue. However, the significance of the negotiations between the EU and China extends beyond the bilateral relationship itself. A future European-Chinese investment treaty will form part of an emerging power triangle between the EU, China and the USA, in which the rules of global investment will be redefined.

Investment treaties traditionally adhered to a simple logic: their intended aim was to provide a legal framework for Western investment in politically unstable developing countries potentially leading to increased investment in those countries. With the exception of Ireland, all EU member states have concluded treaties with China to protect their investments in the Middle Kingdom. These treaties typically protect foreign investors against discriminatory and unfair treatment, guarantee the free transfer of capital and regulate direct and indirect expropriation. In addition, foreign investors also gain the opportunity to bring breaches of treaty provisions before international arbitrators, circumventing the legal system of the host nation in the process.

One area that is not covered by traditional investment treaties is the liberalisation of market access. Host countries such as China therefore continue to have the means of restricting foreign investors in the pre-entry stage. The EU intends a new treaty with China to close this loophole. In addition to the high protection standards of the existing bilateral agreements of the member states an EU-China investment treaty should contribute to a further opening up of the market for European companies. Moreover, it is also expected that the EU will aim to achieve rules against performance requirements such as enforced technology transfer and a prescribed local value-added share. The EU will also call for greater transparency with regard to state-owned companies. Can such a treaty lead to greater flows of investment, as both sides hope?

Current research findings show that investment treaties with market access rules serve to promote investment. For foreign investors the EU is one of the most open economies, whilst China maintains a series of limitations on market access. The new Chinese leadership under President Xi Jinping and Premier Li Keqiang has embarked upon an ambitious programme of reform that should result in the extensive dismantling of these barriers to investment. A pilot project is currently being prepared in Shanghai, which is set to be declared a free trade zone. An EU-China investment treaty increases the pressure on China to actually bring these reforms to fruition. European investors in China will thus benefit in particular from an investment treaty.

However, this treaty should not be considered unilaterally from the point of view of European investors in China. For a number of years now, Chinese companies have also increasingly been investing in the EU. An EU-China investment treaty will not lead to a significant rise in Chinese investment, however, because the Chinese already benefit from free market access, as the EU also applies the principle of free movement of capital to third countries. The consolidation of 27 different bilateral agreements in one standardised investment treaty is therefore unlikely to result in increased investment. The reason for this is that the challenges faced by Chinese investors in Europe have nothing to do with legal uncertainties, instead they are the result of their lack of experience in operating in an unknown and highly regulated market. If the EU is to attract more Chinese investors, it should therefore not place too much hope in an investment treaty, but instead standardise and expand its investment promotion measures towards China.

If an EU-China investment treaty will not result in increased Chinese investment in the EU and merely augments the planned opening of the Chinese market, where does its true significance lie?

The treaty represents one axis of the emerging triangle of global investment regulations. Because for some years now China has also been negotiating with the USA on an investment treaty that is to take a similar form to the European-Chinese agreement. In addition, the USA and Europe are also conducting negotiations for a Transatlantic Trade and Investment Partnership which will also comprise a comprehensive investment chapter. In all three treaties provisions are being negotiated that should lead to the further liberalisation of investment flows. Rules regarding market access, the prohibition of performance requirements and transparency rules for state-run companies will consequently be elevated to a global standard. On the one hand, other industrialised nations will then demand similar liberalisation from China. More importantly, the EU and USA will use their investment treaty with China and the transatlantic free trade agreement as the blueprint for treaties with developing countries.

It should be in the interests of companies and decision makers of the three economic powers to place these negotiations on a broad footing and take account of the interests of those countries that are not sitting at the negotiating table. Today, transnational companies operate within the scope of global value chains that extend far beyond the triangle described here. Current developments in emerging countries such as South Africa and India show a stance that rejects any further liberalisation of their investment policies, however. The investment negotiations between the EU, the USA and China should therefore be accompanied by a process of global investment dialogue, which will in turn contribute to achieving a global consensus regarding investment policy.

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