

EU-CHINA OBSERVER

DEPARTMENT OF EU INTERNATIONAL RELATIONS AND DIPLOMACY STUDIES



"EXCHANGING IDEAS
ON EU-CHINA RELATIONS:
AN INTERDISCIPLINARY
APPROACH"

College of Europe
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DEPARTMENT OF EU INTERNATIONAL
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Baillet Latour Chair of
European Union-China Relations



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THE EU-CHINA COMPREHENSIVE AGREEMENT ON INVESTMENT (CAI): RISKS OF POLITICISATION

MARIA GARCIA

Introduction

Negotiations for CAI commenced in 2014 and have been protracted. As other articles in this collection suggest, given China's experience with bilateral trade agreements (BITs) in recent years, with BITs referring to international arbitration rules,¹ in principle an agreement between the EU and China should be feasible. Yet, as this article presents, the recent politicisation of trade policies in Europe, as well as defensive positions by the parties could scupper a deal. The major risks are centred around trade defensiveness (linked to market economy status), European concerns over increased Chinese investment in technological firms, and public opinion and civil society groups rejecting investment and trade agreements as manifestations of a form of globalisation they oppose.

Market Economy Status

When China joined the WTO, it was expected that fifteen years after entry (in 2016) China would be granted market economy status. However, the EU and USA decided in late 2016 that domestic practices still did not warrant market economy status. China is keen for that recognition, as it would stop these states from using 'surrogate countries' to determine what costs should really be, when conducting anti-dumping investigations against China.

In February 2017, at a meeting on the side lines of the G20 Foreign Ministers' meeting in Bonn, the Chinese Foreign Minister Wang Yi urged his German counterpart to resolve this matter to ensure the success of the Investment Agreement.² The importance of this matter cannot be underes-

timated. China has typically used free trade agreements (FTAs) to gain market economy status from partners (e.g. FTAs with Australia and New Zealand), and it is clear that they this will be a sine qua non condition.

At the same time, the EU reviewed its position in the run-up to the WTO deadline and, alongside the USA, declined to interpret the WTO Protocol as an automatic recognition of market economy status. It has been argued that over-production in the steel sector leading to EU anti-dumping measures on Chinese steel in 2016, encouraged Germany to not push for EU granting of market economy status.³ It is highly unlikely that in a matter of months the situation would be so different as to warrant a reversal of the decision.

Impact of Trump's policies on the EU and China

Member State Concerns over Access to Investments

Moreover, positions within the EU with regards to the investment agreement may be hardening. In February 2017, the Economy Ministers of France and Germany and the Industry Ministry of Italy, relayed their concerns regarding foreign investment to the European Commission. They argued that whilst EU law gives member states the right to prohibit foreign investments that threaten public security and public order, an additional protection based on economic criteria was needed, as well as some way of subjecting the right of non-EU investors in the bloc to reciprocity. France's newly-elected President, Emmanuel Macron has proposed the EU explore measures to achieve this, although he faces opposition from Dutch and Nordic

governments, who fear retaliation against such measures.⁴ The European Commission's Reflection Paper on Harnessing Globalisation, includes this matter. Whilst it makes no concrete recommendations for action, it does state that "concerns have recently been voiced about foreign investors, notably state-owned enterprises, taking over European companies with key technologies for strategic reasons. EU investors often do not enjoy the same rights to invest in the country from which the investment originates' (and that) (t)hese concerns need careful analysis and appropriate action."⁵

France's and Germany's position on the matter are particularly important given their leadership role within the EU, especially as in the aftermath of the Brexit vote, and the election of Emmanuel Macron, these two states are poised to lead the European Union.⁶ Germany traditionally played the role of China's advocate within the EU (e.g. encouraging a more understanding position towards Chinese export subsidies), in part due to its strong trade relationship with China.⁷ However, as of 2015, Germany has experienced a growing trade deficit with China. This dovetailed in time with the inclusion of the social democrats (SPD) in the coalition government of 2013 and the handing over of the Ministry of Finance to SPD's Sigmar Gabriel, more inclined to listen to the concerns of trade unions in the country.⁸

In the last years, Chinese companies have increased investments in German technological companies taking advantage of low market valuations. German public concerns regarding the takeover of technology have been growing, and were revived in May 2016 when the Chinese

investment fund Midea communicated its plan to acquire the Kuka company, one of Germany's leading producers of robots. The Ministry of Finance attempted to block the acquisition, and encourage a domestic firm to purchase Kuka, given concerns not just over the loss of technology but also of the operation granting Chinese competitors access to the information of other German companies using some of Kuka's robotic applications. This failed, as the Board of Kuka accepted Midea's offer and other business sectors feared antagonising China and facing retaliations.⁹ The situation shows a clear example of the contradictory nature of the independent interests of particular businesses and governments' public interest policies.

The German Ministry for Economic Affairs has powers, under German law, to block a purchase of a 25 percent or larger stake in companies related to state security or critical infrastructure, and can withhold the acquisition by a non-EU investor of a company producing cybersecurity software. However, it cannot block any acquisition of a company producing advanced technology products for civilian application. In view of these limitations, and the growing number of technological acquisitions, the German Finance Minister proposed to the European Commission an amendment to EU laws to enable EU institutions to block non-EU acquisitions of firms with key technology of particular importance for industrial development.¹⁰

This would elevate decisions to the EU level, granting the EU similar powers to those of the US Committee on Foreign Investment, and would raise the contentious part



of the economic relationship to Brussels. Such a move could hamper future investments. In the negotiations for a bilateral investment treaty (BIT) with the United States, a key Chinese aim is to have national treatment for its investments and recourse to ISDS (Investor-State Dispute Settlement) to bolster its investors' possible defences from US Committee on Foreign Investment decisions.¹¹ It is, therefore, unlikely that China will welcome European moves in this direction. However, the EU is under pressure from both businesses wishing better access to the Chinese market and simplified investment access, and publics and governments, increasingly suspicious of the possible long-term effects of Chinese investments in European technology.¹²

Public Opinion and Trade and Investment Agreements

The importance of public opinion cannot be underestimated, especially at a time when elections in the EU are showing signs of a weakening of traditional established parties in favour of newer parties, some with more nationalist and protectionist stances. Moreover, public opinion, and mobilisation led by large civil society organisations, encouraged a shift in the EU-United States Transatlantic Trade and Investment Partnership (TTIP) negotiations, and the European Commission's proposal for an investment court system (ICS) to replace the existing investor-state dispute regime of ad hoc tribunals. It is significant that in the case of TTIP, it was only when TTIP was on the horizon that civil society mobilised against ISDS and regulatory convergence. When the European Commission was granted investment powers in the Lisbon Treaty, no such opposition arose. Moreover, the focus on CETA (FTA with Canada) and the inclusion of ISDS became a focus of popular dissatisfaction only when the prospect of TTIP had raised the salience of these otherwise technical and technocratic matters. The politicisation around TTIP and ISDS, led the Wallonian Parliament to initially vote against granting the Belgian government authority to sign CETA in October 2016. After assurances were made to the Parliament, including the drafting of a Joint Interpretative Declaration that accompanies CETA and reiterates governments' right to regulate and to change laws even if they affect investors, it agreed in a subsequent vote to allow the signature.¹³ The inclusion of investor-state dispute settlement arrangements in the CAI, will trigger the same reaction amongst civil society groups and left-wing political groups, especially with regards to an investor already considered very powerful.

Although the investment negotiations with China have, thus far, failed to attract the salience of TTIP, it is important to note that according to Pew's surveys positive perceptions of

China have been declining in key European states. According to the 2016 Pew Global Attitudes Survey, favourable ratings of China fell in six out of eleven EU states (declining by 17 percent in France, by 13 percent in Spain, eight percent in Italy, eight percent in the UK and six percent in Germany). This decline left only 28 percent of respondents reporting favourable views of China versus 60 percent with negative views in Germany, 28 to 56 in Spain, 32 to 61 in Italy, 32 to 61 in France, 27 to 59 in Sweden, 37 to 44 in the UK, 37 to 42 in Poland, 44 to 45 in Hungary, 37 to 57 in Greece.¹⁴ A 2014 survey conducted by the Chinese telecommunications firm Huawei reported that 59 percent of German respondents viewed China's political power as a threat.¹⁵

Such views have been partly fuelled by high-profile dispute cases (e.g. solar panel dispute of 2013), and the lasting impact of the financial crisis in Europe, which has dovetailed with increased Chinese investment and presence in Europe and elicited European fears.¹⁶ Research into European public opinion on the US and China, made the fascinating discovery that negative views of both US and Chinese influence and leadership on the global stage were highly correlated and linked to opposition to globalisation.¹⁷

Anti-globalisation sentiment has been on the rise in Europe, especially since the financial crisis. The narrow victory of the Leave vote in the UK's 2016 referendum on EU membership has been considered a reflection of this, and in the first round of the 2017 French presidential election 40 percent of voters supported vocal anti-globalisation candidates (Marine Le Pen and Jean-Luc Mélenchon).¹⁸

Mobilisation against TTIP in Europe, conflated a number of issues and diverse groups, including, many involved in previous anti-globalisation movements targeting the WTO.¹⁹ In this climate it is likely that these groups, and sectors of public opinion opposed to further globalisation and trade agreements, will also voice opposition to the signing of an investment agreement with China, which further engrains liberal economic doctrines.

Concluding Remarks

Despite the fact that in practical terms, given recent BITs by the parties, and the fact that China has gradually adopted international (ICSID) standards in its types of investment agreements, and agreement is plausible, the growing politicisation of trade matters in Europe could hamper progress. The Treaty of Lisbon was designed to enhance the European Commission and European Parliament's powers in trade policy. Ironically, the initial impact of the Treaty has been contestation of those new powers by member states

and publics.²⁰ Member States have queried the degree of investment competences transferred to the Commission in the Treaty, and delayed the start of the ratification of the EU-Singapore Free Trade Agreement, as they awaited the European Court of Justice's Opinion on the matter. The Court's decision that non-direct investment (portfolio investment) and measures relating to investor-state disputes remained areas where the European Union did not have exclusive competences, has opened the door to lengthy ratification processes as agreements including these matters will also have to also be ratified in each of the member states.²¹

National ratification affords dissatisfied groups an opportunity to object and stymie the agreement. At a time of increased polarisation of public opinion around globalisation and trade, and an unprecedented level of mobilisation against TTIP, such a scenario is imaginable, as exemplified

in the EU-Canada agreement (CETA). Opposition to TTIP spilled over into CETA, especially over investor-state dispute arbitration. Even though the European Commission has innovated with the ICS and language curtailing its use, public concerns remain.

Moreover, given that China is viewed by some publics as a threat, especially amongst those holding anti-globalisation views, perhaps the question we should be asking is why broader contestation has not happened yet. If domestic politics are likely to affect the negotiations, so too, will the hardening of positions on market economy status. The challenges faced by both parties in the negotiations reveal the importance of economic objectives in negotiations and domestic politics, and show how, despite both China's and the EU's vocal commitment to global trade in the Trump era,²² the reality may be far more challenging. ©

1 On the evolution of China's BITs see Cai, C. 'China-US BIT negotiations and the future investment treaty regime: A grand bilateral bargain with multilateral implications' *Journal of International Economic Law*, 2009, 12(2), 457-506 **2** China Topix 'China: Scrap protectionism to ensure success of China-EU bilateral investment treaty', 17.02.2017, <http://www.chinatopix.com/articles/111617/20170217/china-eu-bilateral-investment-treaty.htm> accessed 23.4.2017 **3** K. Poplaeski, 'Capital does have nationality: Germany's fears of Chinese investments' OSW Centre for European Studies Commentary Number 230, 2017, p. 3 https://www.osw.waw.pl/sites/default/files/commentary_230.pdf accessed 20.4.2017 **4** Financial Times, 'Macron faces backlash over foreign takeovers' 15.06.2017, <http://blogs.ft.com/brusselsblog/2017/06/15/macron-faces-a-clash-on-foreign-takeovers/?mhq5j=e1> accessed 23.6.2017 **5** European Commission, Reflection Paper on Harnessing Globalisation, COM(2017) 240, 10 May 2017, p. 15, Brussels, https://ec.europa.eu/commission/sites/beta-political/files/reflection-paper-globalisation_en.pdf accessed 23.4.2017 **6** Financial Times, 'Merkel-Macron axis to prove pivotal for global investors' 12.06.2017, <https://www.ft.com/content/3db446e8-4cf9-11e7-a3f4-c742b9791d43?mhq5j=e1> accessed 23.6.2017 **7** K. Poplawski, 'Capital does have nationality' p. 2 **8** Ibid. p. 3 **9** Rabe, W. and O. Gippner. 'Perceptions of China's outward foreign direct investment in European critical infrastructure and strategic industries' *International Politics*, 2017, 54(4): 1-19. **10** Ibid. p. 7 **11** Chow, D. C., 'Why China wants a bilateral investment treaty with the United States'. *Boston University International Law Journal*, 2015, 33 (421): 102-136. **12** See Meunier, S. 'A Faustian bargain or just a good bargain? Chinese foreign direct investment and politics in Europe' *Asia Europe Journal*, 2014, 12: 143-158 **13** However, the ratification process is still marred by potential obstacles. Spain's opposition parties are threatening to vote against CETA, some Dutch societal groups are gathering signatures to trigger a consultative referendum on the matter, and left-wing French politicians are challenging CETA in the country's Constitutional Court. **14** Pew Research, Global Attitudes Survey, 2016, <http://www.pewglobal.org/database/indicator/24/> accessed 23.4.2017 **15** China Power, 'How are global views on China trending?' Centre for Strategic and International Studies, 2017, <http://chinapower.csis.org/global-views> accessed 23.4.2017 **16** F. Godement, J. Parello-Plesner and A. Richard, 'The Scramble for Europe', European Council on Foreign Relations, London, 2011, http://www.ecfr.eu/page/-/ECFR37_Scramble_For_Europe_AW_v4.pdf **17** S.Y. Kim, S. Meunier and Z. Nyiri, 'Yin and yang? Public opinion in Europe toward the U.S. and China' *Comparative European Politics*, 2016, doi:10.1057/s41295-016-0005-6 **18** The Guardian, French presidential election: first round results in charts and maps, 24.04.2017, <https://www.theguardian.com/world/ng-interactive/2017/apr/23/french-presidential-election-results-2017-latest> accessed 23.6.2017 **19** F. De Ville and G. Siles-Brügge, TTIP: The truth about the transatlantic trade and investment partnership. John Wiley & Sons. 2016, p. 97 **20** See Garcia, M. 'The Multilevel politics of post-Lisbon FTA ratification in the EU' in Goff, P. and Broscheck, J. (eds.) *Multilevel Trade Politics: Configurations, Dynamics, Mechanisms*, Toronto, University of Toronto Press, 2017 **21** Opinion C-2/15, Opinion pursuant to Article 218(11) TFEU – Free Trade Agreement between the European Union and the Republic of Singapore – 'New generation' trade agreement negotiated after the entry into force of the EU and FTA Treaties – Competence to conclude the agreement, 16.05.2017, <http://en.euractiv.eu/wp-content/uploads/sites/2/2017/05/CP170052EN.pdf> accessed 16.05.2017. **22** Financial Times, 'Xi Jinping delivers robust defence of globalisation at Davos' 17.01.2017, <https://www.ft.com/content/67ec2ec0-dca2-11e6-9d7c-be108f1c1dce?mhq5j=e1> accessed 23.6.2017 Forbes, 'Trump Achieves The Near Impossible, Gets Juncker To Defend Free Trade' 26.05.2017, <https://www.forbes.com/sites/timworstall/2017/05/26/trump-achieves-the-near-impossible-gets-juncker-to-defend-free-trade/#10e3e53b73db> accessed 23.6.2017



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TRANSPARENCY AND ITS ROLE IN THE EU-CHINA COMPREHENSIVE AGREEMENT ON INVESTMENT

FLAVIA MARISI

Introduction

Transparency is aptly deemed as a pivotal principle of effective governance,¹ and its different nuances have a noteworthy impact in both the domestic and the international arena. While promoters of transparency urge for the broadest scope of its application, advocating ample access to documents and narrowly interpreted derogations, opponents remain sceptical and stress, on the contrary, the risks for national security in certain sensitive cases,² and that amicus curiae intervention can lead to an escalation of procedural costs,³ with consequent, tangible detriment to the investor.

In particular, as it emerges from a normative analysis based on the treaties already signed respectively by the EU and China, it is highly likely that, in the EU-China Comprehensive Agreement on Investment (CAI), currently under negotiations between the two actors, the partners will diverge regarding transparency, in both its procedural and regulatory aspects. Hence, it is reasonable to hypothesise that this will be one of the points to which the highest level of attention and detail will be dedicated by the two delegations. The paper is structured in five sections: the first draws the distinction between regulatory and procedural transparency, explaining their value and the implications of a narrower or broader degree of application. Sections two and three analyse respectively the Chinese and the EU approach to procedural transparency through a normative study. Section four focuses on regulatory transparency, and identifies the approach to the legislation of State-Owned Enterprises (SOEs) as an area of high interest and possible collision between the views of China and the EU. Finally, Section five draws the

conclusion of the research, adding a wider perspective which considers the particular significance of the CAI with respect to other International Investment Agreements in the global geo-political context.

The emergence of transparency in international investment law

Although each sphere of the inherently fragmented international law has its own normative structure, courts and tribunals, and thus no universally accepted definition of transparency exists so far, the development of suitable transparency regimes is vital for the achievement of certain important aims of international law.⁴ In the sector of international investment law, among those aims is the production of investment treaties and clauses related to the resolution of investment disputes in arbitration. In pursuing these aims, in the de quo field, transparency may refer to either regulatory transparency, or transparency in investor-state dispute settlement (ISDS).

In keeping with regulatory transparency, all pieces of legislation, administrative regulations and orders pertaining to investment must be disclosed by states. Unsurprisingly then, "access to meaningful information is recurrently cited as a powerful incentive to invest".⁵ Conversely, transparency in ISDS regulates public access to arbitral proceedings.

The value of transparency in investment law has been recalled by the United Nations Commission on International Trade Law (UNCITRAL) during negotiations for the Rules on Transparency in Treaty-based Investor-State Arbitration: transparency is seen as "an important step to respond to the increasing challenges regarding the legitimacy of international investment law and arbitration as such".⁶

Centring now the attention on transparency in ISDS, it is commonly agreed that its application in a number of dimensions of the ISDS system requires improvement, as discerned by the civil society and other actors in international investment.⁷ The UNCITRAL worked for several years to develop the UNCITRAL Rules on Transparency in Treaty Based Investor-State Arbitration.⁸ and it was only in the aftermath of their proposal that increased attention began to be paid to transparency also by other institutions, such as the International Center for the Settlement of Investment Disputes (ICSID), the Permanent Court of Arbitration (PCA), the Arbitration Institute of the Stockholm Chamber of Commerce (SCC), and other institutions of commercial arbitration. On the other hand, some researchers raised doubts regarding the impact of transparency on investment arbitration, despite the importance that was given to it.⁹ Advocates for wider transparency in investor-state arbitration attribute a special significance to the subject, since public interest is strongest in this kind of proceedings: the circumstance that the arbitral panel can undertake a task usually reserved for national courts, namely, the review of state policies, shall be afforded special attention. In effect, in contrast to commercial arbitration, investment arbitration involves a State as respondent party.¹⁰ If the tribunal rules that a State measure has violated the applicable treaty and affected the investor's rights, the respondent faces the likelihood of being compelled to pay a considerable amount for damages, irrespective of whether its actions were meant to serve the public interest.

Furthermore, unlike commercial arbitration, investment arbitration elicits greater public interest, not only because its outcomes are more significant for the entire society, but also because the issues brought up in investment disputes involve to State measures. This occurs particularly when the challenged measures are related to public health, the environment, and/or direct or indirect expropriation. An appropriate degree of transparency in arbitral proceedings and awards may contribute to improve the efficiency of governance, as the public is afforded insight into the approach adopted by their country, acting as host state, in relation to the performance of its public obligations.

Research has discerned several important matters in relation to transparency in ISDS:

- a. Publication of the notice of arbitration;
- b. Publication of the parties' submissions;
- c. Access to proceedings-related documents such as exhibits, expert reports, witness statements, and tran-

scripts of hearings, except for confidential or protected information;

- d. Amicus curiae briefs;
- e. Submission of the claimant's home state in the role of non-disputing party;
- f. Public access to hearings;
- g. Publication of orders, decisions, and the award.¹¹

Most notably, it will be the applicable treaty that will define the transparency regime in each case.

China's approach to procedural transparency in international investment agreements

The first actual Bilateral Investment Treaty (BIT) that China signed was with Sweden, in 1982.¹² China subsequently entered BITs with other Western countries during the initial phase of its economic reform.¹³ As discussed in many studies, the conclusion of treaties exclusively with industrialised countries that were, and continue to be, capital exporters, was motivated by China's desire to attract Foreign Direct Investment (FDI).¹⁴ Gradually, however, China started to manifest greater openness toward BITs, and no longer focused exclusively on FDI inflow. This change coincided with the implementation of the Going Out Policy in 1999.¹⁵

Regarding the BIT text, three Model BIT versions were developed and employed by China over time:

- a. The first version of the Model BIT was used during the 1980s;
- b. The second version was used in the early part of the 1990s;
- c. The third and present version has been in use since the end of the 1990s.

The differences in China's Model BIT versions reflect how the country evolved from a closed to a more open market economy embracing globalisation. In effect, in 1998 China changed its status, becoming not only a capital importer but also a capital exporter, and this transformation had a marked impact on how China approached International Investment Agreements (IIAs).

Focusing on transparency within the BITs signed by China over time is important to have a better grasp of the evolution of Beijing's position on this matter. In fact, assessing whether China's position has been stable or has undergone an evolution throughout time, may allow us to identify a milestone of its negotiations policy, or, vice-versa, a development trend, which, in turn, grants the possibility to make reasoned hypotheses on its stance in the near future.

Considering the situation within the travaux préparatoires of the 2010 UNCITRAL Working Group, China admitted that no provisions on amicus curiae submissions, publication of documents, or involvement of a third party had been included in any of the treaties it entered up to that point.¹⁶ In the following years, however, China started to rethink its approach. In the Canada-China Foreign Investment Promotion and Protection Agreement (FIPA), signed in 2012,¹⁷ the number of clauses related to investor-state arbitration transparency is considerably high, and what is more, the way in which they are phrased is not significantly different from that of the 2004 Canadian Model FIPA.¹⁸ Although the two versions are unquestionably distinct in certain respects, they share close similarities when it comes to the publication of the award and the possibility to submit amicus curiae briefs. Meanwhile, the respondent must consent to additional transparency-related issues, like public access to hearings, publication of written submissions and access to additional documents. The right of the host state to veto certain transparency rules is highlighted in the recent China-Australia Free Trade Agreement (ChAFTA), concluded in 2015, although it has a positive wording: "With the agreement of the respondent, the tribunal shall conduct hearings open to the public".¹⁹

Procedural transparency as a long-established EU priority

The formal emergence of the EU as a competent actor in the field of investment was enshrined in the 2009 European Union treaties, which gave the EU exclusive competence in the investment field;²⁰ prior to this, instruments such as IIAs could be concluded, maintained, and used not only by the EU but also by the Member States.²¹ In May 2017, the Court of Justice of the EU delivered Opinion 2/15, delimiting the scope of the EU exclusive competence on FDI: it clarified that the shared competence pertains, among others, to regulatory transparency and ISDS,²² and consequently required the Member States' consent to conclude preferential trade agreements which include the mentioned provisions.

It is interesting to recall the emphasis on transparency placed by the EU also in its internal procedures: instruments such as public consultations, the transparency register, the register of funding recipients, advanced rules for access to documents, and agendas, calendar, minutes and voting results of Council meetings, prove that transparency is a top priority of the EU institutions.

The same policy applies in external relations, the EU made procedural transparency omnipresent in its negotiations.

In fact, it is of note that the UNCITRAL Rules on Transparency in Treaty Based Investor-State Arbitration²³ are referred to in all IIAs either currently negotiated or finalised by the EU: EU-Vietnam, CETA and TTIP. The UNCITRAL Transparency Rules are responsible for regulating a range of ISDS-related transparency issues, including public access to hearings, publication of documents and the award, and amicus curiae briefs. The EU-Vietnam IIA and the CETA enforce stringent transparency provisions, since they comprise the UNCITRAL Transparency Rules, publication of laws, and acceptance of third-party funding, if they are made known during the preliminary stage of the dispute.

Unravelling the differences between EU and China in terms of regulatory transparency

It derives from the above that transparency in EU-China negotiations concerns not only transparency in ISDS, but also transparency in rules emanated by both countries, referring to the obligation of the State to publish its laws, administrative regulations and orders relating to investment. Also, this field represents an area where the views of China and the ones of the EU may clash, considering the attention that the EU dedicates not only to the publication of its pieces of legislation, but also the long legislative procedures applied to approve them. Precisely because of the differences in the negotiating parties' respective approaches on regulatory transparency, the risk that the final agreement on the CAI will be delayed grows higher. In this regard, some commentators have expressed concern regarding the legislative framework issued by the Chinese government and related to Chinese investors and SOEs. In fact, according to some experts, the whole Chinese industry is marked by vigorous involvement of the state: in particular, SOEs can rely on the Government's economic support.²⁴

In the past, due to the tight control of the State Council, it was believed that China's outward foreign direct investment was closely linked to the government's political considerations.²⁵ This was a source of concern for EU citizens, at that time linked with rather political than economic considerations. Nowadays, the presence and power of SOEs, having a great economic strength derived from substantial State funding, and their ability to energetically conquer the EU markets give rise to disquiet - in its specifically economic angle - on behalf of EU investors.

In addition to the SOEs' enormous economic capacity and their different ability to tackle enterprise risk, which put them in a position of strong advantage vis-a-vis EU companies, another important factor needs to be recalled:

ownership and control of SOEs are rather unclear, although it is known that the latter are supported by the State in their outbound investments, and therefore able to pay acquisitions with State funds. On the other hand, EU competition law prohibits State Aid to EU companies,²⁶ with an exception only for the agricultural sector. These EU law provisions, confirmed by the award of the Micula case,²⁷ penalise EU investors, since Chinese investors can count on State subsidies, but EU investors cannot do so. This carries the risk of distorting the market, threatening fair competition.²⁸ SOEs funding may, in fact, amount to state aid giving them unfair advantage vis-à-vis EU investors.

It has to be added that, due to the scarce transparency of Chinese laws and regulations pertaining to SOEs, EU investors do not have concrete elements to demonstrate the main significant differences of conditions to enter and operate the market by EU enterprises and Chinese SOEs. Furthermore, as reported by several scholars, in various cases the ownership and control of a certain company cannot be easily retraced.²⁹ As a consequence, it is rather improbable that the differences between EU and Chinese companies can be fully documented and brought to light with the aim to persuade the EU to issue, in the interest of EU investors, re-balancing rules. However, on 2nd June 2017, Commissioner Margrethe Vestager, in charge of competition policy, announced that the Commission has agreed to a Memorandum of Understanding with China to start a dialogue on State Aid control.³⁰

Furthermore, as state support may improve the SOEs' purchasing power in international operations of merger and acquisition, political sensitivities might still be involved in host countries specifically due to the SOEs' ties to the Chinese government.³¹ Moreover, the governments of some Member States have recently expressed reservations regarding the participation of Chinese companies to strategic projects such as nuclear power plants construction and high-tech parks development in the United Kingdom, Germany, and France.³² These sectors are considered as important strategic assets of the various countries, and the scarce transparency of Chinese legislation on SOEs, in particular, regarding the ownership and control of these companies, has given rise to concerns based on security grounds. As a consequence, due to the differences in the transparency of laws in China and in the EU, the CAI negotiations may turn out to be quite complex, due to the economic and political implications linked to the lack of transparency of SOEs regulation in China. Hence, a final agreement could take longer to reach.

A further point has been raised by EU lawyers, who are concerned about the extent to which FDI in the EU is channelled through entities based in tax havens such as Hong Kong, eroding the margin for tax collection.³³ Consequently, strong diplomatic skills will be required from both prospective partners to successfully deal with this issue of regulatory transparency.

Transparency projections for the rising star of investment treaties

Based on the normative analysis hereby conducted, there is a high probability that some degree of transparency, both in its procedural and regulatory aspects, will be requested by the EU in its negotiations with China, given the significant emphasis placed on improving transparency and the inclination towards this issue reflected in the IIAs that the EU has recently concluded, and those being currently negotiated.

Transparency is an essential issue on the agenda in the CAI negotiations, as it is concerned not only with publication of laws and regulations, but also within ISDS. China's more flexible attitude towards enhanced transparency, as reflected in its latest investment agreements referring to the UNCITRAL Rules on Transparency in Investor-State Arbitration, means that the EU will likely succeed in demanding some level of transparency. Unquestionably, the way arbitration proceedings will be conducted and the extent to which this tool of dispute resolution will be deemed as legitimate will depend on the phrasing agreed during the negotiations.

There are several expected factors that will determine the degree of transparency consented to in the negotiations, such as the status of China and the EU as capital importers and exporters, their mutual politico-economic relationships, and the relationships forged with other leading powers.

Finally, it is worth to glance at the broader scenario: due to the relevance the EU-China CAI will have in the international arena, other countries will probably seek to emulate the transparency level established therein, imitating it in their own international investment agreements,³⁴ and therefore 'standardising' the phrasing of the transparency provisions in the EU-China CAI at a global level. ©

1 Cf. European Commission, "White Paper on European Governance", COM (2001) 428 final, [2001] OJ C 287/1; C. Harlow, "Global Administrative Law: The Quest for Principles and Values", 17 EJIL, 2006, pp. 187-214, 195, 202. **2** OECD, "Freedom of Investment, National Security and 'Strategic Industries': Progress Report by the OECD Investment Committee", 2008, retrieved 28 June 2017, <https://www.oecd.org/daf/inv/investment-policy/40473798.pdf>. **3** N. Rubins, "Opening the Investment Arbitration Process: At What Cost, for What Benefit?", in R. Hofmann & C. Tams (eds.), *The International Convention on the Settlement of Investment Disputes (ICSID): Taking Stock after 40 Years*, Baden-Baden, Nomos, pp. 213 – 222. **4** See, among others, A. Bianchi & A. 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Loughlin, "Investment Treaty Arbitration as a Species of Global Administrative Law", 17 EJIL 2006, pp. 121-150; T. 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THE EU-CHINA CAI NEGOTIATIONS AND ISDS MECHANISMS: THE ROLE AND STATUS OF CHINESE SOEs

ALESSANDRO SPANO ¹

Introduction

Perhaps, the main challenge in the EU-China CAI negotiations relates to the regulation and treatment of Chinese SOEs. In general, market access barriers on investments continue to exist in China at both national and local levels as a result, *inter alia*, of selective investment screening policies. Various sectors considered strategic for the Chinese economy remain closed to foreign investors. Other industries are only partially accessible. Here, foreign investors face numerous restrictions including the prohibition of incorporating wholly owned foreign companies, the necessity to comply with local laws and regulations and onerous administrative procedures. ²

Barriers to foreign investment are often closely connected with the status and role that SOEs play in the Chinese economy and their linkage with Chinese state authorities at all levels. SOEs (and, at times, private domestic companies) “enjoy an unfair competitive advantage when it comes to public procurement or bidding procedures, either because they can leverage their financial advantages gained via subsidies and access to loans, or because foreign invested companies are simply excluded.” ³ Finally, SOEs often integrate administrative and business functions and, consequently, they assume a regulatory role in the relevant industry. ⁴

Thus, from a European perspective, the EU should prioritise the negotiation of clear provisions and effective enforcement mechanisms to limit the plethora of policies, laws and regulations favouring SOEs.

This article discusses the issue of investment arbitration within the context of the EU-China Bilateral Comprehensive Agreement on Investment (CAI) and its implications for the effective protection of the rights of EU investors. However, the chosen perspective partly differs from previous studies in this area. The analysis will primarily focus on the role and status of Chinese state-owned enterprises (SOEs) within the context of China's system of governance and economic model to explain the Chinese government's ambivalent and cautious approach to investor-state dispute settlement (ISDS) mechanisms in bilateral investment treaties (BITs). First, the analysis shall focus on the status of Chinese SOEs to understand their role in China's gradual liberalisation of ISDS mechanisms in BITs. Second, the study shall discuss the implications of China's system of governance and economic model for investment arbitration. Finally, the article shall consider the challenges emerging from the investment activities of Chinese SOEs in the EU and from the potential application of ISDS mechanisms towards them within the context of the EU-China CAI.

China's liberalisation of ISDS mechanisms in BITs: the role of SOEs

Over the years, the Chinese government has been implementing a number of ad hoc policies to support domestic companies and, in particular, SOEs with the aim of establishing national champions capable of competing at international level. For instance, following the well-known Going Out policy, Chinese companies have been receiving substantial financial support by state authorities and, in various occasions, they have been shielded from the

competition of foreign corporations by means of specific legislative and regulatory instruments.⁵

However, the formulation of policies to introduce more competition in the stagnant SOE sector and the trend of reducing the control of the state over the economy have not proceeded at the same pace. For instance, growing criticism from some government circles about excessive privatisation and the desire to impose stricter controls on foreign investors has contributed to the application of a more relaxed approach towards the anticompetitive conducts of SOEs and has favoured the emergence of an ambivalent attitude towards openness.

STILL TOO MANY UNCERTAINTIES EXIST ABOUT THE FULL IMPLICATIONS OF OPEN ARBITRATION FOR CHINA'S ECONOMIC MODEL.

Interestingly, in recent years, the Going Out policy of the Chinese government has been coupled with a reform strategy promoting a 'mixed-ownership' model for the privatisation of SOEs.⁶ Some commentators argue that this new approach "reflects the shift in the Chinese government's BIT negotiating strategy from investment promotion to investment protection."⁷ With reference to the specific issue of investment arbitration, they report a gradual liberalisation of ISDS mechanisms within the context of China's BITs and they link this phenomenon to the intention of the Chinese government to further promote its Going Out strategy.⁸

In line with what happened with the implementation of many other economic and reforms since the late seventies, the Chinese government opted for a gradualist and cautious approach to BITs, in general, and to ISDS in particular.⁹ It is worth remembering that the decline of China's planned economy began in 1978 when Deng Xiaoping, taking over Mao's legacy, formulated the so-called 'Open Door' policy. Yet, China opted for a gradualist reform approach by privileging pragmatism and experimentalism. Although, China's accession to the WTO has accelerated the pace of economic reform, gradualism has continued to characterise the action of the Chinese government.¹⁰

China's gradualist approach to investment arbitration

These considerations help shed some light on the pos-

sible development of EU-China CAI negotiations on ISDS mechanisms. In their classic form, BITs have primarily focused on post-entry provisions by offering protection to investments which had been allowed under the rules of the host state.¹¹

A similar approach is also the one adopted by China in the BITs negotiated with the EU Member States so far.¹² Hence, it is likely that China would also accept to introduce ISDS covering post-entry protection in the EU-China CAI. For instance, Berger and Poulsen consider that: "China should therefore be willing to accept the approach in the recent EU agreement with Canada, for instance, where investment arbitration is limited to the post-establishment phase."¹³

However, it should also be noted that the protection standards offered to foreign investments differ significantly in the existing BITs between China and the EU Member States. The most significant achievements in the gradual development of Chinese BITs were made by the 2001 Netherlands-China BIT and, in particular, the 2003 Germany-China BIT which incorporates "substantive and procedural provisions that meet the standard of modern investment treaties."¹⁴

For instance, it was noted that the treaty encompasses a far-reaching definition of investment providing that all essential rights and interests for engaging in business activities (including indirect investments) fall under the scope of the agreement.¹⁵ Since other agreements concluded by Member States with China fail to introduce such high standards, a major goal for the EU would be to upgrade in the EU-China CAI "the conditions and standards for EU investors in China and Chinese investors in the EU through processes of legal definition and improved clarification of rights and obligations."¹⁶

Following this line of reasoning, however, much more controversial would be China's acceptance of ISDS covering pre-entry protection. Consistently with its gradualist approach to economic reforms and liberalisation, China has been first experimenting and assessing ISDS covering post-entry protection, but it does not seem to have a coherent and clear strategy in relation to ISDS covering pre-entry protection yet. Thus, China is likely to be unwilling to adopt a liberal approach on the matter in the near future. For instance, it was noted that: "Chinese and other scholars have been worried by ICSID and the international arbitration community's broad BIT interpretations [...]."¹⁷

In this regard, still too many uncertainties exist about the

full implications of open arbitration for China's economic model. The Chinese government aims at maintaining China's authoritarian system of governance in equipoise and this requires a careful and cautious planning of any changes in politically and socially sensitive policies including investment policies.¹⁸

China's system of governance and economic model: implications for investment arbitration

Irrespective of the types of investment arbitration procedures that China will decide to adopt in the EU-China CAI, the discussion on the actual effectiveness of ISDS mechanisms for the protection of European investors' rights in the Chinese market is intrinsically linked with the analysis of China's system of governance and economic model. One crucial factor to understand these issues is the analysis of the role the state over the Chinese economy that, although gradually diminishing, remains prominent. China's socialist market economy is not intended to be an economy free of state regulation. The formulation of market rules has been considered by the Chinese government in its own way as a new form of state intervention into the economy.¹⁹ Arguably, nowadays, the Chinese government still retain control over the economy in order to pursue targeted policy goals, such as promoting strategic industries, creating national champions, favouring the development of domestic SMEs and ensuring social stability.²⁰ Macro-

economic policy instruments remain effective tools of intervention. In this respect, the Chinese government has been adjusting its role from directly planning and redistributing economic resources to implementing ad hoc industrial policies to redistribute these resources on the market.

In conclusion, it appears that China's attitude towards market openness remains often instrumental to the achievement of the economic goals pursued by the Chinese government. If such an instrumental view is predominant, any provisions introduced in investment agreements and any types of arbitration mechanism will not enjoy an entirely autonomous status. Most likely, these will continue to be regarded as subordinate to policies and rules which are considered by the Chinese government as strategic at a particular time for the promotion of the socialist market economy.

Chinese SOEs' investment activities in the EU: ISDS mechanisms and the protection of European investors' rights

When considering ISDS mechanisms within the context of EU-China CAI negotiations, the other side of the coin refers to the many controversies deriving from the investment activities of Chinese SOEs in Europe. Major concerns are especially related to their status and to the leading role



that these enterprises play in terms of Chinese outward FDI. European business operators and policy makers complain that SOEs benefit of unfair competitive advantages as a result of the support of the Chinese government. In this respect, they have started to question the transparency and the true intentions of Chinese SOEs' investment activities which have been progressively perceived "as a threat to fair market competition and even national security".²¹

The constant increase of Chinese investment by SOEs in key sectors of Member States' economy makes the approximation of rules and mechanisms regulating foreign investments at EU level a priority. Nicolas notes that: "Such an approach may help guard against the risk of a protectionist drift inside the EU, as well as the possibility that some investors may one day pose a threat to national security."²²

It is worth saying that, consistently with the EU principle of non-discrimination, Member States' policies and rules are neutral when considering the origin of foreign investment. Furthermore, the EU Member States, perhaps also as a consequence of the prolonged financial and economic crisis in Europe, have demonstrated an unexpected openness towards investments originating from Chinese SOEs in industries which are usually considered of strategic importance for the national economy.²³ However, while most EU member States have not implemented any formal national security review mechanisms for foreign investors, "some major EU countries, including Germany, have recently amended their national security review policies so as to make them more restrictive."²⁴

On the basis of these considerations, additional concerns seem to emerge in relation to the implications of the investment activities of Chinese SOEs in Europe and the introduction of ISDS in the EU-China CAI. Again, the root cause is China's system of governance and economic model, and their relationship with Chinese SOEs.

Certainly, since the beginning of the reform in the late 1970s, China's system of governance has progressively become "more flexible, entrepreneurial, legalistic and technocratic."²⁵ However, far from repudiating the crucial role of the state into the economy, the current approach seems to privilege a more indirect control of China's economic development by means of industrial policies, including investment policies. Within this context, it appears that the Chinese government aims to encourage SOEs to develop and to expand globally for the purpose of increasing

the international competitiveness of the whole Chinese economy.

By operating on the international market as de facto 'emanations of the state' in the pursuit of China's economic goals, SOEs and their investment activities may generate imbalances and asymmetries in the application of ISDS not as a result of the architecture of arbitration mechanisms but rather of the nature and characteristics of the claimants.

THE EU MEMBER STATES HAVE DEMONSTRATED AN UNEXPECTED OPENNESS TOWARDS INVESTMENTS ORIGINATING FROM CHINESE SOES IN INDUSTRIES WHICH ARE USUALLY CONSIDERED OF STRATEGIC IMPORTANCE FOR THE NATIONAL ECONOMY.

In this regard, in their policy considerations for negotiating a US-China Bilateral Investment Treaty, US analysts noted that: "The status of SOEs in ICSID procedures is ambiguous. At issue is the question of whether an SOE is a state entity (therefore falling within the scope of state-to-state disputes) or a commercial entity (therefore falling within the scope of investor-state disputes)."²⁶ The challenging questions, which have characterised the recent academic debate, on whether BITs are also available to SOEs as claimants when acting in a governmental capacity and, if not, how to distinguish commercial from governmental conduct by SOEs become even more intricate when considering the status of Chinese SOEs.²⁷

Conclusion

In the EU, huge concerns already exist about the risk that, similarly to what happens in their domestic market, Chinese SOEs will tend to perpetrate unfair business practices on the EU market. In this regard, the potential imbalances and asymmetries in the application of ISDS mechanisms deriving from the characteristics of the Chinese claimants would likely generate additional tensions among European investors, who would see it as a constraint on their right to enjoy fair treatment and effective judicial protection in the EU market.

The European Commission emphasised that “investment presents itself as a new frontier for the common commercial policy.”²⁸ Thus, the development of an international investment policy at supranational level is viewed as crucial to enhance the EU’s competitiveness and to achieve the objectives of smart, sustainable and inclusive growth as set out in the Europe 2020 Strategy.²⁹

Within this context, the negotiations of the EU-China CAI represent for the EU not only a new phase in the investment relations with China, but also a crucial test for the supranational approach to the CCP as designed by the Lisbon Treaty.

At present, it remains to be seen whether the EU existing policy and legislative instruments will be successful in ensuring legitimacy, effectiveness, respect of the rule of law, and compliance with fundamental rights. From this point of view, the EU-China CAI negotiation process has the potential to lead to a fortified and more integrated European Union or to exacerbate governance and co-ordination problems between the EU institutions and the Member States. ©

1 Dr Alessandro Spano is a Senior Research Associate at the School of Law of King's College London. **2** At the 16th EU-China Summit held on 21 November 2013, both parties announced the launch of negotiations of a comprehensive EU-China Investment Agreement. The first round of negotiations took place in Beijing on 21-23 January 2014. See European Commission, Press Release Database, http://europa.eu/rapid/press-release_IP-14-33_en.htm. The agreement aims at the progressive liberalisation of investment and the elimination of restrictions for investors in both the EU and the Chinese markets. For discussion, see European Commission, “Impact Assessment Report on the EU-China Investment Relations”, Commission Staff Working Document, Brussels, 23.5.2013 SWD (2013) 185 final, http://ec.europa.eu/smart-regulation/impact/ia_carried_out/docs/ia_2013/swd_2013_0185_en.pdf. **3** European Commission (2013), op. cit., at 14. **4** Ibid. **5** See for discussion, inter alia, Y. 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