Brussels, 29 June 2020

ESF Position Paper on the EU-China Comprehensive Agreement on Investment

EXECUTIVE SUMMARY

The main objective of the European services industry is that the Agreement would improve market access conditions for European companies beyond China's existing commitments under the World Trade Organization, and beyond the level of recent China concessions to other trading partners.

The European Services Forum call the EU negotiators:

- **Negative list:** to use the negative list approach for the negotiations. The key objective is to significantly improve EU investors' access to the Chinese market, in particular by eliminating quantitative restrictions, equity caps or joint venture requirements.
- **UpToDate market access**: to negotiate similar access to European services providers than the one China allowed to Australia providers and recently to US providers.
- **Bind current China unilateral openings**: to negotiate the incorporation of new openings by China revised "negative lists" (National Catalogues and FTZ negative lists), as well as any possible further relaxations in the services sectors.
- **Mobility of people:** to ensure that the Agreement will cover all market access issues which are linked to investment, i.e. also the movement of people linked to the investments, i.e. intra-corporate transferees (ICT) who will come and work in the subsidiaries and joint-ventures.

In addition of new market access for services businesses, adoption of strong disciplines will be crucial:

- **Transparency and domestic regulation requirements**: to negotiate provisions in the agreement that will ensure that European companies investing in China have proper access to information affecting their businesses and the opportunity to comment with reasonable time on relevant laws and regulations.
- **Level Playing Field:** to ensure that European services enterprises compete on an equal footing when operating in China, compared to Chinese local companies and third-country companies in China. To that end, the EU will have to achieve strong non-discriminatory treatment provisions, and clear language that will prohibit "performance requirements"
- **Rules for SOEs**: to work towards providing for a level playing field between all company types, regardless of ownership. In many services sectors, some SOEs are also the regulators, or closely linked to them, which is impeding fair competition.

Furthermore, ESF calls upon the negotiators:

- **Strong investment protection:** to negotiate an Investment Protection Agreement that will provide a strong protection to EU investors when establishing or increasing their business in China.
- **Strong dispute resolution mechanisms**. To negotiate an efficient state-to-state dispute resolution mechanism is absolutely essential. The implementation of the market access commitments should be carefully monitored. The State-to-State Dispute Settlement system should be included into the Comprehensive Agreement on Investment, not in the IPA. To negotiate an efficient investor-to-state-dispute settlement.
- **Split agreements:** to split up the deal with China into two legal treaties, one being the Comprehensive Investment Agreement that will tackle market access and national treatment issues, and a second one being the Investment Protection Agreement (IPA), similarly to those agreed with Singapore and Vietnam.

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Table of Contents

ESF Position Paper on the EU-China Comprehensive Agreement on Investment

This Position Paper will first to look at the facts and figures on trade and investment by the European services sectors with China, identify ways for EU services suppliers to increase market access to China and the existing barriers preventing or slowing such an increase.
The European services industry is very much concerned by the lack of access to the Chinese market, and hope that the on-going negotiations between the European Union and China will allow new market opportunities. The second part will look at the on-going negotiations of the EU-China Comprehensive Agreement on Investment and provide a view on the priorities of the European services industry and the improvements that the agreement should bring.

I. INTERNATIONAL TRADE & INVESTMENT IN SERVICES BETWEEN CHINA AND EU: FACTS AND FIGURES

Trade and investment between the EU and China have increased dramatically in the last decade, but foreign direct investment to and from China from and to the EU seems to have declined in the last three years. China has become the EU's biggest source of imports and has become the EU's fastest growing export market, but their relationship in FDI is less prominent.

A. EU Trade in Services with China

Trade in goods largely dominate the trade relationship between the EU and China. Only 19.7% of all EU exports to China in 2018 were from trade in services, which is significantly lower that the EU average with the world, where 32.9% of EU trade comes from services. China's exports in services to the EU were only 7.4% of total exports (goods & services), which is very low, and shows that the bulk of the exports to the EU are goods[1]. There is therefore significant scope for an increase in services trade between Europe and China. 51.6% of China's GDP is made up of services. The country is steadily moving from manufacturing to a more service-orientated economy, but this is not yet transcribed into its exports to the EU. Services make up 71% of EU GDP and provides 73% of employment in the EU. The EU trade in services balance with China in 2018 produced a surplus of 20 billion euro. This was due to a surge in exports. Indeed, exports reached 51.8 billion euro while imports were 31.8 billion euro.[2]

According to the WTO Trade Statistical Review 2019, the EU is still by far the biggest global exporter of services, with $1089 billion (Extra EU28) exports in 2018, representing 25.1% of world export. China is however also a very important player in trade in services, with total exports of $265 billion in 2018, ranking **third** after the US ($808 billion).

It is important to understand the role of trade in services in world trade and in the EU-China relationship. The figures provided by the traditional method of the balance of payments (BOP) inform us of the very large predominance of trade in goods. This is in total contradiction with the fact that in both economies' GDP services play an important role. When we compare the figures

[1] *Indeed, it exported 395.1 billion euros of goods to the EU in 2018, with a huge net surplus of 183.8 billion euros (Source Eurostat 2020 (Data Explorer: ext_lt_maineu)*

[2] *Source Eurostat 2020 (Data Explorer: bop_its6_det)*

obtained through the BOP indicator with those obtained through the Trade in Value-Added indicators (TiVA) - a database compiled by the OECD and the WTO - we see a stark difference in the data. The 2016 TiVA statistics show that 58.9% of the value of total EU exports are coming from services (including services around the exports of goods), and 41.1% from goods. This provides a better understanding of the value of services in international trade. It is now providing a picture that is more conformed to the fact that services contribute to 70% of the national GDPs, but also to nearly 60% of external trade.

When it comes to China, the BOP statistics show that China's trade is heavily influenced by goods (92.6%). This is true, but the TIVA database for China in 2016 shows that 33.2% of the value of all exports from China comes from services (instead of 7.4% through BOP). The TIVA database is crucial for the service sector and gives a more accurate portrayal of the statistics. For China, it shows that a large part of its economy is already orientated towards services.

The reason why it is important to emphasise trade in services in a document dedicated to the EU-China investment agreement is that trade in services is closely linked to the capacity of businesses to establish themselves in the trading partner (i.e. first to make a foreign direct investment in that country), as it has been clearly shown that the preferred way of trading services is indeed through the "commercial presence abroad" (i.e. mode 3 of the WTO General Agreement on Trade in Services – GATS). Indeed, Eurostat found out that in 2015, more than 60 % of the EU services exports to non-member countries were supplied via commercial presence in the territory of the non-member countries[3], (i.e. through mode 3), which essentially consist of intra-company trade. Without market access for such initial investment, no intra-company trade, hence much less trade in services. By increasing the investment opportunities between EU and China, there is no doubt that bilateral trade in services will increase as well.

B. EU Foreign Direct Investment with China

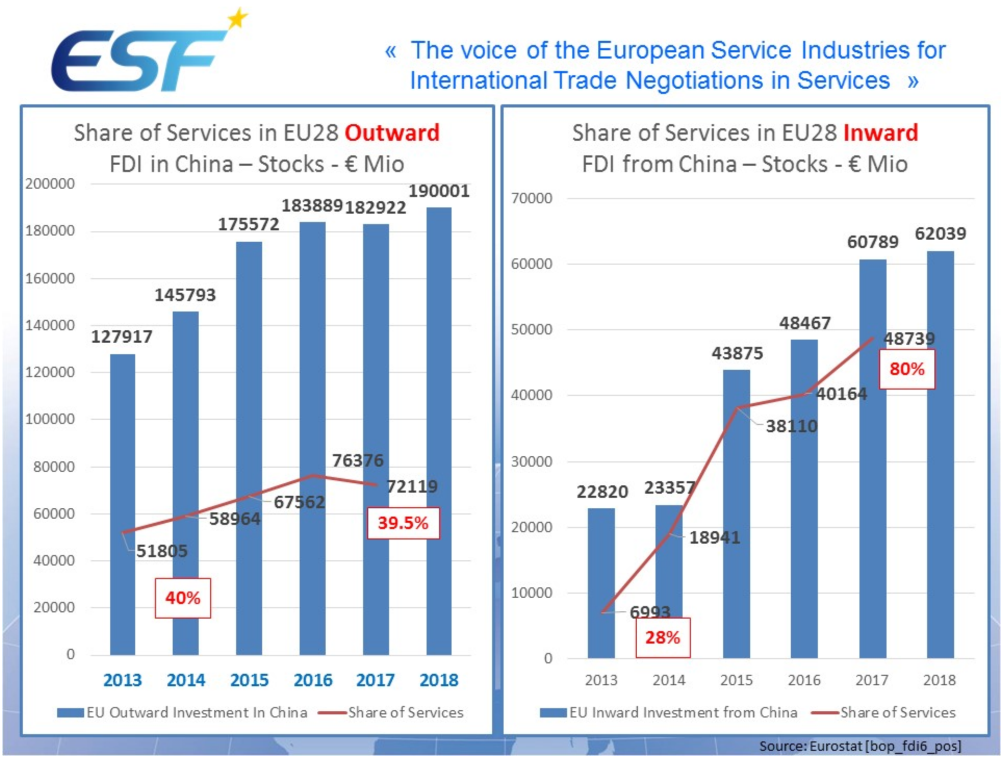
To properly grasp the importance of services in the international trade relationship, one must also take account of the importance of foreign direct investment for services providers who want to reach consumers in other markets. An international trade and/or investment agreement is a mean of opening and securing the market notably to services suppliers in foreign markets. Services commitments **in trade** agreements are directly linked to investment and must be seen through the angle of **FDI commitments**. Indeed, as mentioned above, a large part of Market Access commitments for the services providers in trade agreements are about "commercial presence abroad" commitments, which is the Mode 3 of the WTO General Agreement on Trade in Services (GATS).

This explain why such a large part of the FDI figures are from services sectors. In 2017, 71.3% of total EU Outward Foreign Direct Investment (FDI) stocks were invested in Services. And, 79.3% of EU Inward FDI stocks are invested into services, which is really impressive[4]. Which means that the vast majority of FDI coming to the EU is invested in services sectors. Even if China still invests heavily in manufacturing, it has changed its investment pattern in the EU, and now invests 80% into services (see below). An agreement on Trade and Investment with China should create the conditions for the EU to increase investment in services.

[3] Source Eurostat - Services trade statistics by modes of supply
[4] Source: Eurostat - Foreign direct investment statistics - bop_fdi6_pos

The EU is by very far the biggest investor and recipient of FDI in the world: in 2018, the EU FDI inward stock was $US11.3 trillion (31.3% of global FDI), while the EU FDI outward stock was $US12.97 trillion (37.1% of Global FDI)[5]. China is also a major investor ($US1.62 trillion inward stock – 5% of Global FDI) and recipient of FDI ($US1.93 trillion outward stock in 2018 – 6.25% of Global FDI). But unfortunately, it seems that not much of this FDI is between the EU and China.

According to Eurostat, as of 2018, China only received 1.4% of global EU FDI (€190 Bio stocks). And only 0.55% of Inward FDI in the EU came from China (€62 Bio)[6]. It is interesting to note that investment by EU services sectors in China represent only 40% (€72 Bio stocks in 2017) where the EU global average is +60%; and that the trend has been flat for the last 5 years. On the contrary, investment in services sectors by Chinese businesses in the EU is up to 80% (€48.7 Bio stocks in 2017), close to the world average, and that China quickly adapted itself by significantly increasing this share from 28% in 2013. This is a clear evidence that there remain many market access barriers to EU firms in China, while the reverse is not true. This is another clear indication that a trade and investment agreement between the EU and China could greatly benefit to European services industry. When we look at the FDI flows of the recent years, EU flows to China have diminished from €22.1 Bio in 2013 to €7.12 Bio in 2018. China FDI to the EU28 went up from €7.7 Bio in 2013 to €9.29 in 2019, after a decrease to €5.6 Bio in 2018[7].



These figures are however contested, as not reflecting the reality that Chinese FDI in the EU is in fact much bigger. According to Rhodium Group, which is a consulting firm specialised on China, and the Mercator Institute for China Studies, they consider that Chinese foreign direct investment (FDI) flows into the EU has increased rapidly from EUR 700 million in 2008 to a peak of EUR 37 billion in 2016. Although Chinese investment flows dropped to EUR 17.3 billion in 2018, they would nevertheless vastly exceed European FDI flows into China, which amounted to EUR 6.1 billion in 2018. China would have also exceeded the EU in terms of total outstanding FDI stocks. Cumulative Chinese FDI in the EU reached EUR 149.3 billion in 2018 while the total stocks of EU FDI in China

[5] UNCTAD, World Investment Report 2019 – Annex Table 2, p 215
[6] See Eurostat bop_fdi6_pos
[7] See Eurostat bop_fdi6_flow

equalled EUR 138.3 billion. Data used represents the cumulative value of annual direct investment transactions, including greenfield projects and acquisitions that result in significant ownership control (>10% of equity)[8].

Whatever the figures, one can however consider that the FDI flows and stocks between the two parties are rather low compared to the size of their economies. The decade is likely to see an increase in Chinese presence abroad, and in the EU in particular. But there is no doubt that an investment agreement between the two parties will set appropriate rules and conditions, and hence improve investors' legal certainty.

C. Historical background of China services market

Before asking for improvements through an agreement between EU and China, it is important to understand i) what is the actual legally binding situation for the EU services industry in China; ii) what kind of measures the Chinese government would have taken unilaterally in recent years that are not yet committed through an international agreement, and iii) what are the major remaining barriers that services businesses see as impeding full market access in China.

1) China Services Commitments at Multilateral and bilateral agreements

a) China GATS Commitments

China services sectors remain essentially closed to foreign competitors. China joined the WTO in 2001, and one must recognise that China has taken many more commitments in its GATS Schedule than many WTO members that become WTO members at the WTO's inception in 1995 after committing to rather limited services liberalisation schedules at the end of the Uruguay Round.

However, in China's Schedules, most of the commitments[9] relating to establishment of foreign enterprises were generally limited by restrictions such as compulsory joint ventures, limitations on geographic location, limitations in the form of establishment, etc. Some of these limitations have been phased down over a six-year period, but many restrictions remain in place in many sectors, including banking, life insurance, telecommunications, etc. There were great hopes at the time of its accession to the WTO that the trade liberalization initiated by China would enable foreign firms to increase their share of the Chinese services market, but this did not happen, and foreign banking sector for instance has still today a share lower than 3% of the Chinese domestic market (in terms of total assets) and insurance lower than 2% (for non-life insurance).

China participated to the DDA Services talks and tabled an initial and a revised GATS offer[10], but only a few of these offers were of any real interest. China did not make any significant progress in most of the major services sectors in the "WTO Services Signaling Conference" when the talks collapsed in July 2008. China expressed interest in joining the Trade in Services Agreement (TiSA) negotiations, which might have provided an opportunity to test whether China was ready to bind further liberalisation into a plurilateral agreement. But the the TiSA negotiations fell into abeyance in 2016.

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[8] See notably BusinessEurope Report "A comprehensive EU strategy to rebalance the relationship with China" January 2020 – page 64-65.

[9] See WTO website with China GATS Schedule of Commitments

[10] See here China DDA GATS Initial Offer and Revised Offer and ESF Assessment of the revised offer in June 2006.

b) China Commitments in FTAs

It might therefore be interesting to look at whether China has taken further commitments with other trading partners in some free trade agreements that it has signed since 2001.

- The China-Australia Free Trade Agreement (ChAFTA), which entered into force on 20 December 2015, seems to be an agreement where China has delivered its better services commitments, including the provision of new or significantly improved market access not included in any of China's previous FTAs (other than China's agreements with Hong Kong and Macau).

  According to the Australian Department of Foreign Affairs & Trade, the beneficiaries include Australian banks, insurers, securities and futures companies, law firms and professional services suppliers, and education services exporters, as well as health, aged care, construction, manufacturing and telecommunications services businesses in China. The FTA goes beyond China's existing commitments under the World Trade Organization, ensuring higher levels of market access for Australian services suppliers. ChAFTA includes a framework to advance mutual recognition of services qualifications, and to support mutual recognition initiatives by professional bodies in Australia and China. Through its extensive Most-Favoured Nation (MFN) treatment provisions, China has committed to extend to Australia any more beneficial treatment it provides to other trade partners in the future in many services sectors.

  This is a positive development. ESF calls upon the EU negotiators to negotiate similar access to European services providers that the one China allowed to Australian providers.

- China-US Phase 1 Deal: More recently, in January 2020, China has agreed the first phase of an agreement with the United States of America[11]. By this agreement, China has also taken further commitments in a few services sectors. The ESF has closely examined the **US-China Phase 1 deal**, notably the provisions on forced transfer of technology, and the commitments taken by China notably in financial services and cloud services. ESF urges the EU negotiators to ensure that whatever new market access concessions China granted to the US should be considered as granted as well to the EU without the EU having to give further concessions for them.

2) China Negative List and the Services Sectors

At the beginning the 2010th, China pledged to further open its market to foreign investors. China started to use the system of negative list some years ago, mentioning it in the 12th Five Years Plan (2011-2015) and in the Third Plenum of the 18th Party Congress in November 2013. These Policy documents were very promising steps for reforms and opening up markets, and expectations by potential foreign investors in China were high. But long-awaited promises have not been fulfilled thus far, at least not for the services sectors.

In 2015, a revised Catalogue has lifted restrictions on FDI in several areas, including in the manufacturing sector, but has made limited progress in services, agriculture and infrastructure, which are sectors where European investors are eager to get access. According to the National Development and Reform Commission of the People's Republic of China (NDRC), the catalogue

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[11] Economic & Trade Agreement between the Government of the United States of America and the Government of the People's Republic of China

reduced the number of restricted industries from 79 to 38, with direct sales and insurance brokerage companies among the beneficiaries[12]. It limited the number of sectors for which Chinese-controlled joint ventures were required from 44 to 35. It also reduced the number of industries requiring joint ventures with Chinese partners, but decreasing foreign control restrictions, from 43% to 15%, including in real-estate developments. All of these announcements are more than welcomed, and it is hoped that these promises will effectively be implemented on the ground and that they will be transcribed into the bilateral investment agreement with the EU.

If we focus on the services sectors in particular, one can see that the 12th FYP for "*Utilization of Overseas Capital and Investment Abroad*", issued by NDRC in 2012 encouraged foreign investment in China in production services such as modern logistics, software development, engineering design, vocational skill training, information consulting, technology, and intellectual property services. It is also argued that it *"steadily open up*" banking, securities, insurance, telecom, fuel and logistics industries, guides foreign capital to enter healthcare, culture, tourism, home services and encourages foreign capital to enter creative design. In practice however, the Chinese government largely failed to fully deliver this programme.

The 13th FYP (covering the period of 2016-2020) was adopted in the fall of 2017. In a Chapter 24 on "Increase Quality and Efficiency within the Service Sector", it is stated that "*We will accelerate the development of modern services, further open them to foreign competition, and improve their development environment, …*". But in the substance of that chapter it is only referred to opening up a long list of services sectors to "non-governmental capital "(i.e. Chinese private sector). Chapter 49 entitled "Improve the Strategy for Opening Up" refers much more to China going out to the world than to China opening up its internal market to foreign competition, mentioning notably the "Belt and Road Initiative". Most of this chapter is about China investing abroad, stating that "*We will guide enterprises in participating in international markets in ways that utilize their group advantage, and develop industrial clusters overseas suitable to local conditions. […] We will improve services such as taxation, finance, insurance, investment and financing platforms, and risk assessment to support efforts in this regard*".

However Section 4 of Chapter 49, entitled "Foreign Capital and Outbound Investment" states "*We will open more sectors to foreign investment, relax restrictions on market access, work proactively and effectively to bring in foreign capital and advanced technology, and increase the overall efficacy of foreign capital utilization. We will remove restrictions on market access for foreign capital in service sectors such as child care, architectural design, accounting, and auditing, and expand access to markets in the banking, insurance, securities, elderly care, and other sectors. We will encourage more foreign capital investment in sectors such as advanced manufacturing, new technology, energy conservation and environmental protection, and modern service industries as well as in the central, western, and north-eastern regions, and will support the establishment of research and development centres with foreign capital. We will encourage Chinese financial institutions and enterprises to obtain financing in foreign markets*." These encouraging words for foreign investors in China however strike the only positive note over the 219 pages. The flag ship of that 13th FYP is the "Made in China 2025" action plan, which focus on further strengthening China manufacturing sectors, including "*service orientated manufacturing so as to foster a new competitive edge in manufacturing*" (see Chapter 22). It is obviously too early to assess the results of this still-ongoing five-year plan; but this period of Chinese development is clearly more focussed on reaching out the

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[12] One can also add among services sectors, in the IT sector: "E-commerce business"; in real estate: Investment in luxury hotels, high-class office buildings, international conference centres; as well as in Business services: HR agencies; overseas travel agencies

world rather than opening up the domestic market. This clearly make the task of the EU negotiators even more important.

In 2017, the negative list has been further reduced[13]. Limitations on foreign investment (including both restrictions and prohibitions) in certain service sector activities are eliminated, including highway passenger transportation, cargo handling, creditworthiness investigation and rating services, accounting and auditing, etc. In that year, foreign investors were to be encouraged to invest in industrial design, engineering consulting services, modern logistics, and inspection and certification services in China.

In July 2018, the *Special Administrative Measures on Access to Foreign Investment 2018* ("the Negative List") partly replaced the previous *Catalogue for the Guidance of Foreign Investment Industries*. This new Negative List reduced the number of restrictive measures from 63 in the previous version to 48. Additionally, the *Special Administrative Measures for Foreign Investment Access to Pilot Free Zones (*Negative List*)* ("the FTZ Negative List"), which applies within China's free trade zones, reduced restrictive measures from 95 in the previous version to 45. Again, the main focus was on manufacturing sectors, and with financial and insurance as the main services sector that benefited from the reduction of restrictions.

We take note that the National Development and Reform Commission ("NDRC") and the Chinese Ministry of Commerce ("MOFCOM") have jointly issued the new Special Administrative Measures for Access of Foreign Investment (Negative List) (2019) for general use and a separate Negative List for the Pilot Free Trade Zone (FTZ), both taking effect on the morning of 30th July 2019. The number of policies within the General Use Negative List has been reduced by roughly 16%, reducing the total list of measures from 48 to 40. It is also noted that the FTZ Negative List has seen similar reductions, reducing the number of measurements by roughly 17%, from a total of 45 measurements to 37 measures. On the same date of 30th July 2019, the State Development and Reform Commission and MOFCOM issued the Catalogue of Industries for Encouraged Foreign Investment (2019 Edition)[14].

But most of the relaxation are directed once again to manufacturing sectors. In the 2019 edition of the "National Catalogue", more than 80 percent of the new additions and revisions fall within the manufacturing sector, which supports and encourages foreign investment into high-end manufacturing, intelligent manufacturing, green manufacturing and relevant areas. Those targeting the services sectors are in the field of "transportation, warehousing and postal services". "The investment into the transportation, warehousing, and postal services sector have also seen one major change, specifically within to domestic shipping companies. The new negative list, previously mandating that domestic shipping company be exclusively Chinese owned, has relaxed the measure to attract further foreign investment." ESF calls upon the European Commission to check whether these relaxations have been effectively implemented and to negotiate these new openings to be incorporated into the EU-China CAI, as well as any possible further relaxations in the services sectors.

3) Insufficient access to services sectors and other new barriers

All of these consecutive measures by the Chinese government constitute a signal that China wants to continue to open up its domestic market to foreign investors, and we urge the EU negotiators to

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[13] *The Catalogue for the Guidance of Foreign Investment Industries (Revision 2017) was jointly issued by the National Development and Reform Commission and the Ministry of Commerce of the People's Republic of China and came into force on 28 July 2017.*

[14] *The Catalogue of Industries for Encouraged Foreign Investment (2019 Edition) has been expanded*

bind such openness in the forthcoming agreement. The European Services Forum submitted with its partners of the Global Services Coalition, comments to the Chinese authorities in February 2019 on the new draft Foreign Investment law of December 2018, which is expected to expand investment opportunities to the whole territory of mainland China, beyond the earlier pilot FTZs. This might constitute a significant step forward in making China a more attractive destination for foreign direct investment. ESF of course recommended expanding even further the list of services sectors that will be granted access and called for vigilance in the implementation of the new law.

But, all in all, the measures adopted so far by the Chinese authorities have not significantly improved the business opportunities of the European services industry. The announcement of the setting up of Free Trade Zones, with the first pilot project in Shanghai, let foreign direct investors believe that China would finally, although only gradually, open up its services market to investors. But, unfortunately, there were only minor new openings for services sectors and a lack of persuasion of efficiency of new Free Trade Zone (FTZ). Despite the positive statements by the Chinese government[15] about China opening up its markets, too little progress has been made so far. China has effectively introduced a negative list of sectors open to foreign investors[16], and re-grouped existing restrictions, but the restrictions list is still very broad. In addition to that, there is an evident lack of coordination between the various levels of central, regional and local authorities, which is creating confusion and hence lack of clarity and certainty, which are the two primary elements that investors are looking for.

Furthermore, China is introducing worrying new localisation requirements under the umbrella of "cyber security". This includes insurance, banking and IT sectors. The internet censorship measures are directly hurting the daily activities of foreign companies trying to do and expand business in China. These measures are becoming more and more incompatible with the modern digital economy, where data needs to flow across borders, while respecting personal data protection. Depriving investors of the control of their digital strategy and of their data is perceived as a major impediment to foreign companies. Localisation restrictions can play a negative role in growth, preventing investors to take maximum optimisation of their digital strategy.

The new system of Corporate Social Credit - to enter into full function by end of 2020 - is another set of legislation that is introducing burdensome administrative processes and introducing tension and uncertainties in the business environment. According to the Chinese government, the system collects, aggregates, and analyzes data to build a high-trust society to assess whether businesses and other organisations follow the law and regulations and pay taxes in an appropriate and timely manner, and where product and service quality will also be measured. It will do so by assigning social credit scores to each entity based on their behavior, which are translated into a variety of rewards and punishments.

Instead of reforming the State-Owned Enterprises to make them leaner and more competitive, the reform of "SOE with Chinese characteristics" undertaken by the Chinese government in recent years has made them "stronger, better and bigger", posing significant difficulty for the private sector in

[15] See i) Keynote Address Delivered by Li Keqiang at the 2nd China Beijing International Fair for Trade In Services and the Global Services Forum Beijing Summit – May 2013; ii) China President Xi Jinping's keynote speech at the World Economic Forum – January 2017; iii) *Chinese Premier Li Keqiang's speech to participants at the* World Economic Forum's Annual Meeting of New Champions in Tianjin, China – September 2018.

[16] We also take note that there are recent positive developments, including the raising of foreign-ownership caps for life insurance joint ventures and the removal of caps altogether for certain Financial Services sectors

China, notably regarding access to finance[17]. In many services sectors, some SOEs are also the regulators, or closely linked to them, impeding fair competition. Among the European services businesses in China that are the most impacted one can include aviation, banking, construction, energy services, environmental services, insurance, shipping services, and quality and safety services (QSS). The European Services Forum calls upon the EU negotiators to work towards providing for a level playing field between all company types, regardless of ownership. China should be encouraged to move towards a policy of "competitive neutrality" whereby no differentiation would be made between state-owned over private enterprises, and foremost, between local over foreign owned enterprises.

All of these recent measures are becoming strong disincentive to invest in China. The restrictive market access that European businesses experience can be illustrated by the fact that China still ranked 59th out of 62 countries in terms of openness to FDI in the 2018 OECD FDI Regulatory Restrictiveness Index[18]. There is currently a lack of a level playing field in the area of investment as the EU is open to Chinese investments, but the Chinese market is highly restricted.

Likewise, China ranked 100th out of 180 countries that were assessed in the Heritage Foundation's Economic Freedom Index[19]. China scores particularly low on the 'investment freedom' indicator as it applies restrictive foreign investment policies that protect inefficient SOEs. The European Chamber of Commerce in China noted in its Business Confidence Survey 2019 that a large majority of its members expected regulatory obstacles to increase significantly over the next five years and a fifth of its members report feeling compelled to transfer technology as a condition for market access.

All these indicators show that there is a need to improve the access of European services businesses to the Chinese market, and the European Services Forum strongly support the negotiations for an ambitious Comprehensive Agreement on Investment with China.

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[17] . Financing flows to private firms have dried up, from 57 per cent of all non-financial corporate loans in 2013, to a measly 11 per cent in 2016, at the same time that Chinese SOEs have seized a much greater share of funding,6 jumping from 35 per cent to 80 per cent in the same timeframe. See Lardy, Nicholas, The State Strikes Back, Peterson Institute for International Economics, January 2019, Washington D.C., Figure 4.1

[18] See Organisation for Economic Co-Operation and Development, "*FDI Regulatory Restrictiveness Index*", 2018. A score of 1 equals maximum restrictiveness.

[19] The Heritage Foundation, "*Index of Economic Freedom: China*", 2019.

II. SERVICES IN THE EU-CHINA COMPREHENSIVE INVESTMENT AGREEMENT (CIA)

A. The timeline

The Council of the EU trade ministers authorised the European Commission to initiate negotiations for a comprehensive EU-China investment agreement on 18 October 2013. Negotiations of a comprehensive EU-China investment agreement were formally launched at the EU-China Summit of 21 November 2013 in Beijing. The aim of this agreement is to remove market access barriers to investment and provide a high level of protection to investors and investments in EU and China markets. In early 2016, the EU and China negotiators reached clear conclusions on an ambitious and comprehensive scope for the EU-China investment agreement and established a joint negotiating text. The 26th round of negotiations took place on 16-17 and 20-21 January 2020 in Brussels. Due to the Corona Virus COVID-19 outbreak and restrictions on meetings, a "light" round took place on the week of 2 March 2020 via videoconference, and virtual rounds are now taking place every month.

EU Trade Commissioner Phil Hogan was asked by European Commission new President Ursula von der Leyen in its Mission letter to step up negotiations with China on a Comprehensive Agreement on Investment, with the aim of reaching an agreement by the end of 2020. We understand that this deadline will likely be compromised because of the corona virus pandemic but encourage the Commission to keep an ambitious negotiating programme, although substance must prevail on timing.

B. The main objectives of the European services industry

The negotiations cover all issues that are linked to investment activities, but only linked to investment. The main objective of the European services industry is that the Agreement would improve market access conditions for European companies beyond China's existing commitments under the World Trade Organization. The key objective is to significantly improve EU investors' access to the Chinese market, in particular by eliminating quantitative restrictions, equity caps or joint venture requirements. In addition of new market access for services businesses, adoption of strong disciplines will be crucial. Finally, an efficient dispute settlement mechanism to ensure that the investment will be well protected is also essential.

1) Improvement of China Market Access commitments

The Market Access part of the investment agreement is a key pillar in the ongoing negotiations. So far, China has made no legally binding commitments on investment other than those relating to services in its GATS Schedule of Commitments undertaken on its WTO accession in 2001. These do not cover investment in the primary sectors (agriculture, aquaculture and fisheries, mining & quarrying, other raw material and commodities) or secondary sectors (all the manufacturing sectors). Opening investment opportunities in these two areas is under discussion for the first time between the two parties.

We understand that the parties have decided that for the scheduling of market access and national treatment commitments, they will be using a negative list approach. This means that instead of listing positively the sectors and subsectors which will be open for investment - and consequently all sectors which will not be listed remain closed, or at least uncommitted in the agreement -, the two parties will use a system where by default all sectors are open, except those which are listed as restricted, and then the restrictions are precisely described. ESF strongly supports this approach as this is the EU's industry preferred choice. The negative list approach is preferred so as to ensure a good readability and comparability of the various parties' commitments. Such a method obliges the negotiators to review the way foreign investors in all economic sectors are regulated, and produce greater liberalisation results and greater clarity, since it is much easier for businesses to assess whether their sector is covered or not and what the limitations are. But of course, everything will depend on the content of the list.

The European Services Forum would aim at the removal of all equity caps, with negotiated exceptions. Business will also look at getting more commitments in professional services, which include lawyers, consultants, auditors and accountant, architects and engineers, etc., in telecommunication services, in postal & express services, and in the various financial services sectors (banking, asset management, pensions, insurance). For instance, it is expected that the negotiators will try to remove or reduce these following existing equity caps and joint venture requirements: So far, foreign stakes are limited to 50% in value-added telecom services (excepting e-commerce); 49% in basic telecom enterprises; 51% in life insurance firms and 49% in security investment fund management companies.

2) Improvement of mobility of personnel related to investment in China

The European Services Forum calls upon the negotiators to ensure that the Agreement will cover all market access issues which are linked to investment, i.e. not only the commercial presence abroad (mode 3 of the GATS), but also the movement of people linked to the investments, i.e. intra-corporate transferees (ICT) who will come and work in the subsidiaries and joint-ventures.

Indeed, a typical example of obstacle to do business for foreign investors are the existing Citizenship Requirements, where for instance in the accounting and auditing sectors, the Chief Partner of a firm must be a Chinese national. There are many other examples of this nature in other sectors.

3) Improvement of government disciplines and set regulatory cooperation

a) Performance requirements: The Agreement should ensure that European services enterprises compete on an equal footing when operating in China, compared to Chinese local companies and third-country companies in China. To that end, the EU will have to achieve strong non-discriminatory treatment provisions, and clear language that will prohibit "performance requirements" – i.e. measures requiring investors to behave in a certain way or to achieve certain outcomes (including those leading to forced technology transfer, force transfer of software's code source or of algorithm, etc.).

b) Domestic Regulation Disciplines: The European Services Forum has over the years made the case for better transparency of the local regulation, better predictability of the licensing processes and better legal certainty are among the most important aspects that foreign investors are requesting when doing business abroad. These requirements are even more important when looking at foreign direct investment in China. ESF call upon the negotiators to negotiate provisions in the agreement that will ensure that European companies investing in China have proper access to information affecting their businesses and the opportunity to comment on relevant laws and regulations in a sufficient period of time. It is also important to ensure clear, transparent and objective licensing and authorisation procedures and requirements, as well as to guarantee procedural fairness and due process. The disciplines set in the EU-Japan EPA and in the EU-Canada CETA should serve as a basis for such transparency rules with China.

c) Chapter on "Investment and Sustainable Development": ESF welcomes the fact that the negotiators agreed that the agreement will include a "Sustainable Development Chapter", which will include rules on labour, on environment and climate change, on respect of human rights and other related issues, and for businesses, respect of Corporate Social Responsibilities and Responsible Business Conduct disciplines.

d) Rules on "State-Owned Enterprises": Of even greater interest to the European services sectors, we understand that China has agreed to discuss SOEs in the CAI. It will be important that authorities involved in the regulation of SOEs will be bound by the agreed rules (various ministries at central level, provinces authorities, SOEs). Commitments should be taken to ensure that a clear understanding on the definition of the private sector in China, and that the principle of non-discrimination should be applied on national treatment basis, covering not only the national level, but also the provincial and municipal levels. We would like to highlight that when China joined the WTO in 2001[20], it has already agreed on some general principles related to the SOEs. Of particular importance would be the fact that the regulatory authorities must be fully independent from the SOEs that they regulate. At this juncture, it is important to remember that even if public procurement is not covered by the EU-China CAI negotiations, what the SOEs are buying on the market (goods and services) are not covered in China by the "public procurement rules". Unfortunately, this seems to be contradicted by the fact that the Chinese government has recently passed a law obliging all government bodies **and all SOEs** to change all their software in 4 years (with Chinese software exclusively, developed in China and controlled by China authorities).

e) Rules on Subsidies to apply also to services sectors: This is a reason why it would be crucial to negotiate a set of rules on subsidies, and that this set should cover also the services sectors, contrary to the WTO rules on subsidies that apply only to the goods sectors.

f) Other technical barriers: The European Services Forum calls upon the negotiators to seize the opportunity of the bilateral investment agreement to negotiate the removal of concrete market access barriers, so as to improve the business environment in China. Companies often cite a long list of significant challenges to establishing and operating businesses in China. These challenges include:
   - Difficulty in finding qualified human resources
   - Unclear and inconsistent enforcement of laws and regulations,
   - Corruption at various level of the authorisation and licensing procedures[21],
   - Opaque and selectively enforced investment approval procedures,
   - Licensing barriers that favour domestic firms.
   - Unreliable legal system, plus lack of effective administrative and legal resources.
   - Forced transfer of technology and new barriers on cross border data flows.
   - Forced localisation requirements for data processing and storage, under the new "cyber security law (as mentioned above), etc.

[20] China WTO Accession Protocol - WT/L/432 - 23 November 2001 (see Section 10 page 7)

[21] China has made some progress but still need to continue to implement and enforce anticorruption policies, for instance by ratifying the OECD convention.

- There are still questions as to whether copyrights, patents, and data flows, etc. which are linked to the investment will be covered by the agreement. It would seem logical to cover the intellectual property that is linked to the FDI, including copyrights of software of services companies. Similarly, the flows of data from businesses' headquarters and other subsidiaries to the Chinese subsidiaries are in today's digital economy an integral part of an activity of these entities, and without access to their flow of data, the investors might decide not to invest, or not in the same way.
- Although the business community would argue in favour of it, we understand that government procurement is not part of the EU-China negotiations on a future comprehensive investment agreement. Nonetheless we encourage the European Union to step up the negotiations towards the accession of China to the WTO Government Procurement Agreement, with strong access for European businesses to the huge Chinese procurement market.

The new Commission must work towards obtaining clarity regarding the new Chinese investment law and how it could impact European business. In practice, in a more sophisticated digital Chinese economy, EU businesses are faced with complex and contradictory decisions by the Chinese administration. We believe therefore that there is a need to provide for regulatory cooperation provisions with China in the bilateral investment agreement.

4) Improve the Investment Protection

In addition to the negotiations of pre-establishment market access, the agreement with China aims as well as adopting rules and disciplines on post establishment protection. Investment protection is the logical counterpart to market access secured in investment negotiations. The ESF has therefore welcomed the inclusion of an investment protection chapter in the recent EU trade agreements with Canada, Singapore and Vietnam.

Despite the European Court of Justice's Opinion on the competences of the Union on trade policy[22], the European Services Forum considers that the Investment Protection Agreement with China must be negotiated on its own terms, clearly separated from the traditional trade-offs forming part of the dealings between the negotiating partners in other chapters covering trade issues: levels of investment protection should not be a matter of negotiation in return for concessions in other areas. This principle needs to be very clear and well respected, to ensure a uniformly high standard of investment protection, whatever the trading partner and whatever the quality of the market access commitments negotiated in the other chapters and annexes of the agreements.

This means that the European Services Forum is calling upon the EU institutions **to split up the deal** with China into two legal treaties, one being the **Comprehensive Investment Agreement** that will tackle market access and national treatment issues, **and** a second one being the **Investment Protection Agreement (IPA)**, similarly to those agreed with Singapore and Vietnam.

The Investment Protection Agreement will include the traditional rules of protection of the investors (fair and equitable treatment, etc.). As for the investor to state dispute settlement (ISDS), the European Union is proposing the adoption of the Investment Court System (ICS), like the one established in the agreements with Canada, Singapore and Vietnam.

a) Strong investment protection rules

[22] ECJ Opinion 2/15 of 16 May 2017

ESF already adopted a Position Paper on business support to key principles in bilateral investment agreements by the EU in May 2014, where we provided views on the rules of protection that BIAs should include. So, we will not repeat them here, but provide only with a summary of the priorities.

The European services sectors call upon the EU to negotiate an Investment Protection Agreement that will provide a strong protection to EU investors when establishing or increasing their business in China. We want first to acknowledge that sovereign states will always have the right to regulate and to make changes in their rules in the public interest, for social, environmental, or any other public policy purpose they see fit. Against that background, the investment protection chapter of the CAI should be to ensure disciplines to:

i) Prevent discrimination against investors on grounds of nationality;
ii) Provide fair and equitable treatment to investment;
iii) Guarantee prompt, adequate and effective compensation in the event that the government has to expropriate for a public, non-discriminatory, purpose;
iv) Allow transfers of funds related to the investment.

b) Investment protection through state-to-state dispute resolution mechanism

Before mentioning the post-establishment investment protection, we would like to emphasise that this protection already exists in some sort through commitments in Market access and National Treatment. Indeed, the undertakings by the WTO members in their GATS Schedules of Commitments in the Uruguay Round, or by countries in their commitments under bilateral or regional trade agreements, can be considered as already providing market access and a first layer of protection for investments, since they allow European businesses to establish abroad (mode 3 of the GATS). Any denial of market access, or a requirement to disinvest afterwards, can be challenged through the WTO or specific FTA dispute settlement mechanisms. Such commitments are therefore welcomed, since they provide an initial level of legal security to investors. This is the reason why ESF gives much importance to the market access pillar of these talks.

The dispute resolution mechanisms in WTO, FTAs or other trade agreements are however only state-to-state systems, which require European businesses whose market access has been denied to persuade the European institutions to pursue a case. There is always a degree of uncertainty as to whether a complaint will be pursued in the WTO or bilaterally (political considerations, for instance, might impede the initiation of a case).

However, in the case of the investment agreement with China, ESF considers this state-to-state dispute resolution mechanism as absolutely essential. And the implementation of the market access commitments should be carefully monitored by the European institutions. This State-to-State Dispute Settlement system should be included into the Comprehensive Agreement on Investment, not in the IPA.

c) Investment protection through Investor-to-state dispute settlement

European services firms have always supported their respective EU Member States in negotiating and signing bilateral investment treaties (BITs). These treaties complement EU trade policy by providing a strong post-establishment protection to investors who might otherwise be unable to bring proceedings against states which breach agreed investment guarantees. Since the 1950's EU Member States (other than Ireland) have concluded more than 1400 BITs, or 40% of all 3,400 existing BITs worldwide. These BITs are perceived as an insurance policy for investors. Investment is about trust, and BITs contribute to that essential trust.

The very large majority of European countries BITs include an investor-state dispute settlement (ISDS) process which allows for legal proceedings before an impartial and neutral arbitral tribunal, in addition to the state-to-state dispute settlement mechanism. It must be emphasized that a BIT without an ISDS mechanism is of much less interest, principally because the main purpose of a BIT is to protect investors by setting up rules, and by agreeing on a dispute settlement process governing the interpretation of the rules enshrined in the BIT. And in many instances, only that process is allowed to interpret these rules as a matter of international law, on which a local court is, in the vast majority of the countries, not entitled to reach a judgement.

Currently, there are 25 existing Bilateral Investment Treaties (BITs) between 26 individual EU27 Member States and China (Ireland has no BITs with any other countries in the world). We take note that, should the negotiations succeed, the new agreement would replace all individual EU member-state BITs with one single comprehensive investment Agreement, and all the individual BITs will have to be terminated.

It is also important to note that, to our knowledge, there have been no – or may be very few – case(s) of EU investors invoking against China the ISDS mechanism enshrined in member-state BITs with China. The main reason given is the investor’s fear of being subject to direct or indirect retaliation by Chinese authorities. Indeed, businesses do not like conflicts with the authorities of the host countries in which they invest, and that is particularly the case in China. International arbitration is often the only means to obtain redress when an alleged breach of an investment agreement occurs. But disputes can be lengthy and costly. It must be emphasised that recourse to ISDS often only comes after a lengthy period of difficulty for a business that has had assets expropriated or is suffering from what it considers to be a breach of the investment agreement. Many months can pass before getting an ISDS process activated, and often many months will go by before a decision of the arbitration tribunal is given. In the meantime, the firm is losing business and goodwill in the country where it has invested. Initiating arbitration is often seen as a last resort for companies, and on many occasions, companies prefer to settle arbitration proceedings through mediation or other mechanisms often enshrined in or encouraged by the BITs themselves. A decision to use the ISDS process in China, a country that is not sure to respect the award, and that might put the investor under further pressure, may be tantamount to the investor accepting the likelihood of having to leave the country, with its current or potential business opportunities.

With this in mind, what kind of investor-state-dispute-settlement should the EU-China investment agreement contain? There are two aspects: first, EU foreign direct investors in China need to be able secure compensation in case of expropriation, but secondly, the dispute resolution mechanism will have to operate so as to be able to protect EU defensive interests in the EU market, so that if a member state is subject to a complaint by a Chinese investor, the appropriate right to regulate is respected.

The European Commission confirmed that the EU is proposing to China the adoption of the Investment Court System (ICS), similar to the one adopted in the CETA with Canada and in the Investment Protection Agreements (IPA) with Singapore and Vietnam. ESF takes note of this proposal, and of the fact that none of these Agreements/Chapters are yet implemented, as they require final approval of all relevant national and regional assemblies. Taking this into consideration, the ICSID and the ICC Court of Arbitration should remain as alternatives until the new institution is operational.

One question is whether EU businesses would ever use the new EU wide system? The risk of “retaliation” by the Chinese authorities is a clear disincentive effect in using the national BITs. Will that also be the case with the new ICS process? The question of the independence of the judges/adjudicators will be crucial, as well as the provisions on respecting and complying with the decisions of the ICS that the EU has proposed. The EU must negotiate strong language to ensure that the ICS system put into place will give sufficient guarantees of the independence of the judges nominated by both sides, and respect of their judgements, with an appropriate monitoring procedure to ensure that no pressure is placed on an investor at any stage of ICS proceedings.

List of Supporting Members

1. Amfori
2. Apple
3. Architects' Council of Europe –ACE
4. British Telecom Plc
5. BDO
6. Bureau International des Producteurs et Intermédiaires d'Assurances – BIPAR
7. BUSINESSEUROPE
8. BUSINESSEUROPE WTO Working Group
9. BSA The Software Alliance
10. Conseil des barreaux de la Communauté Européenne – CCBE
11. Danish Shipping
12. Deutsche Post DHL
13. DI – Confederation of Danish Industries
14. Digital Europe
15. EK - Confederation of Finnish Industries
16. EuroCommerce
17. European Banking Federation – EBF
18. European Express Association – EEA
19. European Federation of Engineering and Consultancy Associations – EFCA
20. European Public Telecom Network – ETNO
21. European Satellite Operators Association – ESOA
22. European University Association – EUA
23. Fédération de l'Industrie Européenne de la Construction – FIEC
24. FratiniVergano European Lawyers
25. General Council of the Bar of England & Wales
26. Google
27. HSBC Group
28. IBM Europe, Middle East & Africa
29. Institute of Chartered Accountants in England and Wales (ICAEW)
30. Inmarsat
31. Insurance Europe
32. Irish Business and Employers' Confederation - IBEC
33. Le Groupe La Poste
34. Microsoft Corporation Europe
35. Mouvement des entreprises de France – MEDEF
36. Oracle Europe, Middle East & Africa
37. Orange
38. PostEurop
39. Prudential Plc.
40. Standard Chartered Bank
41. Svenskt Näringsliv (Confederation of Swedish Enterprise)
42. TechUK
43. Telenor Group
44. TheCityUK
45. UPS
46. Vodafone
47. Zurich Insurance