Impacts of the EU-China Comprehensive Agreement on Investment

Economic Insights

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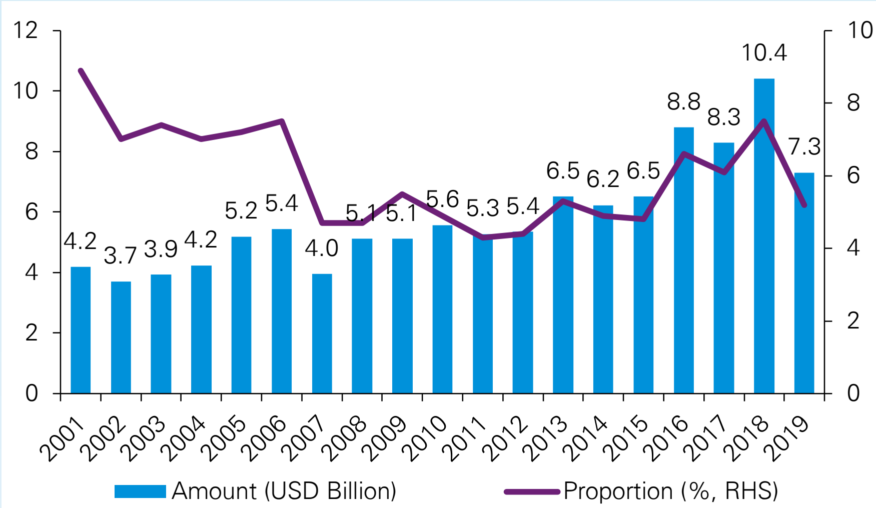
A landmark EU-China investment deal

On 30 December 2020, after 35 rounds of talks over a seven-year period, China and the European Union (EU) held a virtual summit to announce that they had concluded in principle the negotiations for a Comprehensive Agreement on Investment (CAI). The CAI is an ambitious bilateral investment agreement covering diverse areas including market access, level playing field, sustainable development and dispute settlement. Both sides are now working towards finalising the text of the agreement, which will need to be legally reviewed and translated before ratification. The agreement is likely to be officially passed in the first half of 2022.

Although China has already signed bilateral investment agreements with many EU member states, the CAI is the first such agreement with the EU as a bloc and its scope is more ambitious than many existing treaties. The agreement aims to foster cross-border investment and economic ties between China and the EU. China also wants to use the CAI to boost its outbound investment activities. As China's outbound direct investment (ODI) reached USD 2.2 trillion and accounted for 6.4% of the world's total in 2019, it has become an important engine for global cross-border investment.

Figure 1: Annual EU investment into China and share of total



Source: Statistical Bulletin of FDI in China 2020, KPMG analysis

There is significant room for China and EU to further strengthen their economic ties. In 2019, the combined GDP of China and the EU was USD 30 trillion, accounting for 34% of total global GDP. In comparison, bilateral investment between China and the EU is relatively modest. Based on figures from China's Ministry of Commerce, cumulative investment from the EU to China totalled USD 1,100 billion in 2001-2019; for Chinese investment into the EU, the figure is only USD 940 billion, which is 4.3% of China's total ODI. The EU-China CAI would strengthen collaboration on both sides, build an open economic order and promote globalisation.

Impact of the EU-China CAI

From a business perspective, the EU-China CAI would have a significant impact on market access, the 'level playing field', cross-border M&A, R&D and sustainable development.

Expand market access

One of the major focus of the CAI is the opening-up of market access. According to a survey conducted by the EU Chamber of Commerce in China[1], more than half of members believe Chinese companies receive better market access in Europe than vice versa. The CAI will adopt pre-establishment national treatment plus a negative list regarding market access. It is the first time for China include the use of negative lists for all service and manufacturing sectors in an investment agreement. This will be aligned with the principles of China's Foreign Investment Law, effective from 2020.

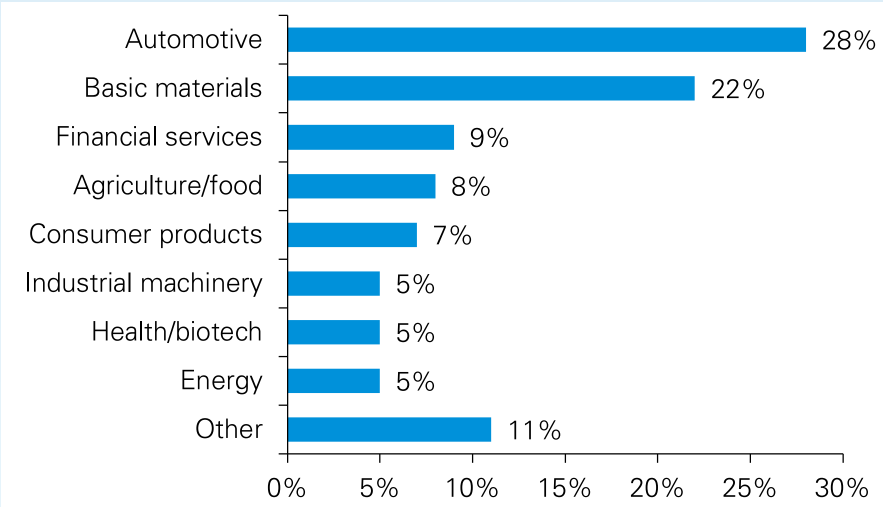
The CAI agreement is expected to provide more investment opportunities in the following sectors:

- Manufacturing
- Automotive
- Financial services
- Business services
- Health (private hospital)
- R&D
- Telecom/Cloud services
- Computer services
- International maritime transport
- Air transport-related services
- Environmental services
- Construction services

[1] Business Confidence Survey 2020, the EU Chamber of Commerce in China, June 2020, https://www.europeanchamber.com.cn/en/publications-archive/774/European_Business_in_China_Business_Confidence_Survey_2020

Automotive sector: China has already agreed to remove joint venture requirements for all types of automakers by 2022. The EU-China CAI will further accelerate opening-up in the automotive sector and encourage EU companies to expand investments in China. In addition, the COVID-19 pandemic has caused supply chain disruptions in many markets, but China has shown strong supply chain resilience thanks to its effective containment measures. A well-rounded industrial base, high-quality infrastructure and the largest and rapidly growing new energy vehicles market all make China an attractive destination for automakers.

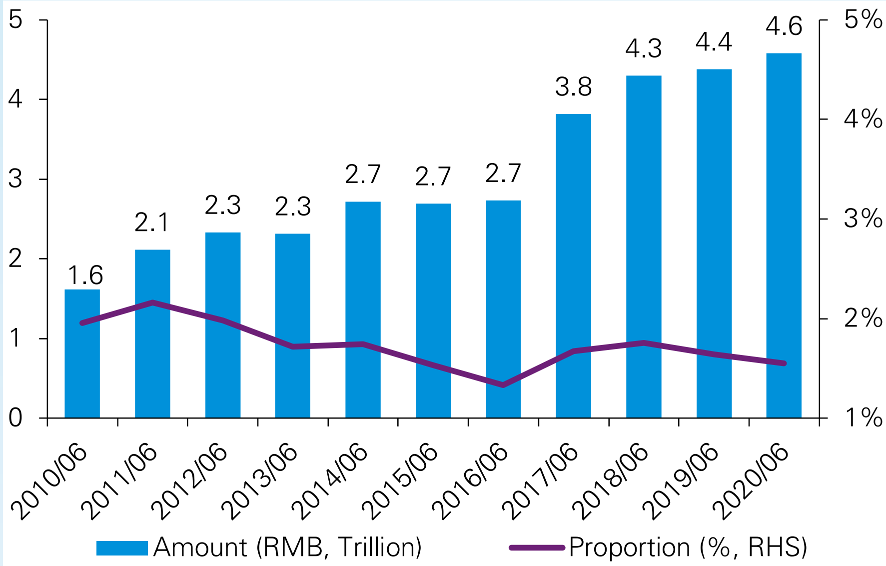
Figure 2: EU companies' investments in China by sector



Source: European Commission, KPMG analysis

Financial services: The CAI will also promote the opening-up of the financial sector in China, providing more opportunities in banking, insurance and asset management for European companies. For example, in the banking sector, in comparison with the large amount of total assets of Chinese banks (RMB 291 trillion), the value of total assets of foreign banks in China is relatively small, at RMB 4.6 trillion. For the insurance sector, the COVID-19 pandemic has raised the awareness of the importance of insurance; increasing demand will provide opportunities for European insurance companies in the Chinese market. Stocks and mutual funds account for only 2% of urban household wealth in China, compared to about 35% in the US. With growing income levels, China's households are diversifying their investment portfolios, presenting significant opportunities for Europe's asset management companies. China will continue to promote the opening-up of the financial sector as well as facilitate the EU's investment in RMB financial assets.

Figure 3: Total assets of foreign banks in China



Source: Wind, KPMG analysis

Promote a fair, level playing field

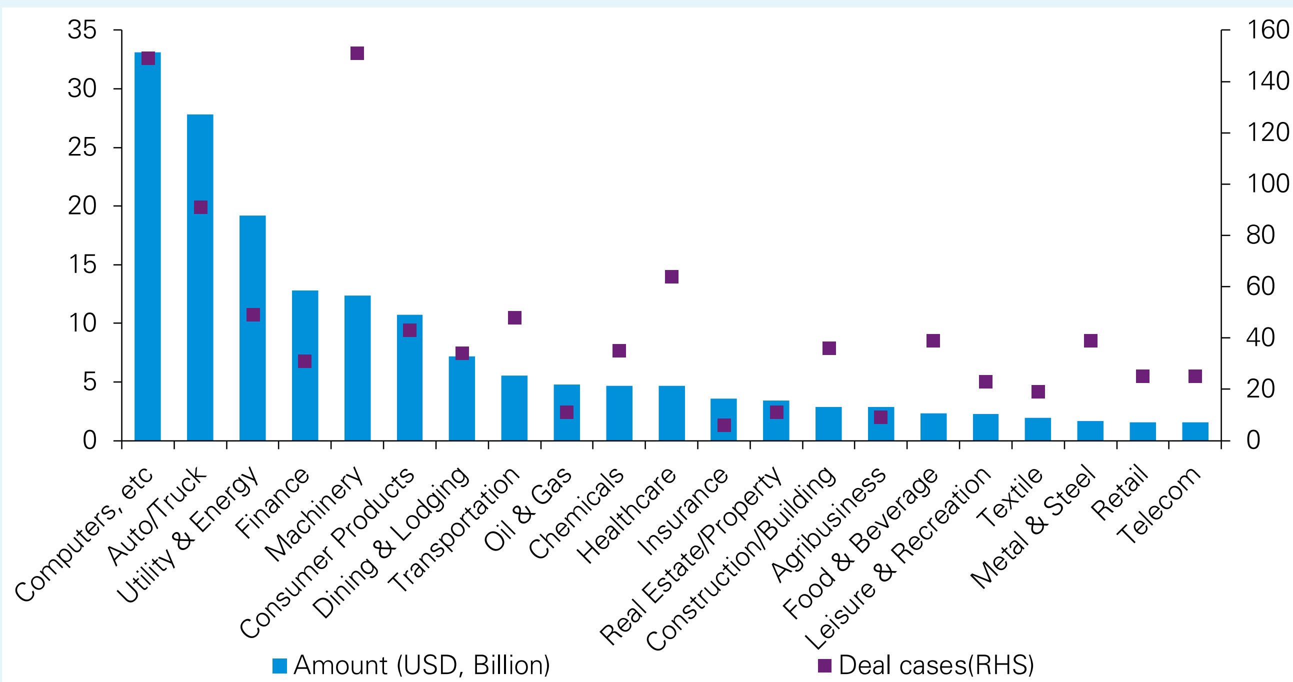
Another important issue in the CAI is improving the level playing field and applying fair competition rules for investment activities. It is the first time that China has agreed to include measures related to state-owned enterprises (SOEs) and subsidy transparency in an investment agreement. SOEs play a critical role in the Chinese economy and receive special attention from the government. Including SOEs in the agreement demonstrates China's determination to reform the SOE sector and promote opening-up. In addition, a stepped-up international competition will stimulate the reform of China's domestic market, and a fairer environment will place all market participants, including SOEs, foreign and private enterprises, at the same level. We believe these provisions will help to boost the confidence of private investors and promote the development of the private economy and SMEs in China.

Stimulate cross-border M&A

Over the past 20 years, Chinese companies have completed 997 mergers and acquisitions of enterprises in the EU member states, accounting for 16.6% of China's outbound M&A deals. The cumulative amount is USD 168.3 billion, 16.2% of the total outbound investment. These transactions were mostly in the machinery, computers and electronic equipment, and auto sectors.

We believe the implementation of the EU-China CAI offers significant growth opportunities for cross-border M&A activity. The EU has comparative advantages in advanced manufacturing technology and production: the removal of investment barriers will facilitate Chinese companies to expand investment in high-tech fields and deepen cooperation with EU enterprises. Potential disposals of high-quality assets also present an opportunity for Chinese companies' to expand their international operations. In addition, as the pandemic has significantly impacted the EU's economy, introducing Chinese capital into the EU will help the market stabilise employment and wages.

Figure 4: Sector distribution of China's outbound M&A in the EU



Source: Dealogic, KPMG Analysis

Improve R&D environment

A major concern of European enterprises is intellectual property (IP) protection. In recent years, China has strengthened the enforcement of IP protection to provide a more solid institutional environment for R&D in China. The EU and China have set out rules against the forced transfer of technology in the CAI. The provisions prohibit investment requirements that compel the transfer of technology, and protect confidential business information., Technology innovation is considered fundamental to China's future growth, and in the 14th Five-Year Plan, China is set to invest heavily in fundamental research and core technology areas. We believe as China constantly reinforces protection of IP, the improving R&D environment will attract European enterprises to expand investment in high-tech and high value-added industries.

Encourage sustainable development

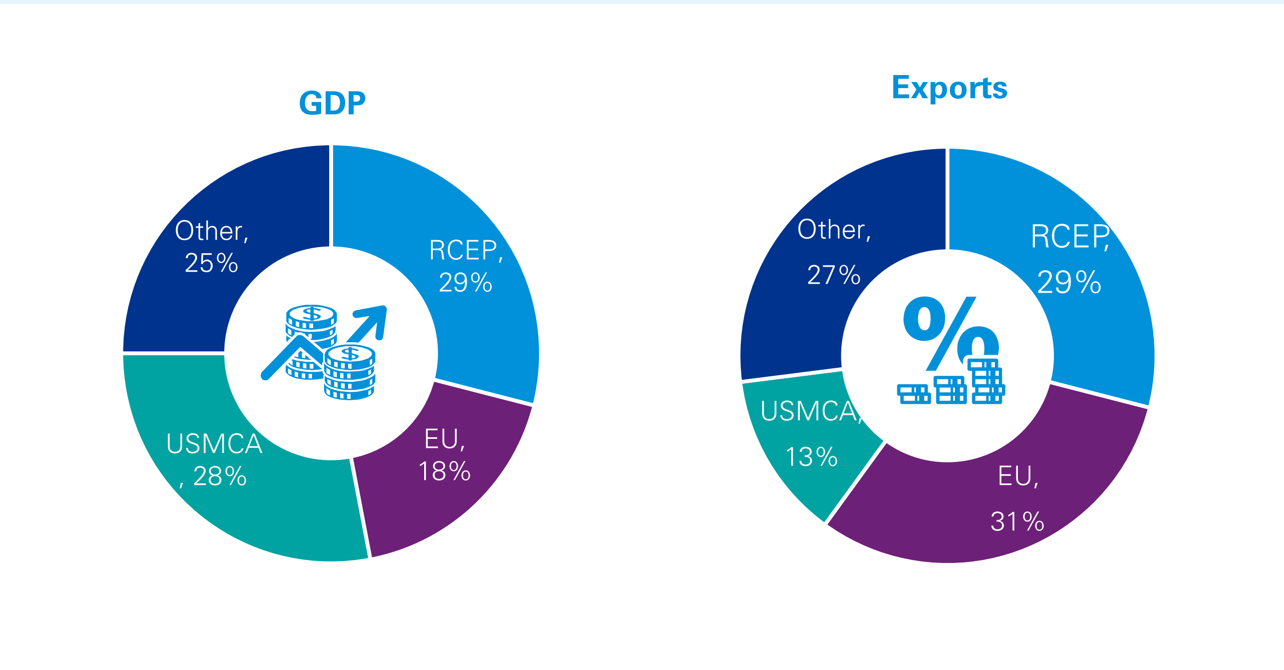
The EU and China have embedded sustainable development in the CAI. It is the first time for China to include provisions such as environment and labour in an agreement with a trade partner. The protection of the environment and improvement of labour interests reflect China's responsibility towards the international community. Those principles would align with China's long-term development as well as benefit China's new development paradigm (dual circulation). The two sides will encourage responsible investments to comply with international commitments.

Strengthen regional economic integration and reshape globalisation

Although the EU's economy rebounded in 2020Q3, the recovery has been weakened by a second wave of the pandemic as many countries re-imposed quarantine measures. GDP of the EU-27 declined by 4.2% in 2020Q3, the services PMI remained in the contractionary range, and the trade volume fell below the same level as of 2019. In contrast, China has led the world in restarting its economy, and became the largest trading partner of the EU. The investment deal will help boost the EU's economic recovery and China's high-quality development.

The EU-China CAI will further strengthen regional economic integration and reshape globalisation, leading to long-term development. Stronger regional economic collaboration has been on the rise as the progress of globalisation has stalled in recent years. The RCEP, signed last November, has pushed Asia Pacific's economic integration into a new phase. The conclusion of CAI is another landmark for regional economic collaboration. In terms of GDP and exports, the three free trade zones (RCEP, USMCA, EU) account for 75% of the world's total. Competition and collaboration among the three regions will likely shape the future of the global economy.

Figure 5: Share of each region to tahe world's total, %



Source: World Bank, WTO, KPMG analysis

CONTACT US

Norbert Meyring
Partner
KPMG China
+86 (21) 22122707
norbert.meyring@kpmg.com

Miguel Montoya
Partner
KPMG China
+86 (10) 85087064
miguel.montoya@kpmg.com

Kevin Kang
Chief Economist
KPMG China
+86 (10) 85087198
k.kang@kpmg.com

Acknowledgement:
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Research Team:
Yuan Zeng, CFA; Cheng Yang (Intern).

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