

# The Rise and Demise of the EU-China Investment Agreement

## *Takeaways for the Future of German Debate on China*

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MARCH 2023

### THE ISSUE

The EU-China Comprehensive Agreement on Investment (CAI) proved short-lived. After seven years of negotiations, only five months passed between its political agreement in December 2020 and the European Parliament voting to freeze its ratification in May 2021. Despite its short tenure, the deal offers an ideal window into Germany's evolving debate on China in the post-Merkel period. It would have deepened EU-China economic ties, and, as this brief shows, was not universally popular within Germany at the time—despite German chancellor Angela Merkel's leadership in pushing it through to a conclusion and suggestions by some European states that the CAI privileged the interests of Volkswagen and other German manufacturers. Examining the landscape of reactions to the CAI within Germany, this brief uncovers the dynamics at play as Berlin reconciles its deep economic ties to China with Beijing's increasing tendency to act in ways that contravene European economic and political interests and values. These dynamics suggest that risk assessments of China in Germany are evolving in an uneven and gradual way that will shape the aperture for transatlantic coordination on China in the near term. U.S. policymakers seeking to enhance opportunities for joint action on China should expand venues to deliberate Beijing's behavior and take care to ensure that the three parts of their invest-align-compete approach to China are working in concert, and not at odds.

### KEY PROVISIONS OF THE CAI

Negotiations over the EU-China Comprehensive Agreement on Investment (CAI) began in January 2014 and spanned 35 meetings across seven years. The CAI would have replaced the individual bilateral investment treaties (BITs)—which regulate how host states treat foreign investors hailing from the treaty partner—that most EU member states hold with China. Brussels sought a comprehensive BIT to secure greater access and more predictable conditions for European firms and rectify the low levels of European investment in China; while bilateral trade in goods and services had grown substantially, when CAI negotiations kicked off China only accounted for 2.1 percent of overseas EU foreign direct investment (FDI),

“way below what could be expected from two of the most important economic blocks on the planet.”<sup>1</sup> For their part, Chinese policymakers were cognizant of China's growing role as a capital exporter and wanted to put regulatory mechanisms in place that would protect Chinese investment access abroad.<sup>2</sup>

After years of limited progress, negotiations proceeded particularly quickly in the final months of 2020 as Chinese president Xi Jinping personally intervened to offer market-access concessions and salvage the deal before a new U.S. administration more willing to work with allies and partners on China entered office.<sup>3</sup> German chancellor Angela Merkel proved an eager partner in this eleventh-hour push, leveraging the final days of Germany's EU

presidency to secure an in-principle agreement.<sup>4</sup> During the last days of December, Merkel jointly announced the deal with European Commission president Ursula von der Leyen, European Council president Charles Michel, and Chinese president Xi Jinping. The CAI was put forth for ratification in the European Parliament.<sup>5</sup>

The agreement had a relatively short tenure in public debate. In March 2021, Beijing sanctioned 10 individuals and four entities within the European Union in retaliation for EU sanctions that same month targeting Chinese individuals and entities involved in the persecution and mass detention of Uighurs in Xinjiang. This tit-for-tat move was a turning point in European debate on China, leading to a steep rise in strategic mistrust in Brussels and many EU capitals. As EU representative for foreign and security policy Josep Borrell put it, Chinese retaliatory sanctions “created a new atmosphere. . . a new situation” in EU thinking toward China.<sup>6</sup> The president of the European Chamber of Commerce (EUCC), Jörg Wuttke, observed a “mood shift” in Berlin by early 2021.<sup>7</sup> This move also pivotally shaped the trajectory of the CAI. In May 2021, the European Parliament voted to suspend ratification while China’s sanctions remained in place.<sup>8</sup>

Although the geopolitical context was an important part of the debate over the CAI within Germany (as the next section shows), China’s concessions to EU investors under the CAI also proved controversial. The text of the agreement was made public on January 22, 2021, and the specific market-access commitments were released on March 12, 2021. The CAI’s core provisions can be split into three categories: market access, a level playing field, and sustainable development. Several provisions within the annexes are also worth introducing since they were hotly debated during the ensuing discussion of the deal within Europe, particularly in Germany.<sup>9</sup>

## MARKET ACCESS

The CAI followed a “positive list” approach, specifying areas of the Chinese economy open for European investment.<sup>10</sup> For the most part, these were “almost entirely a confirmation of earlier openings by China, either under the aegis of the WTO [World Trade Organization], or through the successive issuance of several ‘negative lists’ for foreign investment,” while new market openings were limited.<sup>11</sup> Arguably, the CAI “prevents backsliding” by binding China under the power of an international treaty to preserve existing openings for EU firms in the future.

EU negotiators also pointed to the “ratchet clause”—which stipulated that any further opening China offered investors of other nations would automatically be extended to EU investors—as a win.<sup>12</sup>

## LEVEL PLAYING FIELD

This section of the CAI was its most popular among European businesses and policymakers. China addressed several longstanding complaints by European businesses in China, agreeing to: ban forced technology transfer, mandate transparency over subsidies in services, require state-owned enterprises (SOEs) to act on commercial bases and not discriminate against foreign firms in their procurement and sales of goods and services, and grant EU firms access to China’s standards setting bodies.<sup>13</sup> Some analysts were skeptical of such promises, given what they saw as China’s weak record of compliance with prior international commitments in some of these areas.<sup>14</sup>

## SUSTAINABLE DEVELOPMENT

In the CAI, the European Union secured commitments from China not to lower or fail to enforce certain environmental and labor standards to attract investment. Specifically, China agreed to renew efforts to combat climate change and implement its promises under the 2015 Paris Agreement, as well as to make “continued and sustained efforts” to ratify outstanding International Labor Organization (ILO) conventions (No. 29 and No. 105) banning forced labor. As of the start of 2020, Beijing had reportedly refused to make commitments in this realm.<sup>15</sup> As a result, EU negotiators presented this commitment as a “very strong signal” of China’s intent to improve practices in the environmental and labor domains.<sup>16</sup>

## SPECIAL PROVISIONS

Two further provisions are worth noting since they featured extensively in the debate about the CAI within Germany. The first is a provision in the annexes, which largely enshrined existing restrictions on European NGOs, business chambers, and foundations in China;<sup>17</sup> in it, China also reserved the right to demand that senior executives of foreign nonprofit organizations in China be Chinese citizens. The second provision restricted the rights of European law firms in China, specifying that they were required to entrust Chinese law firms to deal with Chinese legal affairs on behalf of foreign clients, rather than provide representation or advisory services to them directly.<sup>18</sup>

## GERMANY REACTS TO THE CAI: 2020-21

When the CAI was announced, EU-China relations were in a far different state than they had been seven years earlier. Beijing was cracking down on democratic freedoms in Hong Kong through a series of new regulatory measures; the scale and nature of Chinese internment practices targeted at the Uyghur population in Xinjiang were coming to light; Chinese “wolf warrior” diplomats were causing a stir on social media and in many European capitals; and throughout 2020, as Covid-19 spread across the European continent, China benefited financially and ideologically by selling personal protective equipment (PPE) to Europe for a profit, spreading disinformation about the virus’s origins, and highlighting tragedies to suggest the West was in chaotic decay.<sup>19</sup> Commenting on the CAI’s suspension in May 2021, European trade commissioner Valdis Dombrovskis noted, “We cannot ignore the wider context of relations between the EU and China.”<sup>20</sup>

Meanwhile, a month before the CAI was announced in principle, U.S. president Donald Trump, who had ruffled feathers in European capitals for his “America first” rhetoric, was voted out of office in favor of Joseph Biden, whose appointees immediately began communicating a desire to work with partners and allies to preserve the liberal international order from threats—chief among them China. The incoming administration made its hesitation to the CAI clear prior to inauguration day. Just eight days before the European Union and China announced the agreement, Biden’s incoming national security adviser, Jake Sullivan, implied reservations by sharing that the Biden team would “welcome early consultations with our European partners on our common concerns about China’s economic practices.”<sup>21</sup>

The CAI was introduced at this nexus: amid transformative changes in China’s international and domestic policy behavior and amid renewed prospects for transatlantic relations represented by the new U.S. administration. As a result, debate about the CAI within Europe—and among national governments, industry associations, and European civil society more broadly—concerned both the substance of the deal and its timing. The following sections examine how political, business, and civil-society communities within Germany, Europe’s largest and most influential economy, reacted to the CAI, drawing on not only interviews with members of these communities but also statements by the major German political parties, key

German business and industry associations, and German civil society organizations.

## POLITICAL REACTIONS

German political debate on China is driven by coalitional and interparty politics, industry and civil-society positioning, geopolitical developments, and China’s own foreign and domestic policy behavior. The approaches to the CAI within each major political party in part confirm that political debate on China is now broadly driven by what analyst Roderick Kefferpütz has described as a “tug of war” between those who favor Merkel’s longstanding, engagement-centered approach to China and those who prefer a more values-driven foreign policy.<sup>22</sup> The two frameworks for China policy do not fundamentally disagree on the facts of the Sino-German relationship—for example, that China is an important trading partner and that its rising crackdowns at home and assertiveness abroad are concerning. But the two camps differ in how to engage China based on these facts. As parties, Alliance 90/The Greens (the Greens) and the Free Democratic Party (FDP) tend more toward a “dialogue and toughness” approach, as German minister of foreign affairs Annalena Baerbock put it on the 2021 federal-election campaign trail.<sup>23</sup> Within Germany’s historically largest parties, the Christian Democratic Union (CDU)—allied with the Christian Social Union (CSU) in Bavaria—and the Social Democratic Party (SPD), there is more disagreement on the best course of action.

As the following sections show, the reactions of these four major German political parties to the CAI highlight these dynamics. Mirroring the diversity of policy positions found among the major U.S. political parties, each party had members that were more supportive and less supportive of both the CAI and of reevaluating Germany’s approach to a changing China. Nevertheless, some trends are evident.

### *FDP and Greens Led the Criticism*

Political attention to the CAI was limited when it was agreed in principle—perhaps because this was during the winter holiday period—but grew in early 2021 after the full text was made available and China imposed surprising, retaliatory sanctions. None of the major parties were opposed to the CAI outright, but the Greens and FDP argued against ratification in its agreed form.<sup>24</sup> These parties viewed the timing with skepticism: The announcement came as a new U.S. administration eager to work with Europe on China-



related trade and investment issues was entering office and arguably delivered Beijing a diplomatic win amid concerning foreign and domestic policy developments.<sup>25</sup> Beyond this, especially as the text was released, both the Greens and FDP concluded that the CAI represented a missed opportunity to press for greater alignment with European values in China's market orientation and human rights practices.

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Chinese countersanctions on European entities got the ball rolling on a coordinated FDP response, which in June resulted in *Breathing New Life into the CAI: 12 Liberal Demands for a Politically Viable Investment Deal with China*, written by Sandra Weeser, a member of the Economic Affairs and Energy Committee in charge of trade policy, and Gyde Jensen, an FDP colleague who was serving as chairwoman of the Committee on Human Rights and Humanitarian Aid.<sup>26</sup> Within the FDP, Jensen and Weeser faced little internal pushback to their critiques. As one interviewee argued, this reflected an increasingly skeptical party stance on China, owing not only to the party's transatlanticist tendencies and growing concern about China's human rights behavior, but also its core electorate, which included small- and medium-sized "Mittlestand" companies wary of growing competition at home from Chinese industry.<sup>27</sup> According to the interviewee, the inclusion of calls to expand other trade agreements—including the Comprehensive Economic and Trade Agreement (CETA) with Canada and the Free Trade Agreement between Mexico and the European Union—in the *12 Liberal Demands* report reassured the most ideologically pro-free trade elements of the party.

While the Greens did not produce a similarly formal, standalone set of demands for the CAI, quite a few

members spoke out against the deal. Reinhard Bütikofer, a German Greens politician serving as a member of the European Parliament, immediately questioned its hasty conclusion and later drew attention to a wide range of deficits he saw in the text.<sup>28</sup> Bütikofer was not alone in his criticism. However, it is worth noting that some Greens were less critical at the time. One interviewee pointed to prominent Green Party Bundestag member Jürgen Trittin as an exception in this regard.<sup>29</sup> Trittin reportedly saw the timing as unproblematic in a transatlantic context because the United States had recently secured its own economic concessions from China.<sup>30</sup> That said, even Trittin felt that this "window of opportunity" in EU-China relations had not been utilized to its full advantage and argued that certain provisions in the CAI were inadequate in light of recent developments in Hong Kong and Xinjiang.<sup>31</sup>

Upon reviewing the CAI, the Greens and FDP primarily responded to its chapter on sustainable development. China's commitment to "make continued and sustained efforts to pursue ratification" of ILO conventions on forced labor were seen as insufficient, especially in light of the clear violations of these conventions that had come to light in Xinjiang. In an April 2021 interview, then-candidate for chancellor Annalena Baerbock argued that in the CAI, "the European side has not adequately addressed the issue of forced labor in relation to the oppressed Uyghur minority."<sup>32</sup> Margarete Bause, then serving as spokeswoman for human rights and humanitarian aid for the Greens' parliamentary group, called the CAI a "mistake" due to the human rights situation in China.<sup>33</sup> FDP lawmakers involved in organizing the party's response to the deal, including Jensen and Weeser, had been following developments in Hong Kong and Xinjiang for some time with concern.<sup>34</sup> In commentary on the CAI, the Greens and FDP repeatedly suggested more could be done to address Beijing's forced labor practices in Xinjiang.<sup>35</sup> While demanding that the CAI's sustainable-development section be strengthened, including by forcing China commit to ratifying the relevant ILO conventions within a fixed timeline, many politicians from these two parties also advocated for additional initiatives to address these practices.<sup>36</sup>

Outside the sustainable-development provisions, the FDP and Greens largely saw China's market-access and level-playing-field commitments as steps in the right direction but inadequate to justify ratification. Members of both parties critiqued the continued lack of reciprocity

promised by the deal, expressed skepticism based on China's track record of not observing WTO rules, and argued that level-playing-field provisions needed to be combined with robust investment protections to ensure an improved situation for European firms.<sup>37</sup> Other concerns, expressed in the FDP's 12 Liberal Demands, included the restrictions on NGOs in Annex II, Article 9, and the prohibition on foreign law firms practicing Chinese law, which enshrined what the FDP saw as overly restrictive Chinese laws in treaty form.<sup>38</sup>

### ***CDU and SPD: Grand Coalition Support with Individual Critiques***

The CDU and SPD were more muted than the FDP and Greens when it came to China during the 2021 federal-election campaign, which kicked off early that year when the CAI was still in play. This is reflected in party election manifestos: China was mentioned 22 times in the FDP manifesto and 16 times in the Greens', while the CDU/CSU mentioned the country only seven times and the SPD only four.<sup>39</sup> Nevertheless, trends can be distilled from individual lawmaker statements about the CAI and party statements on China in general.

Under Merkel's leadership, the CDU supported the deal throughout the final year of her chancellorship. Despite individual criticisms regarding timing and substance, the CDU/CSU parliamentary group released an endorsement statement wherein Deputy Chairwoman Katja Leikert cited "worrying" developments in the human-rights situation in China but dismissed suggestions that the CAI should be leveraged to force meaningful improvements.<sup>40</sup> Leikert argued it would be "naïve" to expect an investment agreement to "bring about a system change in China" and that Chinese commitments of any variety on this front "must be seen as the positive intermediate steps that they are."<sup>41</sup>

The chancellery and top CDU ministers took steps to boost support for the CAI within Germany. Minister for Economic Affairs and Energy Peter Altmaier, a member of Merkel's cabinet, immediately lauded the CAI as a "trade policy milestone" promising greater market access, legal certainty, and a better competitive environment in China.<sup>42</sup> Merkel's public defense of the deal was arguably limited, but she did attempt to drum up support in more targeted settings. In a speech to CDU/CSU lawmakers in May 2021, just after European trade commissioner Dombrovskis announced he would no longer actively pursue ratification, Merkel argued that despite human-

rights concerns vis-à-vis China, the CAI remained a "very important undertaking" promising German companies more reciprocity in terms of market access.<sup>43</sup>

Reflective of the party today, some CDU members expressed reservations with the deal's timing and what they saw as an inappropriate continuation of Germany's business-first paradigm. In the CAI debate, individual CDU lawmakers questioned whether China would actually address forced labor, a key concern of the FDP and Greens. Norbert Röttgen, a CDU politician who had led the push against Huawei's role in Germany's fifth-generation (5G) wireless infrastructure in 2019, expressed alarm from his vantage point as chair of the Committee on Foreign Affairs in the Bundestag that allowing the CAI to proceed as is, with China merely committing to "efforts" to ratify the ILO conventions on forced labor, would be akin to concluding an agreement in which "forced labor is implicitly accepted."<sup>44</sup> Nevertheless, there was no organized opposition to the deal within the CDU.<sup>45</sup>

As part of the CDU's governing coalition at the time, the SPD did not oppose the CAI upon its in-principle agreement. Some in the SPD were seeking to distance the party from Merkel's business-first approach to China, while maintaining dialogue and engagement at the center of its approach. Germany's muted reaction to Beijing's draconian crackdown in Hong Kong was an important turning point for this group. In the wake of events in Hong Kong, Nils Schmid, the SPD's spokesperson on the Committee on Foreign Affairs and who had played a role in Germany's 5G debate, critiqued Merkel's China approach for being "out of date" and argued it was time to retire the idea that "as we deepen our economic ties with China, it will become more liberal."<sup>46</sup> Spearheaded by Schmid, together with prominent SPD politicians Metin Hakverdi and Christoph Matschie, in June 2020 the SPD parliamentary group released a position paper on China calling for a tougher stance. While endorsing the European Union's three-part approach to China as a partner, competitor, and systemic rival, the authors argued that systemic rivalry should condition both partnership and competition, rather than having Germany approach China as "a partner on Monday, competitor on Tuesday, rival on Wednesday."<sup>47</sup>

Nevertheless, some wings of the SPD favored continuing a pro-engagement approach akin to Merkel's, which

had historically been the party's stance.<sup>48</sup> On the 2021 campaign trail, SPD candidate (now chancellor) Olaf Scholz—who had a track record of promoting trade and investment with China during his years as minister of finance and mayor of Hamburg—arguably downplayed the need for a departure from past policy.<sup>49</sup> As members of a historically pro-labor party, many SPD politicians were particularly conscious of the employment and profit opportunities tied to trade and investment with China. For example, one interviewee pointed to the fact that SPD stronghold Lower Saxony holds an ownership stake in Volkswagen, which employs nearly 300,000 Germans and remains heavily invested in China.<sup>50</sup> The SPD's 2021 federal election platform signaled the perceived importance of continuing to “conduct dialogue with China on cooperation and competition in a . . . constructive and critical manner.”<sup>51</sup>

The SPD did not issue a formal party position on the CAI. Its lack of organized opposition arguably reflects the diversity of views about China and the deal among its members but also suggests cautious but lingering optimism about deepened trade and investment ties with China despite geopolitical developments—in alignment with the CDU, its coalition partner at the time. Individual lawmaker statements support this conclusion. Even while expressing concern that China's behavior was running antithetical to CAI promises, SPD member and chair of the European Parliament's Committee on International Trade Bernd Lange argued that “a trade and investment agreement offers the possibility of dialogue and the gradual change of facts.”<sup>52</sup> In an interview in September 2021 on what German trade policy toward China should look like, Bernd Westphal (the economic and energy policy spokesman for the SPD parliamentary group) did not mention the then-frozen CAI but did emphasize that the SPD sees “China as an important trading partner” and that Germany should focus its efforts on “integrating China into the rules-based world trade system.”<sup>53</sup> Revealingly, FDP and Greens representatives answered the same question by discussing the various barriers they felt needed to be addressed before the CAI could even be reconsidered.<sup>54</sup>

## BUSINESS COMMUNITY

Expectations for the CAI among German industry had been high. Even the China-invested companies most in favor of continued engagement and fearful of Chinese retaliatory behavior supported calls by the federal government and

business associations for greater reciprocity and a more level playing field in China for European and Chinese companies. While they had long advocated for better operational conditions for their firms in China, major German associations such as the Federation of German Industries (BDI) and Association of German Chambers of Commerce and Industry (DIHK) intensified this push as Chinese firms began leveraging European economic openness to sell and invest within the European Union—and as Beijing launched industrial policy plans such as Made in China 2025, which sought global leadership in fields of German economic advantage.<sup>55</sup> Accordingly, while encouraging progress in CAI negotiations, German industry associations cautioned European negotiators that quality would be as important as speed; as the DIHK put it, any agreement would require an “ambitious offer by China,” leveling the playing field and reducing market asymmetries, to be meaningful.<sup>56</sup>

By these metrics, German business associations found the CAI underwhelming. Despite calls for substance, “in the end, it was only speed,” as BDI executive board member Wolfgang Niedermark put it in April 2021.<sup>57</sup> Few German firms found major “wins” to point to, especially in market access, a member of the business community shared.<sup>58</sup> Market-access deliverables fell short of true reciprocity<sup>59</sup>—and in many cases duplicated existing openings, primarily serving to “legally safeguard . . . access to market areas where liberalization has been under way for quite some time.”<sup>60</sup> German business associations noted that longstanding complaints of their members in China had gone entirely unaddressed in the CAI, including in the fields of government procurement, intellectual property protection, and cross-border data transfer.<sup>61</sup>

This did not prevent the community from officially supporting the CAI. Business associations saw the deal as an important, if marginal, symbolic move toward improving investment planning and security. The German Association of the Automotive Industry (VDA) called the CAI an “important step . . . in a process toward ever-improving framework conditions for fair competition” in China and felt it “must be ratified as quickly as possible.”<sup>62</sup> The Chemicals Industry Association (VCI) “[welcomed] the agreement.”<sup>63</sup> The Machinery and Equipment Manufacturers Association (VDMA) called the CAI a “bird in the hand” whose provisions represented a “first step in the right direction.”<sup>64</sup> As a BDI representative put it in April 2021, “It's all a piece on our way to have rule-based cooperation between China and us. And we are not

enthusiastic, but we think it is a good thing to have such an agreement.”<sup>65</sup> Another member of the German business community held that despite its deficits, the CAI was “one part in an overall strategy that moves us forward in a certain direction.”<sup>66</sup>

Indeed, German industry largely welcomed its core provisions as a step forward, while acknowledging they were just that: a step that would need to be combined with others to level the playing field for European firms in China. Almost immediately, the attention of these major business associations vis-à-vis the CAI turned to how to achieve additional business community objectives following its as-is ratification. Friedolin Strack of the BDI, for example, argued in April 2021 that a “CAI phase two” would be necessary: “We have reached a certain step, but we need more steps. We should make clear at every occasion (and we in BDI try to do that) . . . that we do not leave China in this position of feeling comfortable in this role of a Party-driven economy.”<sup>67</sup>

Due to its perceived deficits, when the CAI was frozen due to tit-for-tat sanctions in spring 2021, the German business community did not see this as a big loss or organize to lobby against the freeze. On balance, Chinese concessions were not seen as substantial, and businesses largely remained interested in the Chinese market with or without an EU-China investment agreement in place. As BDI’s Niedermark put it after China sanctioned EU officials, a failure of the CAI would “not mean that we have to stop our engagement or could not even invest more in China.”<sup>68</sup>

## CIVIL SOCIETY

German civil society—including NGOs, foundations, and think tanks—meaningfully entered the national debate on the CAI after March 2021, once the full text was published and China implemented retaliatory sanctions on EU entities. This group was in some ways the most outspoken in its criticism of the deal. Civil-society actors had not been extensively engaged during negotiations; although the directorate-general for Trade at the European Commission had convened “civil society dialogues” beginning in 2017, these reportedly “served primarily as a communication tool and mostly attracted business representatives.”<sup>69</sup> As a result, the initial reaction was one of surprise at the NGO provision. As Bertram Lang, a researcher at Goethe University with expertise on civil-society issues in China, shared, “When the Annexes

were published . . . there was mostly astonishment, because NGOs didn’t really have the CAI on the radar.”<sup>70</sup>

Surprise among civil society was soon accompanied by criticism, even if some groups expressed this cautiously and privately.<sup>71</sup> As Tagesschau reported, German political foundations—many of which had offices in China—found the NGO provision “irritating” and “threatening,” a symbol that this community was not seen as important enough to be included in negotiations.<sup>72</sup> But they were also immediately concerned about implications for their operations within China. As Lang shared in an interview, foundations reacted strongly to this provision partially because “they read it as if the next day, they would have to appoint a [Chinese] senior executive” to lead their operations in China in order to comply with Chinese law. As noted above, the NGO provision would also affect businesses and industry associations such as the BDI, and this helped fuel media attention to the issue within Germany in early 2021.

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Think tanks also drove criticism of the deal. For example, while seeing the market access and level-playing-field provisions as positive developments, Mikko Huotari and Max Zenglein of the influential German think tank, the Mercator Institute for China Studies (MERICS), argued that the “(geo)political context and what’s not in the agreement” meant that it was not “the deal the European side had hoped for when negotiations started seven years ago.”<sup>73</sup> On the eve of the CAI’s in-principle agreement, a group of 14 EU-China experts at German and other European think tanks and research organizations suggested that concluding the CAI at the end of 2020 would symbolically endorse Beijing’s political trajectory after a year of shocking developments in its international and domestic policy and that “Europe will thus lose leverage not only on issues critical for its future competitiveness but also on fundamental value issues.”<sup>74</sup> Noah Barkin, managing editor at the Rhodium Group and a visiting senior fellow at the German Marshall Fund, shared in an interview that criticism grew over time, particularly after China



imposed sanctions on European entities, including MERICS.

## A WINDOW INTO EVOLVING GERMAN DEBATE ON CHINA

Beijing remains interested in the CAI, particularly as support for stricter investment screening grows in many European capitals.<sup>75</sup> The most immediate hurdles to the agreement are China's sanctions and implementation of the ILO conventions, as attention in Europe has grown substantially over the past year toward Beijing's human-rights practices. These hurdles to the CAI will be difficult to overcome as promise fatigue grows in European capitals. China's commitments to uphold international economic norms or respect European values and interests are increasingly viewed with skepticism—a trend accelerated by Beijing's tacit support for Russia during the Ukraine war despite its stated support for sovereignty and territorial integrity.

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This dynamic is evident in how European leaders have reacted to China's more recent efforts at signaling commitment to CAI ratification. In meetings with sanctioned EU organizations and individuals in fall 2022, Beijing reportedly communicated that outstanding restrictions would not be strictly enforced.<sup>76</sup> Reflective of the wide range of concerns with China and the CAI, however, this did little to move the needle. Furthermore, although Beijing announced in April 2022 that it would ratify ILO conventions 29 and 105, arguably following through on its promises to make “efforts” toward ratification, many European policymakers did not see this as a gamechanger.<sup>77</sup> Ongoing concerns about China's human-rights practices, as well as an overall sense of skepticism regarding promises from Beijing, had taken hold in many corners of the German and European parliaments.<sup>78</sup>

While a bilateral investment deal between Europe and China looks unlikely as of 2023, the Biden administration will be seeking to maximize transatlantic coordination in the years ahead as U.S. strategic competition with China accelerates. The CAI's trajectory uncovers several realities about the dynamics of German

debate on China that U.S. policymakers would do well to keep in mind going forward.

**First, the primary determinant of German sentiment on China will be Beijing's actions.** Souring German (and European) sentiment toward China is not the result of U.S. pressure, despite Chinese assessments to the contrary.<sup>79</sup> The key driver is the trajectory of a changing China.<sup>80</sup> China's ratification of ILO conventions in 2022 did little to convince European policymakers that Beijing was newly committed to improving its human rights practices, for example, because its policies in Xinjiang were telling another story.

**Second, pull factors remain strong for many German enterprises in China, preserving a pro-engagement voice in the national debate.** Today, while German companies are wary of a growing set of risks to their business operations in China and increasingly exploring options for diversification, they remain interested in China as a production site, source of innovation, and market. Larger German firms (and their top suppliers) with meaningful China exposure continue to invest heavily in the country.<sup>81</sup> Many German firms are adapting to growing geopolitical tensions by localizing staff, supply chains, and data flows and taking advantage of local research and development (R&D) and partnerships with Chinese firms to tailor their products and services.<sup>82</sup> A representative of one business association observed that while the field itself may be shifting and becoming less level, given rising Party-state intervention in shepherding economic resources toward strategic ends, “there is still a lot of political and economic will to . . . play on that playing field” among German companies.<sup>83</sup>

These pull factors explain why China-invested German corporate heavyweights recently “buted heads” with the Greens-controlled Foreign Office and Ministry of Economic Affairs and Climate Action over government missives to diversify away from China and an intensified emphasis on systemic rivalry in some corners of the Traffic Light Coalition, which they see as risking retaliation from Beijing and jeopardizing profits in China.<sup>84</sup> It also suggests that this pro-engagement lobby will remain a player in German debate on China going forward. The fault line within the German business community on this topic, several members of this community suggested, may increasingly be between those companies with a China presence and those without, as



investing in China is becoming harder due to German government pressures, market competition, and a changing Chinese regulatory environment.<sup>85</sup>

**Nevertheless, and third, support is widespread among German businesses (and government officials) for an enhanced EU and transatlantic toolbox of defensive measures designed to level the playing field and bring China more in line with the multilateral rules-based system.** German industry felt the CAI failed to secure comprehensive improvements in these areas, and associations called for additional instruments to level the playing field, such as stronger European investment screening and anti-foreign subsidy measures.<sup>86</sup> As a representative of German business put it, “We’re all in heavy favor of sharpening our tools because . . . it’s a much better diplomatic deterrent and a clearer way of working together.”<sup>87</sup> Another representative held that supranational tools were widely supported given prioritization on improving reciprocity and leveling the playing field: “China reacts to strength.”<sup>88</sup>

## **RECOMMENDATIONS: TAKEAWAYS FOR TRANSATLANTIC COOPERATION ON CHINA**

The Biden administration would do well to recognize these realities as it seeks to enhance transatlantic cooperation on China in the years ahead. Cooperation should be approached incrementally, with recognition that while risk assessments of China in the European Union’s largest member state are evolving, they are doing so in an uneven and gradual way, with significant disagreement over the speed and scale of policy change. Some of the largest businesses remain ambivalent about national directives that push the country toward targeted economic and technological decoupling from China, such as Germany’s recent supply chain due-diligence law and proposals to eliminate government investment guarantees and screen outbound investment.<sup>89</sup> And as negotiations over Germany’s China strategy clarify, differences remain between and within the major German political parties regarding adjustments to policy toward Beijing. These realities do not mean German policymakers are inattentive to the risks associated with a changing China but—as in any democracy—will create pressures on political parties and lawmakers that may naturally condition the scope and speed of policy response to these risks.

**Additional channels for U.S.-EU consultation about China’s foreign and domestic policy developments and the risks they pose are needed.** From the perspective of the European Union, worrisome trends include but are not limited to the following: China’s tacit support for Russia in the war in Ukraine; expanding influence in international organizations, including those intended to protect and preserve human rights; military assertiveness across the Taiwan Strait, a key maritime trading route; economic coercion against both European states and its neighbors in the Indo-Pacific; efforts to export Chinese policing and security practices to authoritarian regimes; and influence operations in Europe—all of which overlap with U.S. concerns about China’s rise. The number of substantive venues for regular dialogue on China have increased under the Biden administration. For example, the EU-U.S. Trade and Technology Council first met in September 2021. The high-level EU-U.S. Dialogue on China was launched in May 2021 and the now meets regularly. More frequent government exchanges on China, as well as regularized Track 1.5 and Track 2 dialogues, could serve as an additional basis for sharing information about the Chinese actions and initiatives that are most destabilizing, determining which can be jointly addressed most feasibly, and developing effective policy approaches.

**The overall health and stability of the transatlantic relationship will be vital for coordination on China, so care should be taken to anticipate and address spillover effects from the U.S. “invest-align-compete” approach to China.** U.S. policymakers need to ensure that the “invest” and “compete” components of this three-part framework are not working at odds with its desire to deepen alignment with key partners and allies. Recent U.S. export controls on China, as well as the Inflation Reduction Act, triggered frictions with Europe not only because they affect the economic prospects of European firms, but also because they were reportedly carried out with insufficient consultation and communication about these consequences. Putting the merit of individual policies aside, ensuring regular attention to implications for broader transatlantic ties in U.S. economic and technology policymaking—especially as this becomes a more important part of U.S.-China strategic competition—will preserve the goodwill needed for further coordination on China down the line. ■

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*The author would like to thank the myriad experts and practitioners who shared their time and insights for the benefit of this research. Special thanks also go to Steve Sokol and Robin Cammarota at the American Council on Germany, and all those at the council who supported this project.*

*This brief was made possible by the generous support of the American Council on Germany, where the author was a DZ Bank Scholar on Transatlantic Business and Finance.*

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