LEGAL ANALYSIS OF SELECT ISSUES UNDER THE EU-CHINA COMPREHENSIVE AGREEMENT ON INVESTMENT

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List of abbreviations

CETA – EU-Canada Comprehensive Economic and Trade Agreement

ChAFTA – China-Australia Free Trade Agreement

CPC – Central Product Classification

CSCS – Corporate Social Credit System

DSB –Dispute Settlement Body

DSM – Dispute Settlement Mechanism

EC – European Communities

EU – European Union

FDI – Foreign Direct Investment

FIL – China Foreign Investment Law of 2019

FTAs – Free Trade Agreements

FTT – Forced Transfer of Technology

GATS – General Agreement on Trade in Services

ILO – International Labour Organization

ISIC – International Standard Industrial Classification of all Economic Activities

MFN – Most-Favoured-Nation Treatment

MOFCOM – Ministry of Commerce

MS – (EU) Member State

NDC – Nationally Determined Contributions

NDRC – National Development and Reform Commission

NEV – New Energy Vehicle

NSL – National Security Law

NT – National Treatment

OEM – Original Equipment Manufacturer

SOEs – State Owned Enterprises

SPS Committee – Sanitary and Phytosanitary Committee

TRIPS – Agreement on Trade-Related Aspects of Intellectual Property Rights

TSD – Trade and Sustainable Chapter

UEL – Unreliable Entity List

UNFCCC – United Nations Framework Convention on Climate Change

VCLT – Vienna Convention on the Law of Treaties

WTO – World Trade Organisation

Executive Summary

- The objective of the present study is to provide a comprehensive legal analysis of certain fundamental aspects of EU-China Comprehensive Agreement on Investment. More specifically, it investigates thoroughly national treatment commitments (with a focus on NEVs), and reflects on the extension thereof, also in light of Chinese relevant domestic law. The study continues discussing national security matters within the legal framework of CAI and the Chinese National Security Law. It examines the dispute settlement mechanism enshrined in the treaty and the legal viability of retaliatory and cross-retaliatory measures, both under CAI and EU law. The study proceeds by engaging in an assessment of political risk and coercion, in particular in relation with the corporate social credit system (CSCS), and questions whether and how the CSCS interacts with CAI and with what consequences. Finally, the study analysis the Sustainable Development Section of CAI and exposes its mostly hortatory language and lack of stringent obligations, also in light of both EU and China's carbon neutrality and sustainability objectives.
- The numerous reservations and limitations on liberalization in CAI could partially offset new market openings of CAI's Section II. Annex I is subject to a standstill and ratchet effect, which means that future amendments to the limitations listed are also exempted from NT obligations, insofar as they are less restrictive than the limitations prescribed in the CAI. Annex II applies to existing and prospective measures, which means that China is not restricted to only liberalising amendments but can also adopt more restrictive measures.
- Annex III identifies the sectors in which China undertakes specific commitments for market access; yet, these liberalization commitments remain subject to 'measures relating to qualification requirements and procedures, technical standards and licensing requirements and procedures.'
- Important reservations and limitations to liberalization exist for new industries, the automotive sector, manufacturing and minerals. In sectors like medicine and telecommunications, where some notable concessions have been made, factors possibly limiting the apparent liberalization have been identified.
- China's Foreign Investment Law (FIL) had already made important openings for foreign investors. In comparison to China's FIL, the CAI makes further market access commitments in the sectors of medicine, telecommunications, and new energy vehicles. Even if the market openings in CAI are only marginal vis-à-vis China's FIL, unilateral liberalisation does not offer the assurances of a binding international agreement.
- Annex X, which lifts limitations on market access for NEVs subject to an investment threshold of at least USD 1 billion, is legally binding for the contracting parties. Its status as legally binding is derived from a systematic interpretation of the role the Annexes play in the agreement.
- Neither Annex III nor Annex X are subject to a standstill clause (or to a ratchet clause). The restrictions for investment in NEVs in Annex III – of which Annex X constitutes an exception – are understood not as derogations from the principle of non-discrimination but rather as conditions to the granting of market access.

- The benefits of Annex X extend solely to EU investors. Manufacturing operations are beyond the definitional scope of GATS and, as such, MFN commitments do not apply.
- When unpacking the clause 'in order to intensify cooperation in the field of new energy vehicles between both Parties', the emphasis should be placed on its aspirational, political, and strategic dimensions, as opposed to its legal significance.
- On limitations for EU investors with regards to investment in NEVs.
    - Limitations for investments *below* the USD 1 billion threshold: Capacity limits and targeted output are set by the government and ad hoc regulation in different provinces may discourage foreign investors. Limitations related to overcapacity favour businesses already operating, which have not only captured a significant part of the market share, but also have a first mover advantage in exhausting the capacity limits as set by the government.
    - Limitations for investments *above* the USD 1 billion threshold: The threshold will exclude start-ups or small and medium-sized enterprises. EU manufacturers may still face general limitations related to the regulatory environment and consumer preferences, as well as to infrastructure development (e.g., battery manufacturing).

- The Chinese notion of national security included in the Measures for National Security Review is to be interpreted according to the definition provided in the National Security Law (NSL) of 2015. The NSL definition is relatively broad and encompasses threats to 'sovereignty, unity and territorial integrity, the welfare of the people, the sustained development of the economy and society and other major State interests'.
- The instrument stipulating the Measures for National Security Review is not explicitly carved-out from CAI, either in the main text or its Annexes. However, it is reasonable to think that such carve-out will be included in the Annex referred to under Section II, Article 2 (market access), which is currently missing from the agreement. In any event, measures taken under this instrument might be justified under Section VI, Subsection II, Article 10 (security exceptions). Yet, these two alternatives would likely imply a difference in the extent of the review conducted by arbitration panels in case of disputes.
- The Chinese concept of national security expanded significantly in connection with China's entry in the global market. This mainly depends on the understanding that economic growth and development can ensure security and reduce social unrest. Hence economic development is heavily entrenched with national security.
- This protean understanding is not necessarily compatible with the interpretation provided by international dispute settlement bodies. CAI either explicitly incorporates or includes substantively equivalent WTO obligations and mandates arbitration panels to take into consideration WTO case-law. Therefore, it seems unlikely that the Chinese notion of national security could be upheld in the context of CAI Article 10 (Security Exceptions).
- IIAs concluded by China are varied in terms of pre-establishment commitments and security exceptions. This potentially allows more space of maneuver for China to justify actions on grounds of national security in the context of IIAs. Yet, China has also constantly manifested its (formal) intention to adhere to multilateral trade and investment rules. This does not necessarily mean that China will not (ab)use national security exceptions under Article 10 CAI or fully exclude its National Security Review from the scope of application of CAI. However, it might indicate a certain attitude of

restraint on the part of China in the context of international dispute settlement around national security issues.

- The restriction of cross-retaliation to exceptional circumstances is consistent with cross-retaliation rules in the WTO DSU and other major trade agreements. As goods are not covered by the CAI, it is not unusual that cross-retaliation in the goods sector is not allowed.
- Under the CAI the EU could suspend obligations in such a way that is expropriatory, and it would be up to the EU to decide whether it can take such measures based on its external obligations or internal law (and whether to change internal law to accommodate suspension).
- The potential effectiveness of the DSM is a political question, as the EU can take retaliatory measures but whether this will induce compliance depends on many other non-legal factors.
- China's retaliatory/coercive measures against Australia have not been prevented, deterred, or addressed by ChAFTA. Australia has not, to public knowledge, made use of the ChAFTA DSM, preferring to take their disputes to the WTO. The CAI DSM is very similar to that of the ChAFTA, with some extra procedural detail. There is no reason to think that the CAI provides any more protection against state-supported coercive measures than ChAFTA.
- CAI includes a number of articulate 'level-playing field' provisions, which – to a certain extent – go beyond what is already agreed at the WTO level, but also in comparison to what is provided at the domestic level. Whether these provisions will be effective depends on actual implementation and enforcement.
- The same applies to CAI provisions heavily constricting forced transfer of technology (FTT). While some of these provisions might be subject to abuse, this is not due to the way these are formulated. In fact, these rules are, at least formally, reasonably strict. Yet, politicization cannot be completely removed via legal means.
- The Corporate Social Credit System (CSCS) does not *per se* target foreign companies. Foreign companies might be disadvantaged by the substantive rules and instruments that the CSCS aims at enforcing. However, this does not depend directly on the CSCS, but rather on the underlying substantive provisions.
- Depending on local/sectoral implementation and requirements, CSCS might potentially breach CAI provisions on transparency, clarity, and timely publication of laws and regulations – as well as guarantees of judicial review. In terms of CAI liberalization commitments, CSCS could remain unchallenged, since China might successfully invoke Section VI, Subsection II, Article 4 (GATT-like general exceptions) to justify CSCS related enforcement and sanctions.
- CAI Section on Sustainable Development is unlikely to bring about transformative change. There is no concrete evidence that CAI will facilitate China in achieving carbon neutrality by 2060.
- The main deficiencies of the Sustainable Development Section are the eminently hortatory provisions and the weak dispute settlement system. Overall, this Section does not constitute a major breakthrough vis-à-vis other EU TSD Chapters.
- On the positive side, the Section on Sustainable Development could facilitate dialogue and cooperation on sustainable development issues. It could thus create a 'forum for socialization', where shared values could be forged and sustained. This in turn could lead to faster climate action by both China and the EU. Yet, the potential for such 'socialization' function is hard to assess empirically, as it will depend on a wide variety of factors related to, among others, geopolitics.

1. National Treatment in the context of CAI

1.1. A short introduction

In the last couple of decades, China has gradually opened up its market and undergone a process of liberalization for foreign investments. Such process has been spurred and regulated by both international and domestic law. Internationally, China joined the WTO in 2001 and, in this context, it has undertaken several commitments under the General Agreement on Trade in Services (GATS). Unilaterally, China has progressively opened its market to foreign investors through several laws, culminating in the adoption of the 2019 China Foreign Investment Law (FIL). The EU – China Comprehensive Agreement on Investment (CAI) follows this pattern of progressive liberalization by establishing new market openings.

CAI can be seen as deepening the liberalization process mainly in two ways. Firstly, it expands the commitments undertaken by China in GATS. Under GATS, China made a number of commitments on all modes. The commitments made under Mode 3 (commercial presence)[1] have been criticized for being under-ambitious and it has been argued that critical markets remain foreclosed to foreign investors.[2] In this respect, CAI increases the number of sectors liberalized. According to one study 'China completely opens to foreign investment in eight sectors that were previously closed in its WTO schedule. … China partially opens to foreign investment in eleven sectors that were previously closed in its WTO schedule.'[3] Secondly, CAI 'hardens' some of the unilateral openings already undertaken under domestic law (most importantly the 2019 FIL and the 2020 Negative List) by turning them into international obligations, as will be discussed in Section 2.

The EU Commission Director General for Trade has stated that the additional market openings beyond the existing ones are 'notably, in sectors of key EU interests, manufacturing, electric cars, private health care, cloud services and auxiliary air transport services.'[4] In many quarters, CAI has been saluted as introducing welcome developments, such as the rules prohibiting forced transfer of technology, new liberalization commitments on specific sectors, transparency rules on subsidies in services, new rules on State Owned Enterprises (SOEs) and, last but not least, rules on sustainable trade.

CAI has been characterized as a *sui generis* agreement, as it is neither a traditional free trade agreement nor a typical investment agreement. Section II, titled 'Liberalisation of Investments' establishes a variety of rules on market access, performance requirements, such as prohibition on forced transfer of technology, and national treatment.[5] Market access (e.g. quantitative limitations affecting the operation of covered of enterprises) is granted to sectors and sub-

[1] For an overview Aaditya Mattoo, 'China's Accession to the WTO: The Services Dimension', Journal of International Economic Law (2003), 6:2, 299–339.

[2] See Mavroidis and Sapir in connection to Lardy's (2019) conclusion 'that various lucrative services markets in China remain closed to foreign suppliers', Petros C. Mavroidis and André Sapir, 'Complaints against China: (EUPHORIA EXITS AND DYSPHORIA ENTERS)', in 'China and the WTO. Why Multilateralism Still Matters' (Mavroidis and Sapir eds.), Princeton University Press, 2021, at. 92.

[3] Uri Dadush and André Sapir, 'Is the European Union's investment agreement with China underrated?' 09/21 Bruegel Policy Contribution (April 2021), at 6.

[4] For example, see the speech of Sabine Weyand at https://www.piie.com/events/eu-china-comprehensive-agreement-investment-will-it-be-game-changer

[5] Markus Krajewski, 'Dancing with the Dragon: The new EU-China Investment Agreement', 05-01-2021, Verfassung blog, On matters constitutional, https://verfassungsblog.de/dancing-with-the-dragon/ and Guillaume Van der Loo, 'Lost in translation? The Comprehensive Agreement on Investment and EU–China Trade Relations', 03-06-2021, Discussion Paper, Europe in The World Programme Europe's Political Economy Programme at 5.

sectors specifically indicated in Annex III (positive list approach).[6] Other liberalization requirements (e.g. rules on performance requirements) are liberalised following a negative list.[7] Audiovisual services, the great bulk of air transport services and 'activities supplied in the exercise of government authority' are excluded at the outset from the scope of application of Section II CAI.[8]

1.2. Unpacking National Treatment in CAI: The Scope of Reservations

National Treatment (NT) is one of the cornerstones of Section II. Introduced as a general rule in Article 4, NT is subject to several limitations – some of which are strictly defined and some of which allow broader margins of discretion.

Annex I and II to Section II, in conformity with Article 7, list a wide variety of measures which are not subject to NT (negative lists). Annex I, which applies to already existing measures, lists 36 entries. Annex I is subject to a standstill clause, which means that future amendments to the limitations listed are also exempted from NT obligations, insofar as they are less restrictive than the limitations prescribed in the CAI.[9] Annex II, applying to existing and prospective measures, lists 17 entries. These entries are not subject to a standstill clause, which means that China is not restricted to only liberalising amendments but can also adopt more restrictive measures.[10] These entries also form the 'hard core' of NT reservations and include fields such as social services, cultural heritage, and atomic energy. Annex II purposefully opts for a broad scope, as in most entries 'China reserves the right to adopt or maintain any measure', with respect to the different covered areas. Among the entries of Annex II, special attention should be paid to the provision for '**new industries**' (Entry 15). China reserves the right to adopt any measures with respect to a new industry, which is defined as 'an economic activity that does not exist as of the date of entry into force of this Agreement and that cannot be classified in the fourth version of International Standard Industrial Classification of all Economic Activities (ISIC) published by Statistical Office of the United Nations in 2008'.[11] The definition leaves a significant interpretative space, as when an economic activity can be said to 'exist' may be disputed, especially considering the only slightly different variations and format emerging technologies may assume. At the same time, the ISIC dates from 2008, which means that certain areas, especially with regards to digital services, are excluded. As such, the 'new industry' provision could potentially have implications for emerging industries, for example in the fields of Artificial Intelligence, blockchain, or robotics. It is also worth pointing out that the 'new industry' reservation did not appear in previous free trade agreement concluded by the EU, such the Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada or the Free Trade Agreement with the Republic of Korea, nor does it feature in China's schedule of commitments of the GATS.

Annex III identifies the sectors in which China undertakes specific commitments for market access; yet, these liberalization commitments remain subject to 'measures relating to qualification requirements and procedures, technical standards and licensing requirements and procedures.'[12] Given that one important obstacle for foreign investors has been the opacity of

[6] See Section II, Annex III.
[7] See Section II, Annex I and II.
[8] See Section II, Article 1(2).
[9] Section II, Article 7(1)(c).
[10] Section II, 7(2). Annex II Explanatory Note 1.
[11] Annex II, Entry 15 (2).
[12] See the Explanatory Note to Annex III.

Chinese domestic law, regulations, and administrative system, CAI may yield less liberalisation than what an analysis of the individual sectors may suggest.

Against this background, it is worth noting that to fully appreciate the potential scope and depth of the liberalization of investments under CAI, the multitudes of reservations and limitations on liberalization of the 3 Annexes taken together ought to be considered. In the following we consider some of the areas of key interests for EU investors and offer a preliminary assessment of the relative CAI provisions. These have been generally identified as New Energy Vehicles (NEVs), manufacturing, telecommunications (cloud services), private hospitals, and minerals.[13]

In the **automotive sector**, while current joint venture restrictions will be phased out by 2022 independent of CAI ratification and there is an opening of market access for NEVs, the current regime of national treatment reservations remains important for EU investors, especially considering that the automotive sector accounts for one of the largest shares of EU foreign direct investment in China.[14] In fact, 'the establishment of new traditional fuel-powered motor vehicle enterprises is prohibited' and increasing capacity for already existing companies is subjected to a long list of conditions.[15] In addition, in the NEV market, which promises to be particularly important in the next decade, China's concessions allow EU firms to invest with a number of limitations.[16] As will be discussed in more detail in Section 2, the formal limitations relate either to overcapacity in a given province or to the investment threshold of USD 1 billion, which poses a hurdle for smaller firms and start-ups. Given that the market opening for electronic vehicles has been largely considered one of the most important achievements for EU investors, the CAI provisions on this are discussed separately below.

Item 12 in Annex III of CAI introduces market access commitments in the **manufacturing sector**. This might be a welcome development for some industries, e.g. chemical and food processing industries. Yet, in this context it is worth recalling that the trade of a number of relevant manufactured commodities remain subject to state trading administration. In fact, as per Entry 7 in Annex I of CAI, the import and export of the certain goods (listed in Annex 2A1 and Annex 2A2 to the WTO Protocol on the Accession of the People's Republic of China) are subject to state trading administration. This means in practice that foreign investors investing in the manufacturing of listed goods will operate in markets, which are not fully liberalized. As per Article 11 of the Foreign Trade Law of The People's Republic of China (2004), '[t]he State may implement state trading on certain goods. The import and export of the goods subject to state trading shall be operated only by the authorized enterprises unless the state allows the import and export of certain quantities of the goods subject to state trading to be operated by

[13] According to the statistics publicized by the European Commission, 28% of EU companies in China invest in the automotive sector and 22% in basic materials including chemicals See, European Commission, EU & China Comprehensive Agreement on Investment, Fact sheet, European Commission, 2020, https://trade.ec.europa.eu/doclib/docs/2020/december/tradoc_159239.pdf

[14] Dadush and Sapir (n. 3), at 6. See also the report produced by the Rhodium Group for the European Commission 'Cross Border Monitor of China - EU direct investment' (2019) available at: https://trade.ec.europa.eu/doclib/docs/2019/april/tradoc_157871.pdf,according to which the automotive sector accounted for the largest share of EU FDI in China in 2018.

[15] Annex III, W1.

[16] See below, Section 2.

the enterprises without authorization.'[17] Goods still subject to state trading in China include, among others, sugar, grain, tobacco, cotton, tea and oil (crude and processed).[18]
The liberalization in the sector of **medicine** has been generally listed as a good result of the CAI negotiations. In this sector, the CAI establishes an allegedly exceptional regime for EU investors, allowing them to establish wholly foreign owned private hospitals and clinics (excluding Traditional Chinese Medicine) in eight Chinese cities and one area (Beijing, Tianjin, Shanghai, Nanjing, Suzhou, Fuzhou, Guangzhou, Shenzhen and the whole island of Hainan).[19] This is a departure from GATS, where the liberalization was subjected to a joint venture form, although foreign majority ownership was permitted.[20] However, the liberalization of the medicine sector remains subject to quantitative needs limits (a similar provision is included in the GATS schedule).[21] This quantitative limitation is vaguely formulated, as assessing what constitute China's needs may be rather controversial. The vagueness of the formulation may suggest that in the future such criterion could be used to de facto limit the opening to foreign investors in this area, even if theoretically NT will continue to apply.

In the field of exploration and exploitation of **minerals**, according to the CAI, foreign investors may not invest in 'the exploration, exploitation or ore dressing of rare earth' and of tungsten, while engaging in mineral geology is also forbidden.[22] This reservation is important in light of China's resources in rare earth minerals and their importance for global supply chains, especially for emerging clean energy technologies. Rare earth minerals are critical for the batteries and motors of new energy vehicles, for wind turbines and solar panels, but also for computers, catalysts in oil refineries, fibre optics, televisions, microphones, etc. China is home to approximately one-third of global rare-earth reserves and is responsible for 85% to 90% of the processing operations that convert mined rare earths into metals and magnets.[23] As their importance for clean energy transition becomes apparent, rare-earth minerals increasingly become a field of geopolitical antagonism.[24] In this context, it is worth recalling that China has been imposing several restrictions on exports of raw materials and rare earths. The US, the EU and other WTO Members have challenged such restrictions before the WTO adjudicatory

[17] Foreign Trade Law of The People's Republic of China (2004) Available in English at http://english.mofcom.gov.cn/article/policyrelease/Businessregulations/201303/20130300045871.shtml
[18] WTO, Trade Policy Review Body, Trade Policy Review, Report by the Secretariat, China, WT/TPR/S/375 6 June 2018, at 87. Some of the mentioned commodities are subjected to state trading for imports and other for exports, for more details see, WTO, Working Party on State Trading Enterprises, State Trading New and Full Notification Pursuant To Article Xvii:4(A) of The GATT 1994 and Paragraph 1 of The Understanding on the Interpretation of Article XVII China, G/STR/N/16/CHN, G/STR/N/17/CHN, 24 July 2018.
[19] Annex I, Entry 18 (1).
[20] See The People's Republic of China, Schedule of Specific Commitments, GATS/SC/135, 14 February 2002 (Specific Commitment A. Professional Services (h) Medical and dental services.
[21] Annex III, II 1(h).
[22] Annex I, Entry 16.
[23] Tae-Yoon Kim and Milosz Karpinski 'Clean energy progress after the Covid-19 crisis will need reliable supplies of critical minerals' (2020), available at: https://www.iea.org/articles/clean-energy-progress-after-the-covid-19-crisis-will-need-reliable-supplies-of-critical-minerals. There have also been talks about China's policy becoming more restrictive with regards to exports of such minerals. So far, such limitations have not materialized, see Sun Yu and Demetri Sevastopulo, 'China targets rare earth export curbs to hobble US defence industry' (2021), FT available at: https://www.ft.com/content/d3ed83f4-19bc-4d16-b510-415749c032c1
[24] Jane Nakano, 'The Geopolitics of Critical Minerals Supply Chain' (2021), Center for Strategic and International Studies, available at: https://csis-website-prod.s3.amazonaws.com/s3fs-public/publication/210311_Nakano_Critical_Minerals.pdf?DR03x5jIrwLnNjmPDD3SZjEkGEZFEcgt.
See, also Panel Report, *China-Measures Related to the Exportation of Rare Earths, Tungsten, and Molybdenum* – WT/ DS431/ R, WT/ DS432/ R, and WT/ DS433/ R., 26 March 2014, where the Panel found that China's export duties on rare earths, tungsten, and molybdenum were inconsistent with its Accession Protocol.

bodies.[25] In the first two disputes, China's export restrictions have been found to violate WTO law, while the third dispute is still pending. Even if formally China has reformed its measures to comply with the rulings of the WTO Appellate Body, in practice it has maintained similar export restrictions. This persistent breach of WTO rules on export restrictions by China is aligned with China's 'economic policy goals of building up strategic emerging technology industries.'[26] Against this background, restricting the sector from foreign investment appears as an expected, and yet important, reservation from national treatment obligations.

In the **auxiliary air transport services**, concessions are made in Annex I, Entry 10, where it is provided that after one year from the date of entry into force of this Agreement, EU investors may invest in computer reservation system services. Such opening, however, may be limited in the future as per Annex II, Entry 7, 'China reserves the right to adopt or maintain any reciprocal measure with respect to computer reservation system services and ground handling services.'

1.3. Comparing the CAI to the Foreign Investment Law and Negative List of 2020

China's Foreign Investment Law was enacted on March 15, 2019 and took effect on January 1, 2020.[27] This is the latest step in a way of progressive liberalisation of China's investment regime. Liberalisation by means of unilateral measures is not a novelty for China. One prominent area of such unilateral liberalising initiatives has been China's manufacturing sector, which now forms a significant part of global value chains.[28] On the contrary, unilateral FILs have been less prevalent in the services sector, which overall remains less liberalised.[29] Multilateral measures have played a greater role in moderately advancing liberalisation in the services sector.

The most recent FIL establishes a regime of pre-establishment national treatment for foreign investors, according to which foreign investors must receive the same treatment as their domestic counterparts.[30] In addition, the FIL makes reference to the Negative List that compiles the exceptions from national treatment and the relevant administrative measures for market access for foreign investment in particular sectors. Importantly, according to Article 4 of the FIL, 'if more preferential treatment concerning access is offered to a foreign investor under any international treaty or agreement that the People's Republic of China concludes or joins in,

[25] See respectively, Appellate Body Report, *China – Measures Related to the Exportation of Various Raw Materials*, WT/DS394/AB/R, WT/DS395/AB/R, WT/DS398/AB/R, 30 January 2012; Appellate Body Report, *China – Measures Related to the Exportation of Rare Earths, Tungsten, and Molybdenum*, WT/DS431/AB/R, WT/DS432/AB/R, WT/DS435/AB/R, 7 August 2014; Request for Consultations by the United States, *China – Export Duties on Certain Raw Materials*, WT/DS508/1, 14 July 2016; Request for Consultations by the European Union, *China – Duties and Other Measures Concerning the Exportation of Certain Raw Materials*, WT/DS509/1, 25 July 2016.

[26] Mark Wu, 'China's Export Restrictions and the Limits of WTO Law', World Trade Review (2017), 16: 4,. 673–691, at 688. For a short discussion of China's lack of compliance with WTO law, see Section 4.6.

[27] China's Foreign Investment Law (2019), English translation available at: https://investmentpolicy.unctad.org/investment-laws/laws/317/china-foreign-investment-law-of-the-people-s-republic-of-china.

[28] As discussed by Dadush and Sapir (n.3), China's Foreign Direct Investment (FDI) Restrictiveness Index in manufacturing decreased from 0.379 in 1997 to 0.073 in 2019, at 4.

[29] Dadush and Sapir (n. 3) 5, China's FDI restrictiveness score decreased from 0.739 in 1997 to 0.306 in 2019, which is still significantly higher than the average score of less than 0.06 in the three biggest EU countries.

[30] FIL, Article 4.

relevant provisions in such treaty or agreement may prevail'. Therefore, insofar as CAI provisions set higher standards of market access for foreign investors, they take precedence over all other provisions.

Comparing the most recent Negative List (2020)[31], which contains China's unilateral commitments and national treaty reservations, and the exceptions from market access and national treatment obligations as listed in the CAI reveals that there is very little difference between them. In other words, only few concrete concessions regarding market access for EU investors are granted by the CAI that do not already form part of the unilateral liberalisation of the Chinese market as advanced by the FLI and the Negative List.

One sector where the CAI makes concrete further commitments of market openness, as opposed to the Negative List, is that of **medical institutions**. While the 2020 Negative List provides for foreign investment in medical institutions only in the form of equity joint ventures, as mentioned above the CAI establishes an exceptional regime for EU investors, allowing them to establish wholly foreign owned private hospitals and clinics (excluding Traditional Chinese Medicine) in eight Chinese cities and one area (Beijing, Tianjin, Shanghai, Nanjing, Suzhou, Fuzhou, Guangzhou, Shenzhen and the whole island of Hainan).[32] The majority of doctors and medical personnel of both joint ventures and wholly foreign owned hospital and clinics must be of Chinese nationality. Yet, as discussed above the quantitative limitations included in Annex III may offsets some of the benefits of such provisions.

Another sector where the CAI makes a concession that is new in comparison to the 2020 Negative List is **telecommunications**. More specifically, the CAI allows EU investors to invest in data center (cloud) services with shareholding ownership limited at 50%.[33] This is an option that was not available under the 2020 Negative List, which only referred to possible joint ventures in value-added telecommunications services (except for ecommerce, domestic multi-party communications, storage-forwarding and call centers).[34] The cloud market could indeed be an important field for future investments, especially as the data of Chinese citizens must be stored in mainland China.[35] However, China's strict requirements on data storage and security assessment could discourage foreign investors. This could be the case as cloud service providers are under 'continuous supervision' by China's cyberspace authorities and must go through regular security assessments.[36] While China makes an opening for investments in data centres, the shareholding ownership limitations continue to apply for both value-added telecommunications and cloud services, while foreign investors are also excluded from internet access services.

In other sectors, the provisions of the CAI repeat and further refine the standards of market access guaranteed by the 2020 Negative List. For example, in the field of **financial services** the 2020 Negative List lifts the shareholding restrictions for securities companies that were still

[31] Special Administrative Measures on Access to Foreign Investment (Negative List 2020), English translation available at: http://is.mofcom.gov.cn/article/supplydemandofchina/202107/20210703174729.shtmlf
[32] Annex I, Entry 18 (1).
[33] Annex I, Entry 12 (2).
[34] Negative List 2020 (n. 31), No 16.
[35] Hari Kannan and Christopher Thomas, 'Public cloud in China: Big challenges, big upside' (2018), available at: https://www.mckinsey.com/industries/technology-media-and-telecommunications/our-insights/public-cloud-in-china-big-challenges-big-upside
[36] See Yihong Zhang, 'Up in the clouds: Impact of the EU-China CAI' (2021), discussing China's Cybersecurity Law and the Security Assessment Measures of Cloud Computing Services, available at: https://artnet.unescap.org/trade/advocacy/e-forum/clouds-impact-eu-china-cai.

part of the 2019 Negative List. The CAI specifies that foreign investors investing in securities companies shall be foreign financial institutions, while stipulating further restrictions to market access that do not constitute reservations from national treatment.[37] In the **automotive sector**, the CAI repeats the joint venture requirements of the 2020 Negative List, as well as the commitment to remove these restrictions by 2022. The CAI contains more specific provisions and commitment to market access with regards to New Energy Vehicles (NEVs), as will be discussed in detail in Section 2.

Although there are not numerous concessions in the CAI to which China has not committed already unilaterally, it is worth mentioning that unilateral liberalisation does not offer the assurances of a binding international agreement. The commitments that form part of the CAI cannot be revoked unilaterally, while the exceptions to national treatment obligations are subject to a standstill and ratchet effect, which means that any future amendments must be less restrictive than the standards established by the CAI.[38]

[37] Annex I, Entry 28. Further specific restrictions (not ownership related) listed in Annex III, II 7.
[38] See below, Section 2.

2. NEVs: Commitments for a new market

A Brief Introduction to New Energy Vehicles (NEVs)

As New Energy Vehicles (NEVs) are designated by the Chinese government the vehicles that are partially or fully powered by electricity. China has been a market leader in the field, with currently 4.92 million such units operating on Chinese streets and a sales forecast of 1.9 million units for 2021 and 2.7 million vehicles for 2022.[39] In 2020, nearly half of the world's plug-in electric car production was in China, which also produces about half of world's plug-in electric vehicle batteries and has developed a home-grown battery manufacturing supply chain.[40] This has been a result of a coordinated, government-led approach, involving initially subsidies to producers and regulations designed to raise demand but also, more recently, to directly increase the market share of NEVs – including for example a mandate to producers that a certain fraction of the cars sold must be battery-powered.[41] The importance of the Chinese market for battery-powered vehicles makes the relevant provisions in the CAI agreement particularly relevant for European investors.

Relevant CAI Provisions

2.1. Reservations Against National Treatment Obligations in the Automotive Sector

The CAI provides for a special regime of market liberalisation with regards to NEVs. First of all, it specifies that NEVs do not fall under the general reservations assumed by China against national treatment obligations in the automotive sector.[42] In the sector of 'Manufacture of Transport Equipment', China imposes two limitations of market access with regards to passenger cars: 1) For investments by foreign investors in the manufacture of passenger cars, shareholding percentage of the Chinese party shall not be less than 50%. 2) A foreign investor may establish less than two (included) equity joint ventures that manufacture complete automobiles of the same category (passenger cars) within the territory of China, unless the foreign investor acquires other domestic automakers jointly with the Chinese party to the equity joint venture. These restrictions will be in place until 2022 but they *do not apply* to NEVs. Importantly, these limitations apply to the acquisition of existing fuel-powered motor vehicle enterprises. Reflecting China's intention to promote NEVs, the establishment of new fuel-powered motor vehicle enterprises is in principle prohibited and only exceptionally possible under restrictive conditions.[43]

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[39] Hui He and Lingzhi Jin, 'How China put nearly 5 million new energy vehicles on the road in one decade' (2021), available at: https://theicct.org/blog/staff/china-new-energy-vehicles-jan2021. 'China new energy vehicle sales to grow over 40%/yr in next 5 yrs -industry body' (2021), available at: https://www.reuters.com/business/autos-transportation/china-nev-sales-grow-over-40-each-year-next-5-years-industry-body-2021-06-18/

[40] Hui He and Lingzhi Jin (n. 39).

[41] Nancy W Stauffer, 'China's transition to electric vehicles: Benefits will come, but at what cost?' (2020), available at: https://energy.mit.edu/news/chinas-transition-to-electric-vehicles/

[42] Annex I Entry 6 (3). Yet, as already pointed out in Section 1, the automotive sector has already been progressively liberalized unilaterally, most notably since the 2018 edition of the Negative List and the Foreign Investment Law of 2020. China has granted limited market to its automotive sector already since its entry to the WTO in 2001, although at the time requiring foreign investors to receive prior authorisation and limiting them to joint-venture arrangement with local partners.

[43] Annex III, 12W (1).

2.2. Market Access Limitations Specific to the New Energy Vehicles Market

However, the CAI does impose certain more specific limitations on market access for new investors with regards to NEVs. A new independent investment project for NEVs by an enterprise may only be established in a province meeting the following conditions, essentially related to overcapacity in a given province: (1) The utilisation rate of automobile capacity in such a province in the previous two years was higher than the average level of the same product category; (2) The existing independent investment projects for NEVs of identical product categories by an enterprise in such a province have all been completed and the annual output has reached its constructed scale.[44] It is clarified that existing automobile manufacturers in China that expand their businesses to the production of NEVs are not subject to these conditions.

Yet, the above limitations on market access for NEV investment projects are lifted when the total investment amount for the project is no less than USD 1 billion.[45] The expressed purpose of this provision is to 'intensify cooperation' between the parties in the field of NEVs. Annex X, Paragraph 2, which is the focus of this analysis, reads:

> 'In order to intensify the cooperation in the field of new energy vehicles between both Parties, Paragraph 2 in 12W of China's Schedule of specific commitments and limitations on market access does not apply to the establishment of a new independent investment project for pure electric vehicles by an enterprise that is invested by an investor of the other Party provided that the total investment amount for this project is no less than USD 1 billion'.

The Legal Status of Annex X

2.3. Annex X as Legally Binding

Annex X, which lifts limitations on market access for NEVs subject to an investment threshold of at least USD 1 billion, is legally binding for the contracting parties. Its status as legally binding is derived from a systematic interpretation of the role the Annexes play in the agreement.

In light of Article 31 (2) of the Vienna Convention on the Law of Treaties (VCLT), as well as of the principle of integration, according to which a treaty must be read as a whole,[46] the Annexes form an inextricable part of the context of the treaty. In this case, the main text of the treaty repeatedly refers to Annexes as specifications of the binding terms of the agreement, thus according to them the same legal binding character. One such instance is Section II, Article 7, which specifies that National Treatment and Most-Favoured-Nation Treatment (MFN) clauses do not apply if the measures are consistent with the reservations listed in Annex I. A more important instance for interpreting the status of Annex X is that of Section II, Article 2(1) on Market Access. This article specifies that 'market access commitments…are subject to the terms, limitations and conditions specified in [Annex]'. The Annex this provision refers to is Annex III – 'Schedule of specific commitments and limitations on market access' (Positive List). Indeed, Annex III clarifies[47] that it sets out the limitations that do not conform with the

[44] Annex III, 12W (2).
[45] Annex X, Paragraph 2.
[46] ICJ Second Admissions Case [1950] ICJ Rep 4, 8.
[47] Annex III, Article 1(b).

article on Market Access.[48] It is this Annex that contains the market access limitations for investments in NEVs.

Annex X must be read jointly with Annex III and accorded the same legal status. This is because Annex X is a clarification (Paragraph 1) and an exception (Paragraph 2) of the limitations established in Annex III. Considering that Annexes are repeatedly referred to as specific, binding terms of the agreement and considering that Annex III in particular is referred to as the binding regime providing the limitations that do not conform with the obligations of Market Access, Annex X must also be understood, in good faith, as being equally legally binding for the contracting parties. It would, indeed, be against the principle of good faith and contrary to interpreting a treaty in its context and in light of its object and purpose as established by 31 VCLT to accord a binding character to the limitations of market access established in Annex III but not to their exception in Annex X – insofar as no indication is provided that a separate normative status is reserved for Annex X.

2.4. Rules Applicable: Standstill and Ratchet Clauses and the Questionable Exclusivity for EU Enterprises

The purpose of standstill and ratchet clauses is to frame the scope of reservations for the future.[49] Standstill clauses refer to the commitment to keep the market at least as open in the future as it was at the time of the conclusion of the agreement. In other words, if reservations against liberalising measures (e.g., National Treatment) are subject to standstill clauses, then subsequent unilateral regulation of the particular area where a reservation has been made (e.g., automotive sector) cannot be more restrictive than what is provided in the agreement. Ratchet clauses guarantee that subsequent unilateral measures that liberalise the market above the levels prescribed by the agreement are 'locked in' and cannot be reversed.

Following the negative list approach employed in the CAI, and as provided by Section II, Article 7, China's reservations under Annex I are subject to a standstill and ratchet effect. The form of the reservations is in that sense comparable to recent free trade agreements concluded by EU, such as the CETA. According to Article 7.1 (ii)(c), the liberalising provisions of the Section on Liberalisation of Investment (including National Treatment and MFN Treatment) do not apply for China to

> 'an amendment to any non-conforming measure referred to in subparagraph (a) [i.e,, measures of the central government consistent with reservations listed in Annex I] to the extent that the amendment does not decrease the conformity of the measure, as it existed immediately before the amendment'.

The standstill and ratchet effect extends to the reservations related to the automotive industry of traditional fuel-powered automobiles, which make part of Annex I.[50] As such, China may amend existing non-conforming measures (i.e., reservations of the Negative List) that are excluded by the provisions on liberalisation only insofar as the new regulations are not more restrictive than what the current negative list, as included in the agreement, provides.

[48] Section II, Article 2.
[49] On the definition of the terms as employed in EU Free Trade Agreements, see 'Services and investment in EU trade deals: Using 'positive' and 'negative' lists' (2016), available at https://trade.ec.europa.eu/doclib/docs/2016/april/tradoc_154427.pdf
[50] Annex I, Entry 6.

Furthermore, further liberalization undertaken by China reflects in its commitments under the CAI, as per the clause cited above. For national treatment obligations not to apply to an amendment to a reservation, the amendment has to be less restrictive than the preceding stage of market openness. The same obligation also applies to the EU.

While Article 7(ii)(c) explicitly refers to the reservations of Annex I (including those in the 'traditional' automotive sector), it is less clear whether the standstill and ratchet effect could be said to extend also to Annex X. Annex X should be understood as a self-standing exception to China's 'Schedule of specific commitments and limitations on market access' (Annex III), which lists the limitations for investment in NEVs. Yet, Article 7 is silent with regards to Annex III, not mentioning the limitations included therein as grounds for derogating from the liberalising provisions of National Treatment or MFN Treatment. Annex III, in its explanatory note, also outlines that it only covers limitations that do not conform with obligations imposed by the provisions on Market Access.[51] Therefore, the restrictions for investment in NEVs in Annex III – of which Annex X constitutes an exception – are understood not as derogations from the principle of non-discrimination but rather as conditions to the granting of market access in the first place and could apply to national investors as well.[52] In other words, if the establishment of an investment does not comply to the conditions set by Annex III, the question of national treatment does not apply anyway. Not being understood as legitimate exceptions to the principle of non-discrimination, neither Annex III nor Annex X are subject to a standstill clause (or to a ratchet clause).

However, this does not mean China can unilaterally scrap the provision of Annex X which, as discussed above, is legally binding. As the limitations to market access in NEVs are not framed as exceptions from the principle of non-discrimination, China cannot amend the relevant non-conforming measures as Article 7(ii)(c) allows. This means that the current level of restriction to market access is locked-in, and further restrictions cannot be implemented. At the same time, should China further liberalise access to the NEV market for foreign investors (e.g., by lowering the USD 1 billion threshold), this new unilateral liberalisation does not become part of the agreement and can always be reversed.

A final point concerns the extent to which Annex X can benefit solely EU-based enterprises. While the provision of Paragraph 2 clearly targets EU-based enterprises, enabling them to invest in NEVs without limitation if the investment amount is no less than USD 1 billion, it could be argued that the concession would have to be extended to all other WTO members on the basis of the MFN principle. The General Agreement on Tariffs and Trade (GATT) defines narrowly the exceptions from the MFN principle and requires that, in the case of regional free trade areas, 'the duties and other restrictive regulations of commerce […] are eliminated ***on substantially all the trade*** between the constituent territories in products originating in such territories'.[53] The Appellate Body has ruled that 'substantially all trade' is not equated to *all* trade but, at the same time, it means more than *some* of the trade.[54] Similarly, the General Agreement on Trade in Services (GATS), in Article V, also requires that regional agreements liberalizing trade in services must have 'substantial sectoral coverage' and provide for 'the

[51] Annex III, Article 1(b).
[52] As allowed by the General Agreement on Trade and Services (GATS), Article XVI.
[53] Article XXIV:8 (b).
[54] Appellate Body Report, *Turkey - Restrictions on Imports of Textile and Clothing Products*, WT/DS34/AB/R, 22 October 1999, , para. 48. See, also Matthias Herdegen, 'Principles of International Economic Law', Oxford University Press, 2016, at. 215.

absence or elimination of substantially all discrimination' in the sectors covered. It is questionable whether the limited scope of the CAI agreement – which covers primarily trade in services with a particular focus on commercial presence – can satisfy the substantial sectoral coverage requirement and thus constitute a legitimate exception from the MFN principle.[55] A negative answer to this question would mean that the preferential provision of Annex X would have to be extended to all other WTO members.[56]

While this reasoning is applicable for other aspects of the agreement, manufacturing operations are beyond the definitional scope of GATS and, as such, MFN commitments do not apply – which inevitably means that the benefits of Annex X extend solely to EU investors.[57] While the term 'service' is not defined in the GATS agreement, the scope of services covered by GATS is clarified in the document MTN.GNS/W/120 entitled 'Services Sectoral Classification List' (W/120). The W/120 list, in turn, was based on the provisional Central Product Classification (CPC) of the Department of Economic and Social Affairs of the United Nations Secretariat. The W/120 lists among the covered services 'Services Incidental to Manufacturing', indicating as the corresponding section in the CPC 'Services incidental to the manufacture of metal products, machinery and equipment' (CPC 885). This category could cover manufacturing 'on a fee or contract basis', which, according to the explanatory notes of the CPC includes 'manufacturing services rendered to others where the raw materials…are not owned by the manufacturer'. However, the GATS employs a positive list approach and China has not included 'services incidental to manufacturing' in its schedule of commitments. Besides, Annex X specifically refers to 'the establishment of a new independent investment project'. If the investor-manufacturer owns the input and resulting products and does not hire the services of other manufacturers, it excludes the applicability of GATS Article V, which would otherwise extend the MFN principle to all contracting parties of the GATS agreement.

2.5. The meaning of 'cooperation'

The rationale for the provision of Annex II Paragraph 2, which carves out an exception from the market access limitations for NEVs set by Annex III 12 W (2), is to 'intensify cooperation in the field of new energy vehicles between both Parties'. 'Cooperation' is not concretely defined in the agreement. From the preamble of the agreement, as well as from secondary policy documents, 'cooperation' should be understood as having both a commercial and a political dimension, while the urge to intensify such cooperation should be understood as primarily aspirational and not substantive.

A first reference that may guide the interpretation of its meaning is found in the first considerant of the Preamble, according to which:

[55] See, also Henry Gao, 'The EU-China Comprehensive Agreement on Investment: Strategic Opportunity Meets Strategic Autonomy' (2021), available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3843434

[56] Regional trade agreements are subject to the scrutiny of the Committee on Regional Trade Agreements as to their compatibility with Article XXIV:8 of the GATT and Article V of the GATS. For a short discussion of the question of China's compliance with WTO law, see below Section 4.6.

[57] According to Sabine Weyand, Director General for Trade for the EU Commission, 'The situation is different with regard to manufacturing because there are no MFN commitments in the WTO on investment in manufacturing. So these benefits accrue to EU investors', *Trade Talks* Episode 148, available at: https://www.tradetalkspodcast.com/wp-content/uploads/2021/01/Episode-148-Transcript.pdf

> ‘NOTING with satisfaction the continuous expansion of exchanges and **cooperation** (sic) between China and the EU since the establishment of diplomatic relations in 1975, notably through the EU-China Trade and Cooperation Agreement of 1985, and the establishment of the China-EU Comprehensive Strategic Partnership in 2003’.

In the preamble, cooperation is conceived in strategic and formalist terms. It denotes not only the building of a relationship of diplomatic and commercial trust but also the eventual establishment of legal bonds. Perhaps more importantly, the preamble sheds light to the double meaning of cooperation as both commercial/economic and political. This is also indicated by the choice of points of reference. While the EU-China Trade and Cooperation Agreement of 1985 has been the legal instrument upon which bilateral trade and economic relations between the parties are based, the China-EU Comprehensive Strategic Partnership articulated broader aspirations of political dialogue for global governance, as well as of human rights dialogue and better addressing security issues.[58]

Similarly, Chinese policy documents highlight that market liberalisation serves the goal of enhancing political cooperation, in addition to the economic advantages of a potential increase in trade surplus. In ‘China's Policy Paper on the EU: Deepen the China-EU Comprehensive Strategic Partnership for Mutual Benefit and Win-win Cooperation’ of 2014[59], it states that ‘China stands ready to work with the EU to bring the two major markets closer to build a China-EU community of interests […] carry out win-win cooperation at higher levels and contribute more to the building of an open world economy’.[60] Similarly, the Central Committee’s Recommendations on Making the 14th Five-year Plan recommended that China shall ‘actively seek change’ and try to ‘promote international cooperation by taking advantage of China’s huge market’.[61] Literature in the field underlines that increased political cooperation is a likely development, suggesting that despite the limited nature of new concessions, ‘the agreement will likely boost not only investment but also trade, and it will likely establish a closer political cooperation between China and the European Union’.[62] The strategic dimension of the CAI has also been highlighted in analyses that focus on the tripartite trade and investment relations among the EU, the U.S., and China.[63]

Overall, when unpacking the clause ‘in order to intensify cooperation in the field of new energy vehicles between both Parties’, the emphasis, at least at this stage, should be placed on its aspirational, political, and strategic dimensions, as opposed to its legal significance. The aspirational tone conveys the intention to use market liberalisation to forge broader economic and political alliances.

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[58] ‘EU-China: Commission adopts new strategy for a maturing partnership’, IP/03/1231 Brussels, 10 September 2003.

[59] The policy paper is available at https://www.chinadaily.com.cn/world/cn_eu/2014-04/02/content_17401044.htm. Similar open-ended commitments to win-win co-operation featured in China's Policy Paper on European Union of 2018, available at: https://www.fmprc.gov.cn/mfa_eng/wjdt_665385/2649_665393/201812/t20181218_679556.html

[60] ‘China's Policy Paper on the EU: Deepen the China-EU Comprehensive Strategic Partnership for Mutual Benefit and Win-win Cooperation’, 2 April 2014.

[61] 中共中央关于制定国民经济和社会发展第十四个五年规划和二〇三五年远景目标的建议，（2020 年10月29 日中国共产党第十九届中央委员会第五次全体会议通过 cited in Henry Gao (n. 55).

[62] Peter H Egger, ‘Putting the China-EU comprehensive agreement on investment in context’, China Economic Journal, (2021), 14:2, 187-199.

[63] Henry Gao (n. 55).

2.6 Limitations for EU Manufacturers

EU manufacturers of NEVs in China could undertake investments *below* the USD 1 billion threshold, insofar as there is no overcapacity in the province where the investment is to take place.[64] A possible limitation, in such a case, relates to the fact that capacity limits and targeted output are set by the government. It is, therefore, conceivable, that top-down, ad hoc regulation of capacity limits in different provinces may discourage foreign investors. In addition, limitations related to overcapacity favour businesses already operating, which have not only captured a significant part of the market share, but also have a first mover advantage in exhausting the capacity limits as set by the government.

As far as the threshold of USD 1 billion is concerned, the amount seems to correspond to recent investments in NEVs around the world.[65] However, it is a threshold that will exclude start-ups or small and medium-sized enterprises. This might further reinforce the position of Chinese OEMs (Original Equipment Manufacturers), which have been dominant in the NEV market.[66] In addition, automakers that have already invested in China through joint ventures may find the threshold for *new* investment projects onerous and expensive. EU manufacturers that invest in China with investments that *exceed* this threshold may still face general limitations related to the regulatory environment and consumer preferences. For example, as subsidy policies are being phased out and the field is becoming more crowded by local and foreign competitors (e.g., keeping in mind the mandate on automakers to produce battery-powered cars), investors might have to compete in a more competitive market.

In terms of infrastructure development, one issue that is critical for NEV manufacturing and could present a limitation for EU manufacturers is battery manufacturing. Ownership restrictions in the field were lifted by the Negative List of 2017 and the 'white list' was removed in 2019,[67] which means that foreign investors may now invest in the production of batteries for NEVs. While such investment is possible, the difficulties of establishing battery production at scale might pose a problem for foreign investors, eventually forcing them to use locally made batteries or establish joint venture with local manufacturers.[68] There are multiple reasons why establishing industrial capacity in a field already dominated by local firms is challenging. These relate to existing infrastructure capacities and market share dominance – especially as global OEMs are tying up with local suppliers – but also extend to the access of the necessary

[64] Annex III, 12W (2).

[65] General Motors plans to invest more than $1 billion in a plant in Mexico, see https://www.cnbc.com/2021/04/29/gm-to-invest-1-billion-in-mexico-for-electric-vehicle-production.html. Ford invests $1 billion in German plant, see https://www.cnbc.com/2021/02/17/ford-invests-1-billion-in-german-electric-vehicle-plant.html.

[66] Clemens Dabelstein et. al., 'Winning the Chinese BEV market: How leading international OEMs compete' (2021), available at: https://www.mckinsey.com/industries/automotive-and-assembly/our-insights/winning-the-chinese-bev-market-how-leading-international-oems-compete

[67] The importance of the 'white list' was that only NEVs that used batteries offered by suppliers included on the 'white list' were qualified to enter the Catalogue of Recommended Models for the Project of New Energy Automobile Popularization and Application, the prerequisite to receive subsidies. See, 'China annuls 'white list' of recommended EV battery suppliers, MIIT' (2019), available at: https://autonews.gasgoo.com/china_news/70016084.html

[68] See, Trefor Moss 'One Chinese Firm Dominates Electric Car Battery Business --- Beijing pressured foreign auto makers to use its batteries' Wall Street Journal, (2019), A.1. Numerous automakers (SAIC Group, Geely Group, Dongfeng Motor, FAW Group, BAIC Group, GAC Group, and BMW Brilliance) have chosen to establish joint ventures with China's biggest battery producer, CATL, see 'China's 'White list' of power battery companies abolished' (2019), available at: http://english.news18a.com/news/english_134466.html

materials and components.[69] It is worth pointing out that the exploration, exploitation and smelting of rare earth minerals is an exception from national treatment principles,[70] which means that necessary minerals for lithium-ion battery production would have to be imported or traded locally. This exposes supply chain management to further difficulties associated with the contingent trade policies of the central government.

Arguably, the biggest contribution of CAI in the liberalisation of the automotive sector – currently the most important sector for EU investment in China – is the moderate liberalisation of investment in NEVs. This should not necessarily be construed as a simple concession by China but rather as consistent with China's strategic positioning as a market leader in NEVs. At a time when the NEV market is growing at an increasing pace and when Chinese firms have already been established and infrastructure capacities solidified, allowing European investors to invest in China may also support domestic goals related to further market growth and even environmental objectives. Taking into consideration the size and potential of the Chinese market but also the limitations and difficulties for foreign investors, European investors will have to carefully consider the benefits guaranteed by the exceptional regime of Annex X.

[69] See, KPMG, 'Sinocharged: The bright future of China's electric vehicle market' (2021) 19, available at: https://assets.kpmg/content/dam/kpmg/cn/pdf/en/2021/01/2020-china-leading-autotech-50.pdf

[70] Annex I, Entry 4. The specific reference to tungsten might also impede innovation, as research has shown that it may be useful for lithium-ion energy storage, see Kent J. Griffith, Kamila M. Wiaderek, Giannantonio Cibin, Lauren E. Marbella & Clare P. Grey, 'Niobium tungsten oxides for high-rate lithium-ion energy storage' Nature (2018), 556-563, at 559.

3. National Security: An expansive notion

3.1. The National Security Review and its implications in a nutshell

On December 19, 2020, the NDRC (National Development and Reform Commission) and the Ministry of Commerce (MOFCOM) jointly released the 'Measures for Security Review of Foreign Investment' (hereinafter the Measures).[71] This instrument implements related provisions included in the 2015 National Security Law (NSL) at Article 59 and the already mentioned 2020 Foreign Investment Law, at Article 35. The Measures set out criteria and procedures for a security review of foreign direct investments into China. Together with the 2020 Negative List and the publication of the Unreliable Entity List (UEL), the Measures complete the foreign investment regulatory environment of China.

The Measures are an attempt at both counterbalancing recent investment liberalization commitments and responding to similar initiatives enacted worldwide, including the EU Foreign Direct Investment (FDI) Screening Regulation.[72] Security reviews had already been in place in China as of 2011 for the purposes of Mergers and Acquisitions operations. The new Measures extend the scope of application of the previous instruments to both direct and indirect FDIs and – importantly for CAI – also to greenfield investments, regardless whether the investment targets a foreign-invested-enterprise or a domestic enterprise.[73] Sectors covered by the instrument are wide-ranging: investments related to military and national defense; 'important' agricultural products; 'important' energy and resources; 'major' equipment manufacturing; 'important' infrastructures; 'important' cultural products and services; 'important' IT and internet online products and services; 'important' financial services, key technologies, and other 'important' sectors. There is however a qualifier: except for the military sector, the instrument applies where the investor acquires 'actual' control of the investee enterprise. This means either more than 50% in equity interest, less than 50% but investor's voting rights 'enable it to exercise major influence' (Article 4(2)(2)), or other circumstances that might as well accrue the investor major influence over investee's decision-making processes.

Admittedly, significant space is left to the interpretation of a number of elements pertaining to the Measures. As to the sectors, there is no term of reference or threshold for what is to be understood under 'important'. Likewise, sector categories are not clearly defined and the safeguard clause 'other important sectors' that have a bearing on national security can certainly expand the regulatory discretion of the 'Working Mechanism', the NSR (National Security

[71] The Measures have entered into force on January 18, 2021. An unofficial English translation is available at https://foreigninvestment.bakermckenzie.com/2021/01/06/china-enacts-new-foreign-investment-security-review-measures/. For a comment on the Measures see Covington and Burling LLP, 'China Issues Measures on National Security Review of Foreign Investment', Lexology, available at https://www.lexology.com/library/detail.aspx?g=fe0d4559-bc89-49c8-b3d5-236ae6cc3fce; Lester Ross, Kenneth Zhou, Tingting Liu, 'China's New Foreign Investment Security Review Measures', WilmerHale, available at https://www.wilmerhale.com/en/insights/client-alerts/20201222-chinas-new-foreign-investment-security-review-measures; King & Wood Mallesons, 'China Releases National Security Review Rules Version 2.0', China Law Insight, https://www.chinalawinsight.com/2020/12/articles/corporate-ma/ma/china-releases-national-security-review-rules-version-2-0/.

[72] EU Reg. 2019/452.

[73] China Law Insight (n. 71).

Review) office supposed to organize and run the review. The same applies to the 'major' influence requirement needed to establish actual control.

The question is how relevant the Measures are for the commitments achieved in CAI. The national security review includes certain sectors, which are anyway excluded both by the CAI and the 2020 Negative List. In relation to these sectors, the Measures are possibly forward looking and might signal the intention of China to gradually open its market and further liberalize investments in other areas. Yet – crucially for CAI – the new Measures do apply to sectors that have been liberalized,[74] most importantly the manufacturing sector, but also financial services, information technology and Internet services.[75] The question is therefore to what extent this new instrument might constrain commitments crystallized in CAI and how these relate to the security exception clause formulated in the agreement in Section VI, Subsection II, Article 10. The following section will focus on these two aspects.

3.2. Relevance for CAI commitments

Albeit issued around the same time of the publication of the current text of CAI, the Measures are not explicitly referred to in the agreement. Therefore, one might think that the Measures do not apply to the liberalization commitments stipulated in CAI: pursuant to Article 4 of the FIL, 'if more preferential treatment concerning access is offered to a foreign investor under any international treaty or agreement that the People's Republic of China concludes or joins in, relevant provisions in such treaty or agreement may prevail'.

However, the fact that the Measures are not mentioned in CAI, does not take away from their potential relevance. At a general level, FDI screening instruments like the Measures might circumscribe market access and (pre-establishment) national treatment commitments included in investment agreements. In other words, these screening instruments may still apply, and their application might be justified on different grounds, depending on the architecture of the treaty.[76] If an agreement does not include market access or pre-establishment commitments, then the screening can be conducted without raising any issue of compatibility. Differently, where investment liberalization provisions are included in the treaty, national treatment is extended to admission and establishment. In the latter case, liberalization commitments are often accompanied by long negative lists, which exclude entire sectors from market access and national treatment and formulate lengthy and articulate reservations. These reservations typically insert FDI screening instruments for the purposes of national security among non-conforming measures, which means that these instruments are excluded from liberalization commitments.[77]

As per the current text, CAI presents a more uncertain situation. In fact, the Measures do not appear in the Schedule of commitments of China, either in the limitations to the positive list (Annex III) for market access, or among the reservations of Annex I and II. It also seems unreasonable to read the National Security Review as implicitly included. The Explanatory

[74] See Section 1 of this report for an extensive analysis of the liberalization commitments.

[75] Cloud services might be considered as such for the purposes of the Measures, although these are listed under 'Telecommunications' under CAI.

[76] Cheng Bian, 'Foreign Direct Investment Screening and National Security: Reducing Regulatory Hurdles to Investors Through Induced Reciprocity', Journal of World Investment and Trade, (2021), 22, 561-595. Lizzie Knight and Tania Voon, 'The Evolution of National Security at the Interface between Domestic and International Investment Law and Policy', Journal of World Investment and Trade (2020), 21, 104-139.

[77] Bian, supra n.76, at 588 makes the example of CETA: Annex I, Schedule of Canada, Reservation I-C-1 excludes the Investment Canada Act and its implementing Investment Canada Regulations from the application of pre-establishment national treatment. The same goes for EU MS ex ante screening instruments.

notes to Annex I in combination with Section II, Article 7 and the explanatory note to Annex III seem to clearly indicate that the relevant '(non-conforming) measures' are only those explicitly listed therein.[78] Arguably, this implies that the scope of the reservations either under the positive or negative lists is strict and cannot be expanded or reduced via interpretation.[79] Thus, whatever is not covered by the reservations, limitations or carve-outs is fully subject to market access and (pre- and post-establishment) national treatment.

Following this logic, since the Measures are not explicitly excluded, these should not apply to the liberalization commitments of CAI.

However, this does not exhaust the relevance of the Measures. In fact, the EU Commission itself has insisted that both the EU FDI screening regulation and its Chinese counterpart will remain applicable in parallel to CAI.[80] Meaning, liberalization commitments might be affected by decisions taken under the Measures, for example a refusal to grant clearance or a decision of approval with conditions.

There are two main ways by which the Measures might still have significance for CAI. First, under Section II, Article 2, market access is granted 'subject to the terms, limitations and conditions specified in [Annex]'. It is reasonable to imagine that this 'unnamed'/ 'unnumbered' Annex will include various conditions to market access, including a provision explicitly excluding FDI screening instruments of both parties (including MS regulations) from liberalization commitments[81], as this is already the case for other EU FTAs. Secondly, Section VI, Article 10 (Security exceptions) might justify departure from liberalization commitments on national security grounds – as it will be further elaborated below.

The two alternatives are different also in terms of justiciability. The 'unnamed' Annex might explicitly exclude screening instruments from dispute settlement[82]. This is the case in ChAFTA for example.[83] Short of such an exclusion, if the 'unnamed' Annex incorporates the Measures under the reservations to market access and national treatment, a CAI arbitral panel might still entertain disputes around the applicability of this carve-out. The scrutiny would arguably be limited to verify whether a certain governmental action is or not within the scope of the reservation. Yet, considering the wide discretion stipulated in the National Security Review instrument, it is difficult to imagine that the panel would reach an opposite conclusion from that of the government, beyond manifest cases. Furthermore, the panel would not be competent to conduct a substantive national security assessment. How China conducts this review and what are the relevant factors at play are outside the panel's authority. Its competence would be circumscribed to verifying whether a certain governmental decision/measure falls within the scope of the reservation.

[78] Annex III explicitly excludes measures related to qualification and licensing requirements and procedures, as well as technical standards.

[79] Annex II is excluded from this reasoning since – as explained in Section 1 – China retains the right to introduce stricter measures.

[80] See for example the Answer of the EU Commission to (parliamentary) question E-002005/2021.

[81] Nikolaus von Jacobs, 'The Eu-China Comprehensive Agreement on Investment: A First Glance', MWE Insights, February 5, 2021, available at https://www.mwe.com/insights/the-eu-china-comprehensive-agreement-on-investment-a-first-glance/.

[82] As reported by Knight/Voon n. 76, this is the case for the Korea-Australia FTA, Annex 11-G: 'A decision by Australia with respect to whether or not to refuse, or impose orders or conditions on, an investment that is subject to review under Australia's foreign investment policy shall not be subject to the dispute settlement provisions of Section B.'

[83] Ibid., at 135.

In the absence of an explicit carve-out, a decision adopted pursuant the Measures might be justified under Section VI, Article 10 (Security exceptions).[84] The panel would probably have more 'bite' in this case. As it will be further articulated below, the debate as to whether national security exceptions included in international trade and investment agreements are self-judging is quite open. Yet, judicial and quasi-judicial bodies do not necessarily adopt a referential attitude in this regard. A CAI panel could therefore engage in a substantive (more stringent) review of national security justifications under Section VI, Article 10.
It is important to note that while no monetary penalties are provided for by the Measures, failure to comply might imply, beyond divestment and disposal of interests and assets, a violation to be possibly recorded in the Corporate Social Credit System.[85]

3.3 The 'Chinese' notion of national security in the Measures

The Measures do not include a definition of national security. Considering that these are meant to implement the 2019 FIL (Article 35) and the 2015 NSL (Article 59), the relevant definition applying to security review is the one provided for in the 2015 NSL at Article 2. The provision is quite encompassing and refers to 'a situation in which the national regime, sovereignty, unity and territorial integrity, the welfare of the people, the sustained development of the economy and society and other major state interests are not in danger or under internal or external threat, as well as the capacity to ensure a sustained situation of security'. The definition stipulated therein signals a specific understanding of the Chinese notion of national security. Until early 2000s, the understanding of national security in China was limited to external threats and interference,[86] and reflected a fairly 'traditional' approach. This changed with China's accession to WTO in 2001 and its entry into the global market and its increasing role as a major international trade player. National security was re-conceptualized as being intimately interconnected with economic development: the underlying idea is that economic growth and development can ensure (internal) security and reduce social unrest. Thus, both internal and external threats are perceived as 'not just military or political, but also economic and development-related'.[87] Inevitably, this has determined a significant extension of the notion of national security, which now permeates an ever-increasing number of sectors. This evolution is specific to the Chinese path towards liberalization.[88] Yet, there is an undoubtedly global trend in the overexpansion of the concept of national security, which tends to be either overtly or vaguely defined also in other jurisdictions. Such a re-conceptualization significantly

[84] This seems to be reflected in the Answer supra n.80 regarding the Measures: 'CAI also provides for a robust state-to-state dispute settlement mechanism and institutional framework to monitor the implementation of the commitments. While CAI allows each side to take measures for security and public order purposes, reflecting the World Trade Organisation (WTO) standard, possible abuses by China towards EU investors in the implementation of its foreign investment security review could thus be addressed through the Agreement's monitoring and dispute settlement mechanism, if there is a breach of CAI. Furthermore, any breach of China's WTO commitments can be also addressed with dispute settlement action under the WTO.'
[85] On which, see below Section 5.
[86] Chieh Huang, 'China's Take on National Security and Its Implications for the Evolution of International Economic Law', Legal Issues of Economic Integration, (2021), 2, 119-146. The author signals how the change in the responsible administrative authorities (which now includes the NDRC) for the Measures is another indication of the expansion of the notion of national security towards economic and development dimensions.
[87] Ibid., at 123.
[88] More generally on the Chinese experience towards liberalization see Gregory Shaffer and Henry Gao, 'A New Chinese Economic Law Order?' in 'Emerging Powers and the World Trading System. The Past and Future of International Economic Law' (Gregory Shaffer ed.), Cambridge University Press, 2021, 222-268.

influences the way states try to claim security exceptions in the context of international trade and investment rules.[89]

The question is whether this 'protean' understanding of national security is compatible with these rules and with the interpretation thereof provided by international dispute settlement bodies. The following paragraphs look first at the WTO regime and the international investment agreements China is party to, and then analyze the security exceptions as stipulated in CAI.

3.4. Chinese practice concerning security exception in trade and investment agreements

Securitization of international economic relationships is a growing concern. In the past, states had generally shown some level of 'self-restraint' when it came to justifying their measures on security grounds.[90] Yet, this has changed in the recent years. States have been invoking security exceptions more often and have been claiming that security exception provisions in trade and investment agreements are self-judging and thus non-justiciable. However, in the context of the WTO, the security exception in Art. XXI GATT has been interpreted as being subject to review, since it entails objectively assessable elements.[91] This view was upheld both by the panel in *Russia-Transit* and the panel in *Saudi Arabia-Measures*.[92] The disputes are particularly relevant for CAI essentially for two reasons. First – as discussed below – the security exception included in the agreement (Section VI, Article 10), practically replicates Art. XXI GATT. Secondly, because of China's position on this matter. The country filed a third-party submission in *Russia-Transit*, maintaining that measures taken under GATT Art. XXI are in fact reviewable and justiciable.[93] The country insisted that a balance should be struck between the actual protection of the essential security interests of a state and the risk of the exception being abused and invoked in bad faith. China maintained the same position in the submission of its WTO reform proposal filed in May 2019, where it stated that states should exercise restraint in the invocation of security exceptions and suggested a number of (stricter) instruments to address potential abuse.[94] Generally speaking – at least formally – China has repeatedly shown its intention to comply with multilateral trade rules[95].

Chinese IIAs present instead a more varying environment in terms of security exceptions and liberalization commitments. First, it seems that only two IIAs include pre-establishment

[89] See amongst others J. Benton Heath, 'The New National Security Challenge to the Economic Order', Yale Law Journal, (2020), 129, 1020-1098; Mona Pinchis-Paulsen, 'Trade Multilateralism and U.S. National Security: The Making of the GATT Security Exceptions', Michigan Journal of International Law, (2020), 41, 109-193; Anthea Roberts, Henrique Choer Moraes, Victor Ferguson, 'Toward a Geoeconomic Order in International Trade and Investment', Journal of International Economic Law, (2019), 22, 655-676; Geraldo Vidigal, 'WTO Adjudication and the Security Exception: Something Old, Something New, Something Borrowed – Something Blue?' Legal Issues of Economic Integration, (2019), 46, 203-224.

[90] Jürgen Kurtz, Baihua Gong, 'The EU–China Comprehensive Agreement on Investment: A Model for Investment Coverage in the World Trade Organization?' RSC Working Paper 2021/58.

[91] Panel Report, *Russia-Measures Concerning Traffic in Transit on Ukrainian Products*, WT/DS512/R, 5 April 2019.

[92] Panel Report, *Saudi Arabia-Measures Concerning the Protection of Intellectual Property Rights*, WT/DS567/R, 16 June 2020.

[93] Huang (n.86), at 140.

[94] Kurtz/Gong (n. 90), at 11.

[95] On the more general level of compliance of China with WTO law, see below section 4.6.

national treatment.[96] Of the two, the Japan-Korea-China treaty includes a security exception clause very similar to GATT Art. XXI and CAI Section VI, Article 10. The treaty with Hong Kong instead includes a much wider clause: 'This Agreement shall not be construed to require (…) to prevent one side from taking any measures that it considers necessary to protect its essential security interests' (Article 22(5)). As reported by Huang, of the other China IIAs, which are limited to post-establishment commitments, only twelve include explicit security exceptions. Some contain broadly drafted clauses – and thus allow for more malleability in interpretation – others, like the 2008 China-Colombia BIT, include stricter provisions. In the absence of an explicit security exception, invoking essential interests to justify an otherwise infringing measure might be more complicated. Yet, China might still rely on other type of defenses, like the customary international law doctrine of necessity. Unsurprisingly, considering the fragmented nature of international investment adjudication, arbitral case-law is quite scattered on this issue. Investment tribunals have issued divergent interpretations of security related exceptions and related defenses like the state of necessity, with some tribunals showing more deference than others.[97] This makes it difficult to identify a trend in the international investment realm; much depends on the text of the security exception under scrutiny.

3.5 The compatibility of the Chinese notion of national security with Section VI, Subsection II, Article 10 CAI

How is this debate relevant to CAI? As already mentioned, Section VI, Subsection II, Article 10 of the agreement incorporates Art. XXI GATT (which in turn is incorporated in Art. XIVbis GATS). The transposability of trade-like security exceptions into investment related treaties can be a complex exercise and not always necessarily a straightforward one.[98] Yet, CAI makes it clear that 'The panel shall also take into account relevant interpretations in reports of WTO panels and the Appellate Body adopted by the WTO Dispute Settlement Body relating to substantially equivalent obligations.' (Section V, Article 11, fn. 1). Consequently, one would expect the panels constituted under CAI to take a WTO compatible approach to the security exceptions included in the agreement, and thus adopt a more restrictive stance.

Section VI, Article 10, just like GATT Art. XXI, provides a basis for one of the parties to adopt measures diverging from treaty commitments, when these are necessary to protect its 'essential interests'. The provision includes some qualifiers: measures necessary for the protection of 'essential interests' are either related to war, military and nuclear activities and products, or are taken in times of war and emergency in international relations. As already clarified above, WTO case-law considers such exception to be reviewable, and most likely so would a CAI arbitral panel. As to the substantive interpretation of the clause – besides the quite straightforward references to war, military and nuclear activities – the main question revolves around the understanding of 'emergency in international relations'. The panel in *Russia-Transit*

[96] As indicated by Huang, supra n. 86, 138, these are the 2012 China-Japan-Korea Trilateral Investment Agreement and 2017 China Hong-Kong CEPA Investment Agreement.

[97] Knight/Voon, (n. 76), suggesting that leaving security exception determinations to investment tribunals might be suboptimal. Similarly, Kürtz et al., (n. 90), at 11.

[98] For diverging views see Diane Desierto, 'Public Policy in International Investment and Trade Law: Community Expectations and Functional Decision-Making', Florida Journal of International Law, (2014), 26, 52-150 and Andrew D. Mitchell, Caroline Henckels, 'Variations on a Theme: Comparing the Concept of "Necessity" in International Investment Law and WTO Law', Chicago Journal of International Law, (2013), 14, 93-164.

stated that '(…) the reference to "war" in conjunction with "or other emergency in international relations" in subparagraph (iii), and the interests that generally arise during war, and from the matters addressed in subparagraphs (i) and (ii), suggest that political or economic differences between Members are not sufficient, of themselves, to constitute an emergency in international relations for purposes of subparagraph (iii) *(….) An emergency in international relations would, therefore, appear to refer generally to a situation of armed conflict, or of latent armed conflict, or of heightened tension or crisis, or of general instability engulfing or surrounding a state* (emphasis added)' (Panel Report, paras. 7.74-7.77). If – as reasonable – a CAI panel takes the same approach, then the Chinese all-encompassing notion of 'national security' would hardly find space under CAI. A more restrictive interpretation of national security would therefore apply. This concerns both the pre-establishment and post-establishment commitments, including the Measures, unless these are explicitly excluded from the scope of the treaty and the dispute settlement mechanism to the extent explained above. Should this be the case, then the restrictive interpretation under Section VI, Article 10 would still be relevant for measures adopted on grounds of national security in the post-establishment phase. The decision of blocking the admission of a foreign investment would instead not be reviewable in substance; at best just to assess whether it falls within the ambit of the reservation. This would inevitably leave quite some discretion to China in the admission of foreign investments. It remains to be seen whether and how the Measures will be excluded from the liberalization commitments of CAI.

Two final brief considerations: as indicated by recent scholarship, besides the specific security and general exception clauses (Section VI, Article 4), CAI still preserves some space for states to control the admission of investments also in other areas: 'the CAI has been complemented by a set of horizontally applicable exceptions based on the WTO approach consisting of (…) taxation flexibilities, balance of payment safeguards and carve-out for prudential measures to protect integrity and stability of the financial systems'.[99] Thus, while officially outside the security realm, other exceptions and carve-outs might still apply to market access.

Finally, the MOFCOM released the Provision on Unreliable Entities List (UEL) in September 2020.[100] The list has been adopted mainly as a response to the US/Huawei saga, yet the measure has a general scope of application. The mechanism for implementation has been set out. Foreign entities might be included in the list and subject to sanctions if they (1) either endanger sovereignty, security, or developmental interests of China, or (2) suspends transactions with legal or natural Chinese persons or applies discriminatory measures. The second category has been defined as 'anti-boycott' and targets companies that have implemented or will implement sanctions or export control restrictions imposed by other countries. From what is publicly known, there is no entity on the list yet. As mentioned above, the UEL might add to the complex records converging in the Corporate Credit Social System, which will be discussed below.

[99] Kürtz et al., (n. 90), at 11.
[100] MOFCOM Order No. 4 of 2020 on Provisions on the Unreliable Entity List, available at http://english.mofcom.gov.cn/article/policyrelease/questions/202009/20200903002580.shtml.

4. CAI Dispute Settlement Mechanism, Cross-retaliatory and Retaliatory measures

4.1 Summary – Cross-retaliation

Cross-retaliation between the trade in services sector and the trade in intellectual property rights sector is allowed in exceptional circumstances. It is normal that retaliation is not allowed in the goods sector because goods are not covered by the CAI. Some, but not all, restrictive measures that would constitute retaliation in the area of investment market access would amount to illegal expropriation or otherwise breach EU law. WTO case law suggests that states may be authorised to suspend obligations in such a way that is expropriatory but it is up to states to decide whether they can take such measures based on their external obligations or domestic law (and whether to change domestic law to accommodate suspension). The effectiveness of the DSM is a political question, as the EU can take retaliatory measures but whether this will induce compliance depends on many other non-legal factors.

Section 4.2 sets out the main features of the DSM. Section 4.3 explains the operation of the limitation on cross-retaliation, while section 4.4 considers the meaning of the cross-retaliation clause in the context of the CAI. Section 4.5 answers the question of whether the EU could retaliate in the area of investment market access, and section 4.6 addresses the question of effectiveness of the DSM.

4.2 Relevant CAI provisions - Section V Dispute Settlement

This section sets out the main features of the DSM. The state-state dispute settlement mechanism of CAI is found in Section V and applies to any dispute concerning the interpretation and application of the provisions of this Agreement,[101] except where application of Section V is excluded (for example, Sub-section 4 of Section IV Investment and Sustainable Development excludes that section from application of Section V).[102] It is pertinent to set out some of the features of Section V that are relevant to the question.

Section V sets out a procedure of dispute settlement that contemplates consultations, mediation, mutually agreed solution, and arbitration. If consultations are unsuccessful, the complaining party may proceed directly to request the establishment of an arbitration panel[103] by delivering a written request to the other party identifying the measure at issue and explaining how it constitutes a breach of the Agreement.[104] The task of the arbitral panel is to make findings of facts and on the conformity of the measure(s) at issue with the covered provisions and to deliver a report including a recommendation, if relevant, to bring the measure into conformity with the Agreement.[105] The arbitral panel is required to interpret the provisions of the Agreement in accordance with customary rules on interpretation of public international law, as codified in the Vienna Convention on the Law of Treaties, and – as mentioned earlier – it must also take into account relevant interpretations in reports of WTO panels and the Appellate Body adopted by the WTO Dispute Settlement Body relating to substantially equivalent obligations.[106]

[101] CAI Section V, Article 2.
[102] See below Section 6 on Sustainable Development.
[103] CAI Section V, Article 3(4).
[104] CAI Section V, Article 6.
[105] CAI Section V, Article 9(2).
[106] CAI Section V, Article 11.

The arbitral panel is required to produce a final report setting out its findings of facts, the applicability of the covered provisions and the basic rationale behind any findings and conclusions.[107] The report of the arbitration panel is final and has no binding force except between the Parties and in respect of the matter to which the report refers,[108] meaning that it cannot be enforced extraterritorially and the New York Convention does not apply.[109] Where an arbitration panel concludes that the Party complained against has acted inconsistently with the obligations of the Agreement, it shall recommend that the Party complained against bring the inconsistency into conformity with the Agreement.[110]

The decisions and reports of the arbitration panel shall be unconditionally accepted by the Parties and they shall not create any rights or obligations with respect to natural or legal persons.[111] Within 30 days the Party complained against must deliver a notification to the complaining Party of its intentions in respect of compliance.[112] If immediate compliance is not possible, the party complained against must indicate that it will bring itself into compliance with the Agreement within a reasonable period of time (normally not longer than 15 months from the issuance of the arbitral panel's report).[113] If the arbitral panel finds that a party has not complied with its obligations, and the party complained against: a) indicates that it is not possibly to comply, b) fails to indicate its intentions in respect of compliance or c) the arbitral panel finds that measures taken to comply were inconsistent with the Agreement, the party complained against must enter into negotiations for mutually agreeable compensation.[114]

If the Parties fail to reach an agreement on compensation, the complaining Party may deliver a written notification to the Party complained against that it intends to suspend the application of concessions or other obligations under the Agreement[115] (also known as 'retaliation').[116] The level of the suspension of obligations must not exceed the level of the nullification or impairment caused by the violation.[117]

Importantly for the answer to this question, in considering what obligations to suspend:

> (a) the complaining Party should first seek to suspend obligations in the same sector(s) as that affected by the measure that the arbitration panel has found to be inconsistent with the obligations under this Treaty; and
> (b) if the complaining Party considers that it is not practicable or effective in inducing compliance to suspend obligations in the same sector(s), it may suspend obligations in other sectors.[118]

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[107] CAI Section V, Article 12(4).
[108] CAI Section V, Article 12(6).
[109] Amélie Canonne, Lora Verheecke, Maxime Combes and Nicolas Roux, 'Accord UE-Chine : L'UE Rassure les Investisseurs au Mépris des Droits Humains', Aitec and Attac France, April 2021, available at http://aitec.reseau-ipam.org/IMG/pdf/accord_ue_chine_-_rapport_vfin.pdf, 31.
[110] CAI Section V, Article 12(6).
[111] CAI Section V, Article 12(6).
[112] CAI Section V, Article 13(2).
[113] CAI Section V, Article 14(5).
[114] CAI Section V, Article 16(1).
[115] CAI Section V, Article 16(2).
[116] WTO, 'The process — Stages in a typical WTO dispute settlement case', in Dispute Settlement Training Module (WTO, 2004), https://www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c6s10p1_e.htm, 6.10.
[117] CAI Section V, Article 16(4).
[118] CAI Section V, Article 16(4).

If the party complained against notified level of suspension of obligations exceeds the level equivalent to the nullification or impairment caused by the violation, it may seek a decision from the arbitration panel and obligations may not be suspended until the panel has delivered its decision.[119]

If the disputed measure is also an alleged breach of an obligation under another international agreement between the parties, including the WTO Agreement, the Party seeking redress shall select the forum in which to settle the dispute.[120] Once the forum is selected, other fora are excluded unless the selected forum fails to make findings.[121] The CAI does not preclude parties from suspending obligations under other agreements when authorised by the WTO Dispute Settlement Body or other international agreements, and the WTO Agreement or any other international agreement between the Parties shall not be invoked to preclude a Party from suspending obligations pursuant to the CAI dispute settlement mechanism.[122] This means that if one of the parties takes a dispute to the WTO and is authorised to suspend trade obligations, the CAI cannot be used to challenge such measures. Likewise, if one of the parties is authorised to suspend obligations under the CAI by the arbitration panel via the CAI DSM, the WTO DSM cannot be used to challenge the suspension.

The Investment Committee set up by Section VI of the CAI may adopt binding interpretations of the provisions of the Agreement,[123] which would be used by the arbitral panel to interpret the agreement.

4.3 Cross-retaliation only exceptionally permitted

The suspension of obligations in sectors other than those affected by the measure complained about is called cross-retaliation.[124] Cross-retaliation is only exceptionally permitted under the CAI, following the WTO system.

The plain meaning of Section V Article 16(4) of the CAI is that cross-retaliation is permitted: firstly, this section is written in non-mandatory terms, and secondly, cross-retaliation is contemplated in circumstances where the retaliating party considers that it is not practicable or effective in inducing compliance to suspend obligations in the same sector(s). However, the language of this paragraph reflects WTO Dispute Settlement Understanding (DSU) Article 22.3,[125] which has been treated as ensuring the exceptional nature of permissible cross-retaliation. Only three cases have ever been authorised by the WTO DSM for cross-agreement

[119] CAI Section V, Article 16(5).
[120] CAI, Section V, Article 21(1).
[121] CAI, Section V, Article 21(2).
[122] CAI, Section V, Article 21(4).
[123] CAI Section VI, Article 1(5)(iii).
[124] WTO, 'The process — Stages in a typical WTO dispute settlement case', in Dispute Settlement Training Module (WTO, 2004), available at https://www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c6s10p1_e.htm, 6.10.
[125] WTO, Dispute Settlement Rules: Understanding on Rules and Procedures Governing the Settlement of Disputes, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, 1869 U.N.T.S. 401, 33 I.L.M. 1226 (1994), Article 22.3 (hereafter WTO DSU).

retaliation, one in relation to services,[126] and two in relation to intellectual property.[127] The arbitral panel must also take into account relevant interpretations in reports of WTO panels and the Appellate Body adopted by the WTO Dispute Settlement Body relating to substantially equivalent obligations.[128] We can therefore look to WTO case law and interpretation to understand how to interpret CAI provisions such as Article 16(4).

The rationale for the limited authorisation of cross-retaliation by the WTO is that where trade relations are uneven due to differences in the size of trading partners and reliance on certain areas of trade, suspending obligations in the same sector as that where the breach occurred is not likely to be practicable or effective in inducing compliance.[129] In the EC-Bananas III case, the arbitrators considered that suspension in the same sector is unlikely to be effective 'where a great imbalance in terms of trade volume and economic power exists between the complaining party seeking suspension and the other party'.[130] In the US-Gambling case, Antigua successfully argued that if it were to suspend obligations in the travel, transportation and insurances services sectors, the suspension would have very little impact on the United States, while potentially having negative impacts for Antiguan consumers and its economy.[131] Article XXIII.2 of the GATS further stipulates that the dispute settlement body may only authorise suspension of obligations 'if circumstances are serious enough to justify such action'.[132] Based on the WTO case law, as there is not a similar trading power imbalance between the EU and China, and indeed the EU is the larger economy, an arbitral panel is not likely to consider that cross-retaliation should be permitted for the EU under the CAI. However, the parties chose to include the cross-retaliation provisions in the CAI rather than expressly prohibiting cross-retaliation, this could be interpreted as the parties intending for cross-retaliation to be permitted in exceptional circumstances particular to the parties, such as areas where there is a particular trade power imbalance between the EU and China. In any case, it is difficult to speculate with any accuracy how an arbitral panel will interpret these provisions.

[126] Decision by the Arbitrator, *European Communities - Regime for the Importation, Sale and Distribution of Bananas*. Recourse to Arbitration by the European Communities under Article 22.6 DSU, WT/DS27/ARB/ECU, 24 March 2020 (hereinafter EC-Bananas III (Ecuador)).

[127]Decision by the Arbitrator, *United States - Measures Affecting the Cross-Border Supply of Gambling and Betting Services*. Recourse to Arbitration by the United States under Article 22.6 DSU, WT/DS285/ARB 21 December 2007 (hereinafter US-Gambling) and Decision by the Arbitrator, *United States - Subsidies on Upland Cotton*, Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement and United States - Subsidies on Upland Cotton - Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 7.10 of the SCM Agreement, WT/DS267/ARB/1 and/2, 31 August 2009 (hereinafter US-Upland cotton): see Chisik and Chuyi Fang, 'Cross-retaliation and International Dispute Settlement' (2021) Working Papers 078, Ryerson University, Department of Economics, available at https://ideas.repec.org/p/rye/wpaper/wp078.html; Richard Chisik and Harun Onder, 'Does limited punishment limit the scope for cross retaliation?' Economic Inquiry, (2017), 55:3, 1213-1230, at 1214.

[128] CAI Section V, Article 11.

[129] WTO, 'The process — Stages in a typical WTO dispute settlement case', in Dispute Settlement Training Module (WTO, 2004), https://www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c6s10p1_e.htm, 6.10.

[130] EC-Bananas III (Ecuador) (Article 22.6 – EC), para 73.

[131] US–Gambling, decision by the arbitrators, para. 4.49; see also Werner Zdouc, 'Cross-retaliation and suspension under the GATS and TRIPS agreements' in 'The Law, Economics and Politics of Retaliation in WTO Dispute Settlement' (C. Bown & J. Pauwelyn eds), Cambridge University Press, 2010, 515-535.

[132] GATS: General Agreement on Trade in Services, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, 1869 U.N.T.S. 183, 33 I.L.M. 1167 (1994), Article XXIII.2.

4.4 Meaning of Section V Article 16(4) 'should first seek to suspend obligations in the same sector(s) as that affected by the measure'

The CAI does not define the term 'sector', but does define services as including 'any service in any sector except services supplied in the exercise of governmental authority'.[133] Both the EU's and China's Schedules use the term 'sector' to describe each entry/reservation concerning industries or areas such as fishery and education.[134] The WTO DSU defines the term 'sectors' for the purposes of the cross-retaliation provisions in three categories: all goods; services identified in the 'Services Sectoral Classification List'; and with respect to trade-related intellectual property rights, each of the categories of intellectual property rights covered in various sections of the Agreement on TRIPS.[135] In regard to services, the 'Services Sectoral Classification List' contains twelve distinct sectors.[136]

Under the WTO system, retaliatory measures are therefore considered to be 'cross-sector' if they are, for example, imposed in relation to one service sector (e.g. business services) when the measures retaliated against were imposed in relation to another service sector (e.g. communication services); or imposed in relation to intellectual property rights when the measures retaliated against were imposed in relation to services.

The CAI does not cover tariffs or trade barriers on goods, but it does deal with trade in services and trade-related intellectual property rights. As tariffs and trade barriers on goods are not covered by the CAI, for a Party to retaliate in the goods sector (for example by imposing tariffs) in response to a breach of the CAI would be to retaliate outside of the CAI and potentially breach WTO rules where parties to the WTO Agreement have agreed to lower or eliminate tariffs and other trade barriers. It is therefore not unusual or unreasonable that the parties to the CAI cannot cross-retaliate in the goods sector. Most trade agreement retaliation has occurred via imposition of tariffs on the import of targeted goods, and such measures are relatively easier for states to quantify and impose. As discussed in the next section, it may be relatively challenging for the EU to induce compliance with the CAI by suspending investment market access obligations rather than being able to impose retaliatory tariffs as it can where trade in goods is at issue.

4.5 Could the EU retaliate by restricting investment market access for Chinese firms or would this amount to illegal expropriation?

The question of whether retaliatory measures taken by the EU would amount to expropriation depends on the measures, and whether the measures are taken retroactively or prospectively. If restrictions affected already established businesses they could, for example, infringe the prohibition of discrimination on the grounds of nationality set out in Article 18 of the Treaty on the Functioning of the European Union.[137]

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[133] CAI Section I, Article 2.

[134] CAI, Schedules of China, Annex I, Entries 2 and 17; Schedule of the European Union, Annex I, Reservations 14 and 7.

[135] WTO DSU, Article 22(3)(f).

[136] (1) business services; (2) communication services; (3) construction and related engineering services; (4) distribution services; (5) educational services; (6) environmental services; (7) financial services; (8) health-related and social services; (9) tourism and travel-related services; (10) recreational, cultural and sporting services; (11) transport services; and (12) other services not included elsewhere.

[137] The Charter of Fundamental Rights of the European Union applies to the negotiation and implementation of EU legislation and policy both internally as well as in its external relations.

Retaliatory measures applying to firms in the pre-establishment phase would not be expropriatory because the firm would not have established property in the EU. For example, if China breached the CAI in the tourism sector, the EU could restrict the number of Chinese companies that are allowed to establish tourism-related businesses in the EU going forward. This would not infringe property rights because property has not yet been established. However, measures applicable to firms post-establishment may infringe laws or investment agreements prohibiting expropriation. Using the same example, if the EU were to retaliate by preventing already established Chinese tourism businesses from operating, this could be contrary to the property rights of those businesses such as under Article 17 of the EU Charter of Fundamental Rights.[138] The fundamental rights under these instruments are not absolute and the EU may be justified in restricting them in the context of retaliation if proportionality and public interest of the expropriatory measure are proven.[139] It is therefore up to the EU to decide whether it is worthwhile to suspend these obligations given the potential necessity to amend domestic law or compensate the affected investors.

This was discussed in the Bananas III dispute, where Ecuador noted that it could, with authorisation, 'order a commercially present service supplier to stop its activities or impose a supplementary tax on each unit of its service output' but that this would not be practicable because taking measures against 'service suppliers of a particular foreign origin could lead in many jurisdictions to conflicts with rights to, e.g. equal treatment embodied in national legislation or international treaties and would entail substantial administrative difficulties'.[140] The DSB held that:

> 'it does not seem difficult to prevent EC service suppliers (in the preestablishment stage) from establishing themselves in Ecuador. However, it may be possible in theory, but difficult to implement in practice, to prevent already locally established service suppliers of EC origin (in the post-establishment stage) from supplying services within Ecuador's territory. For example, it may cause administrative difficulties to close or limit the service output of a commercial presence in the form of a branch or representative office. Additional legal and administrative difficulties may arise when closing or limiting the output of a commercial presence in the form of an establishment enjoying legal personality in its own right due to the legal protection granted to juridical persons by national or international law.'[141]

The outcome in this case was that the DSB agreed that the circumstances were such that Ecuador should be permitted to cross-retaliate against the European Communities due to the impracticability of regular retaliation. However as noted above, a similar outcome is unlikely between China and the EU.

The retaliatory measures that the EU is able to take against China to induce compliance with the CAI are limited by EU law, meaning that inducing compliance via permissible measures may be complex. Commentators have suggested that there is a 'lack of obvious benefits for

[138] See Mavluda Sattorova, 'Investor Rights Under EU Law and International Investment Law' Journal of World Investment and Trade, (2016), 17, 895-918, at 904; J Sluysmans and E Waring, 'Core Principles of European Expropriation Law' European Property Law Journal, (2016), 5:3, 142-169.
[139] Sattorova n. 138, at 914.
[140] EC-Bananas III (Ecuador), para 113.
[141] EC-Bananas III (Ecuador), para 114.

Chinese investors'[142] and that 'China does not obtain significant new openings in the European market',[143] indicating that there may be little in the way of obligations that the EU could suspend that would be effective in inducing compliance. An exception to this may be the reciprocal residency and work permits for senior managers and specialists working for foreign investors, which has been noted as a 'win' for China given the importance of work and permit difficulties.[144]

4.6 How effective can a DSM be if measures can only be taken in the area of investment market access?

The question of effectiveness of the DSM is predominantly a political one. The institutional infrastructure per se does not give a specific indication as to the potential effectiveness of the mechanism. The CAI DSM is modelled on existing DSMs in the WTO system and trade agreements such as ChAFTA, and aside from providing some additional procedural detail, does not diverge remarkably in its stipulation that complaining parties may only exceptionally cross-retaliate. Cross-retaliation has rarely been used to induce compliance in the WTO system. While the EU has previously successfully retaliated within the same sector as the disputed measures, retaliatory measures involve erecting trade barriers that are likely to harm the domestic economy.[145] In any event, the parties are also able to select the WTO as the dispute resolution forum (as discussed under question 5) where the dispute overlaps with the WTO agreements.

The question of whether suspension of investment market access obligations would induce China to comply with the CAI depends on many non-legal factors such as the lobbying power of those affected by the suspension, the sector in which the disputed measures have been imposed and the political message that China wishes to project at the time. Therefore, it is difficult to predict whether retaliation or cross retaliation in any sector would effectively induce compliance with an international agreement.
In this context, it is also important to reflect on the more general limits of a DSM, which in many ways replicates the WTO DSM template. There is a debate on the level of compliance of China with WTO law. On the one hand, it has been noted that China has an overall 'respectable' record of compliance, because it has generally modified its laws and regulation following adverse rulings, albeit at times imperfectly so.[146] In fact, other WTO Members have also not always complied with rulings of the WTO adjudicatory bodies. On the other hand, other scholars have argued that China's compliance amounts to mere 'paper compliance.'[147] While

[142] Bart-Jaap Verbeek, 'Unpacking an empty box? The EU-China Comprehensive Agreement on Investment', SOMO, 8 July 2021, available at https://www.somo.nl/unpacking-an-empty-box-the-eu-china-comprehensive-agreement-on-investment/
[143] François Godement, 'Wins and losses in the EU-China Investment Agreement (CAI)', Institut Montaigne, January 2021, available athttps://www.institutmontaigne.org/en/publications/wins-and-losses-eu-china-investment-agreement-cai
[144] Ibid.
[145] US-Wheat Gluten Safeguards and US-Foreign Sales Corporations, see: Lothar Ehring, 'The European Community's Experience and Practice in Suspending WTO Obligations' in Chad P Bown and Joost Pauwelyn eds, n. 131, 244-266.
[146] James Bacchus, Simon Lester, and Huan Zhu, 'Disciplining China's Trade Practices at the WTO: How WTO Complaints Can Help Make China More Market-Oriented, Policy Analysis', Cato Institute, 15 November 2018, available at https://www.cato.org/policy-analysis/disciplining-chinas-trade-practices-wto-how-wto-complaints-can-help-make-china-more
[147] Timothy Webster, 'Paper Compliance: How China Implements WTO Decisions', Michigan Journal of International Law (2014), 35, 525–578.

not being so dismissive of China's record, international trade law professor Mark Wu has argued that China engages in repeated violations (particularly in the context of export restrictions) because of the WTO 'remedy gap.'[148] By this, he refers to the fact that the WTO DSM is only prospective, entailing the possibility for Members to procrastinate compliance and possibly adopt 'new' laws that are still non-conforming. The lack of the possibility to award damages and address non-compliance retrospectively gives rise to a 'remedy gap.' From this vantage point, it could be argued that the CAI DSM is likely to suffer from similar deficiencies.

4.7 Summary – Retaliatory and coercive measures

China's retaliatory/coercive measures against Australia have not been prevented, deterred or addressed by ChAFTA. Australia has not, to public knowledge, made use of the ChAFTA DSM, preferring to take their disputes to the WTO. The CAI DSM is very similar to that of the ChAFTA, with some extra procedural detail. China's retaliatory/coercive measures with Australia involve tariff hikes and import bans based on legitimate trade concerns, which are not covered by CAI. There is no reason to think that the CAI provides any more protection against state-supported coercive measures than ChAFTA.

Section 4.8 briefly describes the background of the China-Australia trade dispute. Section 4.9 addresses the question of whether Australia has been able to counter China's retaliatory and coercive measures through the DSM of ChAFTA. Finally, section 4.10 addresses the question of whether the CAI provides protection against state-supported coercive measures in comparison to ChAFTA.

4.8 Brief description of the China-Australia trade dispute

The trade dispute between Australia and China arises from a complex set of political circumstances including Australia's call for an investigation over the origin of the COVID-19 pandemic.[149] Prior to the pandemic, the relationship between Australia and China had been troubled for around five years due to allegations of foreign interference and Australia's close relationship with the US. In the past two years Australia has initiated and continued anti-dumping duties and investigations into various Chinese exports including steel, paper, and silicon metal products.[150] On 21 April, Australian Prime Minister Scott Morrison discussed a probe into the origins of the coronavirus with other world leaders.[151] Australia did not consult China before pursuing the inquiry internationally, offending the Chinese government.[152]

Before April 2020, China had already begun anti-dumping investigations on Australian barley, but the coronavirus probe appears to have instigated a raft of actions against Australian

[148] See Mark Wu, supra note 26.
[149] For a detailed analysis, see Weihuan Zhou and James Laurenceson, 'Demystifying Australia-China Trade Tensions' [2021] UNSWLRS 36, Forthcoming Journal of World Trade, (2022) 56:1.
[150] Su-Lin Tan, 'China-Australia relations: termination of free trade deal ahead of review unlikely despite tensions, experts say', South China Morning Post, 25 November 2020, available at https://www.scmp.com/economy/china-economy/article/3111162/china-australia-relations-termination-free-trade-deal-ahead
[151] Paul Karp and Helen Davidson, 'China bristles at Australia's call for investigation into coronavirus origin', The Guardian, 29 April 2020, available at https://www.theguardian.com/world/2020/apr/29/australia-defends-plan-to-investigate-china-over-covid-19-outbreak-as-row-deepens
[152] Jordan Hayne, 'Australia "hurt the feelings" of China with calls for coronavirus investigation, senior diplomat says', ABC News, 26 August 2020, available at https://www.abc.net.au/news/2020-08-26/senior-chinese-diplomat-addresses-australia-coronavirus-tensions/12596602

products. However, most of these actions have been based on apparently legitimate concerns, such as problems with customs paperwork (meat), pests (timber), weeds (grains), and anti-dumping (wine). China has reportedly also verbally advised state owned power stations, steel mills and cotton mills not to buy Australian products, and unofficially caused severe delays in clearing Australian products through customs. There is further evidence of an unofficial block on Australian coal, iron ore and cotton exports.

China and Australia both signed the Regional Comprehensive Economic Partnership Agreement in November 2020. In December 2020 Australia lodged an appeal to the WTO against China's tariffs on Australian barley[153] and in June 2021 a complaint against China's anti-dumping tariffs on Australian wine.[154] Soon after, China lodged a WTO complaint against Australia's anti-dumping and anti-subsidy duties on various Chinese metal products.[155]

A spokesperson of the Chinese Foreign Ministry appeared to admit that the ongoing trade dispute was politically motivated, saying 'We will not allow any country to reap benefits from doing business with China while groundlessly accusing and smearing China and undermining China's core interests based on ideology.'[156]

Informal accusations have been made on both sides that there have been breaches of ChAFTA, however none of the alleged breaches have been clear. The official trade measures taken by both parties have been based on potentially legitimate trade concerns such as contamination and dumping, and allegations of verbal import bans have yet to be proven. In regard to treatment of individual investors, Chinese commentators cite the blocking of Huawei from its 5G construction as a breach of ChAFTA, whereas Australian exporters were reportedly considering suing China for discriminatory trade action.[157] However many investors are reluctant to initiate ISDS against China due to potential effects on future investment opportunities.[158]

4.9 Has Australia been able to counter China's retaliatory/coercive measures through the DSM of the FTA?

Neither China nor Australia has publicly made use of the state-state dispute settlement mechanism of ChAFTA.[159] Rather, both Australia and China have preferred WTO dispute resolution processes to address the recent back-and-forth over anti-dumping duties and tariff hikes. In a ChAFTA dispute process, arbitrators must apply similar principles and WTO case law, 'therefore it is reasonable to anticipate that the [WTO] DSM will remain a preferred forum

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[153] *China – Anti-dumping and countervailing duty measures on barley from Australia*, DS598 https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds598_e.htm

[154] *China – Anti-dumping and countervailing duty measures on wine from Australia*, DS602, https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds602_e.htm

[155] *Australia – Anti-dumping and countervailing duty measures on certain products from China*, DS603, https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds603_e.htm

[156] Stephen Dziedzic, 'Chinese official declares Beijing has targeted Australian goods as economic punishment', ABC News, 7 July 2021, available at https://www.abc.net.au/news/2021-07-07/australia-china-trade-tensions-official-economic-punishment/100273964

[157] Xie Jun and Chi Jingyi, 'It's Australia, not China that's violating free trade deal, analysts say, urging China to resort to international courts', Global Times, 17 December 2020, available at https://www.globaltimes.cn/page/202012/1210293.shtml

[158] Dilini Pathirana, 'A look into China's slowly increasing appearance in ISDS cases', IISD, 26 September 2017, available at https://www.iisd.org/itn/en/2017/09/26/a-look-into-chinas-slowly-increasing-appearance-in-isds-cases-dilini-pathirana/

[159] Weihuan Zhou and James Laurenceson, n. 149, at 26.

for settling the disputes between the two parties.'[160] This is the case despite the Appellate Body stalemate, as both the EU and China are part of the multi-party interim appeals arbitration arrangement designed to give the parties access to a two-step dispute settlement system as a stopgap measure until the Appellate Body is operational again.[161]

In the December 2020 ChAFTA Post Implementation Review consultation process, stakeholders reportedly raised 'concerns over ability of dispute resolution mechanisms within ChAFTA to address or resolve anti-dumping and countervailing duties issues'.[162] However, neither the Post Implementation Review report nor the DFAT ChAFTA news page disclose any instances where either party has invoked the state-state dispute resolution processes under ChAFTA or suspended obligations under the agreement.

Commentators have suggested that Australia's decision to bring the disputes to the WTO instead of under ChAFTA is strategic, in that it could be 'a gesture that offers Beijing a chance to walk back a trade war it can't politically win'.[163] According to this view, the parties' agreement to use the novel Multi-Party Interim Appeal Arbitration mechanism will likely generate significant publicity, which China will wish to avoid and therefore return to the negotiating table. On the other hand, Zhou and Laurenceson conclude:

> 'While Australia's potential legal claims against China's economic sanctions have merit, they do not guarantee a win. Even if Australian wins, China's international obligations under the WTO or ChAFTA do not require it to compensate for Australia's losses already caused. Nor does a successful claim prevent China from taking similar actions on the same or other Australian exports in the future. Despite the uncertainties and potentially limited effects of WTO litigation, it does provide a rules-based forum for the two governments to engage formally while the deeper political challenges can be confronted, and hopefully addressed.'[164]

4.10 In comparison to ChAFTA, does the CAI provide protection against state-supported coercive measures?

In the context of the China-Australia trade dispute, China's 'state-supported coercive measures' include imposition of high tariffs, blocking import of goods both officially citing trade breaches such as pests and faulty paperwork, and unofficially via verbal instruction to Chinese customs and importers, and non-trade related actions such as taking Australian citizens for questioning.

The China-Australia dispute is mostly playing out via tariffs and import bans, which are not covered by the CAI. Procedurally, there is nothing to suggest that the CAI DSM would be any more or less effective than the ChAFTA DSM. The language of the CAI DSM largely reflects

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[160] Ibid.

[161] Statement on a mechanism for developing, documenting and sharing practices and procedures in the conduct of WTO disputes, JOB/DSB/1/Add.12, Addendum (30 April 2020) circulated at the request of the Delegations of Australia; Brazil; Canada; China; Chile; Colombia; Costa Rica; the European Union; Guatemala; Hong Kong, China; Iceland; Mexico; New Zealand; Norway; Pakistan; Singapore; Switzerland; Ukraine and Uruguay, https://trade.ec.europa.eu/doclib/docs/2020/april/tradoc_158731.pdf

[162] China-Australia Free Trade Agreement Post-Implementation Review (December 2020), available at https://obpr.pmc.gov.au/sites/default/files/posts/2021/03/china-australia-free-trade-agreement-pir.pdf, para 166.

[163] Marc L Busch, 'COVID, barley and a most unusual Australia-China trade war'. The Hill, 2 May 2021, https://thehill.com/opinion/international/537581-covid-barley-and-a-most-unusual-australia-china-trade-war

[164] Weihuan Zhou and James Laurenceson, n. 149, at 31.

that of ChAFTA, including the process for suspension of obligations and limitation of cross-sector retaliation.[165] CAI provides more specific procedural detail than ChAFTA, including clarity on choice of forum and provision for the arbitral panel to seek technical advice.[166] Both ChAFTA and CAI have a choice of forum clause that allows the disputing party to select a forum for the dispute to the exclusion of all others, meaning that if the EU and China had a dispute that also fell under the WTO Agreement, they could choose to take the dispute to the WTO rather than deal with it under the CAI as Australia has done in its trade dispute with China.

[165] ChAFTA, Article 15.16.
[166] CAI, Section V, Articles 21 and 20.

5. Risk(s) of Politicization and Coercion in the context of CAI

5.1. A 'level-playing field' for foreign and domestic enterprises

CAI includes a number of 'level-playing field' provisions aimed at creating a common ground for both foreign and domestic enterprises in China and ensuring that market access provisions are not deprived of their meaning. The agreement encompasses a more articulate discipline on covered entities (Section, II, Articles 3bis and 3ter), but also on transparency, forced technology transfer and more general commitments on the domestic regulatory framework, including licensing and qualification procedures (Section III, Subsections 1 and 2). Article 3ter, Section II, stipulates for example a provision requiring regulators of both Parties to act impartially, enforce laws and regulations in a non-discriminate manner towards all companies, and preserve their independence from the enterprises they are meant to be regulating. While the provision is general in nature, it is located right after the specific discipline addressing SOEs and it explicitly singles out covered entities as being within the scope of the provision. The article is certainly a step forward in explicitly prescribing and extending 'good governance' criteria to SOEs. Yet, there are a number of exceptions attached (see fn 11 related to a number of entries in Annex I) to this provision, which also act as a sort of reminder that covered entities preserve a favored position in Chinese economy. While the increased level of transparency commitments and obligations around notification of subsidies certainly increases the pressure on Chinese regulators, these obligations '(…) do not address or even reduce many forms of preferential treatment of Chinese SOEs by the Chinese government (such as specific subsidies or tax exemptions or their preferential access to capital and other production factors) either'.[167] Subsidies, for example, are excluded from the state-to-state dispute settlement.[168] Additionally, while Phase One Deal with the US includes a 'pledge' on behalf of China not to support or direct outward FDI aimed at acquiring foreign technology by its industrial plans that create distortion,[169] a similar provision is not present in CAI. This means that covered entities might still be employed to this purpose and hence their outbound activity subject to 'politicization'. Nonetheless, the CAI provisions do provide a more stringent level of transparency and notification commitments in comparison to China's commitments in the context of the WTO ASCM (Agreement on Subsidies and Countervailing Measures).[170]

Section IV on the regulatory framework includes an extensive and articulate array of obligations as well. It offers several guarantees both in terms of transparency and judicial review across all regulatory, administrative, and legislative processes. In terms of licensing and qualification requirements, the relevant provisions stress that these need to be clear, impartial, and made publicly available in advance. Legislative and administrative-wise, the text goes in the same direction, requiring transparent, timely and clear publication, as well as judicial or

[167] Frank Bickenbach, Wan-Hsin Liu, 'The EU-China Investment Agreement as Seen from Europe: Achievements with Shortfalls', in Kiel Focus, Kiel Institute for the World Economy, 02/2021.

[168] In order to tackle foreign subsidy-related distortions, the Commission has recently published a proposal for an EU Regulation. See Proposal for Regulation of the European Parliament and of the Council on foreign subsidies distorting the internal market 5 May 2021, COM(2021) 223 final.

[169] Chapter 2, Article 2.1(3).

[170] Weinian Hu, 'The EU-China Comprehensive Agreement on Investment. An in-depth Reading', CEPS Policy Insights, N0PI2021-07/May 2021. Lauge N. Skovgaard Poulsen, 'The EU-China Investment Deal and Transatlantic Investment Cooperation, Paper Prepared for the Shapiro Geopolitics Workshop on Transatlantic Disruption', Perry World House, University of Pennsylvania, January 25 and 26, 2021. Note that, as highlighted by Poulsen, WTO rules do not require notification of subsidies to service companies.

quasi-judicial review, including for administrative processes.[171] Formally at least, these rules provide a predictable environment for investors. Yet, whether these will be implemented and enforced, and whether the dispute settlement mechanism provided in the agreement will be of effective avail is difficult to assess. Admittedly, their explicit and binding nature acquires significance as at least it offers companies a term of reference and obliges the Parties to justify departure from the discipline included therein.

5.2 Forced Transfer of Technology

In the same vein, CAI regulates forced transfer of technology (FTT), essentially incorporating the commitment of the Parties to abolish this practice. More specifically, the agreement includes both the prohibition to impose transfer of technology for the establishment and operation of an investment (Section II, Article 3(1)) – a traditional performance requirement – and the prohibition to condition preferential treatment to technology transfer (Section II, Article 3(2)). This discipline is complemented by the prohibition to interfere in contractual freedom in relation to transfer or licensing of technology (Section II, Article 3(3)). Some of the provisions on domestic regulation mentioned above are also applicable to FTT, as these mandate administrative bodies not to disclose confidential business information.
Prohibition of technology transfer was a salient feature for EU negotiators and has been heralded as one of the main wins of the CAI. In fact, some of the commitments had already been included in the FIL, e.g. under Article 22. As such, the CAI does not go particularly beyond what is already prescribed by domestic law. Yet, the FIL contains unilateral commitments, which are easily retractable. The added value of the CAI resides in it being a binding treaty, not necessarily in the innovativeness of the agreement itself. Whether or not such provisions will be sufficient depends – once again – from implementation and enforcement. If one looks for example at Section II, Article 3(5), the FTT provisions do not apply, if the requirement to transfer technology is imposed by a court, administrative tribunal, or competition authority to 'prevent or remedy a restriction or distortion of competition'. Clearly, such provision might be subject to abuse, especially in its preventative dimension. However, it is not the letter of the law that gives leeway to arbitrariness per se. In fact, risk of politicization is made more difficult by this framework, but it cannot be completely removed by way of legal means. There might be other more subtle ways for the government to exert pressure, as recently shown by the Tesla's[172] or the Blackstone's[173] fallouts.

[171] It is interesting to note here that the National Security Review decision will be final, with no opportunity for review, pursuant to FIL, Article 35. Section III, Subsection 2, Art. 6(1) CAI is however very clear: the provisions on judicial and quasi-judicial review apply to matters 'covered by this treaty'. If the Measures are excluded from the scope of application of the treaty, investors will not be able to request review and/or correction on the clearance and rejection decision based on security grounds.
[172] Matthew Campbell, Tesla's 'Fall from Grace in China Shows Perils of Betting on Beijing', Bloomberg Businessweek, 06 July 2021, available at https://www.bloomberg.com/news/features/2021-07-05/tesla-s-fall-from-grace-in-china-shows-perils-of-betting-on-beijing
[173] Tabby Kinder, Kaye Wiggins, 'Collapsed Blackstone deal shows that 'everything is political' in China', Financial Times, 23 September 2021, available at https://www.ft.com/content/19e5002a-7ac8-45c8-ae7c-e33bcf731939 – Yet, massive asset buying and accumulation is per se quite political, regardless of the geography.

5.3. The Corporate Social Credit System and its potential interaction with CAI Commitments

Along these lines, progress in the nationwide implementation of the Corporate Social Credit System (CSCS) has sparked severe criticism.[174] The CSCS is a framework meant to monitor and act upon the (un)trustworthiness of companies. It functions on the basis of data aggregated on large scale and merged into 'Corporate Social Credit Files'. The data included therein comprise both government records and market-generated data on the regulatory conduct and commercial behavior of companies, categorized along a number of indicators.[175] While the plan of the National Development and Reform Commission (NDRC) is to move to a single standardized social credit system, at the moment the framework is composed of a scattered and divergent set of local public (regional, provincial and district-based) and private programmes, running independently, albeit on the basis of strategic policy guidance and catalogues issued by the NDRC, the last of which were circulated in July 2021[176]. Thus, specific criteria to assess the trustworthiness of companies are at times inconsistent across the geography of the country, but also across commercial sectors, making it difficult to provide a single assessment of the system.

Besides the monitoring element, what the CSCS enables is a public, immediate mechanism to 'punish' non-compliant companies, through collective sanctioning issued by an array of regulatory authorities. 'Blacklisted' infringing enterprises would typically see their access to the market restricted, licenses suspended or removed. On the other side of the spectrum, (highly) compliant companies would be rewarded with tax breaks and other economic incentives and be placed in 'red lists'.

As mentioned, the new governmental 'Plan on Building the Rule of Law in China (2020–2025)' is pushing the Social Credit standardization forward, with a draft of the Social Credit Law being currently circulated internally. Thus, it seems reasonable to reflect on the potential entrenchment between CAI and CSCS. While this requires more extensive investigation, the following considerations are in order. The starting point for analysis is that – so far – in-depth studies conducted on the CSCS did not identify a direct or indirect intent to discriminate against foreign companies in the application of the social credit system.[177] CSCS applies to domestic and foreign companies alike, meaning that the latter are not a target of this regulatory

[174] See a.o. Evelyn Cheng, 'China is building a 'comprehensive system' for tracking companies' activities, report says', CNBC, 4 September 2019, available at https://www.cnbc.com/2019/09/04/china-plans-for-corporate-social-credit-system-eu-sinolytics-report.html; Frank Tang, 'China pushing ahead with controversial corporate social credit rating system for 33 million firms', South China Morning Post, 6 September 2019, https://www.scmp.com/economy/china-economy/article/3027674/china-pushing-ahead-controversial-corporate-social-credit?module=inline&pgtype=article; for an overview of the CSCS see Drew Donnelly, 'An Introduction to the China Social Credit System', New Horizons, 15 September 2021, available at https://nhglobalpartners.com/china-social-credit-system-explained/ ; Kendra Schaefer, 'China's Corporate Social Credit System. Context, Competition, Technology and Geopolitics', Trivium China, 16 November 2020, available at https://www.uscc.gov/sites/default/files/2020-12/Chinas_Corporate_Social_Credit_System.pdf; European Union Chamber of Commerce in China, 'The Digital Hand: How China's Corporate Social Credit System Conditions Market Actors - **分数决定命运**：**企**业社会信用体系如何规**制市**场主**体**', available at https://www.europeanchamber.com.cn/en/publications-archive/709/The_Digital_Hand_How_China_s_Corporate_Social_Credit_System_Conditions_Market_Actors

[175] Schaefer, n. 174.

[176] Donnelly, n. 174.

[177] Schaefer, n. 174; European Chamber, supra n. 174.

framework. In fact, social credit in China has been originally implemented mainly to address pervasive corruption of domestic legal entities and a non-functioning domestic market.[178]
Nonetheless, there might be concerns that the nationwide implementation of the CSCS will end up de facto placing foreign companies at a disadvantage. Yet, this would not necessarily depend on the CSCS per se. The CSCS signals non-compliance with Chinese laws and regulations. In those cases where adherence to these laws is fundamentally problematic for foreign companies, then fear of CSCS implications might pressure enterprises into compliance.[179] In other words, the CSCS makes norm obedience more efficient and immediate, it does not add to the substantive obligations of companies.
As an example of this dynamic, the Trivium report recalls the 2018 airlines incident, where the Civil Aviation Administration of China threatened to blacklist 44 international airlines, if they kept Taiwan as a separate country destination from China on their international website. The aviation authority considered this to be in violation of the One China policy, which considers Taiwan as one of the provinces of mainland China. Most airlines corrected the 'error' and some even admitted to the 'great mistake'.[180]
In a similar vein, while forming a separate category, the Unreliable Entity List (UEL) mentioned in Section 3 might also be 'captured' by CSCS, a concern shared by some analysts.[181] An entity might be listed under the UEL due to its compliance with (trade) sanctions issued against China. Listing under UEL might become part of the records collected for the purposes of the CSCS and thus reduce the trustworthiness of the company. By the same token, the National Security Review instrument explicitly refers to the CSCS in Article 19: 'If a Party conducts itself as mentioned in Article 16, 17 or 18 hereof, a negative credit record of such Party shall be entered in the relevant credit information system of the state and the Party shall be subjected to joint penalties in accordance with relevant national regulations.'
However – as mentioned above – policies like the UEL or 'One China' are problematic in and of themselves, regardless of CSCS, and can certainly influence the investments' environment. Yet, whether the implementation of CSCS would actually infringe current CAI provisions is a different question. Rules that might potentially be breached are those stipulated under Section III (regulatory framework) discussed above. Considering the fragmented nature of the CSCS and its changing landscape, CAI provisions on transparency, clarity, and timely publication of laws and regulations – as well as guarantees of judicial review –[182] could be relevant in the context of CSCS. However, infringement of these rules would need to be assessed on a case-by-case basis, looking at the specific CSCS local/sectoral programme involved. Such an assessment cannot be generalized at least until a fully centralized system is in place.
Looking at CSCS from a 'liberalization commitments' perspective, even if the social credit system determined an indirect 'regression' of what is stipulated under CAI, this would not by itself imply a violation of the treaty. As mentioned already above, CAI incorporates a number

[178] Schaefer, n. 174.
[179] Ibid.
[180] Tara Francis Chan, 'China wants to dictate how foreign airlines refer to Taiwan and the US is having none of it — this is how every major airline is responding', Business Insider, 5 May 2018, available at https://www.businessinsider.nl/what-do-airlines-call-taiwan-china-2018-5?international=true&r=US
[181] 'China races to set up Corporate Social Credit System through sweeping data-collection scheme to create blacklists and redlists for firms, study finds', Dailymail, 10 December 2020, available at https://www.dailymail.co.uk/news/article-9038783/China-races-set-Corporate-Social-Credit-sweeping-data-collection-scheme.html
[182] There have been reports of the removal and correction mechanisms of certain regional/sectoral programmes being quite burdensome. See Schaefer, n.174.

of GATT-like exceptions. Section VI, Subsection 2, Article 4 replicates GATT, Article XX.[183] The provision is to be interpreted in line with WTO case-law. Should a dispute around CSCS arise, it is likely that the dispute settlement body of CAI would consider the social credit system to be in line with the agreement, as long as it is applied in a non-discriminatory manner to domestic and foreign entities alike and is considered necessary for the protection of legitimate goals. Article 4(1)(a) – the protection of public morals – comes to mind in the context of companies' 'trustworthiness', and orderly functioning and reliability of the market.[184] Therefore, CSCS might remain unchallenged.[185]

In fact, the pervasive monitoring of the social credit system presents risks that CAI – in its current version – leaves unaddressed, related for example to data collection and its localization, privacy, digitalization and cyberspace. CSCS also cloaks bigger and fundamental underlying issues,[186] such as human and labour rights, and environmental compliance. These issues existed before the advance of the social credit system, and – as further explored below – CAI does only partially tackle them.

[183] Par. 2 of this provision explicitly mandates the incorporation of Article XX *mutatis mutandis*.

[184] China has already invoked the protection of public morals in a WTO dispute to justify censorship measures. Panel Report, *China — Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/R, 12 August 2009) and Appellate Body Report, WT/DS363/AB/R, 21 December 2009. Both the Panel and the Appellate Body found that measures departing from the commitments included in the Chinese Accession Protocol could be justified pursuant Art. XX(a). Yet, in the specific case the 'necessary' requirement was not met, thus the DSB requested China to bring its measures to conformity.

[185] Ryan Swift, Finbarr Bermingham, 'China's social credit system for business creates new and complex headaches for EU trade officials', South China Morning Post, 5 November 2019, available at https://www.scmp.com/economy/global-economy/article/3036445/chinas-social-credit-system-business-creates-new-and-complex

[186] Mercator Institute for Chinese Studies, 'EU-China investment deal leaves a lot to be desired', 14 January 2021, available at https://merics.org/en/briefing/eu-china-investment-deal-leaves-lot-be-desired

6. The CAI Section on Investment and Sustainable Development: high aspirations, weak rules

CAI includes the equivalent of a Trade and Sustainable Chapter (TSD Chapter), which has become a standard feature of EU trade and investment agreements. This is Section IV, titled 'Investment and sustainable development' (hereinafter the Section on Sustainable Development). As most TSD Chapters, CAI Section IV is a mixed bag. On the one hand, it has been branded as a major breakthrough. In the EU Commission statement announcing the conclusion of the Agreement, for example, we read 'The Agreement also includes important commitments on environment and climate, including to effectively implement the Paris Agreement, and on labour standards.'[187] On the other hand, the Sustainability Section has been widely criticized for being under-ambitious, largely worded in aspirational jargon and lacking a credible enforcement mechanism.[188]

While any answer to the question of whether the Sustainable Development Section may facilitate achieving sustainability would be highly speculative, a brief analysis of its main elements could help us gauging some of the potential benefits and major limits of this part of the CAI.

The Section on Sustainable Development is subdivided in 4 Sub-sections. The first Sub-section sets out the context and objectives; the second and the third deal with the environment and labour; the fourth with an emasculated dispute settlement mechanism (euphemistically labeled as 'Mechanism to Address Differences'). This template does not dramatically depart from TSD Chapters in EU Trade and Investment Agreement, although some specific institutions set up under other TSD Chapters are not included in the CAI.
Sub-section 1 offers important context, identifying a number of key international documents with regard to sustainable development (eg Agenda 21 on Environment and Development of 1992).[189] While such type of provisions do not establish hard obligations, they can be used for interpreting other provisions of CAI, as per Article 31(2) VCLT.[190] Further, this Sub-section recalls the importance of Corporate Social Responsibility and all the most relevant instruments in the field of business and human rights (eg UN Guiding Principles on Business and Human Rights).[191] These rules are hortatory and vague, establishing among others that Parties 'promote responsible business practices, … by encouraging the voluntary uptake.'[192] This emphasis on voluntarism is unlikely to lead to transformative change or yield major benefits. As concluded by some of the architects of the international business and human rights framework, '[f]orty years of pure voluntarism should be a long enough period of time to conclude that it cannot be counted on to do the job by itself.'[193] Sub-section 4 is concluded with a provision on 'Review

[187] See https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT_20_2546
[188] See Lorenzo Cotula 'CAI; Appraisal of Sustainable Development Section', Business and Human Rights Journal (2021), 6:2, 360-367; Surya Deva, 'Being Naïve or Putting Business First? The EU–China Comprehensive Agreement on Investment, Human Rights and the Hong Kong Situation', Verfassungsblog (19 January 2021), available at https://verfassungsblog.de/beingnaive-or-putting-business-first/; for an early critical assessment on the leaked draft, see Jessica Lawrence, Tara Van Ho and Anil Yilmaz Vastardis, 'EU–China Comprehensive Agreement on Investment: A Scoping Study', Henrich Böll Stiftung, 2020, at 17-23, available at https://www.boell.de/sites/default/files/2020-12/E-Paper-EU-China-Investment-Agreement-on-Investment.pdf
[189] Section IV, Sub-section 1, Article 1.
[190] This a fortiori, when considering that the Preamble of CAI mentions the protection of human rights.
[191] Section IV, Sub-section 1, Article 3.
[192] Ibid.
[193] John Gerard Ruggie & Tamaryn Nelson, 'Human Rights and the OECD Guidelines for Multinational Enterprises: Normative Innovations and Implementation Challenges', Harvard Kennedy Sch. Working Paper, No.

of sustainability impacts.' Measuring the sustainability impacts of an investment agreement would be a welcome development, as it could produce key knowledge instrumental for setting in motion necessary reforms to achieve sustainable goals.[194] Regrettably, also this provision, is worded only in aspirational terms.

The Sub-sections on Environment and Labour are not very ambitious either, as they mainly focus on the right to regulate (already included in other EU trade and investment agreements), which have been criticized for being too indeterminate and include aspirational jargon ('the Party shall strive') on achieving high level protection.[195] Despite the overall dismal framework, there is at least one provision worthy of note in Sub-section 2 on Environment. Article 6 stands out for establishing obligations related to the Paris Agreement. It provides, for example, that 'each Party shall: a. effectively implement the UNFCCC and the Paris Agreement adopted thereunder, including its commitments with regard to its Nationally Determined Contributions'[196] (NDC). Even if the 2015 NDCs by China were under-ambitious, the renewed NDCs have improved.[197] With a strong dispute settlement mechanism, such provision could be considered as a genuine breakthrough and potentially yielding substantial benefits in nudging the Parties into complying with their obligations under Paris Agreement. As discussed below, however, the dispute settlement mechanism is relatively weak. Yet, even in the absence of a strong dispute settlement system, such type of provisions may facilitate climate action, as they could stimulate dialogue and help reinforcing shared values, as indicated below.

One of the most controversial dimensions of the Agreement with China relates to its poor track record in respecting human rights and, most importantly for economic treaties, labour rights. Illustrious commentators have asked: 'Can democracies remain true to their values while engaging in trade and investment with China?'[198] While the CAI Section on Labour (Sub-section 3) has been heralded as a major victory for the EU, when looked at in its entirety, it is unlikely to become a bastion for the protection of labour rights. Beyond the provisions mentioned above on right to regulate and the levels of protection, the Section merely re-asserts the commitments of respecting treaties already ratified by China and introduces a rather loose commitment to 'make continued and sustained efforts on its own initiative to pursue ratification of the fundamental ILO Conventions No 29 and 105.'[199] While it is remarkable that China has engaged to such extent with the EU, the level of commitments in this field is under-ambitious when compared with the urgent challenges faced.

The recent dispute between EU and Korea regarding labour issues[200] is illustrative of the potentials and limits of the CAI sub-section on Labour. Under the EU-South Korea Free Trade Agreement,[201] the EU brought a dispute against Korea for (among others) being in breach of its obligations to make 'sustained and continued efforts' to ratify certain ILO conventions (including the one on forced labour). In relation to this point, the Panel concluded that 'the

15-045, 2015, https://papers.ssrn.com/sol3/paperscfm?abstract_id=2601922 (commenting on the malfunctioning of the weak enforcement mechanisms of the OECD Guidelines for Multinational Enterprises).

[194] Section IV, Sub-section 1, Article 4.

[195] Section IV, Sub-section 2, Article 3 and Section IV, Sub-section 3, Article 3.

[196] Section IV, Sub-section 2, Article 6.

[197] Arcy Carlson, Stacy-ann Robinson, Catherine Blair, Marjorie McDonough, 'China's climate ambition: Revisiting its First Nationally Determined Contribution and centering a just transition to clean energy', Energy Policy, (2021), 155:C.

[198] Dani Rodrik, 'Europe's China Gambit', Project Syndicate, 11 January 2021.

[199] Section IV, Sub-section 3, Article 4.

[200] Report, Panel of Experts Proceeding Constituted under 13.15 of the EU-Korea Free Trade Agreement, adopted 20 January 2021, (hereafter: EU-Korea Panel Report).

[201] EU-South Korea Free Trade Agreement (2015) (EUKFTA).

absence of explicit targets or at least any informal understanding on expected milestones towards ratification' implies that the Party has a certain leeway in selecting the ways to make these efforts.[202] Given that also in CAI explicit (temporal) targets or expected milestones remain unspecified, such finding in the EU-Korea Panel Report suggests that the obligation to make sustained and continued efforts to ratify certain ILO Conventions in CAI will be hardly enforceable. Even more, this Panel Report could be used in informal talks to further push back dialogue on the questions related to ILO Conventions ratification. At the same time, the Panel has read the substantive obligations of the general commitment to 'respecting, promoting and realising the principles concerning the fundamental rights'[203] in an expansive way. Most significantly, according to the Panel these principles include 'the right to freedom of association.'[204] This finding by the Panel hints at the possibility of a progressive reading of the CAI provisions on Labour, which could have important implications. Considering that also CAI establishes that '[e]ach Party, … shall respect, promote and realize, in good faith and in accordance with the ILO Constitution, the principles concerning the fundamental rights which are the subject of the fundamental ILO Conventions', it could be inferred that a wide variety of labour rights are effectively covered by the Sustainable Development Section of the CAI.

Even in this case, one of the main limitations of the CAI Sustainable Development Section is that it lacks a proper dispute settlement mechanism (DSM). This is similar to other TSD Chapters, which have been widely criticized for their weak DSM.[205] Sub-section 4, titled 'Mechanism to Address Differences' establishes procedures in case of disagreement. More prosaically, in case of disputes, this Sub-section provides that when consultations over a disputed issue do not lead to a mutually agree solution a Panel of experts can be established.

On the positive side, the expertise of the Panel should include experts in international labour law, international environmental law or relevant aspects of international trade or investment agreements. Also, the procedures are relatively transparent and amicus curiae briefs can be submitted (unless the Parties agree otherwise). Yet, the implementation of the final report of the Panel is left to the good will and discretion of the Parties. In this regard, the lack of a sanction system has been criticized.[206] The argument that sanctions are problematic because they would come at the cost of dialogue has been rebutted as sanctions, rather than antagonistic, can be complementary to dialogue.[207] It also appears contradictory to argue that the lack of implementation of norms on sustainability is to be tackled with dialogue, whereas all the other provisions are subjected to a traditional state to state dispute settlement system with sanctions. This puts the rules on sustainability on a subaltern plane.

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[202] EU-Korea Panel Report, para 278, supra n 200. See also Marco Bronckers and Giovanni Gruni, 'Retooling the Sustainability Standards in EU Free Trade Agreements', Journal of International Economic Law, (2021) 24, 25-51.200

[203] EU-Korea Panel Report, para 122, supra n. 202.

[204] Ibid.

[205] James Harrison, Mirela Barbu, Liam Campling, Ben Richardson and Adrian Smith, 'Governing Labour Standards through Free Trade Agreements: Limits of the European Union's Trade and Sustainable Development Chapters' Journal of Common Market Studies, (2018) 57:2, 260-277, at 269.

[206] For a critical assessment of the enforcement mechanisms of TSD Chapters see Alessandra Arcuri, Sophia Paulini and Federica Violi, 'Legal frameworks for monitoring and enforcing GSP and TSD Chapters in EU FTAs - Promoting sustainability, human rights and civic engagement' (Report for Network Matters, 2021). See also, Lise Johnson et al. 'Aligning International Investment Agreements with Sustainable Development Goals' (2020), available at https://scholarship.law.columbia.edu/cgi/viewcontent.cgi?article=1186&context=sustainable_investment_staffpubs.

[207] See, for instance, Bronckers and Gruni, n. 202, at 38.

Against this background, it is safe to conclude that the CAI Section on Sustainable Development is rather weak and unlikely to bring about major changes. The mainly aspirational rules of this section coupled with the lack of a traditional dispute settlement system diminish the credibility of the CAI framework for achieving sustainability. In short, there is no concrete evidence that CAI will facilitate China in achieving carbon neutrality by 2060.

To this it should be added that the Section on Sustainable Development could still have positive value, as it may create a forum for socialization, where common narratives are forged and progress towards a green and sustainable economy could be constructively discussed and eventually lead to cooperative regulation. In the field of international economic law, there are several institutions which have worked as socialization fora, leading to cooperative regulation and solutions and some scholars have carefully identified various areas of successful non-judicial governance.[208] One such example is the Sanitary and Phytosanitary Committee (SPS Committee) at the World Trade Organization (WTO). Such committee has worked as a forum for discussing concerns, but also to further delineate existing rules.[209] It is regrettable that under the Sustainable Development Section, no specific body has been established to foster such dialogue for regulatory cooperation. Yet, it is plausible that the various norms on cooperation in the CAI Section on Sustainable Development (eg Section IV, Sub-section 2, Article 3, Section IV, Sub-section 3, Article 3), coupled with the rules on the mechanisms to address differences will foster regulatory cooperation. While this a plausible hypothesis, it is neither possible to empirically assess nor to evaluate the eventual impacts of such cooperation.

Finally, few words are to be spent on the potential impact of the weak rules relating to the cooperation on sustainable development. The lack of force of the SD Section and its likely incapacity to stimulate the adoption of effective laws for the achievement of sustainable development in China may negatively affect EU economic actors. This is because the absence of serious sustainability standards in China will continue to put EU economic actors at a disadvantage vis-à-vis foreign competitors producing in the Chinese territory. This is all the more important in this historical moment, when the EU has announced its Green Deal. In fact, under the aegis of the EU Green Deal, more stringent regulations are to be expected in the EU. An investment agreement, part and parcel of the legal system forging transnational markets, could have been an opportunity to foster cooperation on the adoption of sustainability standards.

[208] Andrew Lang and Joanne Scott, 'The Hidden World of WTO Governance', European Journal of International Law, (2009), 20:3, 575-614.
[209] Joanne Scott, 'The Sanitary and Phytosanitary Measures Agreement: A Commentary', Oxford University Press, 2007.

7. Conclusions

The CAI aspires to further advance and solidify access to the Chinese market for EU investors, although numerous reservations to national treatment obligations could partially offset market openness. While the agreement includes certain limited concessions to which China had not already committed unilaterally (i.e., in the sectors of medicine and telecommunications), CAI's greatest contribution to market liberalization arguably stems from its nature as a binding international agreement. This means that the commitments included therein cannot be revoked unilaterally, while the exceptions to national treatment obligations are subject to a standstill and ratchet effect. As such, any future amendments must be less restrictive than the standards established by the CAI.

With reference to the particularly important area of New Energy Vehicles (NEVs), the CAI establishes a regime of limited market access for foreign investors, most importantly by means of a binding commitment to lift limitations on market access subject to an investment threshold of at least USD 1 billion. This applies solely to EU investors, but the high threshold will de facto exclude start-ups or small and medium-sized enterprises. Despite this opening for new investment projects, EU manufacturers may still face general limitations related to the regulatory environment, increased competition in market where it is no longer possible to have a first-mover advantage, and infrastructure development, especially with regards to battery manufacturing.

The Chinese notion of national security as incorporated in its domestic law provides for an expansive understanding based on the idea that economic growth and development can ensure security and reduce social unrest. The question is whether and how this admittedly protean notion might find space in CAI. Given the current status of the agreement, two alternatives are possible. Either China excludes its domestic security review measures from the scope of the treaty, thus affecting pre-establishment commitments from the outset, or it relies on the CAI security exception provision(s). Should the second route be taken, it seems plausible that a potential arbitration panel would reject an overtly expansive notion of national security, in light with WTO case-law. It remains to be seen which of the two alternatives will find its way into the treaty.

We have also noted that if China breaches the CAI and the DSM must be used to enforce the agreement, it may be difficult for the EU to suspend obligations due to existing EU laws prohibiting, for example, discrimination and expropriation. Enforcement mechanisms under CAI also present very similar (if not the same) challenges and weaknesses as other international dispute resolution mechanisms, exacerbated by the fact that the subject matter of the CAI and the reality of the economic relationship between the parties makes it legally and politically difficult for the EU to suspend obligations in a way that would effectively exert pressure on China to comply. The CAI DSM is similar to the ChAFTA DSM, which to date has not prevented or addressed China's retaliatory or coercive measures against Australia. The narrative that the CAI will be more effective than the FIL due to its DSM may therefore be challenged.

While the CAI stipulates a number of articulate 'level-playing field' and FTT provisions that are more advanced than Chinese domestic law provisions, abuse cannot be completely removed. Whether or not these provisions will prove effective, will depend on implementation and enforcement, rather than on (strict) formulation. Risk of coercion and politicization is also connected to the potential application of the CSCS. Yet, the interaction of the social credit system with CAI is not entirely clear. CSCS might breach transparency and other good governance rules, yet the problem lies rather in the underlying substantive provisions that CSCS tries to indirectly enforce. However, from a liberalization commitment perspective CSCS could remain unchallenged since China might successfully invoke 'public morals' to justify CSCS related enforcement and sanctions.

The Sustainable Development Section of CAI includes some important substantive provisions to achieve sustainability (eg, the obligations for the Parties to 'effectively implement the UNFCCC and the Paris Agreement'). Yet, most of its provisions are aspirational. The main deficiencies of the Sustainable Development Section are the eminently hortatory nature of its provisions and the weak dispute settlement system. To this it should be added that the Section on Sustainable Development could bring about positive change, as it may create a forum for socialization, where progress towards a green and sustainable economy could be constructively discussed and eventually lead to cooperative regulation. Yet, the potential for such 'socialization' function is hard to assess empirically, as it will depend on a wide variety of factors related to, among others, geopolitics.

In sum, the CAI Section on Sustainable Development is rather weak and unlikely to bring about major changes. The aspirational nature of most rules and the lack of a strong dispute settlement mechanism diminish the credibility of the CAI framework for achieving sustainability. This study did not find concrete evidence that the Sustainable Development Section of CAI will facilitate China in achieving carbon neutrality by 2060.