The Regulation of Trade-Distorting Restrictions in Foreign Investment Law

An Investigation of China's TRIMs Compliance

Julien Chaisse

Introduction: The Regime of International Investment and the WTO Rules

Capital-exporting countries use international rules to seek investment opportunities abroad[1] and to protect their investments in foreign jurisdictions. Capital-importing economies wish to promote inward investment by ensuring that foreign investors have a stable business environment which is in accordances with high international standards. A selected group of developing countries stands on both sides of that road. As developing countries, they wish to benefit from foreign investment. As vigorous and growing economies, it is in their interests to expand their businesses into other markets. The People's Republic of China stands in this particular position.[2] Mainland China has for the last decade been the primary developing

[1] However, the extent to which BITs actually attract increased flows of foreign direct investment remains disputed. See Salacuse/Sullivan, Do BITs Really Work?: An Evaluation of Bilateral Investment Treaties and Their Grand Bargain, Harvard International Law Journal 46 (2005), pp. 67–127 (111).

[2] From this dual perspective, China's interests were on providing substantive protection for its investors abroad as well as opening new investment opportunities, while simultaneously consolidating through the undertaking of international obligations internal reforms conducive to promoting domestic market openings and a stable business environment. Given these interests, it may not come as a surprise that China also ranks high in the conclusion of bilateral investment agreements: China has signed 117 such treaties, outclassed only by Germany, which has a world-high of 133 BITs. These agreements negotiated outside of the WTO system, however, demonstrate China's willingness to complement the commitments taken under the WTO in order to improve investment climate for foreign investors.

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country receiving foreign direct investment.[3] As a capital-exporting developing country, China also ranks amongst the world highest – it is in the third position.[4]

The current legal framework for foreign investors in China consists of a wide variety of national and international rules and principles that differ in form, strength, and coverage.[5] The result is an increasingly complex international setting for international investment in which governments must ensure consistency between differing sets of obligations. An important advantage of bilateral investment treaties and regional agreements is that they can be tailored to the specific circumstances of the parties concerned, such as their development issues.[6] Comprehensive multilateral rules governing international economics are currently limited to trade issues. Even though the WTO agreements contain major loopholes, multilateral rules on trade constitute a broad umbrella of rights and obligations under which regional, plurilateral and bilateral agreements as well as national laws all regulate trade issues.[7] Although foreign direct investment (FDI) has increased significantly over the last two decades, outpacing the already significant expansion of trade during the same period, the current international legal framework for FDI is highly fragmented.

The WTO and its predecessor organization, GATT, have not directly tackled the broad issue of foreign investment rules. Instead, GATT and the WTO have dealt with a narrow set of very specific issues, which has left nations to formulate their own policies, or through BITs. The WTO handles two major agreements that

[3] Bungenberg, Going Global? The EU Common Commercial Policy After Lisbon, in: Herrmann/Terhechte (eds.), *European Yearbook of International Economic Law (2010)*, 2010, p. 125.

[4] On economic data, see e.g., Gugler/Chaisse, Patterns and dynamics of Asia's growing share of FDI, in: Chaisse/Gugler (eds.), *Expansion of Trade and FDI in Asia: Strategic and Policy Challenges*, pp. 4–7.

[5] International investment regulation is an example *par excellence* for fragmentation in an important area of international economic law. See Boie/Chaisse/Gugler, The International Investment Framework – Regulatory Fragmentation Challenge in a Changing World Economy, in: Cottier/Delimatsis (eds.), *The Prospects of International Trade Regulation – From Fragmentation to Coherence*, 2011.

[6] The "treatification" of international investment law shows the significant and quick recalibration of the law of international investment law over the last 20 years. Whereas in 1990 there were approximately 400 BITs negotiated worldwide, by 2010 the number of BITs negotiated globally stood at a staggering 2,740. However, as the number of bilateral investment treaties and regional agreements continues to expand, different standards and disciplines are beginning to be exerted over foreign investments. This might create confusion for MNEs operating on a global scale. See Salacuse, The Treatification of International Investment Law, Law and Business Review of the Americas 13 (2007), pp. 155–166.

[7] Contemporary international of foreign direct investment is one of the fastest-growing areas of international economic regulation. Although national laws and policies still constitute the most concrete and detailed part of the legal framework of FDI, the current system has become increasingly dependent upon international treaties. Predictability may be enhanced when domestic policies and regulations are enshrined or locked into regional and bilateral treaties and agreements. See Xiao, Chinese Bilateral Investment Treaties in the 21st Century, in: Chaisse/Gugler (eds), *Expansion of Trade and FDI in Asia: Strategic and Policy Challenges*, 2009, pp. 4–7.

address investment directly: the General Agreement on Trade in Services (GATS) and the Agreement on Trade-Related Investment Measures (TRIMs).[8] Among the issues addressed, GATT and the WTO have dealt with specific aspects of the relationship between trade and investment through (GATS,[9] which concerns the supply of services by foreign companies, and through TRIMs. Additionally, under WTO rules, investment measures, such as local content rules or trade-balancing requirements, would be prohibited, to the extent that they impact upon trade and violate the GATT rules on national treatment and quantitative restrictions.

Upon China's accession to the WTO, China made comprehensive commitments in areas of international trade and foreign investment, and China has made serious efforts to implement those commitments.[10] It is an important case study because

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[8] Three further agreements (the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs), the Government Procurement Agreement (GPA), and the Agreement on Subsidies and Countervailing Measures (ASCM)) have only indirect effects on investment. The Agreement on Government Procurement deals with public procurements and services because GATS excludes public procurement services. The GPA requirements deal with investment once they apply to procurement of foreign products or services as well as to goods or services produced by locally established foreign suppliers. The Agreement on Subsidies and Countervailing Measures deals with subsidies. Because the Agreement includes in its definition of subsidies a number of commonly used investment incentives, it does not address this subject in terms of discrimination between foreign and domestic investment. For this reason, this Agreement tackles investment directly but it does not build up any significant incompatibility between foreign and domestic investment. Among them the TRIPs is the most interesting. It provides protection for intangible assets that form the basis of the activities of multinational corporations. It further requires that Members provide effective legal procedures and remedies for the enforcement of such rights.

[9] To the extent that trade in services may require a commercial presence by a foreign service-provider in the territory of another state, the provider may enjoy certain investment rights under the GATS. In the GATS, China made specific commitments in nine out of the 12 large sectors contained in the classification list generally used by Members for GATS scheduling purposes. There are comprehensive commitments related to market access through commercial presence. China has passed laws and regulations which implement those commitments. For example, with regard to value-added, basic mobile voice and data services, Foreign Service providers were permitted to establish joint ventures with the foreign equity restricted to 30%, and the geographic restrictions of providing services were gradually eliminated. To regulate foreign investments in this sector, the 'Provisions on Administration of Telecommunications Enterprises with Foreign Investment' have been promulgated by the State Council in December 2001 and amended in September 2008 (Laws and regulations indicated in this article are available at: http://www.fdi.gov.cn/pub/FDI_EN/Laws/default.jsp?type=530). In April 2004, MOFCOM approved "Measure for the Administration on Foreign Investment in Commercial Field", which permitted the establishment of foreign-funded commercial enterprises and cancelled the geographic restrictions as from 11th December, 2004. Similar foreign investment guidelines were issued by MOFCOM and other Ministries in service sectors, such as international maritime transportation (Provisions on the Administration of Foreign Investment in International Maritime Transportation, on 25th February, 2004) and advertising (Provisions on the Administration of Foreign-invested Advertising Enterprises, on 2nd March, 2004, amended on 22nd August, 2008).

[10] As underscored by Pasha Hsieh, China "has become increasingly active in WTO rule-making by submitting proposals to revise WTO rules and by appointing Chinese nationals to WTO bodies". But this movement has been reinforced by a significant shift "from having a passive attitude to

foreign investment is a crucial parameter of China's development, albeit the TRIMs is certainly not the most commented agreement of the WTO. The TRIMs remains however a frequent origin of trade dispute and is fundamentally the only multilateral agreement addressing investment in the field of goods (the major sector of export for China).[11] China's compliance with the TRIMs Agreement is the main focus of this article and it will be discussed in the following sections. We present the WTO contribution to disciplining China's investment policies (section "WTO Contribution to Disciplining Investment Policies"). The multilateral framework is logically followed by a presentation of the relevant Chinese domestic rules before and after accession (section "China Evolving Regulation of FDI: The Accession Effect"). This effort of compliance by China will be assessed in the light of WTO litigation over the past decade (section "Lessons and Prospects of TRIMs Litigation"). We conclude by drawing key lessons as to the enforcement of the TRIMs in China and its consequences for Chinese investments (section "In Lieu of Conclusion: The TRIMs, the WTO and Beyond").

WTO Contribution to Disciplining Investment Policies

In the Uruguay Round the Agreement on Trade-Related Investment Measures, which prohibits performance requirements involving quantitative restrictions, was adopted. Developing countries are frequent users (but by no means the only users) of TRIMs. The TRIMs Agreement has constituted a next step forward in the investment area at the multilateral level, firstly from the substantive point of view, but it also 'unambiguously and explicitly put investment policies on the multilateral agenda'.[12] It addresses investment measures that are trade-related and which violate Article III (National Treatment) or Article XI (general elimination of quantitative restrictions).

Basically, it prohibits member countries from making the approval of investment conditional on compliance with laws, policies or administrative regulations that

acting preemptively in its litigation approach, as demonstrated by a series of complaints that China filed against the US and the European Union from 2007 to 2010". See Hsieh, China's Development of International Economic Law and WTO Legal Capacity Building, Journal of International Economic Law 13 (2010) 4, p. 999.

[11] China amended the Foreign Trade Law in 2004, which replaced the examination and approval procedures by a registration requirement for the right to trade in goods and technology. China has made efforts to improve transparency, e.g., publication of all foreign trade-related laws, regulations, and rules in the China Foreign Trade and Economic Cooperation Gazette, establishment of enquiry points and enquiry websites under the Ministry of Commerce (MOFCOM) and the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ), and regular notifications to the WTO (See also Trade Policy Review, Report by the Secretariat, People's Republic of China, WT/TPR/S/161, 28th February, 2006).

[12] Brewer/Young: Investment issues at the WTO: the architecture of rules and the settlement of disputes, Journal of International Economic Law 1 (1998) 3, p. 462.

favoured domestic products. The scope of TRIMs regulation is pretty narrow. As an agreement that is based on existing GATT rules on trade in goods, the TRIMs Agreement is not concerned with the regulation of foreign investment. The disciplines of the TRIMs Agreement focus on the discriminatory treatment of imported and exported products and do not govern the issue of entry and treatment of foreign investment. Even if commentators frequently pointed out the shortcomings of this agreement, the TRIMs agreement adds value to the WTO system by describing types of trade-related investment measures that are considered to be inconsistent with GATT Article III or XI.

Prohibition of Trade-Distorting Restrictions

Governments often tend to impose trade-related investment measures (performance requirements) to achieve certain national priorities. These measures relate to trade-distorting restrictions imposed by the host country on multinational enterprises, which negatively influence trade as well as investment development. According to John Dunning,[13] performance-related measures may embrace the whole gamut of operating practice. They can notably include behavioural guidelines or requirements in respect of local purchases of capital goods, raw materials, intermediate goods and services, the proportion of output exported, the type of value added (e.g., R&D) undertaken by affiliates, information provided on intra-firm pricing practices, conditions attached by MNEs on the use of technology transferred.

The TRIMs Agreement, however, does not attempt to regulate the entry and treatment of foreign investment, but it applies only to those measures that impose discriminatory treatment on imported and exported goods. This Agreement recognizes that certain national practices, such as local content requirements, can restrict and distort trade and, therefore, supports the concept of ‘national treatment’. As a result, the Agreement outlaws investment measures that restrict quantities, and it discourages measures which limit a company’s imports or which set targets for the company in relation to exporting. Among the measures not covered by the Agreement are export performance requirements, technology transfer requirements, and subsidies to attract investments in specific industries or projects.

The Agreement did not define TRIMs, but provided an illustrative list (Annex 1). The lack of a precise definition means that the issue is not always clear-cut, and there has been disagreement as to whether or not certain measures are covered by the Agreement. Yet, the WTO has recognized that some of the TRIMs violate the principles of the GATT and it has required countries to abandon the TRIMs that have been identified as being inconsistent with the GATT rules.

[13] Dunning, Multinational Enterprises and the Globalization of Innovatory Capacity, Research Policy 23 (1994) 1, pp. 67–88.

A few things should be mentioned at this stage on the question of the relationship between TRIMs and GATT. The issue of the legal relationship between the GATT and the TRIMs Agreement arises when a measure is challenged under both agreements. Several panels have dealt with measures which have been challenged under both provisions of the GATT and Article 2.1 of the TRIMs agreement. Panels have analysed whether measures should be examined under the TRIMs Agreement before being examined under the GATT, based on the principle that, where two agreements apply, the more specific agreement should be examined before the more general agreement.[14] In another case, the panel analysed the measures in question under the GATT first, partly because India, the responding party, encouraged the panel to refrain from analysing the measures under the TRIMs Agreement. The panel then stated that 'for the purposes of this case, therefore, there appears to be, in that respect, no particular reason to start our examination on any particular order. Nor does it find that the end result would be affected by either determination of order of analysis'.[15] The order of analysis should not affect the outcome but may have an impact on the potential for panels to apply the principle of judicial economy.[16] WTO jurisprudence suggests that panels finding a violation of one of the agreements will consider that the action taken to remedy the inconsistencies under one agreement would necessarily remedy any inconsistencies under the other agreement.[17]

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[14] "As to which claims, those under Article III:4 of GATT or Article 2 of the TRIMs Agreement, to examine first, we consider that we should firstly examine the claims under the TRIMs Agreement because the TRIMs Agreement is more specific than Article III:4 as far as the claims under consideration are concerned. A similar issue was presented in *Bananas III*, where the Appellate Body discussed the relationship between Article X of GATT and Article 1.3 of the Licensing Agreement and concluded that the Licensing Agreement being more specific it should have been applied first. This is also in line with the approach of the panel and the Appellate Body in the *Hormones* dispute, where the measure at issue was examined first under the SPS Agreement since the measure was alleged to be an SPS measure" (footnotes omitted). Report of the Panel, Indonesia – Certain Measures Affecting the Automobile Industry, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, 2nd July, 1998, para. 14.63.

[15] Report of the Panel, India – Measures Affecting the Automotive Sector, WT/DS146/R, WT/DS175/R, 21st December, 2001, para. 7.158.

[16] See Report of the Panel, India – Measures Affecting the Automotive Sector, WT/DS146/R, WT/DS175/R, 21st December, 2001, paras. 7.158–7.161. See Matsushita/Mavroidis/Schoenbaum, *The World Trade Organization – Law, Practice and Policy*, 2003, pp. 527–529.

[17] "Under the principle of judicial economy, a panel only has to address the claims that must be addressed to resolve a dispute or which may help a losing party in bringing its measures into conformity with the WTO Agreement. The local content requirement aspects of the measures at issue have been addressed pursuant to the claims of the complainants under the TRIMs Agreement. We consider therefore that action to remedy the inconsistencies that we have found with Indonesia's obligations under the TRIMs Agreement would necessarily remedy any inconsistency that we might find with the provisions of Article III:4 of GATT". Report of the Panel, Indonesia – Certain Measures Affecting the Automobile Industry, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, 2nd July, 1998, para. 14.93.

Scope of TRIMs Regulation

TRIMs may be understood to be any measure taken by a government to discriminate between a domestically produced good and a good produced overseas. This includes:

- Local content requirements: where governments require a corporation to use or purchase domestic products in order to avoid a penalty or to benefit from an incentive.
- Trade-balancing measures where governments impose restrictions on the import of inputs by a corporation or limit the import of inputs in accordance with its level of exports.
- Foreign exchange balancing requirements where an enterprise has the level of imports linked to the value of its exports in order to maintain a net foreign exchange earning.

Article III:4 and Article XI:1 of the GATT are worded broadly enough to cover investment-related measures. Article III:4 of the GATT applies to 'all laws, regulations and requirements affecting . . . internal sale, offering for sale, purchase, transportation, distribution or use'. Article III:4 has been found to apply to investment-related measures that require the investor to use a certain amount of 'domestic content' in manufacturing operations.[18] Article XI:1 applies to 'prohibitions or restrictions' other than duties, taxes or other charges on the importation, exportation or sale for export of any product. By definition, we must emphasize that any measure that conditions investment upon export performance operated as a restriction.

The Illustrative List is annexed to the TRIMs Agreement and it 'provides additional guidance as to the identification of certain measures considered to be inconsistent with Article III:4 and XI:1 of the GATT 1994'.[19] As the *Indonesia – Automobiles* panel observed: 'An examination of whether the measures [in question] are covered by Item (1) of the Illustrative List . . . will not only indicate whether they are trade-related but also whether they are inconsistent with Article III:4 and thus in violation of Article 2.1 of the TRIMs agreement'.[20]

This List cites the following as examples of host-country investment measures that either restrict imports or exports or require imports or exports: local content requirement; export performance requirements; trade-balancing requirements; foreign exchange balancing restrictions; and restrictions on an enterprise's export or sale for export of products. Such measures are prohibited.

[18] Report of the Panel, Canada – Administration of the Foreign Investment Review Act (FIRA), L/5504 - 30 S/140, 7th February, 1984, p. 140.

[19] Report of the Panel, India – Measures Affecting the Automotive Sector, WT/DS146/R, WT/DS175/R, 21st December, 2001, para. 7.157.

[20] Report of the Panel, Indonesia – Certain Measures Affecting the Automobile Industry, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, 2nd July, 1998, para. 14.83.

Member states were then given a 'transition period' during which their notified TRIMs were to be eliminated. The TRIMs agreement provided for three different transition periods during which WTO Members, according to their level of development, must phase out WTO- inconsistent TRIMs that were notified to the Council on Trade in Goods.[21] A transition period allowed WTO Members to phase out WTO-inconsistent measures that were notified to the WTO under the TRIMs Agreement. If a government does *not* notify the WTO of an existing TRIM, then it is open to legal action by other WTO members. The length of time was based on a state's level of development: developed countries were given 2 years; developing countries were given 5 years; and least-developed countries were given 7 years. Therefore all developing countries should have implemented the TRIMs agreement and eliminated their regulations by 1st January, 2000. The problem with this notification provision is that failure to notify can be largely left unpunished because WTO remedies are always prospective.

The general WTO dispute settlement procedure, as laid down in the Dispute Settlement Understanding, also applies to disputes arising under the TRIMs Agreement (Article 8). Issues relating to the alleged inconsistency of particular measures with the TRIMs Agreement have been raised in a dispute settlement proceeding in which a panel was established in 1997 concerning measures applied by Indonesia in the automotive sector. We will detail this case and subsequent ones to examine in which circumstances the TRIMs Agreement has been used to regulate investment domestic regulations.

TRIMs Shortcomings: Issues and Options

The TRIMs Agreement bans a limited number of performance requirements insofar as they are inconsistent with GATT provisions on national treatment and quantitative restrictions. All Members needed to notify and phase out contravening measures, although developing and least-developed countries were granted transitive periods. The Agreement has considerably enhanced the transparency of investment policies around the world. To promote business and investment, it is very important to emphasize transparency. The TRIMs Agreement greatly relies on transparency because it requires each Member to notify of the publications in which TRIMs may be found, including those applied by regional and local governments and authorities.

But beyond these beneficial aspects, the TRIMs Agreement has several drawbacks.

[21] Art. 5.2 TRIMs: "Each Member shall eliminate all TRIMs which are notified under paragraph 1 within two years of the date of entry into force of the WTO Agreement in the case of a developed country Member, within five years in the case of a developing country Member, and within seven years in the case of a least-developed country Member".

Firstly, the Agreement is limited only to measures affecting trade in goods.

Secondly, the Agreement is notable for its lack of any reference to most-favoured-nation treatment, for the lack of a specific definition of investment; also fair and equitable treatment is also not mentioned in the Agreement.

Above all, whereas the Agreement prohibits a category of performance requirements that impact negatively upon trade (e.g., requirements to export a given percentage of goods), governments generally remain free to impose a broad range of other requirements on foreign investors including requirements to establish joint ventures, hire local employees (including from minority or disadvantaged groups), or invest in local research and development. In contrast to this, Article 1106 of NAFTA contains an extensive list of prohibited policies concerning export percentages, domestic content percentages, domestic purchase requirements or preferences, relationships between imports and exports or foreign exchange flows, relationships of domestic sales and exports or foreign earnings, technology transfer requirements, or exclusive supplier arrangements. Thus, NAFTA represents a significant advance in attempts to limit performance requirements. To the same extent, whereas the Agreement is only applicable to local content requirements and trade-balancing requirements, the Multilateral Agreement for Investment would have regulated the use of the following performance requirements: trade-related performance requirements such as the ratio of exports to total sales; the domestic content; local purchases; the ratio of imports to exports; and the ratio of local sales to exports.

Technically, TRIMs could be expanded by adding more examples to the Illustrative List.[22] This adds to the uncertainty about which aspects of a national industrial policy can or will be challenged in the WTO – either through a loose interpretation of TRIMs or additions to the Illustrative List.

China Evolving Regulation of FDI: The Accession Effect

All WTO Members, and therefore China, are bound by the obligation to adapt their legal systems to WTO law. This obligation must be seen from the point of view of the international organization for two reasons.[23] The first reason is the willingness to find tools that can ensure that international trade laws are enforced effectively on behalf of those who have undertaken to implement them. In this sense, the provision in Article XVI:4 does not contain anything original because that is the aim of every international organisation or of any entity that lays down rules intended to be

[22] See Edwards/Lester, Towards a More Comprehensive World Trade Organization Agreement on Trade Related Investment Measures, Stanford Journal of International Law 33 (1997), p. 169.

[23] See Chaisse/Chakraborty, Implementing WTO Rules through Negotiations and Sanction: The Role of Trade Policy Review Mechanism and Dispute Settlement System, University of Pennsylvania Journal of International Economic Law 28 (2007) 1, pp. 153–186.

enforced by a particular social body. At the same time, the obligation to conform is justified only insofar as its immediate object is to avoid any risk of conflict between two legal systems (the WTO system and Members' internal systems) as well as serious disputes between various Members of the organization.

China's national regulation of trade-distorting restrictions in foreign investment law had to in compliance with WTO law at the time of its accession to the organisation. China's national regulation of trade-distorting restrictions in foreign investment law is a three-tiered legal system,[24] consisting of constitutional rules, national laws, and sub-national laws. As a result, the current domestic legal framework for foreign investments which has been constructed as a result of the reforms and open policy as from 1978, has also experienced a major transformation in the years 2000 in order to comply with TRIMs. The Chinese efforts to comply will be interpreted.

China's Regulation of FDI: An Overview

Several law, regulations and measures apply to foreign investment in China.[25] The first piece of national legislation in this respect was the *Law on Chinese-Foreign Equity Joint Venture* (EJVL),[26] passed by the National People's Congress in 1979. In 1982, a new Article 18 was added to the Constitution. It requires all foreign enterprises and EJVL in China to abide by Chinese law, and it promises that their rights and interests are protected by Chinese law; the protection of foreign investments has thereby been granted in the Chinese Constitution.

A few years later, the *Law on Wholly Foreign-owned Enterprises* (WFEL, 1986)[27] and the *Law on Chinese-Foreign Contractual Joint Venture* (CJVL, 1988)[28] were promulgated. The EJVL, CJVL and WFEL, with their respective

[24] Chinese laws mentioned in this article are available at: http://www.fdi.gov.cn/pub/FDI_EN/Laws/ default.jsp?type = 530 (last visited on 15th March, 2011), most of which is also in an English version.

[25] The comprehensive list of norms reviewed in this paper is provided in Annex 1: List of Chinese norms with Trade-distorting Restrictions in Foreign Investment Law. For an overview, see Wolff, *Mergers and Acquisitions in China: Law and Practice*, (3rd ed.) 2009, pp. 5–24.

[26] The EJIL was adopted at the Second Session of the Fifth National People's Congress on 1st July, 1979. Under the Equity Joint Venture, the rights and obligations of the partners are divided in accordance with the equity/shares they possess.

[27] The WFEL was adopted at the Fourth Session of the Sixth National People's Congress on 12th April, 1986.

[28] The CJVL was adopted at the First Session of the Seventh National People's Congress on 13th April, 1988. Under the Contractual Joint Venture, everything, e.g., the investment or conditions for cooperation, the distribution of earnings, is defined by the joint venture contract between the partners.

implementing regulations,[29] constitute the basic legal framework for foreign investments in China. Besides, China has issued rules and regulations concerning some specific foreign investment forms, including: *Regulations on the Exploitation of Offshore Petroleum Resources in Cooperation with Foreign Enterprises* (REOFF, 1982); *Regulations on the Exploitation of Onshore Petroleum Resources in Cooperation with Foreign Enterprises* (REON, 1993); *Interim Provisions Concerning Some Issues on the Establishment of Joint Stock Limited Companies with Foreign Investment* (1995); *Interim Provisions on the Establishment of Investment Companies with Foreign Investment* (1995), replaced by *Provisions on the Establishment of Investment Companies with Foreign Investment* (2003); *Interim Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* (2003), replaced by *Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* (2006).

With respect to investment admission, the *Provisions on Guiding the Orientation of Foreign Investment* (hereafter the Guidance) was promulgated in 2002. The Guidance provides that the *Catalogue for the Guidance of Foreign Investment Industries* (hereafter the Catalogue) shall be formulated and revised in a timely way.[30] Projects with foreign investment are thereby classified into four categories, namely, encouraged, permitted, restricted and prohibited. The encouraged, restricted and prohibited industries are listed in the catalogue whereas all the others are classified as permitted by default. In addition, in order to encourage foreign investment into the underdeveloped Central-Western Region, a *Catalogue of Advantaged Industries for Foreign Investment in the Central-Western Region* was adopted,[31] and the industries listed therein may enjoy the preferential policies for the encouraged projects.

Prior to its accession to the WTO, as with many other developing countries, China believed that the imposition of performance requirements would enhance the value of the foreign investment,[32] and many such requirements were incorporated into the Chinese investment laws.

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[29] They are the Regulations for the Implementation the Law on Chinese-Foreign Equity Joint Venture (hereafter the Implementation Regulations of the EJVL), promulgated by the State Council on 20th September, 1983; the Detailed Rules for the Implementation of the Law on Wholly Foreign-owned Enterprises (hereafter the Implementation Regulations of the WFEL), approved by the State Council on 28th October, 1990 and promulgated by the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) on 12th December, 1990; and the Rules for the Implementation of the Law on Chinese–Foreign Contractual Joint Venture (hereafter the Implementation Regulations of the CJVL), approved by the State Council on 7th August, 1995 and promulgated by the MOFTEC on 4th September, 1995.

[30] Accordingly, the Catalogue was promulgated in 2002, and the latest revision took place in 2007.

[31] The latest revision in 2008.

[32] To the point of view of the developing countries in this respect, see Sornarajah, *The International Law on Foreign Investment*, 2004, p. 237.

- Local content: The local content requirement was incorporated into all Chinese basic laws on foreign investment. Article 9(2) of the EJVL (1990),[33] Article 57 of the Implementation Regulations of the EJVL (1983), Article 19 of the CJVL (1988), Article 15 of the WFEL (1986), as well as Articles 19 and 20 of the REOFF (1982), stipulated 'purchasing in China as far as possible'.
- Foreign exchange balancing: The foreign exchange balancing was another performance requirement, like the local content, which could be found in Chinese basic foreign investment laws. With respect to the EJVs, Article 75 of the Implementation Regulations of the EJVL (1983) explicitly provided for that a EJV shall in general maintain a balance between its foreign exchange receipts and expenditures. To this end, Article 14 required a statement in the joint venture contract relating to the arrangement for receipts and expenditures in a foreign currency. It is likely that Article 20 of the CJVL (1988), Article 18(3) of the WFEL (1986), Article 3, and Article 56 of the Implementation Regulations of the WFEL (1990) contained a foreign exchange balancing requirement.
- Export performance: There are several provisions in the Implementation of the EJVL (1983), which stipulated the export performance requirement:
- Article 4 set out the export performance as one of those selective requirements to be complied with when an EJV applied for the establishment;
- Article 14 provided for a statement in the joint venture contract relating to the ratio of products sold within China to those sold abroad;
- Article 28 required industrial property rights contributed as investment by the foreign investor to be capable of producing exports.

Export performance played an important role in the admission of the establishing a WFE in China. According to the Article 3 (1) WFEL (1986), the establishment of a WFE would be permitted only if it was export-oriented or technologically advanced. Therefore, in the Implementation Regulations of the WFEL (1990):

- Articles 10 and 15 required a statement relating to the ratio of products sold within China to those sold abroad for the application for establishment of a WFE, and, according to Article 45, the domestic sales should in general not exceed this ratio;
- Article 28 provided that industrial property rights contributed as investment by the foreign investor had to be capable of producing exports.

Complying with TRIMs

WTO allows its Members considerable room for manoeuvre as far as the formal conditions of conformity are concerned. In fact, it is not obligatory for WTO

[33] The EJIL from 1979 was revised in 1990 and adopted at the Third Session of the Seventh National People's Congress on 4th April, 1990.

members to comply in a determined, homogeneous and formal manner following the enactment of law incorporating these rules in their internal legal systems. "Conformity can be ensured in different ways in different legal systems. [...] Only by understanding and respecting the specificities of each Member's legal system, can a correct evaluation of conformity be established."[34] Hence the statement claiming that "it is the end result that counts, not the manner in which it is achieved".[35]

As the prospect of WTO accession had been cleared, China began with the revision of its investment laws to comply with the obligations of the TRIMs Agreement as well as the Accession Protocol by using different instruments such as laws, regulations and measures. It has to be noted that China had undertaken some TRIMs-plus obligations in its Accession Protocol.[36]

- Firstly, China committed itself to immediate compliance with TRIMs Agreement, without recourse to the provisions of Article 5, which provides for a transition period for the elimination of TRIMs.
- Secondly, China shall not only eliminate trade-balancing and foreign exchange balancing requirements, local content, and domestic sales requirements, which are explicitly mentioned in the Illustrative List, but also the export performance, which might be regarded as not included in the Illustrative List. Moreover, China undertook not to enforce the provisions of contracts imposing such requirements.
- Thirdly, China shall ensure that the distribution of import licences, quotas, tariff-rate quotas, or any other means of approval for importation, the right of importation or investment by national and sub-national authorities, are not conditional on performance requirements of *any kind*, including offsets, the transfer of technology, export performance, or the conduct of research and development in China.[37]

[34] The AB further affirms that "frequently the Legislator itself does not seek to control, through statute, all covered conduct. Instead it delegates to pre-existing or specially created administrative agencies or other public authorities, regulatory and supervisory tasks which are to be administered according to certain criteria and within discretionary limits set out by the Legislator. The discretion can be wide or narrow according to the will of the Legislator". Report of the Panel, United States – Sections 301–310 of the Trade Act of 1974, WT/DS152/R, 22nd December, 1999, para. 7.25.

[35] Report of the Panel, United States – Sections 301–310 of the Trade Act of 1974, WT/DS152/R, 22nd December, 1999, para. 7.24.

[36] Paragraph 7.3 of the Accession of the People's Republic of China, WT/L/432, 23rd November, 2001. China's major impact on WTO law stems from the special terms of the accession of this "gigantic transition economy", many of which depart from the basic norms and principles of the WTO law, see: Qin, China, India, and the Law of the World Trade Organization, in: Sornarajah/ Wang (eds.), *China, India and the International Economic Order*, 2010, p. 182.

[37] It could be an interesting question whether the structure of those China's commitments to TRIMs could contribute to the interpretation of the TRIMs Agreement, e.g., that export performance would be prohibited by the Agreement also, whereas technology transfers are not.

The results of China's efforts to comply with TRIMs requirements are synthesized in Table 1.

On 31st October, 2000, the State Council revised the CJVL[38] and the WFEL. A few months later, on 15th March, 2001, the EJVL was revised. Subsequently, the revision of the Implementation Regulations of the WFEL, on 12th April, 2001, and of the Implementation Regulations of the EJVL, on 22nd July, 2001, took place. Finally, the REOFF and the REON were revised on 23rd September, 2001.

By this revision,[39] the above-listed provisions of the respective laws were either deleted or amended.

- Article 9(2) of the EJVL (1990) was amended, and the new provision[40] read as follows: 'The joint venture may purchase the materials [...] either on the domestic or international market according to the principle of fairness and reasonableness.' Article 19 of the CJVL (1988) and Article 15 of the WFEL (1986) were amended in the same way. The local content requirement in Article 57 of the Implementation Regulations of the EJVL (1983) and Articles 19 and 20 of the REOFF (1982) were simply deleted.
- With respect to the foreign exchange balancing, Article 75 of the Implementation Regulations of the EJVL (1983), Article 20 of the CJVL (1988), Article 18 (3) of the WFEL (1986) and Article 56 of the Implementation Regulations of the WFEL (1990) were deleted. The 'arrangement for receipts and expenditures in foreign currency' in the Article 14 of the Implementation Regulations of the EJVL (1983) was moved away from the required content of joint venture contract. Article 3 of the Implementation Regulations of the WFEL (1990) was revised. Instead of the explicit foreign exchange balancing requirement, the new version of this provision provided that the State 'encourages the establishment of export-oriented wholly foreign-owned enterprises'.
- The export performance requirements in the Implementation Regulations of the EJVL (1983) were deleted, including: Article 4; the phrase 'the ratio of products sold within China to those sold abroad' in Article 14; and the requirement in Article 28 that industrial property rights contributed as investment by the foreign investor must be capable of producing exports. Likely, in the Implementation Regulations of the WFEL (2001), the phrase 'the ratio of products sold within China to those sold abroad' in Articles 10 and 15, and the requirement relating to

[38] The Implementation Regulations of the CJVL were not subject to this revision, probably because they were promulgated in 1995, later than were the other basic investment laws, and they did not contain the prohibited TRIMs.

[39] For a brief notification of this revision of the WTO by China, see Communication From China, G/TRIMS/W/27, 22nd October, 2002. Since then, China has made annual Communications, as follows: G/TRIMS/W/34 from 2003, G/TRIMS/W/40 from 2004, G/TRIMS/W/45 from 2005, G/TRIMS/W/51 from 2006, G/TRIMS/W/56 from 2007, G/TRIMS/W/59 from 2008, and G/TRIMS/W/64 from 2009. Except the Communication from 2008, other Communications did contain little, if any, new information.

[40] Renumbered as Art. 10 of the EJVL (2001).

Table 1 China's Compliance with TRIMs

Piece of legislation	Key provisions	Year of entry into force	Content of revision
Revision of the EJVL		2001	
	Article 9 (2)		Deleted the phrase 'purchasing in China as far as possible'
Revision of the Implementation Regulations of the EJVL		2001	
	Article 57		Deleted the phrase 'purchasing in China as far as possible'
	Article 14		Deleted foreign exchange balancing and export performance requirement
	Article 75		Deleted
	Article 4		Deleted
	Article 28		Deleted export performance requirement
Revision of the REOFF		2001	
	Articles 19 and 20		Deleted
Revision of the WFEL		2000	
	Article 15		Deleted the phrase 'purchasing in China as far as possible'
	Article 18 (3)		Deleted
	Article 3 (1)		Substituted by the encouragement of export
Revision of the Implementation Regulations of the WFEL		2001	
	Article 3		Substituted by the encouragement of export
	Article 56		Deleted
	Article 10		Deleted the phrase 'the ratio of products sold within China to those sold abroad'
	Article 15		Deleted the phrase 'the ratio of products sold within China to those sold abroad'
	Article 28		Deleted the requirement that industrial property rights contributed as foreign investment to be capable of producing exports
Revision of the CJVL		2000	
	Article 19		Deleted the phrase 'purchasing in China as far as possible'
	Article 20		Deleted

Source: Constructed by the author from China's national law the industrial property rights in Article 28 were also abolished. Moreover, the compulsory condition for WFEs to be export-oriented or technologically advanced was deleted. Instead, the new Article 3 of the WFEL (2001) provides that the State ‘may encourage’ the establishment of WFEs of that kind. Accordingly, Article 45 of the Implementation Regulations of the WFEL was changed to read: ‘A wholly foreign-owned enterprise may sell its products in Chinese market. The State encourages wholly foreign-owned enterprises to export their products.’

Hence, the revision of Chinese basic investment laws to comply with the TRIMs Agreement took place prior to the WTO accession. Provisions obviously in contradiction with the obligations in the TRIMs Agreement and those in the Accession Protocol were deleted. On the other hand, it has to be noted that this revision was extensive.[41] Its most important objective was perhaps the compliance with the WTO obligations. Nevertheless, some provisions which were not covered by the WTO rules were amended too, because they were unsuitable to new circumstances in reform and development.[42]

Interpreting China’s TRIMs Compliance

With respect to this revision, one may make some interesting observations.

Firstly, the deletion of TRIMs in the EJVL was thorough and neat, but not in the WFEL. The latter still explicitly *encourages* the WFEs to export their products. Whether this is consistent with the TRIMs Agreement or not will be discussed below. The possible considerations underpinning such differences are noteworthy. In an EJV, Chinese partners play a part in the decision of the enterprise, and they may still learn something from the foreign partners. Thus, the State may consider it as sufficient to benefit domestic industries and development. This is not the case in a WFE. Therefore, the State would encourage the WFEs to be export-oriented and technologically advanced, in order to make foreign investment beneficial to development.

Secondly, the extensiveness of the revision could imply that it was not only the compliance with the WTO obligations, but also a part of the autonomous reform of the legal framework on foreign investment. From the Chinese point of view, the progressive reform of the legal system in accordance with its development level would be as important as the compliance with the international law obligations. China’s attitude towards the performance requirements in general seems to be unchanged, namely, as mentioned above, that they would consider the value of

[41] For a comprehensive description of this revision, see Shan, Towards a Level Playing Field of Foreign Investment in China, Journal of World Investment 3 (2002) 2, p. 327.

[42] Ibid, p. 334.

the foreign investment. Logically, China would impose those performance requirements, which were deemed necessary for development, but not, at least not obviously, in contradiction with the TRIMs Agreement.

The willingness of China to maintain certain performance requirements can be proved by its practice of BITs and investment chapters in the FTAs. The US Model BIT[43] and FTAs, for example the US–Singapore FTA,[44] explicitly prohibit an extended list of performance requirements which go beyond the TRIMs Agreement. Although the ASEAN Comprehensive Investment Agreement, an agreement among developing countries, does not provide for the prohibition of performance requirements as do the US BITs, it is open to further development in this respect, as the Member States shall undertake assessment to consider the need for additional commitment.[45] On the other hand, Chinese BITs and FTAs have not dealt with the issue of performance requirements until now. The only exception is the China–New Zealand FTA (2008), which provides that the TRIMs Agreement shall be incorporated *mutatis mutandis* into the FTA (Article 140). Because both states are WTO Members such a provision does not have practical significance.

Lessons and Prospects of TRIMs Litigation

A given law, independently of its application in a precise case (and comparatively without any actual damage), can be incompatible with the WTO law as reaffirmed on several occasions in jurisprudence.[46] This is what the Panel means when it states that Article XVI:4 "though not expanding the material obligations under WTO agreements, expands the type of measures made subject to these obligations",[47] without, however, claiming that it does not induce a widening of the range of the obligations. The three types of measures explicitly made subject to the obligations imposed in the WTO Agreements ("*laws, regulations and administrative*

[43] Art. 8 of the 2005 Model BIT of the USA, available at: http://www.state.gov/documents/organization/ 117601.pdf (last visited on 20th January, 2011).

[44] Art. 15.8 of the United States – Singapore Free Trade Agreement, available at: http://www.ustr.gov/trade-agreements/free-trade-agreements (last visited on 20th January, 2011).

[45] Art. 7 of the ASEAN Comprehensive Investment Agreement, available at: http://www.aseansec.org/ documents/FINAL-SIGNED-ACIA.pdf (last visited on 20th January, 2011).

[46] Report of the Panel, Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and other Items, WT/DS56/R, 25th November, 1997, paras. 6.45–6.47. Regarding the same case, Report of the Appellate Body, Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and other items, WT/DS56/AB/R, 27th March, 1998, paras. 48–55. Also see Report of the Panel, Canada – Export Credits and Loan Guarantees for Regional Aircraft, WT/DS222/R, 28th January, 2002, paras. 9.124 and 9.208, Report of the Panel, Turkey – Restrictions on Imports of Textile and Clothing Products, WT/DS34/R, 31st May 1999, para. 9.37.

[47] Report of the Panel, United States – Sections 301–310 of the Trade Act of 1974, WT/DS152/R, 22nd December, 1999, para. 7.41.

procedures")) are measures that are applicable generally; not measures taken necessarily in a specific case or dispute.

Basically, the TRIMs Agreement prohibits Member Countries from making the approval of investment conditional on compliance with laws, policies or administrative regulations that favour domestic products. The Agreement did not define TRIMs, but it provided an illustrative list (Annex 1). The lack of a precise definition means that the issue is not always clear-cut and there has been considerable disagreement as to whether or not certain measures are covered by the Agreement.

The TRIMs Agreement prohibits WTO Members from applying TRIMs that are inconsistent with Article III of the GATT. The TRIMs Agreement prohibits WTO Members from applying TRIMs that are inconsistent with Article XI of the GATT. We will the see the potential for TRIMs disputes which involve China. In 2007, the case *China – Measures Granting Refunds, Reductions or Exemptions from Taxes* stopped at the consultation stage, whereas the case *China – Measures Affecting Imports of Automobile Parts* reached the Appelate Body in 2008. None of these two cases offer significant lessons but we can anticipate further disputes by looking at the current Chinese legislation.

Inconsistency with GATT Article III:4

Article III:1 of the GATT 1994 establishes a general principle according to which internal regulations and taxes should not be applied 'so as to afford protection to domestic production'. It informs, as a chapeau, the following paragraphs of the provision. Paragraph 2 stipulates national treatment in relation to internal taxes and other internal charges, whereas Paragraph 4 sets out the general obligation to accord imported products treatment no less favourable than that accorded to like products of national origin in respect of internal laws and regulations affecting the sale and use of such products. The second notion of equal treatment and mainstay of the world trading system under the WTO is the principle of national treatment prohibiting discrimination between products (goods and services) produced domestically and those imported from other member countries. Together with the MFN obligation, it forms the fundamental principle of non-discrimination in WTO law in the limit of existing exceptions.[48]

In regulations explicitly treating domestic and imported products differently, a violation of the national treatment obligation is obvious because an internal law affecting the sale of products, or a tax, on its face has discriminatory effect. Most regulations, however, are designed in a neutral and *de jure* non-discriminatory

[48] National treatment is subject to a number of important exceptions, thus permitting differential treatment for various policy reasons. In the GATT 1994, the most common exceptions are stipulated in Art. III:8 (subsidisation and government procurement), Art. XVI (subsidies), Art. XIX (safeguard measures), Art. XX (general exceptions) and Art. XXI (security exceptions).

manner but nonetheless result in *de facto* discriminatory treatment of imported products. The distinction between *de jure* and *de facto* discrimination is often difficult to draw and blurred in practice. The problem is related to the scope of protection under national treatment. Since the early days of the GATT 1947, the scope of national treatment has been read in broad terms and thus has traditionally covered *de facto* discriminations extensively.

The Illustrative List annexed to the TRIMs Agreement sets out two categories of 'TRIMs that are inconsistent with the obligation of national treatment provided for in [Article III:4 of the GATT]'[49] TRIMs that are inconsistent with Article III:4 include TRIMs that are:

> 'mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which require:
> - the purchase or use by an enterprise of products of domestic origin or from any domestic source [. . .]' or
> - 'that an enterprise's purchases or use of imported products be limited to an amount related to the volume or value of local products that it exports'.[50]

For example, it is a violation of the requirement of national treatment for an investment measure to require the purchase of local products by foreign enterprises to be tied in with its exports. In *Indonesia – Certain Measures Affecting the Automobile Industry*, the panel ruled on the legality of an Indonesian car programme linking tax benefits for cars manufactured in Indonesia to domestic content requirements and linking customs duty benefits for imported components of cars manufactured in Indonesia to similar domestic content requirements. The panel found that these local requirements were 'investment measures' because they had a significant impact on investment in the automotive sector[51] and that they were 'trade-related' because they affected trade.[52] The panel also found that compliance with the requirements for the purchase and use of products of domestic origin was necessary in order to obtain the tax and customs duty benefits and that such benefits were 'advantages' within the meaning of the Illustrative List.[53] As a result, the panel ruled that the local content requirements violated the TRIMs Agreement.[54]

[49] TRIMs Annex, para. 1.

[50] TRIMs Annex, para. 1.

[51] Report of the Panel, Indonesia – Certain Measures Affecting the Automobile Industry, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, 2nd July, 1998, para. 14.80.

[52] Report of the Panel, Indonesia – Certain Measures Affecting the Automobile Industry, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, 2nd July, 1998, para. 14.82.

[53] Report of the Panel, Indonesia – Certain Measures Affecting the Automobile Industry, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, 2nd July, 1998, paras. 14.89–14.91.

[54] Report of the Panel, Indonesia – Certain Measures Affecting the Automobile Industry, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, 2nd July, 1998, para. 14.91.

Inconsistency with GATT Article XI:1

Article XI of the GATT 1994 stipulates the general elimination of quantitative restrictions. Article XI of the GATT 1994 prohibits any measure other than duties, taxes or other charges 'or other measures having equivalent effect'. Therefore, it is not the legal form of the measure but its effect on trade which is important.

The GATT regulation on quantitative restrictions, however, has a limited effect because of the many exceptions. Article XI allows for the following exceptions to this prohibition:

- Temporary export restrictions of foodstuffs or other 'essential' products when there is a shortage of such products on the national market;
- Import restrictions on agricultural and fishery products when these restrictions are part of a national policy of subsidising agricultural prices;
- Restrictions on basic products which follow from an international agreement on basic products.

Moreover, Article XIII:1 prohibits any form of discrimination in the establishment or application of import or export restrictions; quantitative restrictions must apply equally to all third countries (thus, not only to the other GATT members).

Furthermore, quantitative restrictions are also permitted on the basis of other exceptions, particularly for the protection of the balance of payments and the currency reserves of contracting states and for the protection of domestic industries against serious injury. Quantitative restrictions are mainly lifted within regional unions or on the basis of other co-operation agreements.

The Illustrative List annexed to the TRIMs Agreement sets out three categories of 'TRIMs that are inconsistent with the obligation of general elimination of quantitative restrictions provided for in [Article XI:1 of the GATT]'.[55] TRIMs that are inconsistent with Article XI:1 include TRIMs that are:

Mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which restrict:

> the importation by an enterprise of products used in or related to its local production, generally or to an amount related to the volume or value of local production that it exports;
>
> (b) the importation by an enterprise of products used in or related to its local production by restricting its access to foreign exchange to an amount related to the foreign exchange inflows attributable to the enterprise; or
>
> (c) the exportation or sale for export by an enterprise of products.

For instance, it is a violation of prohibitions of quantitative restrictions when investment measures require an enterprise to use its own foreign exchange reserve to import products. The prohibition of quantitative restriction is similarly violated if export is tied in in any way with the local production. In 2001, the *India – Measures Affecting the Automotive Sector* case involved a TRIM requiring 'trade balancing'.

[55] TRIMs Annex, para. 2.

In May 1999 the government of the United States of America lodged a complaint against the Indian government for the auto industry measures it introduced in November 1997. Under the 1997 law, the Indian government required all new foreign auto manufacturing investments to sign a standard Memorandum of Understanding (MoU) with the government establishing:

- A minimum US$50 million investment in joint ventures with majority foreign ownership;
- A waiver of import licences if local content exceeds 50%;
- And the obligation to export within 3 years, with possible restrictions on imports for CKD and SKD if export requirements are not met.

According to the Panel, as of the date of the establishment of the trade-alancing condition, 'there would necessarily have been a practical threshold to the amount of exports that each manufacturer could expect to make, which in turn would determine the amount of imports that could be made. This amounts to an import restriction. The degree of effective restriction which would result from this condition may vary from signatory to signatory depending on its own projections, its output, or specific market conditions, but a manufacturer is in no instance free to import, without commercial constraint, as many kits and components as it wishes without regard to its export opportunities and obligations'.[56] The Panel therefore found that the 'trade balancing condition contained in Public Notice No. 60 and in the MoUs signed thereunder, by limiting the amount of imports through linking them to an export commitment, acts as a restriction on importation, contrary to the terms of Article XI:1'.[57]

After finding that the trade-balancing requirements violate GATT Article XI:1, the India – Measures Affecting the Automotive *Sector* panel invoked the principle of judicial economy and concluded that it was not necessary to analyse the measures under the TRIMs Agreement.[58]

The TRIMs Agreement has an indirect impact on national policies, which may affect the activities of foreign firms.[59] Indeed, as stated above, this agreement relates to local-content requirements and incentives such as tax concessions tied to exports. Domestic regulations in these areas violate the principle of national treatment (Article III GATT) and the prohibition of quantitative restrictions (Article XI GATT). These restrictions are therefore forbidden under the TRIMs Agreement.

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[56] Report of the Panel, India – Measures Affecting the Automotive Sector, WT/DS146/R, WT/DS175/R, 21st December, 2001, para. 7.277.

[57] Report of the Panel, India – Measures Affecting the Automotive Sector, WT/DS146/R, WT/DS175/R, 21st December, 2001, para. 7.278.

[58] Report of the Panel, India – Measures Affecting the Automotive Sector, WT/DS146/R, WT/DS175/R, 21st December, 2001, paras. 7.323–7.324.

[59] Edwards/Lester, Towards a More Comprehensive World Trade Organization Agreement on Trade Related Investment Measures, Stanford Journal of International Law 33 (1997), pp. 169 et seq.

The TRIMs Agreement also prohibits other measures that violate Articles III and IV of the GATT 1994, such as trade-balancing requirements, foreign exchange restrictions related to foreign exchange inflows, and export controls.

The TRIMs Agreement has also been referred to in the disputes concerning the European Community's import regime for bananas; however, the panels established in those disputes did not make any findings under the TRIMs Agreement. Besides, measures taken by Brazil and the Philippines have been the subject of bilateral consultations pursuant to the TRIMs Agreement.[60]

China as a Defending Party? Some Prospects

The TRIMs firstly appeared as a possible cause of violation in 2007 in the case *China – Measures Granting Refunds, Reductions or Exemptions from Taxes* initiated by the USA.[61] The main issue was about Chinese measures providing refunds, reductions or exemptions to enterprises in China on the condition that those enterprises purchase domestic over imported goods, or on the condition that those enterprises meet certain export performance criteria. To the extent the measures accord imported products treatment less favourable than that accorded 'like' domestic products, they were alleged to be inconsistent with Article III:4 of the GATT 1994 and Article 2 of the TRIMs Agreement. However, China and USA reached an agreement in relation to this dispute, in the form of a memorandum of understanding. However, in terms of practice the main candidates for litigation are the Chinese laws and regulations addressing export performance, technology transfer, and industrial policies.

As discussed above, the compulsory local content, foreign exchange balancing, and export performance requirements were deleted from Chinese basic investment laws by their revision prior to the WTO accession. Nevertheless, the WFEL still explicitly encourages the WFEs to export their products. Besides, according to Article 10 of the Guidance from 2002, the permitted projects with foreign investment of which the products are all directly exported shall be regarded as the encouraged projects. Consequently, such projects would enjoy preferential treatments according to relevant laws and administrative regulations (Article 9 of the Guidance), which would not be granted to 'normal' permitted projects. Accordingly, the Catalogue from 2004 explicitly listed permitted projects with foreign investment, and which export all of their production, as encouraged projects. The consistency of such kind of encouragement of export performance with the China's WTO obligations is questionable. This is because the TRIMs Agreement clearly

[60] Kennedy, A WTO Agreement on Investment: A Solution in Search of a Problem?, University of Pennsylvania Journal of International Economic Law 24 (2003), p. 145.

[61] China – Certain Measures Granting Refunds, Reductions or Exemptions from Taxes and Other Payments – Request for Consultations by the United States, WT/DS358/1, 7th February, 2007.

provides that it prohibits not only those TRIMs which are mandatory or enforceable under domestic law or under administrative rulings, but also those the compliance with which is necessary to obtain an advantage. Although the Guidance does not require a permitted foreign investment project to export, it would 'obtain an advantage', i.e. being upgraded to encouraged projects and accordingly enjoying certain preferential treatments, if it export all its products. Hence, it should be quite certain that this kind of upgrade constitute a TRIMs, which is inconsistent with China's WTO obligations. China should be aware of that and abolished this upgrade from the Catalogue 2007.[62] However, the Guidance has not been revised, and Article 10 of the Guidance remains unchanged. Soon after the 2000 revision, the encouragement provision of the WFEL was questioned by commentators.[63] Nevertheless, the consistency of that provision with WTO obligations seems to be not as sceptical as that of the Guidance and the Catalogue 2004. Because the WFEL does not clearly provide whether the State should encourage export performance in all cases and how it would be encouraged. In other words, the consistency depends on the practical implementation of that encouragement provision. Hence, it is not at all unexpected that the USTR Report laid stress on the questionable practice when it referred to such encouragement.[64]

China has been actively exploring international collaboration for technology transfer. Some doubts also concern the Regulations for the Implementation of the Law on Sino–Foreign Equity Joint Ventures.[65] The Sino–Foreign Equity Joint Ventures was amended several times since the accession with a view to removing all articles that were in contradiction with the TRIMs Agreement. However, some doubts have been expressed that Articles 41 and 43 of this Law still imposed requirements on technology transfer agreements concluded by Joint Ventures. In reference to Article 41, technology has to be 'appropriate and advanced'. The question is to know whether Article 43 contains a compulsory requirement that foreign investors must include a technology transfer agreement in their contract.[66] Should this be the case, there is a rick of a TRIMs violation.

Last but not least, China industrial policies are other types of measures which could be a problem in connection with China's WTO obligations. The most famous one was the *Measures on the Importation of Parts for Entire Automobiles*, which

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[62] See also 2010 USTR Report to Congress on China's WTO Compliance (hereafter the USTR Report), available at: http://www.ustr.gov/webfm_send/2460 (last visited on 20th January, 2011), p. 68. The questionable Chinese measures discussed in this article are also noted by the USTR Report.

[63] See for example Shan, Towards a Level Playing Field of Foreign Investment in China, Journal of World Investment 3 (2002) 2, p. 338.

[64] See USTR Report, p. 67.

[65] On this see Wolff, *Mergers and Acquisitions in China: Law and Practice*, (3rd ed.) 2009, p. 1.113.

[66] Doubts have been expressed in 2008 by the EU delegation, see Committee on Trade-Related Investment Measures, Minutes of the Meeting Held on 23rd October, 2008, G/TRIMS/M/27, 29th October, 2008.

had triggered a WTO case, i.e., China – Measures Affecting Imports of Automobile Parts.[67] This case concerns China's measures on imports of automobile parts. The measures impose a 25% charge on imported auto parts used in the manufacture of motor vehicles in China, if the imported auto parts are 'characterized as complete vehicles' according to specified criteria prescribed under the measures. The complainants notably challenged the consistency of the measures with China's obligations under Article 2 of the TRIMs Agreement and paragraph 1(a) of Annex 1. China's measures were considered by the EU, the USA and Canada as being inconsistent with Article 2 of the TRIMs Agreement. In essence, these measures fall within the types of measures covered in the Illustrative List in the Annex to the TRIMs Agreement. The Chinese measures at issue provide an advantage, i.e., an exemption from paying the internal charge and related burdensome administrative requirements, for auto manufacturers that decide to purchase or use domestic auto parts. Thus, the measures require 'the purchase or use by an enterprise of products of domestic origin or from any domestic source' so as 'to obtain an advantage'; they fall squarely within the Illustrative List of measures covered by the TRIMs Agreement.[68] Although the measure did not formally require the use of domestic auto parts, it would bring about in practice. The panel firstly decided to address the claims under GATT Article III, then, because it found that the measure is inconsistent with Article III, the Panel exercised judicial economy with respect to the claims under the TRIMs Agreement[69] and, as a result, the Appellate Body did not have to re-examine the measures in the light of the TRIMs agreement. Nevertheless, it is clear from the decisions of that case that the measure is inconsistent with the TRIMs Agreement, too. In September 2009, China abolished this inconsistent measure.

In Lieu of Conclusion: The TRIMs, the WTO and Beyond

The present paper analyses the Chinese regulations and successive reforms of foreign investment. Following the failure to install a multilateral framework on foreign investment within the OECD as well as within the WTO, opinions diverge as to whether approaches to regulate FDI through multilateral regulations should

[67] Report of the Panel, China – Measures Affecting Imports of Automobile Parts, WT/DS339/R, WT/DS340/R, WT/DS342/R, 18th July, 2008.

[68] Report of the Panel, China – Measures Affecting Imports of Automobile Parts, WT/DS339/R, WT/DS340/R, WT/DS342/R, 18th July, 2008, paras. 3.1(a), 3.4(c), and 3.7(d). In addition, the United States claimed that the measures fell within paragraph 2(a) of the Illustrative List in Annex 1 to the *TRIMs Agreement*. (Report of the Panel, para. 3.4(c)).

[69] Report of the Panel, China – Measures Affecting Imports of Automobile Parts, WT/DS339/R, WT/DS340/R, WT/DS342/R, 18th July, 2008, paras. 8.2, 8.5, and 8.8. See also, Report of the Appellate Body, China – Measures Affecting Imports of Automobile Parts, WT/DS339/AB/R, WT/DS340/AB/R, WT/DS342/AB/R, 15th December, 2008.

continue. This paper does not intend to give an answer, but it can be observed that the Chinese experience reflects current regulatory uncertainities because it firstly concludes that the TRIMs compliance by China is satisfactory as demonstrated by recent litigation.

At the WTO, China has been pro-active in amending its internal laws and no dispute had ended before the DSB with a determination of TRIMs violations by China. The experience of China to date in the WTO, when it comes to investment measures, can be described as a successful one. The TRIMs Agreement prohibits certain measures that violate the national treatment and quantitative restrictions requirements of the GATT. Prohibited TRIMs may include requirements to: achieve a certain level of local content; produce locally; export a given level/percentage of goods; balance the amount/percentage of imports with the amount/percentage of exports; transfer technology or proprietary business information to local persons; or balance foreign exchange inflows and outflows. These requirements may be mandatory conditions for investment, or can be attached to fiscal or other incentives. As is suggested by the case law, China has been doing well because only a small number of disputes with China as the defending party have included TRIMs measures. The absence of disputes does not however mean that all regulations are being fully complied with and we identified a few of them which are good candidates for a prompt clarification. Despite the relative lack of WTO coverage on investment, many WTO Members have seized on the WTO accession process as a lever to encourage prospective Members to go beyond the WTO agreements on investment and investment-related issues, and China is a very good case in point. They believe, with some justification, that they will never have more leverage as long as a State wants to join the WTO. As a result, investment-related issues have become an important aspect of WTO accession: prompt compliance with the requirements of TRIMs industrial policy, including subsidies under the SCM Agreement market for access for certain types of investment, including financial services and telecom.

International investment law fragmentation is also reflected in the fact that the accession to the WTO did contribute to the development of the new generation of Chinese BITs in several aspects. Because of the market access and national treatment commitments in the GATS, China has made further liberalization of investment regime in its service sectors. The acceptance of the national treatment standard in China was pushed forward by the WTO accession. The trade liberalization has promoted China's economic development, which has resulted in the rapid increase of Chinese outward investment and a growing interest in the protection of Chinese investments in foreign countries. With respect to the performance requirements, the WTO accession and the undertaking of obligations of the TRIMs Agreement has had little influence on China's BITs and FTAs. There are still some performance requirements in the Chinese investment regime; their consistency with the TRIMs Agreement and China's Accession Protocol is at least questionable.

Beyond the WTO commitments related to foreign investments, China has undertaken obligations to protect foreign investments in a large number of BITs and Free Trade Agreements (FTAs). Following the reforms and open policy from 1978, and beginning with the first Chinese BIT between China and Sweden (1982), China has signed more than 120 BITs, second in number only to Germany.[70] In accordance with the progressive integration of China's economy into that of the rest of the world, Chinese BITs have reflected the gradual acceptance of high-level investment protection in China, especially with respect to the national treatment standard and the investor-state arbitration mechanism. In the Chinese BITs signed in the 1980s and 1990s, only a fraction of them contained a provision of national treatment, whereas the fair and equitable treatment and the most-favoured-nation treatment had usually been provided for. The absence of a national treatment provision had been seen as a speciality of Chinese BITs in comparison with BITs signed by other countries.[71] But since 2000, the post-establishment national treatment obligation has been stipulated in most of the new Chinese BITs. With regard to the investor-state arbitration provisions, the access of foreign investors to international arbitration was restricted to disputes concerning an amount of compensation by the former Chinese BITs. The China–Barbados BIT from 1998 is the first Chinese BIT, in which the contracting parties have granted a far-reaching consent to international arbitration for 'any dispute concerning investments'.[72] Since then, similar investor-state arbitration consent has been given by most of the Chinese BITs conducted in the 21st century. Because these new Chinese BITs contain substantial improvements both with respect to investor's substantive rights (national treatment) and procedural rights (investor-state arbitration),[73] they constitute a new generation of Chinese BITs.

There are many reasons for this development. The first two directly derive from the WTO experience and they are the understanding and accepted practice of national treatment and international litigation. The third reason is a consequence of a globalised world into which China is fully integrated and needs now to protect its (growing) investment abroad. The accession to WTO has generally contributed to the acceptance of granting national treatment to foreigners. The WTO accession and 'culture' has also played a role in a better understanding of international litigation. China has changed its perception of the international judge role[74] and accepted international investment arbitration which has witnessed an exponential

[70] UNCTAD, Recent Developments in International Investment Agreements (2008 – June 2009), IIA Monitor (2009) 3, available at: http://www.unctad.org/en/docs/webdiaeia20098_en.pdf.

[71] WTO, The Development Provisions, WT/WGT/W/119, available at: http://docsonline.wto.org.

[72] But it did not provide for national treatment.

[73] It is in the 1998 Sino-Barbadian BIT that for the first time China agreed to allow foreign investors to resort to international arbitral tribunals without specific consent from the Chinese government. See Hsieh, China's Development of International Economic Law and WTO Legal Capacity Building, Journal of International Economic Law, 13 (2010) 4, p. 1005.

[74] China tended for many years to employ strategies of "dispute avoidance", see Hsu, China, India and Dispute Settlement in the WTO and RTAs, in: Sornarajah/Wang (eds.), *China, India and the International Economic Order*, 2010, pp. 255–259.

surge of investment disputes between foreign investors and host country governments. Traditionally, China has restricted unilateral consent to arbitration to disputes on the amount of compensation to be granted in cases of expropriation. Controversies on other matters, such as the existence of expropriation itself, or breaches of treatment obligations, were to be settled in domestic courts, or could be submitted to arbitration by mutual consent of the investors and national authorities.[75] The new generation of Sino–Foreign BITs have instead eliminated this substantial restriction, granting unilateral consent to disputes concerning all disciplines of the agreement. Finally, a number of investment agreements require the foreign investor to fulfil certain procedural requirements prior to filing the arbitration claim.[76] Last but not least, there is surely a desire to attract more foreign investment into China, but the growing interest in the protection of Chinese investors in foreign countries by means of BITs should also underpin the acceptance of high-level investment protection in BITs.[77]

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[75] See, for instance, China-Korea BIT, Art. 9.3. for a discussion, see Xiao, Chinese Bilateral Investment Treaties in the 21st Century: Protecting Chinese Investment, in: Chaisse/Gugler (eds), *Expansion of Trade and FDI in Asia: Strategic and Policy Challenges*, 2009, pp. 122–130.

[76] The most usual procedural restrictions pertain to waiting periods and the exhaustion of local remedies. Both of these types of requirement are commonly found in Sino-Foreign BITs. Prior to the launch of the arbitration, foreign investors must hold negotiations with the host country's authorities with a view to reaching an amicable settlement. Should these negotiations fail to bring the parties to a commonly agreed solution within a 6-month period, the investor may bring the claim to international arbitration. Whereas the great majority of Sino-Foreign BITs require a 6-month waiting period, a few agreements require somewhat shorter periods – i.e., 3 months: BITs with the Netherlands (2001), Germany (2003), and Finland (2004) – or, exceptionally, no waiting period at all – i.e., Ghana (1989).

[77] For a detailed discussion to the new generation of Chinese BITs, see Xiao, Chinese Bilateral Investment Treaties in the 21st Century: Protecting Chinese Investment, in: Chaisse/Gugler (eds.), *Expansion of Trade and FDI in Asia*, 2009, p. 122. There are views that Chinese BITs should be divided into three generations, yet in different periods, see Cai, China-US BIT Negotiations and the Future of Investment Treaty Regime: A Grand Bilateral Bargain with Multilateral Implications, Journal of International Economic Law 12 (2009) 2, pp. 457 et seq. (462); Gallagher/Shan, *Chinese Investment Treaties: Policies and Practice*, 2009, pp. 35–43. Indeed, those changes which lead to the differentiation of three generations are also important. Nevertheless, the two-generations-analysis would be simpler and properly reflect the more significant and consistent improvements mentioned here.

implications of this research. Thanks also are due to Ms Yaling ZHANG from CUHK Faculty of Law for the background research and for producing the information synthesized in Table 1 and Annex 1.

Annex 1: List of Chinese Norms with Trade-Distorting Restrictions in Foreign Investment Law[78]

Law

Law on Chinese-Foreign Equity Joint Venture, 2001; (PRC Sino-Foreign Equity Joint Venture Law, Second Revision) Adopted in 1979, first amended in 1990

PRC Sino-Foreign Equity Joint Venture Law Implementing Rules, adopted in 1983, revised in 1986, 1987 and 2001

PRC Sino-Foreign Cooperative Joint Venture Law, adopted in 1988, revised in 2000

PRC Sino-Foreign Cooperative Joint Venture Law Implementing Rules, adopted in 1988, revised in 2000

PRC Wholly Foreign-Owned Enterprises Law, adopted in 1986, revised in 2000

PRC Wholly Foreign-Owned Enterprises Law Implementing Rules, adopted in 1990, revised in 2001

Regulations on the Implementation of Enterprise Income Tax Law of the People's Republic of China, 2008

Rules for the Implementation of the Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises, adopted in 1991. repealed

Regulations and Measures

Changes in Equity Interest of investors in Foreign-Invested Enterprises Several Provisions, 1997

Asset Reorganization by State-Owned Enterprises Using Foreign Investment Tentative Provisions, 1998

Investment within China by Foreign-Invested Enterprises Tentative Provisions, 2000

Merger and Division of Foreign-Invested Enterprises Provisions (Revised), 2001

[78] Available at: http://www.fdi.gov.cn/pub/FDI_EN/Laws/ default.jsp?type = 530 (last visited on 15th March, 2011).

Issues Relevant to the Transfer of State-Owned Shares and Legal Person Shares in Listed Companies to Foreign Investor Circular, 2002
Using Foreign Investment to Reorganize State-Owned Enterprises Tentative Provisions, 2003
Decision of the State Council on Reforming Foreign Investment System, 2004
Administration of Equity Investment of Overseas Financial Institutions in Chinese-Funded Financial Institutions Procedures, 2004
Measures for the Administration on Foreign Investment in Commercial Fields, 2004
Supplementary Provisions on the Establishment of Companies with an Investment Nature by Foreign Investors Provisions (or Supplementary Provisions on the Establishment of Investment Companies by Foreign Investors), 2006
Establishment of Companies with an Investment Nature by Foreign Investors Provisions, 2004
Supplementary Provisions to the Establishment of Companies with an Investment Nature by Foreign Investors Tentative Provisions, 1999
Establishment of Companies with an Investment Nature by Foreign Investors Tentative Provisions, 1995
Administration of Strategic Investment in Listed Companies by Foreign Investors Procedures, 2005
Foreign Investment Industrial Guidance Catalogue (Amended in 2007)
The Foreign Investment Industrial Guidance Catalogue (Amended in 2004)
Administration of the Takeover of listed Companies Procedures, 2007
Guidelines for the Administration of Entry of Foreign Investments, 2008
Provisions of State Council on Declaration Threshold for Concentration of Business Operators, 2009
Catalogue of Dominant Industries for Foreign Investments in Central and Western China, 2009
Provisions on Merger and Acquisiton of Domestic Enterprises by Foreign Investors, adopted in 2003, revised in 2006, 2009
Notice of the General Office of the State Council on Launching the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, 2011
Interim Provisions on Issues Related to the Implementation of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, 2011