

LITHUANIA, CHINA AND EU LAWFARE TO COUNTER ECONOMIC COERCION

Breaking bad?



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Steven Blockmans is Director of Research at CEPS. He is also a Professor of EU External Relations Law and Governance at the University of Amsterdam and editor-in-chief of the *European Foreign Affairs Review*.

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Without any formal notification, China recently declined customs clearances for shipments from Lithuanian firms in the pharmaceutical, electronics, and food sectors, and warned multinationals of secondary sanctions if they did not sever their ties with Lithuania. These covert actions were taken in response to Lithuania's invitation to Taiwan, which the People's Republic of China (PRC) claims as its own territory, to open a 'representative office' in Vilnius. No other country has ever found itself at the receiving end of such intense and politically motivated Chinese economic pressure.

While the immediate cost of the alleged de-listing is not expected to be much higher than the pain inflicted since the summer¹, after Lithuania pulled out of the '17+1' diplomatic grouping in which China engages central and eastern European states, it is politically explosive because it raises serious questions about the international conduct of the Chinese Communist Party (CCP). If it can simply wipe a country off its trade book, a state belonging to the EU's customs territory no less, then what does it mean to be a member of the WTO, or a signatory to any other number of international agreements? And, given the lamentable state the WTO is in: could the Commission's newly proposed anti-coercion instrument bring any solace to Lithuania and the EU?

Did China just tear up the WTO rulebook?

This episode is the latest iteration of China's normative economic statecraft applied to adversaries of CCP policies. Over the years, the PRC has developed a growing appetite to sanction selected commodities: from Norwegian salmon and Philippine bananas, to an exceptionally high 13 hits in the case of Australia. The goal is to force the targeted state to change its policy to fall in line with CCP interests but not to halt trade. To be sure, China is not the only country to throw its global economic weight around like this. The US has been using the status of the dollar as a reserve currency for years to threaten foreign companies and individuals with financial sanctions, wherever they are. Our recent review of such 'secondary sanctions' regimes and their evolving geopolitical contexts predicted that the PRC would follow suit in using these measures. Just four days after Lithuania noticed that its trade had been cut by the PRC, President Xi called for promoting the development of a system of Chinese laws for extraterritorial application.

In the case at hand, however, the CCP has escalated its economic coercion to an entirely new level. By reportedly de-listing Lithuania from the Chinese customs administration's country list on December 1, Beijing has –despite a brief blip– blocked all trade, in either direction. Outside of wartime conditions, full trade bans are extraordinarily rare. The constellation of UN Security Council-mandated arms embargoes and trade sanctions on North Korea and US primary and secondary sanctions on Iran come close. But China's de-listing of Lithuania from its customs declaration system is *de facto* the most comprehensive trade sanction any country can apply.

¹ China amounts to less than 1 % of Lithuania's exports.

China has never done this before, not even to Taiwan, which —as a customs territory— is a member of the WTO.

China's action is not only unprecedented, it also constitutes a serious threat to the integrity of the multilateral rules-based trade system. It is entirely incompatible with the PRC's membership of the WTO and indeed casts a dark shadow over the 20th anniversary of its accession to the WTO that fell this month on 11 December. Refusing to administratively recognise another member as a customs territory breaks almost every provision in the WTO rulebook. If confirmed, then Beijing's decision effectively puts a bomb under the WTO, which was already limping on one leg after the Trump administration refused to replenish the quorum of the appellate body. While the latter did not kill the entire dispute settlement procedure, it has dramatically stunted it. How other WTO members respond to China's massive violation will determine the future of the global rules-based trade order.

How to respond?

In a letter addressed to the European Commission and EEAS, the Lithuanian foreign minister asked for EU solidarity against China's economic coercion. The initial EU level reaction, and that from fellow Baltic and other Member States for that matter, was not quite as strong as the signal that Vilnius had hoped for. A Commission spokesperson meekly defended Lithuania's Taiwan-office move by saying that 'the EU doesn't think the Taiwan representative office, which is not an embassy or a consulate, should be of any issue'. Declaring, more assertively, in a joint statement issued two days later, that 'the development of China's bilateral relations with individual EU Member States has an impact on overall EU-China relations', Commission Vice-President Dombrovskis and High Representative Borrell vowed 'to stand up against all types of political pressure and coercive measures applied against any Member State'. But they also reserved time for the EU to study the Chinese action, see if it was a one-off or systematic, and assess the compatibility of China's action with its obligations under the WTO. The EU's initial advances were knocked back when the Chinese customs authority first rejected a request by the Commission to clarify the situation, claiming it was too preoccupied with the coronavirus pandemic, and then stonewalled the EU Ambassador to China when they did agree to a meeting. As in previous instances of Chinese pressure (diplomatic and other) applied on a Member State (cf. Sweden), the EU-level channel was effectively closed by Beijing.

Within the confines of standing international law, and absent the mediation and arbitration mechanisms enshrined in the frozen bilateral Comprehensive Agreement on Investment, the EU could take WTO action against China. But preparing the evidence to file a complaint takes time; the procedure leading to a first panel ruling a further 18 months. And even if China has joined the multi-party interim appeal arrangement, the workaround mechanism that various countries set up after the US put the WTO appellate body into the deep freeze, a decision allowing for retaliatory measures would be far from certain and too late anyway to save Lithuanian businesses that trade with China from the brink of collapse. Anticipating WTO

reform would be akin to waiting for Godot. So, which other avenues remain for the EU to address and resolve existing trade issues with China?

An eye for an eye...

Over the past two years, the ‘geopolitical’ Commission has been working steadily to fill its toolbox with instruments that can be used in a more proactive and targeted fashion to protect European industry from exposure to unfair trade practices. These ‘surgical’ instruments include a new export control regulation on sensitive dual-use goods and technologies; support for Member States in setting up a fully-fledged European FDI screening mechanism; a legislative proposal to address potential distortive effects of foreign subsidies in the single market; and a proposal for due diligence legislation to ensure that EU companies trade in a sustainable and fair manner, especially with regard to rules on forced labour.

The Commission has also put tools in place to assertively enforce the commitments on market access and sustainable development contained in the EU’s trade agreements with third countries: the first EU Chief Trade Enforcement Officer was appointed in 2020 and the so-called enforcement regulation was updated to enable the EU to suspend or withdraw concessions or other obligations under its trade agreements. This update was done specifically so that the EU can better respond to future breaches by third countries of international trade rules that impact the Union’s commercial interests in situations where dispute settlement under the WTO or bilateral agreements are blocked.

To deter, desist or —as a last resort— counteract the kind of economic blackmail exerted by China, a country with which the EU has no bilateral trade and/or investment agreement, the Commission has now proposed legislation for an ‘anti-coercion instrument’ (ACI). This potentially game-changing geopolitical tool is not targeted at China but geared up to deflect forms of economic coercion by *any* third country. In fact, work on the ACI started at a time when the EU faced threats from the Trump administration, specifically retaliatory car tariffs and a ‘trade war’ over the adoption of the EU digital services tax. The ACI is an attestation of the fact that the EU now inhabits a global environment of interdependence that is based on power, not rules.

The Commission’s proposal defines economic coercion as ‘seeking to pressure the Union or a Member State into making a particular policy choice by applying, or threatening to apply, measures affecting trade and investment’. The coercive measures could be aimed towards any area of EU or Member State activity, such as taxation, food safety, climate protection, and the forms of pressure include twisting rules, selective border food-safety checks, and state-sponsored boycotts of goods of a certain origin. Had the ACI been in place sooner, then possible triggers would have included Russia’s boycott of EU produce in 2014 after the Union imposed sanctions over the downing of a Malaysia Airlines flight over Ukraine and an effective ban by Indonesia on EU spirit imports in 2019, in response to action the Union had taken to tackle palm oil production, a leading cause of deforestation.

Under the proposed regulation, the Commission would be able to respond swiftly to secure a cooling-off period. It would first assess the form of pressure —whether the intent is coercion and if there is a clear systematic pattern of action by the third country— and the level of interference, as suggested by Dombrovskis and Borrell in their joint statement in support of Lithuania. The Commission could attempt dialogue and negotiations with the country concerned to de-escalate the situation and might even seek mediation or cooperation from other partners. If talks did not solve the issue, the Commission could, after detailed consultation with stakeholders and with Member State approval, take 12 possible countermeasures. These include levying tariffs and imposing quotas and public procurement restrictions; banning chemical imports; restricting intellectual property protection; suspending science cooperation; curbing access to EU-funded programmes; and 'the imposition of restrictions for banking, insurance, access to Union capital markets and other financial services activities'. The measures could be taken against companies or individuals. To be sure, these countermeasures would not only have to be proportionate, consistent with international law and designed to make the country halt its actions, they would also have to be crafted to cause the EU the least amount of economic damage. They would thus need to be removed or suspended if the economic pressure is lifted.

... makes the world go blind?

'The weaponisation of trade for other geopolitical purposes is a fact,' Vice-President Dombrovskis told reporters when officially presenting the Commission's ACI proposal. Using exclusive trade competences rather than foreign policy instruments would certainly give the Commission more leeway to respond to the blunt economic hammer wielded by China on Lithuania. The ACI only requires a qualified majority vote in the Council and a simple majority in the European Parliament before it can enter into force. And when forged and implemented in a WTO compatible way, this form of 'lawfare' would allow the EU to defend itself more quickly and through more finely honed surgical strikes, thereby substantially raising the cost of illegal practices by adversaries.

Make no doubt about it, the latter point is key: the EU would not be fighting fire with fire. The EU is bound to its own rulebook, which includes the promotion of, and respect for, international law. Its autonomous countermeasures should therefore not be put on the same level as the coercive trade policies of global hegemonies that undermine the integrity of the multilateral rules-based trade system. Worries about the EU exacerbating trade disputes, inviting retaliation and accelerating a 'global trade arms race' may be warranted, but critics of the ACI and other EU lawfare instruments should consider that these tools are intended to defend the multilateral rules-based order which has allowed the Union, and the process of globalisation, to grow and prosper for the past few decades. It is in the EU's interest to try and uphold this order with every legal means it can muster, while simultaneous attempts are made to adjust it for tomorrow's global trade purposes. The alternative might look bleaker still: one where collective trade alliances slug it out over the WTO's freshly dug grave, a grave the unchained hegemonies would have helped to dig.