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THE IMPACT OF WTO ACCESSION ON CHINA'S LEGAL SYSTEM:  
TRADE, INVESTMENT AND BEYOND

Julia Ya Qin

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## **The Impact of WTO Accession on China's Legal System: Trade, Investment and Beyond**

Julia Ya Qin

*Abstract: This paper assesses the impact of China's accession to the World Trade Organization on its foreign trade and investment regime. While the government had begun liberalizing the Chinese economy long before joining the WTO, the accession induced regulatory, institutional and normative changes that have transformed the landscape of trade and investment in China. The profound impact of the WTO stems directly from the extensive commercial and rule commitments China undertook in its accession. Focusing on the most significant of these commitments, the paper examines their implications for Chinese constitutional law and their effect on the regulation of foreign trade, foreign investment, intellectual property rights, and domestic governance. In addition, it looks at enforcement of China's commitments through the WTO review and dispute settlement mechanisms. The paper concludes that China's WTO accession has made its foreign trade and investment regime far more liberalized and less opaque than a decade ago. More importantly, the accession has institutionalized the process of China's domestic reform externally through the force of WTO obligations. Although much uncertainty remains concerning the future direction of government policies, WTO membership ensures that the course of China's economic development will be charted within the disciplines of the WTO system.*

## The Impact of WTO Accession on China's Legal System: Trade, Investment and Beyond

Julia Ya Qin\*

The foreign trade and investment regime in China has undergone profound change over the past decade. Compared to ten years ago, the Chinese system today is far more liberalized, open and transparent. Much of the progress occurred as a result of China's accession to the World Trade Organization (WTO), which, after fifteen years in the making, finally took place on December 11, 2001. In its accession agreement,<sup>1</sup> China made extensive commitments to lower its trade and investment barriers, further economic reforms, and improve its domestic governance, many of which exceeded the requirements of the WTO Agreement.<sup>2</sup> To implement its WTO obligations, the Chinese government has conducted a major legislative overhaul. Thousands of laws, regulations, rules, and judicial interpretations relating to WTO matters have been scrutinized and a large number of them have been revised or repealed. Over this period, trade and investment barriers have been reduced across the board. The central government has largely shifted its role in the economy from exerting direct control to being a regulator in the marketplace. More significantly, WTO norms, such as market economy, nondiscrimination, and transparency, have gained wide acceptance in the Chinese public. The regulatory, institutional and normative changes brought about by the WTO accession have transformed the landscape of trade and investment in China.

Corresponding to these changes, China's foreign trade and investment has grown tremendously following its WTO accession. From 1996 to 2005, foreign trade increased nearly five folds, of which more than three-fourths took place after the accession.<sup>3</sup> During the same period, China became one of the top destinations for foreign direct investment (FDI). The FDI inflow since 2001 accounted for more than one-third of the total amount of the actually utilized foreign investment since 1979.<sup>4</sup> The expansion of foreign

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\* Associate Professor of Law, Wayne State University Law School, United States. I am grateful for comments and suggestions on previous drafts to Donald Clarke and other participants at the Conference on 'Developments in Chinese Law: The Past Ten Years' organized by The China Quarterly and held at All Souls College, Oxford University, in September 2006, at which an earlier version of this paper was presented. I also wish to thank Milan G. Hejtmanek for his editorial assistance.

<sup>1</sup> *Protocol on the Accession of the People's Republic of China*, WT/L/432 (10 November 2001) (the Protocol), which incorporates by reference selected paragraphs of *Report of the Working Party on the Accession of China*, WT/MIN(01)/3 (10 November 2001) (WPR). The texts of the Protocol and WPR are available at [www.wto.org](http://www.wto.org).

<sup>2</sup> See Agreement Establishing the World Trade Organization (15 April 1994) and its annexes, which contain agreements on trade in goods, trade in services, trade-related intellectual property rights, dispute settlement and trade policy review mechanism, available at [www.wto.org](http://www.wto.org).

<sup>3</sup> The total value of China's imports and exports was \$289.9 billion in 1996, \$509.5 billion in 2001, and \$1,422.1 billion in 2005. Source: China National Bureau of Statistics.

<sup>4</sup> At the end of 2005, the total actually utilized foreign investment was US\$622 billion; the inflow of FDI from 2001 to 2005 was about \$275 billion. See WTO Trade Policy Review, *Report by the People's Republic of China*, WT/TPR/G/161 (17 March 2006), paras. 3 and 4.

investment in turn has fueled China's external trade. As of 2005, nearly 60% of China's imports and exports were conducted by foreign-invested companies, as compared to approximately 50% in the year before the WTO accession.<sup>5</sup>

In the meantime, accelerated globalization of the Chinese economy as a result of the WTO accession has given rise to new issues. The rapid economic growth powered by foreign trade and investment has been at the cost of severe environmental degradation and widening wealth disparity. As the central government readjusts its development strategy towards a more balanced and sustainable growth, however, it has also increased state intervention in the economy. With more foreign competitors entering the Chinese market, protectionism and economic nationalism is on the rise.<sup>6</sup> There are signs that government is tightening control over foreign businesses and has dragged its feet in implementing some of the more difficult WTO commitments. Hence, it seems not at all certain that China's foreign trade and investment regime will continue to develop in the same direction in the post-accession era.

To be sure, China pursued WTO membership because it was consistent with the objectives of its domestic reform. For more than two decades prior to its WTO accession, China had engaged in economic liberalization unilaterally. The decision of the Chinese leaders to accept the many onerous obligations of its WTO membership was motivated primarily by their desire to introduce external pressures to overcome internal obstacles in the reform process. In the grand scheme of China's development strategy, therefore, WTO accession was only one step, albeit a critical one, in the direction of the ongoing reform. And the Chinese reform agenda is much broader than what is called for by its WTO commitments.

Nonetheless, WTO accession marks the formal integration of China into the global trading system. The accession has institutionalized China's systemic reforms through the force of international legal obligations. Upon joining the WTO, whether China stays on the course of reform and how it chooses to pursue its economic development is no longer purely a matter of its domestic policy; instead, it has become a matter subject to the scrutiny of the WTO. While in theory China can always break away from the WTO or in practice find ways to evade its WTO commitments, it cannot do so without incurring considerable political and economic costs. It is in this sense that WTO

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<sup>5</sup> In 2005, imports and exports by foreign-invested enterprises accounted for 58.5% of China's total foreign trade, and the corresponding figure for state-owned enterprises was 25.7%. See WTO Trade Policy Review: *Report by the Secretariat – People's Republic of China*, WT/TPR/S/161/Rev.1 (26 June 2006) (TPR Report), p. 2, fn. 7. In comparison, foreign-funded enterprises accounted for 48% of the exports and 52% of the imports in 2000, and 41% of the exports and 54% of the imports in 1996. See Nicholas R. Lardy, *INTEGRATING CHINA INTO THE GLOBAL ECONOMY* (Washington, D.C.: Brookings Institution Press, 2002), p. 7, Table 1-1.

<sup>6</sup> Domestic critics argue that China has become overly dependent on trade, that economic liberalization has benefited foreign investors more than China, and that China has been unfairly discriminated against in international trade. See Wang Yong, *China in the WTO: A Chinese View*, *The China Business Review*, Sept.-Oct. 2006, p. 42, at 46-47.

membership performs a constitutional function for its members.<sup>7</sup>

This article seeks to assess the impact of WTO accession on the Chinese legal system pertaining to foreign trade and investment. Following a brief introduction on the nature and scope of China's WTO commitments, the article will examine their constitutional implications and survey the major changes they have brought about in the regulation of foreign trade, foreign direct investment, intellectual property rights, and domestic governance. It will then examine how China's compliance has been monitored and enforced at the WTO. The article will conclude with some thoughts on the future prospects of China and the WTO.

## I. Nature and Scope of China's WTO Commitments

The WTO represents a liberal trading system that aims to increase the welfare of trading nations by reducing government restrictions on trade. WTO jurisdiction extends to trade in goods and services, and trade-related investment and intellectual property. It prescribes two types of obligations for its members: (a) market access obligations, which are commitments by each member to open up domestic markets to specific goods and services produced by other members; and (b) rule obligations, which are WTO rules of conduct for international trade. Market access commitments vary from member to member and can be renegotiated periodically.<sup>8</sup> WTO rules of conduct, on the other hand, are uniform and cannot be changed easily.<sup>9</sup> WTO rules are extensive, covering not only border measures, such as customs tariffs and import restrictions, but also internal measures affecting trade, such as domestic taxation and regulation, health and technical standards, government subsidies, investment requirements, and intellectual property protection. All WTO obligations are enforceable through the WTO dispute settlement mechanism, which features compulsory jurisdiction and binding decisions. Failure to implement WTO dispute settlement rulings on the part of a losing party may lead to trade sanctions authorized by the WTO.<sup>10</sup> The WTO also monitors trade practices of all members through various notification requirements and regularly conducted trade policy reviews.

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<sup>7</sup> It has been generally accepted that one of the essential functions of the world trading system is to prevent governments from giving in to domestic protectionist pressure. *See generally*, Frieder Roessler, *The Constitutional Function of the Multilateral Trade Order*, in *ESSAYS ON THE LEGAL STRUCTURE, FUNCTIONS & LIMITS OF THE WORLD TRADE ORDER* (Cameron May, 2000), pp. 109-53; Steve Charnovitz, *Triangulating the World Trade Organization*, *American J. of Int'l Law*, Vol. 96, No. 1 (2002), p. 28, at 43-45. *See also* WTO website: 10 Benefits of the WTO Trading System, available at [www.wto.org](http://www.wto.org).

<sup>8</sup> *See* art. XXVIII of the General Agreement on Tariffs and Trade (GATT); art. XXI of the General Agreement on Trade in Services (GATS). GATT and GATS are set out in Annexes 1A and 1B, respectively, of the WTO Agreement.

<sup>9</sup> Revision of the WTO Agreement is very difficult due to the elaborate and stringent requirements for amendment. *See* WTO Agreement, art. X.

<sup>10</sup> In the case of such a failure, the losing party is required to compensate the winning party or risks retaliation by the winning party in the form of tariff and/or non-tariff measures, subject to authorization by the WTO Dispute Settlement Body. *See* Annex 2 to the WTO Agreement: Understanding on Rules and Procedures Governing the Settlement of Dispute (DSU), art. 3.7.

As an acceding member, China was obliged to make its own market access commitments and to abide by WTO rules. The scope and depth of China's market access commitments is unprecedented in WTO history. For trade in goods, China agreed to bind all tariffs at low statutory rates, a commitment few countries have made.<sup>11</sup> For trade in services, China's commitments are much more extensive than the commitments offered in the Uruguay Round by any other group of countries, including high income ones.<sup>12</sup> This level of trade liberalization is particularly remarkable considering that China is still a developing country.<sup>13</sup> Even more remarkable, however, is the whole set of special rule commitments China made with its accession.<sup>14</sup> These China-specific rules fall into two categories. The first category prescribes obligations that exceed the requirements of generally applicable WTO rules. These 'WTO-plus' obligations address matters concerning market economy conditions, foreign investment, and domestic governance. The second category concerns treatment of Chinese exports by other countries. These provisions essentially permit an importing member to deviate from standard WTO disciplines to use trade remedies (antidumping, anti-subsidy and safeguard measures) against Chinese products on a discriminatory basis. While some of these China-specific rules have built-in expirations, others are permanent in duration. Furthermore, China has agreed to forgo some of the special and differential treatment available to developing country members under the WTO agreements.

All of the market access and rule obligations undertaken by China are enforceable through the WTO dispute settlement mechanism. Moreover, to ensure China's implementation of its extensive commitments, a special transitional review mechanism was set up to monitor its compliance. Under this mechanism, China's practice is subject to annual review by other members during the first eight years after its accession, followed by a final review before the end of the tenth year.<sup>15</sup> This transitional review mechanism is separate from the trade policy reviews regularly conducted by the WTO on its members.<sup>16</sup>

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<sup>11</sup> Lardy, *supra* note 5, p. 79.

<sup>12</sup> Aaditya Mattoo, *China's Accession to the WTO: The Service Dimension*, J. International Economic Law, Vol. 6, No. 2 (2003), pp. 299-339, at 302-04.

<sup>13</sup> Developing countries generally maintain a relatively high level of trade barriers to protect their domestic industries from foreign competition. For instance, the average statutory tariffs on industrial products in Argentina, Brazil, India and Indonesia are 30.9%, 27%, 32.4% and 36.9%, respectively, as compared to 8.9% committed by China. *See* Lardy, *supra* note 5, pp. 79-80. For a comparison in the coverage of specific commitments in services between high-income countries, low and middle-income countries, large developing countries and China, *see* Mattoo, *supra* note 12, p. 303, Table 1.

<sup>14</sup> *See generally*, Julia Ya Qin, "WTO-Plus" Obligations and Their Implications for the WTO Legal System – An Appraisal of the China Accession Protocol, J. World Trade, Vol. 37, No. 3 (2003), pp. 483-522.

<sup>15</sup> *See* Protocol, section 18.

<sup>16</sup> The first regular trade policy review on China was conducted by the WTO in 2006. The review report contains more than 300 pages of text and statistical information detailing China's economic and trade policies, institutions, laws and practices. *See* TPR Report, *supra* note 5.

In sum, China has undertaken extraordinary obligations exceeding those of any other member of the WTO. In fact, the WTO accession protocol is the first treaty of the People's Republic that contains explicit discriminatory terms.<sup>17</sup> But why was the Chinese government willing to take on such onerous burdens? The question seems even more puzzling considering that, under the most-favored-nation treatment (MFN) clause contained in its bilateral trade agreements, China was already enjoying WTO MFN tariff rates in trade with all of its major trading partners, and WTO membership would not necessarily offer much additional market access to Chinese exports.<sup>18</sup> While the motives of the Chinese leaders may never be fully known, one thing has become clear: the government intended to utilize external forces - the increased foreign competition inherent in its market access commitments and the multilateral disciplines imposed by the WTO - to transform the ailing state sector in the economy.<sup>19</sup> In order to achieve this strategic objective, the government was willing to accept certain discriminatory and unfair treatment as part of the cost. In other words, WTO accession was, first and foremost, a strategic decision on the part of the leadership to further liberalize China's economy. The tremendous growth in trade and investment following the accession is the direct result of such liberalization. This essential character of China's WTO accession is not always well understood.

## II. Impact of WTO Accession on the Chinese Legal System

The WTO is the first international organization joined by China that is vested with the authority to police a wide range of domestic policies of its members. The WTO is also the first international organization joined by China that is equipped with a mandatory dispute settlement mechanism with compulsory jurisdiction over all of its members.<sup>20</sup> The WTO accession, therefore, presents many new challenges to the Chinese system.

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<sup>17</sup> The discriminatory terms of the WTO accession agreement are reminiscent of the 'unequal treaties' of China in the late 19<sup>th</sup> and early 20<sup>th</sup> centuries, although the historical unequal treaties were typically imposed on China by foreign powers under the threat of force. *See generally*, Wang Tiewa, *International Law in China: Historical and Contemporary Perspective*, Recueil des Cours, Vol. 221, pp. 205-369 (1990-II).

<sup>18</sup> With WTO accession, China could expect two major improvements in market access in other members. One was to secure permanent MFN treatment in the United States. Although the U.S. had granted MFN to China bilaterally since 1979, the renewal of China MFN was subject to annual Congressional approval. Because the WTO requires MFN be granted on a permanent and unconditional basis, China expected to secure a more stable market access to the U.S. upon accession. The other expected market access improvement was in textile trade. The decades-old global quota system in textile trade was scheduled to be replaced by a tariff-based system for all WTO members at the end of 2004, which would benefit more competitive textile exporters such as China. But the discriminatory textile safeguard of the Protocol put a limit on the expansion of China textile exports. *See infra* text at notes 59 and 60.

<sup>19</sup> For an insightful analysis in this regard, *see* Lardy, *supra* note 5, pp. 9-21. A similar view is expressed in Donald C. Clarke, *China's Legal System and the WTO: The Prospects for Compliance*, Washington U. Global Studies Law Rev., Vol. 2, pp. 97-98 (2003).

<sup>20</sup> The PRC has not consented to the jurisdiction of the International Court of Justice (ICJ) or other major international courts. While China has submitted to the jurisdiction of the International Center for Settlement of Investment Disputes (ICSID), the ICSID is an arbitration center whose jurisdiction in the case of China is limited to investment disputes between the Chinese government and foreign investors over issues of

One of the first issues encountered by the Chinese system is the domestic legal effect of the WTO Agreement. The PRC Constitution is silent about the status of treaties under Chinese law and whether a treaty can be directly applied in China without domestic legislation.<sup>21</sup> This issue had not commanded wide attention prior to WTO accession since few treaties previously entered by China prescribe such a large number of obligations requiring domestic implementation as the WTO Agreement. After much debate, a consensus has emerged that the WTO Agreement does not have direct legal effect under Chinese law and instead must be applied through enabling domestic legislation.<sup>22</sup> In other words, the obligations of the Chinese government under the WTO Agreement can only be enforced in Chinese courts through the enforcement of domestic enabling legislation.<sup>23</sup>

Irrespective of the legal effect of the WTO Agreement under Chinese law, however, China is bound by all of its WTO obligations as a matter of international law. Failure on the part of China to implement such obligations, therefore, will subject it to possible sanctions under WTO rules, regardless of the status of WTO obligations under its domestic law.

#### A. Constitutional Implications

Among the ‘WTO-plus’ obligations undertaken by China, several directly bear upon the fundamental aspects of its economic system and therefore are constitutionally significant. These include the commitments of the Chinese government: (a) to let market forces determine prices of all goods and services except for a few specified categories;<sup>24</sup> (b) to allow, within three years of the accession, all enterprises, including all foreign individuals and entities, whether invested or registered in China, to engage in imports and

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compensation resulting from expropriation and nationalization. Information regarding China’s participation in ICSID is available at [www.worldbank.org/icsid](http://www.worldbank.org/icsid).

<sup>21</sup> The PRC Constitution provides for the supremacy of the Constitution over all laws, administrative regulations and local rules, but does not mention treaties or international agreements to which China is a party. *See* PRC Constitution, art. 5.

<sup>22</sup> For a detailed analysis, *see* Clarke, *supra* note 19, pp. 99-104.

<sup>23</sup> This view has been confirmed by the Supreme People’s Court. *See Provisions on Several Issues concerning the Adjudication of Administrative Cases Relating to International Trade* (Guanyu Shenli Guoji Maoyi Xingzheng Anjian Ruogan Wenti de Guiding), issued by the SPC on 27 August 2002, effective 1 October 2002, arts. 7, 8 and 9.

<sup>24</sup> Protocol, section 9. Annex 4 of the Protocol lists goods and services that may still be subject to price controls. They include: (i) four categories of goods (tobacco, edible salt, natural gas and pharmaceuticals) and four categories of service sectors (public utilities, postal and telecommunication services, entrance fee for tour sites, and education services) which may remain subject to government pricing; and (ii) six categories of goods (grain, vegetable oil, processed oil, fertilizer, silkworm cocoons and cotton) and six service sectors (transport services, professional services, commission agents’ services, banking services, prices of residential apartments, and health related services) which may remain subject to government guidance pricing. In addition, China is required to make best efforts to reduce and eliminate those price controls and not to extend such controls beyond those specified in Annex 4 except in exceptional circumstances and with notification to the WTO. *See also* WPR, paras. 50-64.

exports of all goods, and to limit state trading to a list of specified products,<sup>25</sup> and (c) not to influence, directly or indirectly, commercial decisions of state-owned enterprises (SOEs) except in a manner consistent with the WTO Agreement.<sup>26</sup> Each of these commitments requires the Chinese government to maintain a condition that is necessary for the development of a market-based economy.

These market economy commitments have gone beyond the requirements of the then-existing domestic legislation. For instance, the Price Law of 1997 merely declares that the State should gradually move to a market-based pricing system.<sup>27</sup> While in practice most price controls had been removed before WTO accession, the government is not required by domestic law to refrain from price-setting. Similarly, although the PRC Constitution recognizes the right of SOEs to autonomous management, it does not impose any obligation on the government to refrain from interfering with SOE operations.<sup>28</sup> As for trading rights, under the Foreign Trade Law of 1994,<sup>29</sup> the government still controlled the allocation of all rights to conduct imports and exports. It was the WTO commitment that has finally rid China of this legacy of centrally-planned economy.<sup>30</sup>

More significantly, these market economy commitments cannot be altered by China unilaterally, whereas domestic legislation defining the Chinese economic system, including the Constitution, can be, and has been, revised from time to time. As long as China remains a member of the WTO, it may not negate these commitments without incurring the consequences of breaching WTO obligations.<sup>31</sup> In effect, therefore, China has committed itself to a particular economic system – a matter of constitutional

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<sup>25</sup> Protocol, sections 5.1 and 5.2. State trading was to be maintained in the imports of 84 products in seven categories (including grain, vegetable oil, sugar, tobacco, processed oil, chemical fertilizer and cotton), and in the exports of 134 agricultural products and commodities, such as tea, grains, metals, coal, oil, silk and cotton. See Annex 2A of the Protocol.

<sup>26</sup> WPR, para. 46, which was incorporated into the Protocol.

<sup>27</sup> Price Law of the People's Republic of China (Zhonghua Renmin Gonghe Guo Jiage Fa), adopted by the NPC Standing Committee (NPCSC) on 29 December 1997, effective 1 May 1998, art. 3.

<sup>28</sup> PRC Constitution, art. 16 (stating that SOEs are entitled to 'autonomous management within the limits prescribed by law'). Pursuant to the Company Law, the State assets management agency exercises the right of the State as the shareholder of wholly state-owned enterprises, including the right to decide on 'important matters' of SOEs, such as merger, division, dissolution or applying for bankruptcy of the SOEs. See Company Law of the People's Republic of China (Zhonghua Renmin Gonghe Guo Gongsi Fa), adopted by the NPCSC on 29 December 1993, amended on 25 December 1999, 28 August 2004, and 27 October 2005, effective 1 January 2006, art. 67.

<sup>29</sup> Foreign Trade Law (Zhonghua Renmin Gonghe Guo Duiwai Maoyi Fa), adopted by the National People's Congress (NPC) on 12 May 1994, amended 6 April 2004, effective 1 July 2004.

<sup>30</sup> See *infra* Section II.B.1.

<sup>31</sup> One of the market economy commitments - liberalization of trading rights - has become the subject of a WTO complaint filed by the United States. See *infra* note 140.

importance - through the force of WTO multilateral legal proceedings. No other country has undertaken the same under the WTO Agreement.<sup>32</sup>

## B. Foreign Trade Law

The main theme in the development of foreign trade law in the past decade has been liberalization of the foreign trade regime and bringing that regime into conformity with WTO requirements. Commercially, China has reduced its tariff and non-tariff barriers across the board in trade in goods, and opened up some of its most important service sectors to foreign competition. Institutionally, the government has gradually moved away from direct control over trade and increasingly assumed the role of a regulator. On the legislative front, major laws governing foreign trade, including the Foreign Trade Law, the Customs Law,<sup>33</sup> and laws and regulations on technical and health standards, intellectual property and administrative procedures,<sup>34</sup> have all been revised to ensure WTO consistency. As a result, China today has a foreign trade regime that is considerably more liberal than other major developing countries. Meanwhile, a relatively minor theme has emerged in recent years indicating a rise in protectionism. This trend is reflected in China's extensive use of trade remedies against imports and other non-tariff measures in trade.

The following sections highlight the major developments in foreign trade law concerning trade in goods.<sup>35</sup> Trade in services and technologies is closely related to foreign investment and will be discussed in the context of foreign investment law.

### 1. Liberalization of trading rights

One of the most important developments in China's foreign trade law following WTO accession is the 2004 revision of the Foreign Trade Law of 1994.<sup>36</sup> As noted above, China undertook to allow all domestic and foreign enterprises to engage in foreign trade in all goods, except for a list of specified products reserved for state trading, within three years of its accession.<sup>37</sup> This commitment was implemented by an amendment to the

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<sup>32</sup> Although WTO rules are premised upon market economy assumptions, the WTO does not prescribe any particular economic system for its members, which is consistent with the basic principle of international law that sovereign nations are free to choose their own political and economic system. At least as a formal matter, therefore, a WTO member can change its domestic economic system without violating its WTO obligations. A number of other transition economies have acceded to the WTO and none of them has undertaken such systemic commitments as China. *See* Qin, *supra* note 14, p. 504.

<sup>33</sup> Customs Law (Zhonghua Renmin Gonghe Guo Haiguan Fa), adopted by the NPCSC on 22 January 1987, amended on 8 July 2000.

<sup>34</sup> For a list of relevant Chinese legislation relating to foreign trade, *see* TPR Report, *supra* note 5, Appendix, Table A.II.2.

<sup>35</sup> For a detailed study of China's foreign trade regulation up to 2005, *see* Xin Zhang, INTERNATIONAL TRADE REGULATION IN CHINA (Hart Publishing, 2006).

<sup>36</sup> *Supra* note 29.

<sup>37</sup> *Supra* text at note 25.

Foreign Trade Law, which took effect on 1 July 2004, six months ahead of the schedule. The amendment replaces the previous approval system with a registration system for operating foreign trade businesses in China. Under this new system, any person (legal or natural, domestic or foreign) wishing to engage in imports and exports of goods or technologies may do so by completing certain registration procedures with the Ministry of Commerce (MOFCOM).<sup>38</sup> Documents required for registration are mostly for identification purposes; and MOFCOM must complete the registration within five days of receipt of the required documents.<sup>39</sup> This new system is a primary example of the fundamental shift in government's role in the Chinese economy – the government has finally relinquished direct control over foreign trade operations and assumed the functions of a regulator in a market-based trading regime. The liberalization of trading rights works hand-in-hand with the opening of domestic distribution sectors to foreign investment, which will be discussed below.

## 2. Tariffs, quotas and state trading

Pursuant to its market access commitments to the WTO, China has bound all its tariffs at newly lowered statutory rates. As of 2005, the average MFN rate for imports as applied was 9.7%, down from 39.5% in 1994.<sup>40</sup> As for exports, China has committed to eliminate all export taxes except for a number of specific products.<sup>41</sup>

Non-tariff barriers have also been reduced. Before WTO accession, China had maintained extensive quantitative restrictions on trade, mainly through the use of quotas, licenses, and state trading operations. Following the accession, China has abolished import quotas and has cut the tariff lines subject to licenses by half.<sup>42</sup> While the level of state trading activities remains relatively unchanged, their operations have become much more transparent. Specific goods subject to state trading are listed in the accession protocol, and the adjustments of the list and the enterprises authorized to trade in such goods are published by MOFCOM and notified to the WTO.<sup>43</sup>

## 3. Technical and health standards

One area where non-tariff barriers may have risen in China, however, is the use of technical and health standards in regulating imports and exports. Technical standards aimed to ensure the quality and safety of products, or protection of human, animal and plant life or health or of environment, can constitute trade barriers when applied

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<sup>38</sup> See Foreign Trade Law, arts. 8 and 9; and Measures on Registration of Foreign Trade Operators (Duiwai Maoyi Jingyingzhe Beian Dengji Banfa), issued by MOFCOM Order No. 14 on 19 June 2004, effective 1 July 2004 (Registration Measures), available at [www.mofcom.gov.cn](http://www.mofcom.gov.cn).

<sup>39</sup> See Registration Measures, arts. 5 and 6.

<sup>40</sup> See TPR Report, *supra* note 5, pp. 4 and 277, Table AIII.1.

<sup>41</sup> Protocol, section 11.3 and Annex 6.

<sup>42</sup> See TPR Report, *supra* note 5, pp. 77-79, paras. 49-54.

<sup>43</sup> *Ibid.*, p. 82, paras. 64-65.

arbitrarily or discriminatorily to restrict imports or exports. For this reason the WTO requires that domestic technical and health regulations shall not be more trade-restrictive than necessary to fulfill a legitimate objective and shall not be applied in a manner that would result in arbitrary or unjustifiable discrimination between countries. To that end, WTO members are obliged to use relevant and available international standards as the basis for their national standards. Detailed rules on standards are set out in the WTO agreements on Technical Barriers to Trade (TBT) and on the Application of Sanitary and Phytosanitary Measures (SPS).

Following its accession, China has amended its relevant laws and regulations to ensure WTO consistency and has reorganized its government agencies in charge of the administration and enforcement of technical and health regulations. Yet, China's practice in setting and applying standards has become an increasing concern for its trading partners. At present, a majority of the Chinese standards are not based on international standards.<sup>44</sup> And complaints have been made about a variety of unnecessary, burdensome, excessive and costly procedures for product registration, licensing, and certification that effectively hinder imports and exports.<sup>45</sup> Moreover, China has attempted in recent years to develop its own unique standards in areas where internationally recognized standards already exist, a well-known example of which is the Chinese WAPI security standard for wireless LAN.<sup>46</sup> Such attempts raise the issue of consistency with the TBT Agreement and are viewed as a strategy to benefit Chinese domestic industries at the expense of their foreign competitors.

#### 4. Trade remedies

Another significant development in the past decade is the establishment of a trade remedy regime that enables China to use antidumping, anti-subsidy and safeguard measures to protect domestic industries from foreign competition. Dumping (i.e., selling products abroad at less than their normal value<sup>47</sup>) and certain government subsidies are considered 'unfair' trade practices, and the WTO permits a member to levy antidumping and countervailing duties on dumped and subsidized imports if they are found to cause or

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<sup>44</sup> At the end of 2004, only 32% of the 21,342 national standards were equivalent to international standards. For the numerous sectoral, local and enterprise standards used in China, no data on their conformity with international standards is available. Source: TPR Report, *supra* note 5, p. 90, para. 90. Direct comparison with practices of other countries is difficult due to the complexity and lack of data in the area. The U.S. government, for example, does not maintain centralized statistics on the extent to which U.S. technical regulations are based on international standards. See WT/TPR/S/160/Rev.1 (20 June 2006), p. 50. The EU reported that as of 2004 about two-thirds of the standards developed at the EU level were based on international standards. See WT/TPR/S/136 (23 June 2004), p. 60.

<sup>45</sup> See WTO documents G/TBT/20 (16 November 2006) and G/SPS/43 (26 October 2006), containing reports of WTO committees on the fifth annual transitional review of China's practice in TBT and SPS areas.

<sup>46</sup> See Scott Kennedy, *The Political Economy of Standards Coalitions: Explaining China's Involvement in High-Tech Standards Wars*, Asia Policy, No. 2, July 2006, pp. 41-62.

<sup>47</sup> 'Normal value' of a product is generally the price of like product in the exporting country. For different methods to determine 'normal value' for antidumping purposes, see GATT art. VI:1.

threaten material injury to a domestic industry. In addition, the WTO allows a member to take safeguard measures (tariffs and quotas) against imports when there is a sudden surge in imports that causes or threatens serious injury to domestic producers, even when no 'unfair' trade practices are involved. Because these remedies raise trade barriers and can easily be abused by protectionist forces, the WTO imposes strict disciplines on their use. WTO rules on antidumping, anti-subsidy and safeguard measures are extremely complex, and a large number of WTO disputes have involved trade remedy complaints.

China enacted its first antidumping and anti-subsidy regulation in 1997, which was superseded by two separate regulations on antidumping and countervailing measures in 2001,<sup>48</sup> and its first safeguard regulation in 2001.<sup>49</sup> These regulations generally follow WTO standards, but contain much less detailed provisions than the relevant WTO agreements. Under these regulations, MOFCOM is designated as the chief regulatory authority responsible for conducting all relevant investigations and making determinations on trade remedy measures.

Since the initiation of its first antidumping investigation in 1997,<sup>50</sup> China has quickly risen to become one of the top users of antidumping measures in the world. During the first four years of its accession, China initiated 103 antidumping investigations and took final measures in 68 cases, which made it the third largest antidumping user after India and the United States.<sup>51</sup> Most of the investigations targeted firms from Japan, South Korea, the United States and EU, followed by Russia, Taiwan, India and a number of other countries.<sup>52</sup> It is notable, however, that foreign respondents won a partial or complete victory in more than 40 percent of the concluded cases.<sup>53</sup> To date, China has used its safeguard mechanism only once, which was invoked in response to the US adoption of safeguard tariffs on foreign steel in 2002.<sup>54</sup> Thus far China has not initiated any countervailing investigation.

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<sup>48</sup> PRC Regulation on Anti-Dumping (Zhonghua Renmin Gonghe Guo Fanqingxiao Tiaoli), issued by the State Council, Decree No. 328, on 26 November 2001, amended on 31 March 2004; PRC Regulation on Countervailing Measures (Zhonghua Renmin Gonghe Guo Fanbutie Tiaoli), issued by the State Council, Decree No. 329, on 26 November 2001, amended on 31 March 2004.

<sup>49</sup> PRC Regulation on Safeguard Measures (Zhonghua Renmin Gonghe Guo Baozhang Cuoshi Tiaoli), issued by the State Council, Decree No. 330, on 26 November 2001 and amended on 31 March 2004.

<sup>50</sup> China's first antidumping case was initiated on 10 December 1997, concerning newsprint from South Korea, Canada and the United States. See MOFTEC Notice No. 4, 1997, available at [www.mofcom.gov.cn](http://www.mofcom.gov.cn).

<sup>51</sup> Source: WTO Antidumping Statistics, available at [www.wto.org](http://www.wto.org).

<sup>52</sup> Source: WTO Antidumping Statistics, *ibid*. A majority of the cases involved chemical products, plastics and rubber products. See TPR Report, *supra* note 5, p. 85. Chart III.6 (covering antidumping investigations from 1 January 2002 to 31 December 2004).

<sup>53</sup> For an excellent analysis of the dynamics in China's antidumping practice, see Scott Kennedy, *China's Porous Protectionism: The Changing Political Economy of Trade Policy*, Political Science Quarterly, Vol. 120, No. 3 (2005), pp. 407-432.

<sup>54</sup> China invoked its safeguard measures against steel imports, claiming that there was a sudden increase of steel imports in the wake of the US action and such increase had caused serious injury to the Chinese domestic producers. See MOFTEC, *Final Ruling on Safeguard Measures against Imports of Certain Steel*

In addition to antidumping, countervailing and safeguard measures, the Foreign Trade Law also authorizes the government to take unspecified trade remedy measures based on the results of trade investigations. The types of trade investigations authorized include investigations regarding trade barriers in other countries; discriminatory trade restrictions imposed by other countries against China; protection of intellectual property rights of the PRC persons in other countries; unfair competition practice damaging the foreign trade order; and trade matters affecting national security interests.<sup>55</sup>

The protectionist trend in China's trade remedy law and practice is not surprising. Typically, when tariff and non-tariff barriers are significantly lowered, domestic industries will seek protection through more aggressive use of trade remedies. Besides, China's own experience as the 'victim' of trade remedy measures has unavoidably affected its position. For years, China has been by far the most frequently targeted country in antidumping actions.<sup>56</sup> The designation of China as a 'non-market economy' (NME) by the United States, the European Union and other major trading partners has made China particularly vulnerable to antidumping actions, because the NME status allows the importing country to discard Chinese domestic prices and instead use third country prices as the basis for determining the normal value of the Chinese products, which typically leads to the finding of dumping by Chinese producers and imposition of higher antidumping duties on Chinese goods.<sup>57</sup> To China's great disappointment, its WTO accession did not end such practice. Instead, the China accession protocol allows WTO members to continue to treat China as an NME for as long as 15 years in antidumping actions, and for an indefinite period in countervailing actions.<sup>58</sup> Furthermore, contrary to the explicit WTO requirement that safeguard measures be applied on a non-discriminatory basis, the accession protocol allows an importing member to single out Chinese products for import restrictions. The China-only safeguards can be used against any Chinese products for 12 years and against Chinese textile

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*Products*, 29 November 2002. The measures were terminated in December 2003 after the US ended its safeguard action.

<sup>55</sup> Foreign Trade Law, art. 37(2), (5) and (6).

<sup>56</sup> From 1 January 1995 to 31 December 2005, WTO members initiated a total of 2840 antidumping investigations, of which 469 involved Chinese products; of the 1804 final measures taken by the members during this period, 338 were against Chinese products. Source: WTO Antidumping Statistics, available at [www.wto.org](http://www.wto.org).

<sup>57</sup> See Chad Bown & Rachel McCulloch, *U.S. Trade Policy Toward China: Discrimination and Its Implications* (June 2005), Table 2 (showing that in 23 multi-country antidumping investigations made in the United States in 1990-2003, the mean (median) antidumping duty facing China is 177.38% (118.41%) as opposed to the mean (median) duty of 36.41% (32.23%) facing all other investigated countries), available at SSRN: <http://ssrn.com/abstract=757124>.

<sup>58</sup> Protocol, section 15. For antidumping actions, this section of the Protocol requires an importing member not to use NME methodologies against Chinese products if China can establish that it is a market economy, or that market conditions prevail in a relevant industry or sector in China, under the national law of the importing member. No similar provision, however, is made for countervailing actions against Chinese products.

products till the end of 2008.<sup>59</sup> Both types of discriminatory safeguards have been utilized in practice.<sup>60</sup> Politically, the discriminatory treatment China has received in other countries may well have motivated it to aggressively pursue its own trade remedies.

### C. Foreign Investment Law

WTO accession provided a spur to foreign investment in China. As noted above, the FDI inflow between 2001 and 2005 accounted for more than one third of the total amount of the actually utilized foreign investment in China. This major expansion in foreign investment in turn has contributed to a tremendous growth in foreign trade. Since joining the WTO, China's foreign trade has more than doubled in value, of which nearly 60% are attributable to imports and exports by foreign invested enterprises (FIEs).<sup>61</sup> Given that the WTO agreements provide only limited disciplines on foreign investment, the impact of WTO accession on foreign investment in China is largely the result of its accession commitments. These include China's extensive market access commitments in service sectors and unique rule commitments concerning treatment of FIEs. Furthermore, its pledges on market economy practice and domestic governance work to boost investors' confidence in the overall investment environment in China.

Against this backdrop, however, emerges signs of a new trend of government tightening controls over foreign investment while protecting domestic industries. Some of the new regulations and measures taken by the government call into question China's compliance with its WTO commitments, while others raise issues that cannot be easily addressed by existing WTO rules. This section will highlight the major developments in China's foreign investment law in the post-WTO era.

#### 1. Liberalization of entry restrictions

Ever since China opened up to foreign investment in 1979, the government has maintained restrictions on the entry of foreign capital through an elaborate examination and approval system.<sup>62</sup> Since 1995, foreign investment projects have been classified into

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<sup>59</sup> Protocol, section 16, and WPR, para. 242. For analyses and critique of the China-specific safeguards, see Yong-Shik Lee, *The Specific Safeguard Mechanism in the Protocol on China's Accession to the WTO: A Serious Step Backward from the Achievement of the Uruguay Round*, J. World Intellectual Property, Vol. 5, No. 2 (March 2002) p. 219; Fabio Spadi, *Discriminatory Safeguards in the Light of the Admission of the People's Republic of China to the World Trade Organization*, J. Int'l Econ. L., Vol. 5, No. 2 (2002), p. 421.

<sup>60</sup> According to notifications received by the WTO, the following members have initiated more than a dozen proceedings under Section 16 of the Protocol: United States, Canada, India, Colombia, Peru, Ecuador, Turkey, and Chinese Taipei. See WTO G/SG/N/16/\* documents, available at [www.wto.org](http://www.wto.org). The special textile safeguards have been invoked by the United States, EU, Argentina and Turkey, following the expiration of the global quota system in textile trade at the end of 2004.

<sup>61</sup> *Supra* note 5.

<sup>62</sup> See Pitman B. Potter, *Foreign Investment Law in the People's Republic of China: Dilemmas of State Control*, The China Quarterly, No. 141 (1995) pp. 155-185 for an overview of China's FDI legal regime in its first 15 years.

the categories of encouraged, permitted, restricted, and prohibited.<sup>63</sup> The classification is based on considerations such as the State's industrial policies, technology advancement, use of natural resources, environmental impact, national security and public policy interests. The sectoral restrictions on FDI range from a straight ban to equity limits and other conditions. The government maintains and publishes the Catalogue for the Guidance of Foreign Investment Industries, which provides a detailed list of specific industries under each category.<sup>64</sup>

Market access for foreign investment is not subject to WTO discipline except to the extent covered by the General Agreement on Trade in Services (GATS). Under GATS, members negotiate their market access in services, which include commitments on 'commercial presence' of foreign services in their territories (i.e., foreign investment in service industries).<sup>65</sup> A WTO member is obligated to provide national treatment to foreign service suppliers in its territory, but only to the extent covered by, and subject to the conditions specified in, its service schedule attached to GATS.<sup>66</sup> Hence, the scope and terms of market access for foreign investment in services sectors vary from member to member, depending on their specific commitments under GATS.

As noted above, China made extensive market access commitments in services. Of the 12 service sectors classified under GATS, China is bound by specific commitments in nine, including crucial areas in distribution, construction, transport, communication, and financial services.<sup>67</sup> To implement these commitments, China has substantially revised the Industry Catalogue following WTO accession. Under the most recent Catalogue, the number of encouraged industries increased from 186 to 262, while restricted industries decreased from 112 to 75.<sup>68</sup> As an indication of increased market access for foreign investment, some 75% of foreign investment in China is now in wholly foreign-owned companies.<sup>69</sup>

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<sup>63</sup> *Interim Provisions on Guiding Foreign Investment Direction* (Zhidaow Waishang Touzi Fangxian Zaxing Guiding), issued by the former State Planning Commission, State Economic and Trade Commission and MOFTEC on 20 June 1995, which was superseded by *Provisions on Guiding Foreign Investment Direction*, (Zhidaow Waishang Touzi Fangxian Guiding) issued by the State Council, Decree No. 346, on 11 February 2002, effective 1 April 2002, available at [www.fdi.gov.cn](http://www.fdi.gov.cn).

<sup>64</sup> The permitted category is by default, that is, any industry that is not listed as encouraged, restricted or prohibited is permitted. The most recent Catalogue was issued jointly by the State Development and Reform Commission and the MOFCOM in November 2004, effective 1 January 2005, available at [www.fdi.gov.cn](http://www.fdi.gov.cn).

<sup>65</sup> GATS covers trade in services supplied in four different 'modes', one of which (mode 3) is the supply of a service by a service supplier of one member through 'commercial presence' in the territory of another member. See GATS, art. I:2(c).

<sup>66</sup> GATS, arts. XVI and XVII.

<sup>67</sup> No commitment was made in health related and social services; recreational, cultural and sporting services; or other services not included elsewhere. TPR Report, *supra* note 5, p. 208.

<sup>68</sup> *Ibid.* p. 53, fn. 96.

<sup>69</sup> US-China Business Council, *China's WTO Implementation: An Assessment of China's Year Four of WTO Membership*, Written Testimony Submitted in Response to the Office of USTR's Request for

One of the most significant changes, for example, is the opening of distribution services. Previously, FIEs were not permitted to sell products in China other than those of their own production, and foreign investment in retail business was strictly restricted. After WTO accession, distribution sector has been liberalized according to a specified timetable. Today, FIEs can engage in wholesale and retail distribution of all kinds of products in China, without limitation on the percentage of ownership or geographical location.<sup>70</sup> Distribution rights, together with foreign trade rights, are arguably the most important of China's WTO entry obligations for foreign investors, since most of them are interested in selling directly into the vast domestic market in China. Another example is the opening of the banking sector. China made a commitment to allow foreign banks to operate fully in its territory - without geographic, client or ownership restrictions - within five years of its accession. Evidently, this bold commitment was designed to stimulate the ailing state-owned banking sector that dominated finance in China. To prepare the state-owned banks for the forthcoming foreign competition, the government has injected massive amounts of cash into the banks to clean up their balance sheet and diversified their ownership through private placements and public offerings.<sup>71</sup> A full implementation of the banking commitment can have a major impact on China's banking and financial industries.<sup>72</sup>

It should also be mentioned that, in addition to market access in service sectors, China undertook to reduce entry restrictions on foreign investment in the auto industry.<sup>73</sup> The auto-industry commitments of China are unique within the WTO framework, given that the WTO does not currently cover market access for investment in non-service sectors.

## 2. Elimination of performance requirements

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Comments and Notice of Hearing Concerning China's Compliance with WTO Commitments (14 September 2005), p. 4.

<sup>70</sup> China's implementation of this commitment was reportedly compromised partly due to the MOFCOM policy of discontinuing tax holidays granted to existing manufacturing FIEs if their 'buy-sell' activity exceeds 30% of their total revenues. See US-China Business Council, *ibid.*, p. 7. Furthermore, United States has filed a WTO complaint alleging that China has failed to implement its commitment with respect to the right of foreign service suppliers to distribute books, newspapers and other publications. See *infra* note 140.

<sup>71</sup> Since 2003, the government has injected \$60 billion cash into three of the four major state-owned banks that were slated for initial public offerings in China and Hong Kong. The three banks, the China Construction Bank, the Bank of China, and the Industrial and Commercial Bank of China (ICBC), went public in 2005 and 2006 respectively. The ICBC offering was the largest IPO in the world. The government also sold minority shares in each of the banks to foreign strategic investors before their IPOs. See Wall Street Journal, *ICBC Makes Strong Debut in Hong Kong, Shanghai*, 28-29 October 2006, p. B5.

<sup>72</sup> The government has taken implementing measures to soften the potential impact of this commitment. See *infra* text at note 94.

<sup>73</sup> WPR, paras. 204-207. See generally Eric Harwit, *The Impact of WTO Membership on the Automobile Industry in China*, The China Quarterly, No. 167 (2001), pp. 655-670.

Aside from GATS, the WTO has only a narrow set of rules regulating foreign investment. Under the Agreement on Trade-Related Investment Measures (TRIMs), WTO members must eliminate certain performance requirements imposed on foreign investment, including specifically the requirements on export performance, local content (import substitution), and foreign exchange balancing. These performance requirements are prohibited because they have the effect of either discriminating against imported goods, or restricting imports or exports, all in contravention of GATT obligations. For developing countries, the TRIMs Agreement provides certain exceptions as well as a five-year transitional period for compliance.<sup>74</sup>

Prior to its WTO accession, China imposed many performance requirements on FIEs, including those regarding export performance, local content, foreign exchange balancing, and technology transfer. For example, a wholly foreign-owned enterprise (WFOE) was required to either import advanced technology or export more than 50 percent of its output every year; and preferential terms on land use, tax refund and imports were granted to the Chinese-foreign equity joint ventures (EJV) and contractual joint ventures (CJV) that were export-oriented or utilized advanced technology.<sup>75</sup> While FIEs were allowed to purchase materials in either domestic or international markets, previous laws required them to give priority to the purchase of domestic products over imports under the same conditions.<sup>76</sup>

In its accession protocol, China specifically agrees that it shall, upon accession, comply with the TRIMs Agreement without recourse to the transitional period granted to developing country members.<sup>77</sup> Furthermore, China has agreed not to enforce provisions of contracts imposing performance requirements,<sup>78</sup> which means that FIEs may cease to honor the obligations to comply with these performance requirements under their existing contracts. The most remarkable, however, is China's pledge not to condition the approval for foreign investment on 'performance requirements of any kind', including not only those covered by TRIMs, but also 'the transfer of technology' and 'the conduct of research and development in China.'<sup>79</sup> This commitment to abolish performance requirements of any kind is one of the WTO-plus obligations of China that no other country has undertaken under WTO law.

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<sup>74</sup> TRIMs, arts. 4 and 5.2.

<sup>75</sup> See Law on Foreign-Invested Enterprises (Waizi Qiye Fa), adopted by the NPC on 23 April 1986 (WFOE Law), art. 3; Law on Sino-Foreign Equity Joint Ventures (Zhongwai Hezi Jingying Qiye Fa), adopted by the NPC on 1 July 1979 (EJV Law), art. 9; Law on Sino-Foreign Contractual Joint Ventures (Zhongwai Hezuo Jingying Qiye Fa), adopted by the NPC on 13 April 1988 (CJV Law), art. 4; and Provisions of the State Council on the Encouragement of Foreign Investment (Guowuyuan Guanyu Guli Waishang Touzi de Guiding), issued and effective on 11 October 1986.

<sup>76</sup> See *e.g.*, WFOE Law, art. 15; EJV Law, art. 9.

<sup>77</sup> Protocol, section 7(3).

<sup>78</sup> *Ibid.*

<sup>79</sup> *Ibid.* WPR para. 203, which was incorporated into the Protocol.

To implement its broad commitments, China has revised its foreign investment laws to eliminate the mandatory requirements regarding export performance, local content, foreign exchange balancing, and technology transfer.<sup>80</sup> After the WTO accession, the government has also reformed the approval system for technology transfer. Previously, all contracts for technology import or export must be approved individually by the relevant authorities. This system has been replaced by a new catalogue system under which the government publishes a list of prohibited and restricted technologies.<sup>81</sup> While the transfer of technologies listed in the catalogue still requires government approval, any technology that is not listed in the catalogue can be imported or exported freely, subject only to the requirement of contract registration with MOFCOM.<sup>82</sup>

Despite the revisions of the foreign investment laws, however, China has not eliminated all performance requirements in practice. For instance, the new automobile industry development policy issued in 2004 contains a provision requiring newly-established automobile enterprises to set up their own research and development institutions.<sup>83</sup> Tax benefits and other incentives are still offered to FIEs and domestic enterprises contingent upon the use of domestic over imported equipment.<sup>84</sup> Such measures have given rise to challenges at the WTO, as will be further discussed below.

### 3. National treatment of foreign investment

WTO accession has significantly expanded China's obligations to accord national treatment to foreign investment. Prior to the accession, China had only granted national treatment to foreign investors of selected countries through bilateral investment treaties.<sup>85</sup> The scope of the national treatment clause in these treaties is typically limited to the protection of investment against expropriation or nationalization. By contrast, the accession protocol requires China to extend to foreign investors national treatment with

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<sup>80</sup> EJV Law was amended by the NPC on 15 March 2001; CJV Law and WFOE Law by the NPCSC on 31 October 2000.

<sup>81</sup> See *PRC Regulation on Import and Export of Technologies* (Zhonghua Renmin Gonghe Guo Jishu Jinchukou Guanli Tiaoli), issued by the State Council, Decree No. 331, on 10 December 2001, effective 1 January 2002.

<sup>82</sup> MOFCOM is required to complete the registration within three working days of receipt of the application documents. See *ibid.* arts. 10-19; 33-41.

<sup>83</sup> *Policy on Development of Automobile Industry* (Qiche Chanye Fazhan Zhengce), issued by the National Development and Reform Commission (NDRC), Order No. 8, 21 May 2004, art. 47(5), available at Chinalawinfo.com.

<sup>84</sup> These benefits also raise issues under WTO subsidy rules. See *infra* text at notes 137-138.

<sup>85</sup> Historically, China had been reluctant to accept a 'national treatment' standard and instead preferred the 'fair and just treatment' standard in dealing with foreign interests. Of the more than 100 bilateral investment protection agreements concluded by China, only a small number contain a national treatment clause. For China's evolving practice regarding national treatment, see Wang Yi, *WTO Guomin Daiyu De Falü Guize Jiqi Zai Zhongguo De Shiyong* (WTO LAW ON NATIONAL TREATMENT AND ITS APPLICATION IN CHINA) (Beijing: Chinese Academy of Social Sciences Press & People's Court Press, 2005), chap. 6; Wei Wang, *Historical Evolution of National Treatment in China*, *Int'l Lawyer*, Vol. 39, No. 3, (Fall 2005), pp. 759.

respect to the market access commitments in services,<sup>86</sup> and further, to the conditions affecting their production and sales in China. Specifically, the latter obligation requires China to accord foreign investors and FIEs treatment no less favorable than that accorded to domestic entities with respect to the procurement of goods and services necessary for production, the conditions under which their goods are produced, marketed or sold in the domestic markets and for export, and the prices and availability of goods and services supplied by government and SOEs in areas including transportation, energy, basic telecommunications, other utilities and factors of production.<sup>87</sup> Since WTO national treatment rules do not cover investment activities beyond the provisions of GATS and TRIMs, this production-based national treatment obligation is another WTO-plus obligation of China.

An interesting phenomenon associated with China's WTO obligations on national treatment of foreign investors has been the demand for 'national treatment' (or more precisely, equal treatment) of domestic enterprises. Historically, China has maintained different treatment between foreign and domestic firms, and between SOEs and other domestically-owned enterprises. To attract foreign investment, the government has provided FIEs with substantial tax benefits and other privileges that are not available to domestic enterprises.<sup>88</sup> On the other hand, SOEs traditionally enjoyed more favorable treatment than FIEs with respect to market access, performance requirements, supply of production inputs and state bank credits. With China's entry into the WTO, FIEs have gained national treatment in new areas while maintaining their old preferences. In contrast, SOEs have lost many of their privileges; and domestic private enterprises, the number of which is fast growing, continue to receive less favorable treatment than both FIEs and SOEs in terms of market access, bank financing and access to capital markets.<sup>89</sup> As a result, there have been increasing calls for leveling the playing field for all players in the economy, especially between foreign and domestic firms.

Under WTO rules, China is only obligated to accord foreign interests treatment 'no less favorable' than that accorded to domestic interests, and is therefore not prohibited from granting more favorable treatment to foreign interests.<sup>90</sup> Nonetheless, publicity about the national treatment principle of the WTO has made the Chinese public

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<sup>86</sup> See *supra* text at note 66.

<sup>87</sup> See Protocol, section 3.

<sup>88</sup> Major tax benefits enjoyed by FIEs include: reductions of enterprise income tax rate from 33% to 15% or 24% for FIEs located in the special economic zones or other economic development zones; an income tax holiday of two years, followed by a 50% reduction for the next three years, for manufacturing FIEs with an operating period of longer than ten years; tariff exemption on imports of equipment, or a VAT refund on equipment purchased domestically, by FIEs; and refund of 40% of income tax paid on the sum used by the FIE to reinvest in another FIE. For a summary of tax incentives provided to FIEs, see TPR Report, *supra* note 5, pp. 55-56.

<sup>89</sup> See *ibid.* p. 137.

<sup>90</sup> While preferential treatment of FIEs is well within the perimeter of WTO national treatment requirements, the various FDI incentives provided by the Chinese government, especially tax exemptions, have been challenged at the WTO as inconsistent with WTO subsidy rules. See *infra* text at notes 137-138.

keenly aware of the issue of unequal treatment of enterprises in China. The pressure, therefore, has been building to remove FDI preferences. In March 2007, the National People's Congress adopted the new Enterprise Income Tax Law that provides for a uniform income tax system for domestic and foreign-invested enterprises.<sup>91</sup> Once fully implemented, the new law will end the decades-long preferential tax treatment of FIEs.

#### 4. Rise of protectionism

In the past few years, there has been a growing perception in China that decades of economic reform and opening up have benefited foreign interests more than domestic interests. Critics have sounded alarm that foreign investors have bought out name-brand Chinese companies or acquired valuable Chinese assets at bargain prices, leading to foreign domination in industries and disappearance of domestic brands. They also claim that foreign investment has not resulted in significant technology transfers to China and instead has diverted Chinese domestic resources from research and development to low-end manufacturing sectors.

Partially responding to these concerns, the government began to re-caliber its foreign investment policy in 2006. Recent months have seen a host of new regulations and policies that aim to tighten controls over foreign investment and to promote domestic industries. For example, the new regulation on mergers and acquisitions by foreign investors, issued in August 2006, provides MOFCOM with broad discretion to block foreign purchases of domestic companies, if the purchase would result in the transfer of actual control of a domestic enterprise that is involved in a 'key industry' or holds famous trademarks or Chinese traditional brands, or if the purchase has elements affecting 'national economic security'.<sup>92</sup> In September 2006, the government announced a temporary ban on approval of foreign investment in brokerage houses,<sup>93</sup> a move that was partly intended to bolster domestic brokerages ahead of foreign-invested firms as the government attempts to reorganize the industry. In November 2006, the new regulation on foreign-invested banks was issued which, while implementing China's WTO commitment to completely open its banking industry within five years of its accession, requires foreign banks to establish Chinese subsidiaries, instead of operating as foreign branches, in order to engage in the full range of RMB business with local clients.<sup>94</sup> Also

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<sup>91</sup> Enterprise Income Tax Law (Qiyeshuoshuifa), adopted by the NPC on 16 March 2007, effective 1 January 2008. Under the new law, a uniform income tax rate of 25% applies to both foreign and domestic enterprises.

<sup>92</sup> Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (Guanyu Waiguo Touzizhe Binggou Jingnei Qiyeshuoshuifa), jointly issued by MOFCOM, State-Owned Assets Supervision and Administration Commission (SASAC), State Administration of Taxation, State Administration for Industry and Commerce (SAIC), China Securities Regulatory Commission (CSRC), and State Administration of Foreign Exchange (SAFE), 8 August 2006, effective 6 September 2006, art. 12.

<sup>93</sup> China Daily, *China halts foreign investment in brokers*, 15 September 2006, available at [www.chinadaily.com.cn](http://www.chinadaily.com.cn); BNA, World Securities Law, October 2006, Vol. 12, No.10, *China Foreign Investment in Brokerages, Licensing of New Brokerages Halted*.

<sup>94</sup> PRC Regulations on the Administration of Foreign-Invested Banks (Waizi Yinhang Guanli Tiaoli), issued by the State Council, Order No. 478, 11 November 2006, effective 11 December 2006, chap. 3.

in November 2006, the National Development and Reform Commission (NDRC) issued an important policy document setting forth the foreign investment plan for the next five years.<sup>95</sup> While affirming that China will continue to open its service sectors and strive to improve the business environment for foreign investment, the document outlines a new approach to foreign investment. Under this policy, China will focus on the quality rather than the quantity of FDI, selecting new investments that will bring technology or otherwise fit into China's development strategy. Furthermore, the government authorities will carefully scrutinize foreign acquisitions of key domestic enterprises, paying special attention to the impact of wholly-owned foreign enterprises on China's 'national economic security' and 'industry security'. These new policies and rules have already made a difference in practice. For instance, according to Bloomberg data, almost 70% of the \$19.5 billion of acquisitions in China announced by foreign investors in 2006 were not completed, whereas all but 25% of the \$34.4 billion in purchases were cleared in 2005.<sup>96</sup>

After nearly thirty years of encouraging foreign direct investment, China is entering a stage where it no longer needs to rely on foreign capital to generate growth and employment. Against this economic reality, the tightening of government control over FDI, while evidently a response to a variety of concerns,<sup>97</sup> may signal the rise of a protectionist trend. It remains to be seen to what extent China's WTO commitments can serve as a check on such trend.

#### D. Intellectual Property Rights

The development of intellectual property law in China has been closely related to the development of foreign trade and investment. Since the adoption of the PRC Trademark Law in 1982, China has enacted numerous laws and regulations concerning a wide range of IP rights and acceded to most of the major IP international treaties.<sup>98</sup> In the process of building up a modern IP regime in China, WTO accession has played an important role.

The WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) provides a comprehensive legal framework for the protection of IP rights. It does so by incorporating the principles and rules of other major international

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<sup>95</sup> The 11<sup>th</sup> Five-Year Plan for Utilizing Foreign Investment (Liyong Waizi 'Shiyi Wu' Guihua), November 2006, available at [www.ndrc.gov.cn](http://www.ndrc.gov.cn).

<sup>96</sup> *China's Buyout Backlash Stalls Investments* by Carlyle, Ewing, at Bloomberg.com (30 November 2006). It had been suggested that China's tougher stance on foreign takeovers may be linked to the aborted acquisition of California-based Unocal Corp. by Cnooc. Ltd., China's biggest offshore oil producer. Cnooc withdrew its bid in August 2005 after the U.S. Congress threatened to veto the deal based on national security concerns. *Ibid.*

<sup>97</sup> For one thing, the massive foreign exchange reserves China has accumulated in recent years as a result of accelerated FDI inflows and growing trade surplus may pose certain macro-economic risks. The excesses of foreign exchange reserves, however, may be reversed through appreciation of the Chinese currency and FDI outflows.

<sup>98</sup> For a list of the IP treaties China has acceded to, see TPR Report, *supra* note 5, p. 147, Table III.16.

conventions, and by setting out certain new standards on substantive rights. Furthermore, TRIPS prescribes certain civil, administrative, and criminal procedures and remedies that each WTO member must make available to the IP rights holder under its domestic law. Non-compliance with TRIPS can be addressed through the WTO dispute settlement mechanism and may result in WTO-authorized sanctions.

To ensure compliance with TRIPS, China has made impressive efforts on both the legislative and institutional fronts. Legislatively, new amendments have been made to all major IP laws, including the patent law (2000), the trademark law (2001) and the copyright law (2001), and new regulations have been issued, including those on the protection of computer software (2001), layout-designs of integrated circuits (2001), and new plant varieties (2001).<sup>99</sup> In addition to administrative and civil remedies, specific crimes of IP violations have been added to the criminal code.<sup>100</sup> Institutionally, an elaborate government apparatus has been set up to administer and enforce IP laws, including a special IP adjudication division in the People's Courts. As a result of these efforts, China today has an extensive and basically WTO-compliant legal framework for IP protection.

Despite the presence of a WTO-compliant legal framework, IP violations remain rampant. The main problems identified by China's major trading partners include: the lack of coordination among the large number of government agencies responsible for IP enforcement; local protectionism and corruption; inadequate deterrence provided by the system of administrative, civil and criminal penalties; and insufficient training of government personnel.<sup>101</sup> Although in recent years the government has stepped up enforcement efforts, weak protection of IP rights remains one of the top complaints of the foreign companies doing business in China.

Inadequate enforcement of IP rights in China has prompted the United States to file a formal WTO complaint, charging China for failure to protect IP rights according to TRIPS standards.<sup>102</sup> Specifically, the United States claims that the PRC criminal law sets inadequate thresholds for criminal procedures and penalties for trademark counterfeiting and copyright piracy, that Chinese Customs regulations improperly authorize the release into commerce of confiscated IP infringing goods after removing their infringing features rather than destroying such goods, and that Chinese copyright law denies protection for foreign works that have not been authorized for publication or distribution in China. While the Chinese government has formally rejected the U.S. charges and the outcome of the case remains to be seen, this long-threatened WTO complaint has put great pressure on the Chinese government to enhance IP protection and enforcement. Indeed, merely

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<sup>99</sup> *Ibid.*, p. 145.

<sup>100</sup> A section on IP violations was added to the Criminal Law in 1997, imposing up to 7 years of imprisonment for counterfeits, piracy and violations of trade secrets. *See* Criminal Law (Zhonghua Renmin Gonghe Guo Xingfa) (1979, as amended), arts. 213-220.

<sup>101</sup> TPR Report, *supra* note 5, p. 153.

<sup>102</sup> *China – Measures Affecting the Protection and Enforcement of Intellectual Property Rights*, Request for Consultations by the United States, WT/DS362/1 (16 April 2007).

days before the United States filed the complaint, the Supreme People's Court and the Supreme People's Procuratorate jointly issued a judicial interpretation which, among other things, substantially lowered the threshold for criminal punishment of copyright piracy.<sup>103</sup>

## E. Domestic governance

Domestic governance through the rule of law is essential for sustained economic development.<sup>104</sup> In the past decade, China's rule of law conditions have improved in some important aspects, and WTO accession has played a positive role in that process. Specifically, the accession protocol prescribes a number of special obligations regarding the transparency, uniformity and impartiality of China's trade, investment and IP regimes. The need for implementing these obligations has stimulated significant changes in domestic governance.

### 1. Transparency

Transparency is one of the basic values of the WTO system, given that the proper function of open markets requires transparent rules and procedures. Major WTO obligations on transparency include: publication of all laws, regulations, and other government measures of general application affecting trade before their implementation and enforcement; and notifications to the WTO of any change in such laws, regulations, and government measures. In light of the historical lack of transparency in the Chinese system, the WTO has imposed on China specific obligations that are more stringent than its general requirements on transparency. China is required, for instance, to designate an official journal dedicated to publication of all laws, regulations and measures affecting trade and make all issues of such journal available to individuals and enterprises; to establish enquiry points where traders may obtain all information on measures subject to publication; to respond to requests for information by traders within 30 days upon their receipt; to provide a reasonable period for comment on all laws, regulations and measures affecting trade after their publication but before their implementation (with certain exceptions); and to translate all such laws, regulations and measures into one of the

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<sup>103</sup> The Supreme People's Court and the Supreme People's Procuratorat, *Interpretation on Several Issues of Concrete Application of Law in Handling Criminal Cases of Infringing Intellectual Property (II)*, (Guanyu Banli Qinfan Zhishichanquan Xingshi Anjian Juti Yingyong Falü Ruogan Wenti de Jieshi), adopted 4 April 2007, effective 5 April 2007. Under this Interpretation, the threshold for copyright piracy punishable by imprisonment of less than three years is reduced from the 1,000 illegal copies previously prescribed to 500 illegal copies, and the threshold for piracy punishable by imprisonment between three and seven years is reduced from 50,000 to 25,000 illegal copies.

<sup>104</sup> For an assessment of several theories and empirical evidence on the role of law in sustained economic development in general and in the case of China in particular, see Randall Peerenboom, *China's Long March toward Rule of Law* (Cambridge University Press 2002), chap. 10. The concept of rule of law is subject to different interpretations. At its most basic level, however, rule of law requires that the laws be generally applicable, publicly available, prospective, clear, consistent, capable of being followed, and enforced. *Ibid.*, p. 3.

official languages of the WTO and make such translation available to WTO members within 90 days of their implementation or enforcement.<sup>105</sup>

Since its accession, China has taken concrete steps to implement its transparency commitments. Important legislation has been put into place to regulate government rulemaking process. For instance, the Law on Legislation, enacted in 2000, requires that the government agency in charge of drafting administrative regulations or rules solicit public comments, through meetings, hearings or other means.<sup>106</sup> Effective 1 January 2002, administrative regulations shall not take effect until 30 days after promulgation, except for those involving national security, the setting of foreign exchange rates, monetary policy, and matters the delayed implementation of which would impede their enforcement.<sup>107</sup> The Law on Administrative Permissions, enacted in 2003, standardizes the procedures for granting administrative permissions or licenses.<sup>108</sup> Under this law, unpublished documents can no longer be used as the basis for granting administrative permissions; and outcomes of all administrative permissions must be published, except for those involving state or business secrets or individual privacy.<sup>109</sup> In recent years, the government has utilized the Internet to promote transparency and public participation in the rulemaking process. Most central government agencies and local governments have launched their own websites, and many of them allow the public to provide input directly.<sup>110</sup> Laws, regulations, administrative rulings, judicial interpretations and decisions have become generally available on the official websites.<sup>111</sup>

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<sup>105</sup> See Protocol, section 2(C); WPR paras. 324-336, of which paras. 331-334, 336 were incorporated into the Protocol.

<sup>106</sup> Law on Legislation (Zhonghua Renmin Gonghe Guo Lifa Fa), adopted by the NPC on 15 March 2000, effective 1 July 2000, art. 58.

<sup>107</sup> See Regulation on the Procedures for the Formulation of Administrative Regulations (Xingzheng Fagui Zhiding Chengxu Tiaoli), issued by the State Council, Decree No. 321, on 16 November 2001, effective on 1 January 2002, art. 29; Regulation on the Procedures for the Formulation of Rules (Guizhang Zhiding Chengxu Tiaoli), issued by the State Council, Decree No. 322, on 16 November 2001, effective on 1 January 2002, art. 32.

<sup>108</sup> Law on Administrative Permissions (Zhonghua Renmin Gonghe Guo Xingzheng Xuke Fa), adopted by the NPCSC on 27 August 2003, effective 1 July 2004.

<sup>109</sup> *Ibid.* art. 5.

<sup>110</sup> By the end of 2004, more than 16,000 official websites had been launched by ministries, commissions and other agencies under the State Council as well as by local governments. TPR Report, *supra* note 5, p. 39.

<sup>111</sup> The website of the National People's Congress ([www.law.npc.gov.cn](http://www.law.npc.gov.cn)) contains a legal database boasting more than 200,000 central and local government legal documents, including nearly 2,000 laws and regulations in English translation. The website of the Supreme People's Court ([www.chinacourt.org](http://www.chinacourt.org)) provides judicial interpretations, judicial decisions of various courts, as well as laws and regulations. Beginning in 2003, the SPC has been soliciting public comments on proposed judicial interpretations on its website. English translation of national laws and regulations pertaining to business, trade and investment are available on the websites of the State Council ([english.gov.cn](http://english.gov.cn)) and MOFCOM ([english.mofcom.gov.cn](http://english.mofcom.gov.cn)).

In sum, transparency in the Chinese regulatory system has improved markedly in connection with the WTO accession. To be sure, the government has yet to fully implement its WTO commitments on transparency,<sup>112</sup> and the lack of transparency still ranks among the top concerns for foreign businesses operating in China.<sup>113</sup> However, the present condition is a far cry from the days when ‘internal documents’ ruled government administration, and there is reason to expect further improvement as the Chinese public embraces transparency as a norm for good governance.

## 2. Judicial review of administrative actions

To ensure that government measures affecting trade are administered in a reasonable, objective and impartial manner, the WTO requires its members to maintain independent tribunals (judicial or administrative) and procedures for the review of administrative decisions relating to trade.<sup>114</sup> The accession protocol of China specifies that such tribunals ‘shall be impartial and independent of the agency entrusted with administrative enforcement and shall not have any substantial interest in the outcome of the matter.’<sup>115</sup> Further, the protocol requires that China provide private parties affected by administrative action the opportunity for appeal to a judicial body ‘in all cases’ – a standard exceeding the general requirements of the WTO - and that the reasons for the decision on appeal must be provided in writing.<sup>116</sup>

Previously under Chinese law, administrative decisions on certain trade-related matters were excluded from judicial review, including decisions concerning the validity of patents and trademarks, and determinations in antidumping and countervailing cases.<sup>117</sup> To implement its WTO commitments, China has amended relevant legislation so as to provide the right to appeal to courts in all such WTO-related matters.<sup>118</sup> In addition, the Supreme People’s Court has issued three judicial interpretations to clarify

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<sup>112</sup> For instance, as late as March 2006, the State Council was still instructing its ministries and local governments to notify their trade-related regulations to MOFCOM so as to enable their timely publication in the designated official journal. *See* State Council Notice Concerning Further Implementation of the Transparency Provisions of the WTO Protocol on China’s Accession (March 30, 2006), Guobanfa 2006 No. 23.

<sup>113</sup> According to the 2006 annual membership survey by the US-China Business Council, the top 10 issues for U.S. businesses operating in China are: human resources, administrative licensing and business approvals, IP enforcement, competition and overcapacity, transparency, standards setting, distribution rights, US visas, national treatment and market access in services. *Companies Speak: The State of US Business in China*, China Business Review, Sept.-Oct. 2006, p. 66.

<sup>114</sup> *See* GATT art. X; GATS art. VI; TRIPS art. 41.

<sup>115</sup> Protocol, section 2(D)(1).

<sup>116</sup> Protocol, section 2(D)(2). While judicial review of final administrative decisions is guaranteed under TRIPS, appeal to a court of the decision by an independent tribunal is merely referred to as a possibility under GATT and there is no reference to such appeal in GATS. *See* Qin, *supra* note 14, at 495-6.

<sup>117</sup> Article 12 of the PRC Administrative Litigation Law excludes from judicial review, *inter alia*, any administrative decisions that are declared to be final by any other laws.

<sup>118</sup> *See* Patent Law, as amended, art. 46; Trademark Law, as amended, art. 33; Regulation on Antidumping, art. 53; Regulation on Countervailing Measures, art. 52.

the scope and standards for judicial review of WTO-related administrative decisions.<sup>119</sup> Among other things, the SPC designated intermediate courts or high courts as the first-instance trial courts for international trade, antidumping and countervailing cases, a move aimed to ensure impartiality and quality of judgment in the adjudication of WTO-related cases given that judges in upper level courts tend to be less vulnerable to external interference and are generally better qualified than judges in the basic courts. It is, however, still too early to assess the condition of judicial review in WTO-related cases since few such cases have been reported.<sup>120</sup>

On a broader scale, the WTO requirements on impartial review of administrative actions by an independent tribunal provided a fresh impetus to the development of administrative law and judicial reform in China. A series of legislation has been enacted in the past decade to regulate administrative rulemaking, administrative review, and administrative licensing.<sup>121</sup> These new laws set limits and boundaries for the exercise of government powers, and provide the legal basis for judicial review of specific administrative actions.<sup>122</sup> WTO accession has also inspired intensified efforts of the Chinese judiciary to improve the competency level of its judges and to strive for judicial independence.<sup>123</sup> Although substantive judicial independence in China cannot be achieved without political reform, the WTO requirements on impartiality and independence of tribunals have lent legitimacy and support to the call of the Chinese judiciary for freedom from local and departmental interferences.<sup>124</sup>

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<sup>119</sup> *Provisions on Several Issues concerning the Adjudication of Administrative Cases Relating to International Trade*, *supra* note 23; *Provisions on Several Issues Concerning the Application of Law in the Adjudication of Antidumping Administrative Cases* (Guanyu Shenli Fanqingxiao Xingzheng Anjian Yingyong Falü Ruogan Wenti de Guiding), issued by the SPC on 11 September 2002, effective 21 November 2002; *Provisions on Several Issues Concerning the Application of Law in the Adjudication of Countervailing Administrative Cases* (Guanyu Shenli Fanbutie Xingzheng Anjian Yingyong Falü Ruogan Wenti de Guiding), issued by the SPC on 11 September 2002, effective 21 November 2002.

<sup>120</sup> To date, no judicial review of antidumping determinations has been conducted. There have been judicial reviews of other international trade cases, especially cases involving IPRs. *See WTO Guize yu Zhongguo Sifashencha Zhidu (WTO Rules and the Judicial Review System in China)*, Speech of Zhao Daguang, Director of the SPC's Administrative Court, at the Fourth Academic Annual Meeting on the WTO and China (11 November 2005), available at [www.wtobbs.org/xiazai/asp](http://www.wtobbs.org/xiazai/asp).

<sup>121</sup> E.g., Law on Legislation, *supra* note 106; PRC Law on Administrative Review (Zhonghua Renmin Gonghe Guo Xingzheng Fuyi Fa), adopted by the NPCSC on 29 April 1999, effective 1 October 1999; Law on Administrative Permissions, *supra* note 108.

<sup>122</sup> For a comprehensive study of the WTO and Chinese administrative law, *see* Xin Chunying & Feng Jun (eds.) *WTO YU ZHONGGUO XINGZHENGFA GAIGE (WTO AND THE REFORM OF CHINESE ADMINISTRATIVE LAW)* (Beijing: Social Sciences Academic Press, 2005).

<sup>123</sup> For a general study on the WTO and judicial review in China, *see* Veron Mei-Ying Hung, *China's WTO Commitment on Independent Judicial Review: Impact on Legal and Political Reform*, *Am. J. Comp. L.*, Vol. 52, No. 1, 77 (2004) pp. 77-132.

<sup>124</sup> *See* Hung, *ibid.* at 124 (indicating that the SPC made a series of unusually strong statements in 2002 calling for judicial independence).

### 3. Uniform administration

In its accession agreement, China undertook to apply and administer all its laws, regulations, and measures, including those issued at the sub-national level, in a uniform, impartial and reasonable manner. Specifically, China promised to annul in a timely manner all local regulations and measures that are inconsistent with China's WTO obligations. It also agreed to establish a complaint mechanism under which private parties can bring to the attention of national authorities cases of non-uniform application of the trade regime, and that the authorities must promptly address and remedy such situations.<sup>125</sup> These special commitments targeted at local protectionism, which has become a major trade and investment barrier in China.

It is unclear to which extent China has implemented these commitments following its accession. It is evident, however, that many of the problems China faces today are associated with entrenched localism. As a core reform strategy adopted by the Chinese leaders early on, local governments have been given much flexibility to adopt measures necessary to boost local GDP growth and are allowed to benefit directly from such growth.<sup>126</sup> As a result, local governments have been heavily involved in the investment and operations of local enterprises. To promote their economic interests, local governments may provide subsidies to local firms or otherwise protect them against outside competition. They may have little incentive to enforce IP laws if local enterprises profit from violations of IP rights. Their control over local courts means that it may be impossible to obtain independent and impartial judicial review of matters involving local economic interests. Moreover, the close ties between local officials and firms make it extremely difficult to combat official corruption, which has been plaguing the Chinese system and undermining the legitimacy of the regime.

As a matter of principle, WTO rules apply to the entire territory of each WTO member, and a member is responsible for violations of WTO rules by its political subdivisions. The WTO Agreement specially permits a member to bring to the WTO tribunal complaints arising from measures taken by the local authorities of another member.<sup>127</sup> China's specific commitments have only added to its obligation to ensure uniform administration of laws throughout its territory. Hence, if the Chinese government lacks the political will to rein in local protectionism, other members do have the means available at the WTO to compel it to take action.<sup>128</sup>

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<sup>125</sup> Protocol, section 2(A); WPR, paras. 70 and 75, which were incorporated into the Protocol.

<sup>126</sup> See Kenneth Lieberthal, *Completing WTO Reforms*, The China Business Review, Sept.-Oct. 2006, pp. 52-57, for an insightful analysis of this strategy and its positive and negative consequences.

<sup>127</sup> See Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994, Section 14.

<sup>128</sup> It was reported that the U.S. Trade Representative Office had launched a provincial-level review of China's IP enforcement efforts as part of its monitoring of China's WTO commitments. BNA, WTO Reporter, February 16, 2007, *Meaningful Actions Needed to Make China Comply with WTO Commitments by 2008*.

#### 4. Normative impact

Potentially more significant than the legislative and institutional improvements are the normative changes brought about by the WTO accession. During the years leading up to and following the accession, the government and academia engaged in an unprecedented scale of public education on the WTO, portraying the WTO as mostly a progressive force for China.<sup>129</sup> As a result, WTO principles and concepts, such as nondiscrimination, transparency, due process and judicial review, have gained wide acceptance in China as the norms for good governance in a modern society. The public's appeal to WTO norms often goes beyond the technical scope of their application - a notable example of which was the popular demand for 'national treatment' of domestic enterprises under the WTO principle of nondiscrimination.<sup>130</sup> There is also a tendency among the academics to construe WTO concepts liberally and expansively so as to give them meanings in a larger political and constitutional context.<sup>131</sup> As WTO principles and concepts acquire a normative force in China, their overall impact on the construction of rule of law may well be more profound in the long run than the WTO-conforming changes at the legislative and institutional level.

### III. Enforcing China's WTO Obligations

All of China's commitments under its accession agreement are binding treaty obligations, enforceable through the WTO dispute settlement mechanism. Furthermore, a unique transitional review mechanism (TRM) was set up to monitor China's implementation of its accession commitments. Thus far, WTO members have utilized both mechanisms to ensure China's compliance with its obligations.

#### A. Transitional Reviews

Pursuant to the TRM, China is subject to annual review by the WTO in the first eight years after its accession, followed by a final review before the end of the tenth year. Each review is conducted at two levels: first by the sixteen subsidiary bodies of the WTO that have a mandate covering China's commitments, and then by the General Council of the WTO. In each review, China is to provide the information regarding each area of China's commitments under its accession agreement, and answer questions posed by individual members in each of the subsidiary bodies. The review results of the subsidiary bodies are reported to the General Council, which may make recommendations to China.

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<sup>129</sup> During this period the number of books and articles published in China on WTO-related topics is believed to have exceeded that in the rest of the world combined.

<sup>130</sup> See *supra* Section II.C.3.

<sup>131</sup> For example, legal scholars have interpreted WTO norms such as market economy as requiring the protection of economic rights of citizens under the Chinese constitution. See Xin & Feng (eds.), *supra* note 122, chap. 1.

To date, the WTO has conducted five reviews under the TRM. Despite its resentment to the TRM,<sup>132</sup> China has accepted this annual exercise that puts its practices under the constant scrutiny of other members. The reviews have provided the opportunity for members to raise many of their concerns with China in a timely manner. The questions raised during the fifth review in 2006, for example, ranged from import and export duties, market access in services, technical standards, to investment measures, domestic subsidies, industrial policies and privatization plans. Among other things, members requested clarification and explanation from the Chinese government on WTO consistency of the new automobile policy, the new regulation on mergers and acquisitions, the temporary ban on approval of brokerage houses, and the new banking regulations.<sup>133</sup> As the Chinese government was compelled to address these concerns, the process added to transparency in the Chinese regulatory regime. With its comprehensive coverage and multilateral procedures, the TRM has been playing an effective role in monitoring China's implementation of its accession commitments.

## B. Dispute Settlement

Since its accession, China has encountered eight WTO complaints, of which five were initiated by the United States, and one each by the EU, Canada and Mexico. The eight complaints involve five sets of disputes. The first, *China – Value Added Tax*, was brought by the United States in March 2004, alleging that China's policy of refunding value-added taxes to domestically-produced integrated circuits (IC) discriminated against imported IC in violation of WTO rules.<sup>134</sup> China settled the case through consultations and withdrew the measures in question by April 2005.<sup>135</sup>

The other four disputes are currently pending. The second, *China – Auto Parts*, involves three complaints brought by the EU, the United States, and Canada respectively in 2006.<sup>136</sup> At issue are Chinese regulations that impose a surcharge on imported automobile parts used in manufacturing vehicles for sale in China, effectively raising the tariff on auto parts from 10% to 25%, the same rate for imports of complete vehicles. The

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<sup>132</sup> Although China agreed to undergo the annual review as part of its WTO membership deal, it views the TRM as discriminatory and has refused to reply in writing the questions posed by other members. *See e.g.*, BNA, WTO Reporter, October 5, 2006, *Latest China Review at WTO Begins on Sour Note, as China Refutes U.S., EU*.

<sup>133</sup> *See* Questions from the United States to China, WTO Council for Trade in Goods, G/C/W/560 (6 November 2006); Report of the TRIMs Committee on transitional review of China, G/L/792 (27 October 2006); BNA, WTO Reporter, November 28, 2006, *Trading Partners at WTO Press China on Barriers in Financial Services Market*.

<sup>134</sup> *China – Value-Added Tax on Integrated Circuits*, Request for Consultations by the United States, WT/DS/309/1 (23 March 2004).

<sup>135</sup> *China – Value-Added Tax on Integrated Circuits*, Notification of Mutually Agreed Solution, WT/DS309/8 (6 October 2005).

<sup>136</sup> *China–Measures Affecting Imports of Automobile Parts*, WT/DS339/1 (3 April 2006) (Request for Consultations by the European Communities), WT/DS340/1 (3 April 2006) (Request for Consultations by the United States), WT/DS342/1 (13 April 2006) (Request for Consultations by Canada).

third dispute, *China – Subsidies*, was initiated by the United States in February 2007<sup>137</sup> and later joined by Mexico.<sup>138</sup> The complaints charge that China has been subsidizing domestic firms (including FIEs) through various tax breaks that are WTO-illegal. The fourth and fifth disputes were brought by the United States on the same day in April 2007. The fourth, *China – Intellectual Property Rights*, claims *inter alia* that China's criminal law does not provide sufficient punishment for IP violations, and that the denial by China's copyright law of protection for works under censorship reviews is inconsistent with TRIPS requirements.<sup>139</sup> The fifth, *China – Trading Rights*, raises issue with China's implementation of its commitments on trading rights and distribution services for publications and audiovisual products.<sup>140</sup> The complaint charges that, contrary to its commitment to fully liberalize trading rights, China has continued to reserve the right to import foreign cultural products to designated SOEs.

These pending disputes challenge important aspects of China's industrial policy and legal regime. The auto-parts case and the subsidy case target tax incentives and local content requirements which China has used for decades as part of its development strategy. Although in its accession China agreed to comply with all WTO rules and even accepted more stringent obligations on subsidies than any other member,<sup>141</sup> the government has not fundamentally changed its practice. In fact, the government continues to use financial incentives to encourage and promote the development of particular industries and geographic areas, despite possible WTO challenges to such measures.<sup>142</sup> The outcome of these two WTO cases, therefore, is likely to have a real impact on China's industrial policy.

The IP case is potentially most significant for the Chinese legal system because it contests two major pieces of Chinese legislation – the Criminal Law and the Copyright Law. The case is the first of this kind in WTO history in that it challenges the substantive criminal law of a member state, an area traditionally reserved for national jurisdiction, and raises sensitive issues of government censorship. The trading rights case involves the politically delicate matter of government control over importation and distribution of

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<sup>137</sup> *China – Certain Measures Granting Refunds, Reductions or Exemptions from Taxes and Other Payments*, Request for Consultations by the United States, WT/DS358/1 (7 February 2007).

<sup>138</sup> *China – Certain Measures Granting Refunds, Reductions or Exemptions from Taxes and Other Payments*, Request for Consultations by Mexico, WT/DS359/1 (28 February 2007).

<sup>139</sup> See *supra* note 102 and accompanying text.

<sup>140</sup> *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, Request for Consultations by the United States, WT/DS363/1 (16 April 2007).

<sup>141</sup> See Julia Ya Qin, *WTO Regulation of Subsidies to State-Owned Enterprises (SOEs): A Critical Appraisal of the China Accession Protocol*, J. Int'l Econ. Law, Vol. 7, No. 4 (2004), pp. 863-919.

<sup>142</sup> In its first subsidy notification to the WTO after accession, China identified a total of 78 subsidy programs effective during the period of 2001-2004, including some of the FDI incentives that later became the subject of the U.S. and Mexico complaints in the subsidy dispute. See People's Republic of China, *New and Full Notification Pursuant to Article XVI:1 of the GATT 1994 and Article 25 of the SCM Agreement*, G/SCM/N/123/CHN (13 April 2006).

foreign cultural products. If China loses these cases, it will be compelled to alter important aspects of its legal regime to comply with WTO rulings.

The number of WTO cases brought against China during the first several years of its membership is still small, compared to the number of WTO cases initiated against other major trading nations during the same period.<sup>143</sup> Part of the reason for the small number might be that China's trading partners were willing to give it some leeway to comply with WTO requirements in light of its recent accession. Part of the reason is China's willingness to compromise in potential disputes. For example, in 2004 China imposed export restrictions on coking coal, which is used in steel production, in order to meet the rising domestic demand and also to reduce pollution caused by excessive coke production. When the EU protested and threatened to bring a WTO complaint, China soon backed down and agreed to maintain the same level of coke supply to the EU as the previous year.<sup>144</sup> In late 2005, when the United States threatened to initiate a WTO case against China over its antidumping decision regarding linerboard, China quickly repealed that decision.<sup>145</sup>

That situation, however, is changing. Both the United States and the EU have indicated their intention to initiate more WTO cases against China. Indeed, the United States, under the pressure of record trade deficit with China, initiated three new WTO disputes with China within the first four months of 2007. And, judging from the numerous concerns raised during the TRM annual reviews, there is no shortage of issues that could evolve into formal complaints against China at the WTO dispute forum. Meanwhile, China's attitude towards WTO dispute settlement is also changing. The government apparently adopted a hard line in 2006 when it refused to settle the auto parts case through consultations. If the case proceeds as expected, it will result in the first WTO judgment on the legality of the Chinese trade regulations under WTO law.

To be sure, relying on WTO litigation to enforce China's WTO obligations has its limits. The dispute settlement process is time-consuming and resource-intensive. And the complaint can only target specific government measures, rather than a member's general trade and investment policies. Nonetheless, the WTO dispute settlement mechanism has its teeth – noncompliance with its decisions may lead to WTO-authorized trade sanctions. Given that the Chinese economy is so heavily reliant on foreign trade and that China is bound by more WTO commitments than any other member, it is reasonable to expect that WTO dispute settlement will be relatively effective in enforcing China's obligations.

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<sup>143</sup> From January 2002 to December 2006, more than 40 WTO cases were brought against the United States, and more than 20 WTO cases against the EU, although only three cases against Japan. Source: WTO Dispute Settlement: Disputes by country, available at [www.wto.com](http://www.wto.com).

<sup>144</sup> BNA, WTO Reporter, May 25, 2004, *EC Threatens WTO Suit Against China Unless It Lifts Coking-Coal Restrictions*; BNA, WTO Reporter, June 2, 2004, *EC, China Reach agreement on Continued Chinese Shipments of Coking Coal to Europe*.

<sup>145</sup> BNA, WTO Reporter, January 11, 2006, *China Lifts Dumping Duties on Linerboard in Face of US' Threat of WTO Proceedings*. MOFCOM announced the withdrawal of its antidumping determination without explanation. See MOFCOM Announcement [2006] No. 8, *Terminating Antidumping Measures on Unbleached Kraft Liner/Linerboard*, 13 February 2006, available at [www.mofcom.gov.cn](http://www.mofcom.gov.cn).

#### IV. Future Prospects

China's accession to the WTO has led to extensive changes to its foreign trade and investment regime. They range from substantially lowered barriers for trade and investment to considerably improved domestic governance. As a result of these changes, the Chinese system has become far more open and in accord with WTO standards than a decade ago.

But what does WTO membership hold for China over the next decade? The reason why WTO accession had such a major impact on China was because it served the domestic agenda of economic liberalization set by the leadership in the 1990's. Now that China has substantially implemented its market access commitments and that the government has achieved the main objectives of the accession, will China continue to liberalize its economy beyond what was called for by the WTO? The answer will of course depend on the vision of the leadership and its future agenda. Given the widening gap between the rich and poor and the severe environmental degradation in the country, the Chinese government is compelled to adjust its development strategy to pursue a more balanced and sustainable growth. This adjustment, however, may slow the process of further economic liberalization. Indeed, China has taken the position that, as a recent acceding member of the WTO, it should not be required to make substantial new concessions in the ongoing Doha Round.<sup>146</sup>

In the next few years, the impact of the market access commitments made in the accession will wane as the domestic economy adapts to the new level of foreign competition. The impact of the rule obligations of the WTO, by contrast, may be felt more acutely. With its competitiveness growing in the global market, China will likely find itself a frequent target of WTO complaints. When China loses a case at the WTO forum, the government will feel the external constraints imposed by the WTO directly as China must change its offending law and practice or face possible trade sanctions. The Chinese public may then develop a different image of the WTO from the largely positive one promoted by the leadership during the accession era. The issue of sovereignty and domestic regulatory space will be raised. Other issues that have long generated strong controversies about the WTO and globalization in other parts of the world, such as the relationship between trade and environment, trade and labor rights, and trade and other social policies and values, are likely to attract greater attention in China as well.

In short, when the dust settles from the accession commitments, the impact of the WTO on China will become comparable to that on other major trading nations. That, however, will not change the historic significance of the accession. WTO membership has integrated China into a multilateral system which, through its extensive rules and enforcement mechanisms, will impose meaningful disciplines on China in charting its future course of economic development.

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<sup>146</sup> See e.g., BNA, WTO Reporter, March 14, 2007, *China, Other New WTO Members Seek Special Terms on Farm Tariff, Subsidy Cuts*.