INTERNATIONAL TRADE REGULATION IN CHINA

This book presents a comprehensive survey of Chinese legal and regulatory systems governing international trade following China's accession to the World Trade Organisation (WTO) and the coming into force of the revised PRC Foreign Trade Law. It provides a systematic and in-depth analysis of the text of applicable Chinese laws and rules, with a particular focus on their practical application. It also critically explores whether international trade regulation in China complies with the WTO Agreement both in the text and in spirit and identifies areas where improvements by Chinese trade regulators would be desirable. The book starts with an analysis of basic issues of international trade regulation in China. Part II covers foreign trading rights, trade restrictions and prohibitions, licensing and quotas, customs regulation, health, safety and technical standards, and trade in technology. Part III discusses trade protection and remedies available under PRC law, in the form of anti-dumping law, anti-subsidy law, safeguarding measures and trade retaliation. Part IV explores new regulatory issues, including trade promotion, trade and competition, trade and IP rights protection, and resolution of trade disputes. The book combines analysis with detailed practical advice and will be of interest to academics, practitioners and policy makers.

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This book is dedicated to QR.

International Trade Regulation in China

Law and Policy

XIN ZHANG

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Preface

This book is based on my PhD research at the University of London between September 2001 and February 2005. Since my research focused on the implementation of the WTO Agreement in the People's Republic of China ('China' or 'the PRC'), I spent a lot of time analysing trade regulatory regimes worldwide and in China in particular. My initial aim was to gain a full understanding of the current status of this regime, which would provide a solid basis for exploring the WTO implementation issue and its consequences. I then realised that it was equally important to summarise, analyse and critically review the law and policies of international trade regulation in China, as there are few books that offer an up-to-date and comprehensive picture of this important topic.

Dr Shan Wenhua and I visited Mr Richard Hart of Hart Publishing in the summer of 2002. Following our discussion, Richard Hart confirmed that he would be interested in publishing a series of books on PRC law in the context of economic globalisation. Dr Shan, Dr Zhang Qing and I have acted as the editors-in-general of this series, which is now titled 'China and International Economic Law Series'. The first book of this series (Dr Shan's *The Legal Framework of EU-China Investment Relations: A Critical Appraisal*) was published in 2005. This book will be the second in the series. I would like to take this opportunity to thank Hart Publishing for giving me such a wonderful opportunity to develop my academic interest and to publish the results of my research.

The primary purpose of this book is to provide a comprehensive introduction and analysis of the current law and policies of international trade regulation in China. In other words, it aims to provide up-to-date and thorough 'basic information' on international trade regulation in China. I believe this is the first step of serious research – without sufficient and accurate data, any research in this area cannot claim to be objective and sustainable. In particular, the majority of relevant laws and policies have not been translated into English, so that only a small group of people (such as international law firms or researchers with bilingual capacity) may have access to, and digest, the primary information in connection with China's trade regulation. In some aspects, this book may look more like a 'lawyer's text', being descriptive and thorough in terms of what the law is, rather than designed or arguing for

grand and novel theories. Having said that, the book also purports to critically review China's trade regulation in the WTO context and to identify those areas that need to be revised or improved in order to comply with the words and spirit of the WTO rules. By doing this, it also suggests the direction for developing this regime in China's post-WTO era.

The writing of this book has been influenced by my legal career in an international law firm – Linklaters. I started my traineeship at Linklaters in 2002 and qualified as an English solicitor in 2004. In my second training year I transferred to the firm's Hong Kong office. Thanks to my PRC lawyer's qualification, I have worked on a number of PRC-related cases since then. Writing a legal memorandum on PRC law is not, of course, the same as writing a (more academic) book on PRC trade regulation, but I have gained invaluable insight as a legal practitioner as to how to identify legal issues and present research results in an acceptable way to an audience that may have little knowledge of PRC law. Incorporating this experience into the writing of this book, I have tried to be direct, accurate and unambiguous, and succinct but with all necessary details. I hope that this book will be helpful not only to academic researchers but also to legal practitioners with an interest in China's trade regulation.

I would like to thank my parents (Xiwei Zhang and Jinhui Min) for their continuous enthusiasm and support, and for urging me to pursue my studies as far as a PhD degree. They only know two English words ('hello' and 'bye-bye'), which is why they made sure that I worked hard to study the language from the first day that I took home an English textbook some twenty-one years ago. My thanks also go to Professor Michael Palmer of SOAS, University of London, who has guided me through the PhD and taught me to properly carry out research. Furthermore, I want to take this opportunity to thank QR, who has encouraged me to finally complete this book. Perhaps one day we will write a similar book in Chinese on the same topic. Last but not least, I thank Mr Richard Hart and Ms Mel Hamill of Hart Publishing for their great support to this book and this series. I hope that we will make a small contribution to the introduction of PRC law to the world.

Xin Zhang
Hong Kong, January 2006

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Part I

Introduction

1

Background and Framework

1.1 OVERVIEW

With the increasing status of the People's Republic of China ('China' or 'PRC')[1] in world trade, the understanding of law and policy of international trade regulation in China are of great academic and practical importance to companies, governments and international organisations. The research of this field, if placed in the background of economic globalisation, will go beyond the national scope of China and have international implications.

1.1.1 Purposes

The primary objective of this book is to comprehensively analyse Chinese legal and regulatory systems governing international trade after the PRC's accession to the World Trade Organisation ('WTO') in November 2001, and their application in practice. To achieve this objective, this book focuses on the textual analysis of applicable Chinese laws and rules and on their practical effects in comprehensive, systematic and in-depth manners. In addition, it will critically explore whether international trade regulation in China complies with the WTO Agreement both in the text and in spirit and highlight any areas to be improved.

1.1.2 WTO and China

China became a formal Member of the WTO on 11 December 2001. This has a fundamental influence on international trade regulation in China. The term 'WTO agreements', when used in the context of China, refers to the WTO Agreement[2] as rectified, amended or otherwise modified before the date of

1 Unless otherwise stated, the term 'China' or 'PRC' relates to the Mainland of China, not including the Hong Kong Special Administrative Region ('Hong Kong'), the Macau Special Administrative Region ('Macau') and the Taiwan Province ('Taiwan').

2 The WTO Agreement was finalised on 15 December 1993 and took effect on 1 January

accession, the provisions of the Protocol on the Accession of the People's Republic of China ('the Accession Protocol'), and the commitments referred to in paragraph 342 of the Report of the Working Party on the Accession of China ('the Working Party Report').[3]

On the one hand, the PRC government has been restructuring the legal and regulatory systems so as to implement the accession commitments and comply with the WTO agreements. The WTO agreements are now a benchmark to assessing the legitimacy or efficiency of Chinese trade laws and regulations. On the other hand, the government is also in a learning process—taking advantage of the rights as a WTO Member and adopting some new regulatory measures. Nowadays, the effects of WTO accession are pervasive in every aspect of international trade regulation in China.

1.1.3 Definition of 'International Trade'

There is no statutory definition of 'international trade' in the PRC. The closest one is the term 'foreign trade' under the PRC Foreign Trade Law (2004) ('FTL (2004)').[4] Article 2 of the FTL (2004) defines 'foreign trade' as including import and export of goods, import and export of technology and trade in international services. The first component of this definition is the trade of tangible goods and covers the common usage of the term 'foreign trade' or 'international trade'.

The second and the third components relate to intangible goods in the forms of technology or services. Trade of technology comprises cross-border assignment of patents, assignment of patent application rights, licencing of patents, assignment of know-how, technical services and any other forms of

1995. This term collectively refers to the *Marrakesh Agreement Establishing the World Trade Organization*, the four Annexes to this Agreement (Annex 1A contains the *Multilateral Agreements on Trade in Goods*; Annex 1B contains the *General Agreement on Trade in Services*; Annex 1C contains the *Agreement on Trade-Related Aspects of Intellectual Property Rights*; Annex 2 contains the *Understanding on the Rules and Procedures Governing the Settlement of Disputes*; Annex 3 contains the *Trade Policy Review Mechanism*; and Annex 4 contains the *Plurilateral Trade Agreements*), the accompanying Ministerial Decisions and Declarations and the Understanding on Commitments in Financial Services.

The World Trade Organisation (WTO) came into existence on 1 January 1995, and is formally established by the first Article of the *Marrakesh Agreement Establishing the World Trade Organization*. There were 148 Members as of 30 November 2005.

In this book, the term 'WTO agreements' refers to the components of the WTO Agreements package on an individual basis, and 'WTO Agreement' specifies the *Agreement Establishing the World Trade Organization* and may be used as including all annexes, decisions and understandings in some contexts.

3 The Protocol on the Accession of the People's Republic of China ('The Accession Procotol'), dated 10 November 2001, para 1.2.

4 *The PRC Foreign Trade Law*, *Zhonghua Renmin Gonghe Guo Duiwai Maoyi Fa* (中华人民共和国对外贸易法) , promulgated on 12 May 1994 by the Seventh Meeting of the Standing Committee of National People's Congress of the PRC and taking effect from 1 July 1994, as amended on 6 April 2004 and taking effect from 1 July 2004 ('FTL (2004)').

transfer of technology.[5] As a result, the cross-border transfer of other intellectual properties (such as trademarks and copyrights) falls outside of the scope of foreign trade, thus not subject to international trade regulation in the PRC. Trade in services is not defined under the laws, so the ordinary meaning of this word applies.[6]

1.1.4 Areas Covered

This book mainly covers the regulation of the first component of 'foreign trade': trade in goods. The essence of trade in goods is the physical movement of tangible goods into or out of the customs territory of China.[7] I take a broader view for evaluating the whole picture of international trade regulation in the PRC. As a result, except for those traditional foreign trade issues (such as trading rights, licencing and quota, anti-dumping measures and so on), other trade-related areas must be also covered: first, the tariffs (in particular the categories of tariffs and two related issues – rule of origin and customs valuation); second, the health and safety regulation and technical standards (focusing on their procedures and trade effects); third, some trade-related issues from a wider perspective of trade regulation (such as trade-related intellectual property rights, trade barriers investigation and protection of trade orders, trade and competition). From this perspective, the term 'international trade regulation' is a collection of regulation in all areas relating to export and import of goods, or in other words, of regulation from all trade-related perspectives.

The regulation of trade of technology will be briefly analysed in one chapter, focusing on licencing and registration systems.

This book, however, will not cover the regulation of trade in services. As categorised by the General Agreement on Trade in Services, trade in services comprises four modes of supply of services: *cross-border*, *consumption abroad*, *commercial presence*, *presence of natural persons*.[8] In China, the most significant mode of trade in services is commercial presence, referring to services supplied through any type of business or professional establishment of other countries in the territory of PRC. This basically relates to foreign direct

[5] *Administrative Regulations on Import and Export of Technology of the PRC* (中华人民共和国技术进出口管理条例), the State Council Decree No 331, effective from 1 January 2002 ('Regulations on Import and Export of Technology'), Art 2(2).

[6] The definitions in the General Agreement on Trade in Services, Annex 1B to the *Marrakesh Agreement Establishing the World Trade Organization*, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994 ('GATS'), may be helpful to understand the meaning of 'trade in international services' in China. See GATS, Art I 'Scope and Definition'.

[7] *Administrative Regulations on Import and Export of Goods of the PRC* (中华人民共和国货物进出口管理条例), the State Council Decree No 332, effective from 1 January 2002 ('Regulations on Import and Export of Goods'), Art 2.

[8] GATS, Art I:2, see n 6 above.

investment, that is, to allow foreign investors access to a number of formerly prohibited or restricted service sectors in China through the establishment of foreign-invested enterprises acting as service suppliers. It is beyond the ordinary meaning of 'trade', so will be the subject of another work.

1.1.5 Period Covered

PRC law stated in this book is as of 30 November 2005, nearly four years after China's WTO accession. This period has witnessed the widest and deepest legal reform in the field of international trade regulation in China. In fact, the vast majority of legal sources of the current trade regulatory system have been enacted during this period. Such reform culminates in the revision of the FTL in 2004.

1.2 LEGAL FRAMEWORK

1.2.1 General Rule

China is a unitary state in which state power is an indivisible whole.[9] The legislature, the National People's Congress ([Quanguo Renmin Daibiao Dahui], 'NPC'), is officially the organ of highest state power.[10] One session of NPC is for five years, with an annual meeting. The NPC's Standing Committee is delegated to exercise the majority of its powers between two meetings. The State Council (as the head of the administrative branch, [Guowu Yuan]), the Supreme People's Court (as the highest court, [Zuigao Renmin Fayuan]), and the Supreme People's Procuratorate (as the head of prosecution service, [Zuigao Renmin Jianchayuan]) are responsible to the NPC but independently exercise the powers granted by the Constitution. Thus, though there is a separation of functions among state organs roughly in line with legislation, administration and adjudication.

As a general rule, there are five types of legal sources in China: national laws (enacted by the NPC or its Standing Committee), national administrative regulations (enacted by the State Council), national ministerial rules (enacted by ministries, departments or commissions of the State Council), local regulations or rules (enacted by the empowered local People's Congress or local governments) and judicial or prosecution interpretations (issued by

9 See, for example, PH Corne, 'Creation and Application of Law in the PRC' (2002) 50 *American Journal of Comparative Law* 369–70.

10 *The PRC Constitution* (中华人民共和国宪法), promulgated by the Fifth Meeting of the Fifth Session of the National People's Congress on 4 December 1982 (as amended from time to time), Arts 2–3.

the Supreme People's Court or the Supreme People's Procuratorate). Among these five sources, the prosecution interpretations relate to criminal offences only and have little relevance to international trade regulation, and local regulations or rules cannot conflict with national laws or regulations and thus play a less important role in this field.

1.2.2 National Laws

Three national laws consist of the basic legal sources for international trade regulation in China: the FTL (2004), the PRC Customs Law[11] and the PRC Import-Export Commodity Inspection Law.[12] They respectively empower the relevant regulators to govern the matters falling within their line management jurisdiction (see Section 1.3.1 below).

1.2.3 Administrative Regulations

The State Council has issued administrative regulations to implement the above three national laws. In fact, some administrative regulations were used on a trial basis so that experiences and knowledge could be cumulated for the purpose of revising the corresponding national law.

For the area of foreign trade regulation, two key administrative regulations are the Regulations on Import and Export of Goods and the Regulations on Import and Export of Technology.

For the area of customs regulation, the key administrative regulation is the PRC Import-Export Tariff Regulations.[13]

For the area of regulation on quarantine and technical standards, the key administrative regulation is the *Regulations for the Implementation of* the PRC Import-Export Commodity Inspection Law.[14]

1.2.4 Ministerial Rules

The bulk of ministerial rules issued by relevant trade regulators (as ministry, department or commission of the State Council at the level of PRC Central

[11] *Zhonghua Renmin Gonghe Guo Haiguan Fa* (中华人民共和国海关法) , enacted on 22 January 1987, revised on 8 July 2000 and the revised version taking effect from 1 January 2001.

[12] *Zhonghua Renmin Gonghe Guo Jinchukou Shangpin Jianyan Fa* (中华人民共和国进出口商品检验法), enacted 21 February 1989, revised on 28 April 2002 and the revised version taking effect from 1 October 2002.

[13] *Zhonghua Renmin Gonghe Guo Jinchukou Guanshui Tiaoli* (中华人民共和国进出口关税条例), the State Council Decree No 392, enacted on 29 October 2003 and taking effect from 1 January 2004.

[14] *Zhonghua Renmin Gonghe Guo Jinchukou Shangpin Jianyan Fa Shishi Tiaoli* (中华人民共和国进出口商品检验法实施条例) , approved by the State Council on 7 October 1992 and taking effect from 23 October 1992.

Government) constitutes the flesh of the legal and regulatory systems governing international trade in China. They are often so detailed that ordinary traders can hardly underpin the relevant rules, not to mention understand or apply them in practice. This partly contributes to complaints on the ambiguity or intricacy of the Chinese trade system. Therefore, the main contents of this book are to analyse and apply these ministerial rules.

Ministries also issue 'normative documents' in the names of circular, notice, order or decision. The status of 'normative documents' in the Chinese legal system is ambiguous. On the one hand, these documents issued by one state organ (for example, the Standing Committee of the NPC or the State Council) should have the same legal effect as other legal norms issued by that organ, because both have general applicability throughout China; on the other hand, a number of normative documents take the form of 'internal circulars' and are not accessible by the public. After China's WTO accession, China has undertaken that it will enforce only those laws, regulations and 'other measures' (including normative documents) that are published and readily available.[15] This means a major change in the PRC's approach to normative documents. Subject to WTO transparency obligations, these documents should have the same effect as other legal norms issued by the same state organ, with added advantages of flexibility and easy adaptability to changing needs.

1.2.5 Judicial Interpretations

In general, Chinese courts were not involved in the field of international trade regulation, which was the exclusive jurisdiction of the State Council and local governments, unless the relevant regulatory behaviours were challenged by private parties before Chinese courts by way of judicial interpretation. In the light of WTO accession, the People's Supreme Court has issued three pieces of unprecedented judicial interpretations to address this field. These judicial interpretations are: *Rules on Several Issues Relating to the Adjudication of International Trade Administrative Litigation*[16] (effective from 1 October 2002), *Rules on Several Issues Relating to the Application of Law in the Adjudication of Anti-dumping Administrative Litigation*[17] (effective from 1 January 2003) and *Rules on Several Issues Relating to the Application of Law in the Adjudication of Anti-subsidies Administrative Litigation*[18] (effective from 1 January 2003).

[15] The Accession Protocol, para 2(C)(1), see n 3 above.

[16] The Supreme People's Court, *Guanyu Shenli Guoji Maoyi Xingzheng Anjian Ruogan Wenti de Guiding* (关于审理国际贸易行政案件若干问题的规定). Fa Shi [2002] No 27.

[17] The Supreme People's Court, *Guanyu Shenli Fanqingxiao Xingzheng Anjian Yingyong Falü Ruogan Wenti de Guiding* (关于审理反倾销行政案件应用法律若干问题的规定), Fa Shi [2002] No 35.

[18] The Supreme People's Court, *Guanyu Shenli Fanbutie Xingzheng Anjian Yingyong Falü Ruogan Wenti de Guiding* (关于审理反补贴行政案件应用法律若干问题的规定), Fa Shi [2002] No 36.

1.2.6 The 'WTO Agreements'?

Whether the WTO agreements constitute one legal source in China depends on whether they have direct effect in the Chinese domestic legal system, that is, whether they can be directly invoked by private parties in front of Chinese courts or administrative bodies. This effect means the WTO agreements are capable of conferring legal rights on private parties or imposing legal obligations on the PRC government, without any need of transformation.[19]

The answer is negative: the general view is that the WTO agreements have no direct effect in China so they are not the legal source of international trade regulation in China from the perspective of PRC laws.[20] This is confirmed by the Supreme People's Court. The *Rules on Several Issues Relating to the Adjudication of International Trade Administrative Litigation* ('International Trade Judicial Rules') clearly indicate that the courts will only apply 'PRC laws, administrative regulations, and local regulations issued by the local legislatures within the relevant legislative competence that relate to or affect international trade',[21] whilst 'mak[ing] reference to' ministerial rules.[22] Hence, the WTO agreements are excluded in the adjudication of cases in connection with international trade regulation in China.

Nevertheless, the WTO agreements affect the PRC trade regulation in two ways. First, China has to transform the WTO agreements into domestic law by way of revising inconsistent existing laws or issuing new laws. This does not necessarily mean that such implementing legislation is always consistent with the WTO agreements in the text or in the spirit – any inconsistency would be theoretically subject to potential complaints by other Members in front of the WTO. One key objective of this book is to highlight such points (if any). The second way is through the 'consistent interpretation principle', which requires the Chinese courts to interpret Chinese law in a manner that should be consistent with the WTO agreements where there are two or more interpretations available.[23] The purpose is to avoid the inconsistent application of Chinese law which is potentially subject to other Members' complaints. As a result, the WTO agreements may have an indirect effect in China through the back door.

[19] For a general discussion of the issues of direct effect, see Xin Zhang, 'Direct Effect of the WTO Agreements: National Survey' (2003) 9:2 *International Trade Law & Regulation* 35.

[20] For a full analysis, see Xin Zhang, 'Domestic Effect of the WTO Agreements in China – Trends and Implications' (2002) 3:5 *Journal of World Investment* 913.

[21] *Rules on Several Issues Relating to the Adjudication of International Trade Administrative Litigation* ('International Trade Judicial Rules'), issued by the Supreme People's Court, Fa Shi [2002] No 27, effective from 1 October 2002, Art 7.

[22] *Ibid*, Art 8.

[23] *Ibid*, Art 9.

1.3 REGULATORY FRAMEWORK

1.3.1 Regulators

The Ministry of Commerce ('MOC'), created in March 2003 by the merger of the then Ministry of Foreign Trade and Economic Cooperation ('MOFTEC') and the State Economic and Trade Commission ('SETC'), is the primary regulator for international trade in China. Before MOC, MOFTEC was the regulator for international trade and foreign direct investment, while SETC was responsible for domestic trade. The creation of MOC aims to establish a uniform and efficient platform that applies to all forms of trade, whether cross-border or within the territory of China. This reform is said to be a significant step to implementing the WTO accession commitments. Nowadays, MOC is a regulatory monster, whose jurisdictions cover trade (international and domestic), distribution, market regulation, foreign direct investment, Chinese outbound investment, trade in technology, international trade negotiations and so on.

MOC exercises its regulatory powers at two levels: national and local. MOC, headquartered in Beijing, implements laws and administration regulations and issues ministerial rules and other normative documents governing the regime of international trade across the country. Some matters are handled by MOC directly, for example, anti-dumping, anti-subsidies and safeguarding measures. However, MOC authorises its local counterparts,[24] usually named as the Bureau of Commerce or even in the old name, the Foreign Trade and Economic Commission, to exercise most of the regulatory powers. Some matters can be approved directly by these local branches, while some matters must be submitted to local branches for a preliminary review and then be forwarded to MOC for a final approval. At the local level, the branches may be either at the provincial level or at the municipal level, but as a general rule, important matters must be approved or reviewed at the provincial level. In this book, the term 'provincial local branches' collectively refers to the local branches of MOC in a province, an autonomous region, a Special Economic Zone or a municipality directly governed by the Central Government, all of which are with a provincial status in China's administrative hierarchy.

[24] The terms 'local counterparts' and 'local branches' are used interchangeably in this book when referring to the local arms of MOC or other ministries. Strictly speaking, 'local counterparts' may be more precise, because the local arms of MOC or some other ministries are only accountable to MOC or such ministries for their regulatory activities. Their budget or personnel issues are decided by the corresponding local governments, rather than by MOC or such ministries in a hierarchical manner.

Besides MOC, some ministries or departments also exercise the regulatory powers in relation to some aspects of international trade that fall within their jurisdictions. The Customs General Administration ('Customs') is responsible for the regulation of tariffs, custom valuation and rule of origins. The State General Administration for Quality Supervision and Inspection and Quarantine ('AQSIQ') is basically responsible for health and safety regulation and technical standards that are relevant to international trade. The National Development and Reform Commission ('NDRC'), though with a reduced power, is still the approving authority for the quota or licence for several key commodities, including the tariff quota for the import of agricultural products. Compared to MOC, these regulators have a supplementary function in the international trade regulation in China.

1.3.2 Regulatory Instruments

The details of regulatory instruments available to each trade regulator in relation to specific issues will be discussed in conjunction with various topics in the following chapters. Outlined here is a list of regulatory instruments available to MOC, the primary trade regulator.

Depending on the nature or type of matters subject to the regulation, the matrix of regulatory instruments available to MOC includes:

(1) Information requirements;
(2) Investigation;
(3) Registration (or rejection) of a qualification;
(4) Approval (or rejection) of an application;
(5) Issuance (or rejection of the issuance) of a licence or permit;
(6) Decision of a matter;
(7) Warning;
(8) Penalty;
(9) Confiscation of proceeds from illegal trade activities;
(10) Suspension or prohibition of foreign trading rights; and
(11) Disqualification of the persons that have engaged in illegal trade activities.

Within this matrix, items (1) to (6) are positive regulatory instruments that relate to the approval of business activities (for example, the grant of foreign trading rights, or the issuance of import licence or quota) or the decision of a matter (for example, the existence or non-existence of dumping or damages to domestic industry). It also represents an ascending degree of intervention by the regulator: from the mere requirement of certain information to the decision of a matter that determines the rights and obligations of private parties as the regulated persons.

Items (7) to (11) are administrative penalties that may be applicable to any person violating the FTL (2004) or other trade regulations and rules. In particular, the disqualification in item (11) is directed at the individuals that must be responsible for the illegal trade activities by using the veil of companies or other organisations.

1.4 BASIC PRINCIPLES

The FTL (2004) establishes several basic principles to govern the international trade regulation regime in China. These principles are also key factors to interpreting the law and policy in this regime, especially where the law is ambiguous in or silent to certain issues or seems inconsistent with international treaties entered into by China.

1.4.1 Fair and Free Trade

The FTL (2004) provides that the State maintains 'fair and free foreign trade order'.[25] This principle conveys an important signal: the Chinese government does not adopt a trade protectionist approach; instead, the fundamentally legislative purpose is to achieve the fairness and the liberalisation of trade. It is consistent with the rationale of WTO agreements, that is,

> [to enter] into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international commerce[26]

and 'to facilitate trade between the constituent territories and not to raise barriers to the trade of other Members with such territories'.[27] Thus, any law or policy, the exercise of which may adversely affect the free trade purpose or have a trade restrictive effect, may be interpreted to the extent that it does not conflict with the 'fair and free trade' principle. If the consistent interpretation is not achievable, such law or policy is a prima facie violation of the WTO Agreement.

The fairness of trade means that the government commits to prevent or eliminate unfair trade practices. The test of fairness must be objective, equitable and transparent. Notably, the fairness requirement may have a wider implication than the equality, as the former is more concerned with substance than formality. The FTL (2004) has specific clauses on the order of foreign

[25] FTL (2004), Art 4, see n 4 above.
[26] The WTO Agreement (1995), *Preamble*, para 3, see n 2 above.
[27] Panel Report on *Turkey – Restrictions on Imports of Textile and Clothing Products*, WT/DS34/R, adopted 19 November 1999, para 9.161.

trade, with a focus on restrictive business practices and unfair competition. These provisions apply to both import and export and may have some potentially extraterritorial effects.[28]

1.4.2 Non-discrimination

The principle of non-discrimination is a basic principle of Chinese trade regulation. It comprises the Most-Favoured-Nation ('MFN') Treatment Principle and the National Treatment Principle.[29] There are no statutory definitions of MFN Treatment and National Treatment under PRC law, but the normal definitions, especially those under the WTO Agreement, are reference to the application of these treatments in China. Furthermore, the Accession Protocol also commits the non-discrimination treatment to foreign individuals, enterprises and FIEs in respect of production, procurement, distribution, resources and infrastructure.[30] The scope of this commitment is obviously wider than international trade and extends to the manufacturing and sale of products by FIEs within China. The application of the non-discrimination principle will be discussed in conjunction with specific issues in the following chapters.

1.4.2.1 National Treatment

Generally speaking, foreign exporters may be more concerned about the national treatment principle in China. The Chinese authorities are obliged to treat imported goods, once they have cleared customs and border procedures, no less favourably than that of domestically produced goods. The policy rationale is to prevent the government from employing domestic tax and regulatory policies as protectionist measures that would defeat the purpose of tariff bindings.[31] This principle plays a greater role in China's trade regulation. At the current stage, tariffs and quantitative restrictions – two traditional border measures to control imports – have substantially waned away since the WTO accession. The treatment of imported goods within the territory of the PRC, usually through internal regulation, is now playing a more important role and thus catching more international attention. The analysis of WTO rules and cases below will be of great help to the practice in China.

[28] FTL (2004), Ch 8 'Foreign Trade Remedies', see n 4 above. For details, see chs 9, 10 and 12 below.

[29] FTL (2004), Art 6, see n 4 above.

[30] The Accession Protocol, para 3, see n 3 above.

[31] JH Jackson, *The World Trading System: Law and Policy of International Economic Relations*, 2nd edn (Cambridge, Mass and London, The MIT Press, 1997).

Article III of the 1994 GATT imposes standards of national treatment in respect of internal taxation and regulation. It obliges the Members to provide competitive conditions for imports equal to those of domestic products.[32] The protection application of a measure can usually be discerned from its 'design, architecture, and revealing structure'.[33] Therefore, Article III seeks to achieve *internally* the same goals that Article II (tariff binding) and Article XI (quantitative import and export restrictions) pursue at the border. In practice, the discrimination of foreign products may be explicit (de jure) or covert (de facto). The former expressly conflicts with the WTO rules, and is easier to be discerned and challenged by other Members. Thus, the current trend is to design a set of measures that makes no distinction between imported and domestic goods – that is, origin-neutral – but which have a disproportionately adverse impact on foreign goods in application. They appear to be non-discriminatory on their face, but have the effect of tilting the scales against the imported goods due to various marketing conditions or circumstances.[34]

In order to challenge one de facto discriminatory measure imposed by the Chinese government in international trade regulation, other Members must prove, in the first place, that the foreign products and the domestic substitutions are '*like products*', and second, that the foreign products are treated less favourably than the domestic 'like products'. As the measures are neutrally applicable to both foreign and domestic 'like products', the complaint needs to show that this ostensibly equal treatment has the *effect* of discriminating against foreign products. In contrast, the Chinese authorities can rebut the above deduction on two points: first, the foreign products are not like the domestic products which enjoy more favourable treatment, therefore the GATT national treatment principle is not triggered; second, there is no discriminatory effect to the foreign products or alternatively, even if such effect does exist, there are other legitimate *purposes* or *aims* to impose the measure. Whilst the arguments and counter-arguments should be based on particular facts in each case, two legal issues underlie the arguments: the determination of 'like products', and the application of the 'aims and effects' test.

1.4.2.2 'Like Products'

The 1994 GATT does not provide a clear definition to this terminology. The interpretation depends on the context and the purpose of GATT in each case. Likewise, the PRC accession documents and the domestic law do not lend any assistance. Reference to the general WTO rules is a good starting point.

As a general rule under WTO cases, the only factors to be taken into account in deciding the likeness of products are the physical characteristics of

[32] Report of Appellate Body on *Japan – taxes on alcoholic beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, 1996 ('*Japan – alcoholic beverages*'), s F.

[33] *Ibid*, s H2(c).

[34] Above n 31 at 216.

the product itself and the ways that such products are perceived and treated by users and others. The Appellate Body has identified four categories of characteristics as a non-exclusive checklist: (i) physical properties, (ii) the extent to which the products are capable of serving the same or similar end-users, (iii) the extent to which consumers perceive and treat the products as alternative means of performing particular functions in order to satisfy a particular want or demand, and (iv) international tariff classification.[35] Therefore, the gist is whether and to what extent the products are, or could be, in a competitive relationship.

There is a so-called 'product-process doctrine' for the determination of like products.[36] Under this doctrine, product distinctions based on characteristics of the production process or of the producers, rather than the characteristics of the product itself, are viewed as a priori illegitimate. For example, in the *Shrimp-Turtles* case,[37] a set of US statutes and regulations known as 'section 609' banned the importation of shrimp from countries that did not protect sea turtles from incidental capture during shrimp harvesting, and only allowed such importation from 'certified' countries – countries that could demonstrate both that they had adopted turtle-protective programs similar to those of the US and that their shrimp fishermen captured sea turtles at a rate comparable to or less than that of the US. The Appellate Body ruled that section 609 required other countries to adopt the method favoured by the US of protecting sea turtles (that is, equivalent to a product-process requirement), so this 'single, rigid and unbending' policy that took no account of different conditions in other countries or alternative measures available to protect sea turtles was both arbitrary and unjustifiable.[38] This doctrine reveals the basic rule to analyse the similarities derived from the characteristics of the product, and to ignore the underlying methods of production or process that may significantly vary from country to country and thus be incomparable in some senses.

35 *European Communities—Measures Affecting Asbestos and Products Containing Asbestos*, the Appellate Body Report, WT/DS135/AB/R, adopted 12 March 2001 ('*EC–asbestos*"), para 101. In addition, the Report of the working party on Border Tax Adjustments, BISD 18S/97 (1972), para 18, listed the factors as 'the product's end-uses in a given market; consumers' tastes and habits, which change from country to country; the product's properties, nature and quality'.

36 See, for example, RE Hudec, 'GATT/WTO Constraints on National Regulation: Requiem for an "Aim and Effects" Test' (1998) 32 *International Lawyer* 619.

37 Report of Appellate Body on *United States – import prohibition of certain shrimp and shrimp products*, WT/DS58/AB/R, 1998.

38 *Ibid*, para 177.

1.4.2.3 The 'Aims and Purpose Test'

GATT Article III, paragraph 1 specifies to consider the aims and effects of internal measures. This conclusion is derived from the phrase 'so as to afford protection'.[39] Since the second sentence of paragraph 2 (for the manner of taxation) expressly calls for the application of 'the principles set forth in paragraph 1', the panels held that the objective of the measure and its effect may be examined.[40] However, the position is ambiguous in relation to the first sentence of paragraph 2 (for the excess taxation) and paragraph 4 (for internal regulation) which have no reference to the principles in paragraph 1.

The panels seem to have been always shifting their positions in relation to the first sentence of paragraph 2.[41] In the latest *Chile – alcoholic beverages* case, the Appellate Body held that 'the purposes or objectives of a Member's legislature and government as a whole' must be considered when deciding the legality of one measure for excess of taxation.[42] Before the Appellate Body further clarifies this point, it is safe to presume that the purposes and effects of regulatory measures should be considered in the context of paragraph 2 of Article III.

The current position is less clear in paragraph 4 in connection with internal regulation. The general policy of paragraph 1 is not mentioned in this paragraph, so it does not require a separate consideration of protection.[43] This implies there is no room for the regulatory purposes in examining the measures under paragraph 4. Nevertheless, interpretations of paragraph 2 are relevant to the interpretation of paragraph 4.[44] Recently, the Appellate Body in *EC – asbestos* indicated that in interpreting paragraph 4, explicit account must be taken of the policy in paragraph 1.[45] A logical deduction for this interpretative rule is that the purposes and effects of internal regulations should also be taken into account when deciding whether they are covertly discriminatory against imported goods.[46] However, unless the Appellate Body expressly supports this interpretation, the purposes behind the domes-

[39] *United States – Measures affecting alcoholic and malt beverages*, Report of the Panel adopted on 19 June 1992 (DS23/R–39S/206) (*US – malt beverages*), para 5.25.

[40] *Japan – alcoholic beverages*, s H, see n 32 above; Report of Appellate Body on *Canada – certain measures concerning periodicals*, WT/DS31/AB/R, 1997, s VI.B.3.

[41] DH Regan, 'Regulatory Purpose and "Like Products" in Article III:4 of the GATT (With Additional Remarks on Article III:2)' (2002) 36 *Journal of World Trade* 443.

[42] Report of Appellate Body on *Chile – taxes on alcoholic beverages*, WT/DS87 & DS110/AB/R, 1999 ('*Chile – alcoholic beverages*'), para 62.

[43] Report of Appellate Body on *EC – regime for the importation, sale and distribution of bananas*, WT/DS135/AB/R, 1997 ('*EC – bananas III*'), para 216.

[44] *Japan – alcoholic beverages*, s H, see n 32 above.

[45] *EC – asbestos*, para 93, 98, see n 35 above. This position differs from the former position in *EC – bananas III*, which directed no reference to paragraph 1 when interpreting paragraph 4 (see *EC – bananas III*, para 216). Another explanation may be that the *EC – asbestos* case is distinguished from *EC – bananas III* in this issue in that the latter did not involve the interpretation of 'like products' (see *EC – asbestos*, para 88, n 57).

[46] Above n 41 at 443, 477–8.

tic regulations can only be used as supporting proof in the argument, not a decisive one.

In the case of China, the argument for or against the 'aims and effects' test may be most relevant to the challenges to its internal regulation of imported goods. There are limited cases where the government imposes a less favourable internal taxation on foreign products, because a uniform tax system is now applicable to both domestic and imported products.[47] Once proving the adverse effects of one Chinese implementing measure on foreign products are ascertained, it is necessary to judge the regulatory purposes of the Chinese authorities, especially to discern if there are legitimate purposes to regulate in this manner or if this is actually a disguised protectionism.

It is a challenging task on how to determine the purposes of Chinese legislation and regulation. As a general WTO rule, the purpose or objective of a Member's legislature and government as a whole are relevant to the extent that they are given objective expression in the measure itself, but not the subjective intentions of individual legislators or regulators.[48] So the key is to determine the regulatory purposes underlying the legislations and regulations *as a whole*. This rule may meet practical difficulties in its application in China because of two reasons. First, the transparency of the operation and decision-making process in the National People's Congress ('NPC', the equivalent to Parliament) and the government is at a low degree, usually without public records for the debates during the drafting process. It makes the objective assessment of regulatory purposes a mission without the sources. Secondly, there is no active role for individual legislators[49] during the legislation process. They are hiding behind the uniform cloak of a collective voice. In general, there is only a short explanation for the purposes of enacting a new law or revising an existing law, presented by the sub-committee in charge of drafting. For administrative regulations and rules, even such short explanations do not exist in most cases. Consequently, it would be extremely difficult – if not impossible – to dig out records or public expression of the real purposes of Chinese measures, especially when they are alleged to constitute a disguised discrimination against imported products. Even if such a purpose does exist, it would not be shouted out.

In my view, the purpose of legislature or government should be understood as the political forces that produce the particular action in the light of

[47] There are three main types of taxes applicable to products: value-added tax (VAT), business tax and consumption tax. These taxes are applicable to imported and domestic products (including the products manufactured by FIEs). See the State Council, *Circular on Question Related to Provisional Regulations Concerning Taxations Including Value-Added Tax, Consumption Tax and Business Tax Applicable to Enterprises with Foreign Investment and Foreign Enterprises*, Guo Fa [1994] No 10, issued on 22 February 1994.

[48] *Chile – alcoholic beverages*, para 62, see n 42 above.

[49] Usually around 100 members of the NPC Standing Committee are the actual persons that control the legislative process and outcome, while the NPC meeting is largely a 'rubber stamp'.

China's current political infrastructure.[50] More precisely, 'political forces' mean various interest groups that input their concerns and pressures to influence the outcome of legislation and regulation, if we bear in mind that there exist no opposition parties in a true sense within China's current political stage. In relation to importation of foreign goods, the interest groups may be domestic competitors (especially SOEs), foreign exporters and FIEs, local governments that are anxious to guarantee the growth rate and the social stability within their jurisdiction, and several 'weak' groups such as consumers, farmers and workers who lack collective representation.[51] As a result, trade-related measures may be the outcome of a compromise between interests of various groups. Due to the traditional links between domestic enterprises and the government, there is no doubt that domestic competitors may have the strongest voice and be well represented in the process of policy formulation and legislative drafting. Therefore, a careful cost-benefit analysis of one measure on all involved interest groups would suggest a way to discern its objectives or underlying purposes. The following chapters will employ this theory to underpin the legislative or regulatory purposes of the relevant trade laws and regulations.

1.4.3 Due Regulatory Process

The regulatory process is the application of law 'on the book' to the practice by regulators, and this decides the real effect of law. In China, it is a well-known phenomenon that formal law and institution differ significantly from law in practice due to flaws in process of legal implementation and enforcement. The FTL (2004) and China's WTO accession commitments require all regulators to implement a due regulatory process in the international trade regulation.

Apart from specific requirements on the regulatory procedures and standards in certain agreements (for example, the Agreement on SPM and the Agreement on TBT), the WTO agreements set up several general criteria for domestic regulation. GATT requires that each Member must administer all of its trade-related laws, regulations, decisions and rulings (collectively as 'trade measures') in a 'uniform, impartial and reasonable manner'.[52] Similarly, GATS requires that each Member shall ensure that all measures of general

[50] Above n 41 at 458.

[51] For a discussion of interest groups in China and their role in foreign policy formulation, see Xin Zhang, 'Distribution Rights in China: Regulatory Barriers and Reform in the WTO Context' (2001) 35 *Journal of World Trade* 1285–90.

[52] *General Agreement on Tariffs and Trade 1994,* one document of Annex 1A to the *Marrakesh Agreement Establishing the* World *Trade Organization*, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994 ('GATT'), Art X:3(a).

application affecting trade in services are administered in a 'reasonable, objective and impartial manner'.[53]

Based on the above discussion, a due regulatory process for the regime of international trade comprises four basic criteria: uniformity, transparency, impartiality, and reasonableness (including objectiveness and justifiability). These are the standards for the regulatory behaviours of trade regulators. In the following chapters, whether and how trade regulators can achieve these standards will also be analysed in light of the interpretation and application of trader laws and regulations.

1.4.4 Reciprocity

The FTL (2004) expressly authorises retaliation for discriminatory treatment of China by another country in respect of international trade. Article 7 allows the government to adopt prohibitive or restrictive actions against a country or region that adopts similar discriminatory actions against Chinese trade (including the export of goods, technologies or services). This article is the statutory basis for the government's unilateral actions to engage in trade wars with other countries or regions. Even though the WTO Agreement prohibits this kind of unilateral retaliation without recourse to the dispute settlement mechanism of WTO, the government may still be able to rely on the domestic law.

In addition, the grant of MFN Treatment and National Treatment to imported goods is also qualified by the conditions as 'in accordance with international treaties or agreements signed or entered into by [China] or with the principles of mutuality and reciprocity'.[54] This implies that the PRC government is entitled under the domestic law to refuse or withdraw the MFN or National Treatment to the imported goods from a specific country or region, provided that such country or region does not comply with the relevant international treaty (most likely, the WTO Agreement) or the principle of reciprocity to grant the same treatment to goods imported from China.

1.5 STRUCTURE OF THE BOOK

This book is divided into four parts and composed of fourteen chapters. Except for this chapter as part one (Introduction), the structure of the remaining chapters is as follows.

Part two (Basic Regulation) analyses the basic issues of international trade regulation in China, taking into account the business chain of import or

[53] GATS, Art VI:1, see n 6 above.
[54] FTL (2004), Art 6, see n 4 above.

export of goods. Chapter two discusses the liberalisation of foreign trading rights to foreign trade operators in China, which is the legal capacity for engaging in international trade. State trading and designated trading, two new potential areas for trade protectionism against imported goods, will be the new focus of regulation and of international concerns. Chapter three discusses the general rules of trade restrictions and prohibitions under PRC law and chapter four discusses the licencing and quota system for import and export of goods. As China commits to phase out almost all licencing or quota requirements for key goods generally by the end of 2005, this chapter does not intend to describe in great detail the requirements that have been eliminated or are to be eliminated in the near future. Rather, the focus of research is on some licencing or quota measures that will survive (such as automatic import licencing), to evaluate whether its application in practice may amount to a disguised protectionist measure. Chapter five considers the customs regulation, covering three issues: tariffs, custom valuation and rule of origin. Chapter six is a new area to be discussed in the context of international trade regulation: the health and safety regulation and technical standards. Again, the focus is not on the technical side of this topic, but on the possible abuse of these origin-neutral regulations to discriminate against foreign goods. The issue of genetically-modified agricultural goods will be a case study to test these regulations. In addition, chapter seven presents a brief analysis on the regulation of trade in technology.

Part three (Trade Protection and Remedies) approaches international trade regulation from the perspective of trade protection and remedies under PRC law. Since free trade is the basic tune of regulation in China, the grounds of trade protection available to Chinese trade regulators and their application must be a significant concern of other countries and foreign exporters. Besides the traditional trade protection measures such as anti-dumping and anti-subsidies (chapter nine) and safeguarding measures (chapter ten), this book also discusses the general principles of trade protection and retaliation by the PRC government, as well as the foreign trade investigation procedures available to MOC (chapter eight).

Part four (Related Issues) discusses several issues inherent to international trade in order to give a broader picture of trade regulation in China. These issues are trade promotion (chapter eleven), trade and competition (chapter twelve), trade-related intellectual property issues (chapter thirteen) and the resolution of trade-related disputes between private parties and Chinese trade regulators (chapter fourteen).

Part II

Basic Regulation

2

Foreign Trading Rights

The term 'foreign trading rights' or 'trading rights' means the legal competence of domestic and foreign enterprises to import and export products to or from the PRC and thus have access to China's distribution system.[1] There are three categories of trading rights applicable under the Chinese regulatory regime: general trading rights, state trading rights, and designated trading rights. The first category – general trading rights – relates to the import and export of goods that are not subject to special restrictions, which should be available to every eligible foreign trade operator with the liberalisation of the regulatory regime after the WTO accession. The second and the third categories of trading rights are only available to selected PRC companies, which represent a degree of state control or restriction of the trade in some specific goods. Consequently, whether or not the PRC government applies state and designated trading rights in a way that complies with the WTO Agreement must be carefully assessed.

2.1 GENERAL TRADING RIGHTS

2.1.1 Before the WTO Accession

Before the WTO accession, Chinese domestic enterprises could not freely engage in foreign trade within the territory of China, unless authorised or otherwise exempted by the law. The old FTL (1994) defined these eligible enterprises as 'foreign trade operator' ('FTO'),[2] a term still used in the new FTL (2004). The essence of the FTO system was a licencing system. National control on scopes of FTOs and their businesses virtually constituted a regulatory barrier to the market access of foreign goods because foreign exporters

1 For a discussion of foreign trading rights in China, generally see the text and footnotes of Xin Zhang, 'Distribution Rights in China: Regulatory Barriers and Reform in the WTO Context' (2001) 35:6 *Journal of World Trade* 1247–91.

2 *The PRC Foreign Trade Law*, *Zhonghua Renmin Gonghe Guo Duiwai Maoyi Fa* (中华人民共和国对外贸易法), promulgated on 12 May 1994 by the Seventh Meeting of the Standing Committee of National People's Congress of the PRC and taking effect from 1 July 1994, as amended on 6 April 2004 and taking effect from 1 July 2004.

had to channel their goods into the Chinese market through a FTO and could not deal directly with the end-users. This qualification may be a form of disguised quantitative restriction of trade where the authorisation system itself tends to reduce the number of FTOs.[3] Furthermore, it tended to weaken the competitiveness of foreign goods for two reasons: first, the price of imported goods would generally be increased to add a profit margin for those 'middleman', thus more or less undermining its competitiveness with domestic substitutes[4]; second, foreign exporters were effectively excluded from the provision of after-sale services and would have to appoint a Chinese entity to carry out these services on their behalf.[5] From a GATS view, the limited trading rights also hindered the cross-border supply of distribution services, in the forms of both wholesale and retailing services.

Comparatively, foreign-invested enterprises (FIEs) in China had been enjoying more favourable treatment in trading rights. They were automatically granted limited trading rights upon its establishment, in relation to export of their own products and import of relevant materials.[6] Moreover, they were entitled to distribute, by themselves or through an agent, any product they made in China into the domestic market, except for a few items subject to state control.[7] This distribution right did not extend to products made by the FIE's parent company or any of its subsidiaries, or to products made by other firms.

2.1.2 The WTO Commitments

Trading rights have been one major concern of trading partners in their WTO-related negotiations and these rights have been subject to hard negotiations.[8] Trading partners regarded the legal restrictions on foreign trading rights by the Chinese government as one important non-tariff barrier that violated the 1994 GATT,[9] as well as a restriction on cross-border supply of distribution services under GATS by foreign service suppliers.

China finally committed to liberalise the trading rights regime within a

[3] Bing Wang, 'China's New Foreign Trade Law: Analysis and Implications for China's GATT Bid' (1995) *John Marshall Law Review* 504–5; Zhong Jianhua and M Williams, 'The Foreign Trade Agency System in the People's Republic of China: Agency or Monopoly' (Sept 2000) *Journal of Business Law* 440–50.

[4] Zhang Shuguang, Zhang Yansheng and Wan Zhongxin, *Measuring the Costs of Protection in China* (Washington DC, Institute for International Economics, 1998) 14–21.

[5] DA Rondinelli, *Expanding Sino–US Business and Trade: China's Economic Transition* (New York, Quorum Books, 1994) 82–3.

[6] FTL (1994), Art 9(3), see n 2 above.

[7] Above n 1 at 1271–72.

[8] S Leonard, *The Dragon Awakens: China's Long March to Geneva* (London, Cameron May, 1999) 84.

[9] Bing Wang, above n 3 at 532–3.

three-year transition period after the WTO accession. It has committed under the Accession Protocol that:

> 1. Without prejudice to China's right to regulate trade in a manner consistent with the WTO Agreement, China shall progressively liberalize the availability and scope of the right to trade, so that, within *three years* of the entry into force of this Protocol, *all enterprises* in China shall have the right to trade in all goods throughout the customs territory of China, except for those goods listed in Annex 2A which continue to be subject to state trading in accordance with this Protocol. Such right to trade shall be the right to import and export goods. All such goods shall be accorded *national treatment* under Article III for GATT 1994, especially paragraph 4 thereof, in respect of their internal sale, offering for sale, purchase, transportation, distribution or use, including their direct access to end-users. For those goods listed in Annex 2B, China shall phase out limitation on the grant of trading rights pursuant the schedule in that Annex. China shall complete all necessary legislative procedures to implement these provisions during the transition period.
> 2. Except as otherwise provided in this Protocol, all foreign individuals and enterprises, including those not invested or registered in China, shall be accorded treatment no less favourable than that accorded to enterprises in China with respect to the right to trade.[10] (emphasis added)

Indeed, the liberalisation of trading rights is one major reason for revising the former FTL in 2004. In accordance with the Explanatory Note to the Standing Committee of NPC, one reason for the revision is that,

> in accordance with Paragraph 5.1 of [the Accession Protocol], China has committed to liberalise foreign trading rights and shall complete the necessary legislative procedures for implementing these commitments within the transition period.[11]

2.1.3 New Regulation: A Registration System

Under the new FTL (2004), Article 9(1) now complies with the WTO commitments by providing that a FTO may engage in the import and export of goods and technologies 'upon registration'. This marks the most fundamental change in the trading rights regime: from a licencing system to a registration system. The following sections will analyse the evolution from a licencing system to a registration system in respect of the grant of general trading rights.

10 The Protocol on the Accession of the People's Republic of China ('The Accession Procotol'), dated 10 November 2001, cl 5 'Right to Trade'.

11 Mr Yu Guangzhou (Vice-Minister of Ministry of Commerce), 'Explanatory Notes on the PRC Foreign Trade Law (draft amendment)', addressed to the Standing Committee on 22 December 2003.

2.1.3.1 The Expansion of FTOs

China traditionally granted trading rights to FTOs on the basis of their ownership, a feature of the planning economy and the state monopoly of foreign trade.[12] During the past two decades, one clear direction of reform has been the expansion of trading rights formerly monopolised by state-owned foreign trade companies to various types of state-owned or private-owned enterprises.[13] However, notwithstanding the expansion of trading rights, Chinese citizens (as natural persons) were not always allowed to engage in foreign trade. A possible policy consideration may be that individuals have less financial means and expertise in this business and permitting their participation in foreign trade would disturb the state-controlled trade order.

Significantly, the FTL (2004) makes a breakthrough in this respect by relying on China's accession commitments. The legislators allege that the Accession Protocol requires the grant of trading rights to foreign individuals and enterprises a treatment 'not less than that to Chinese enterprises'. While a foreign individual may engage in foreign trade in China, 'Chinese natural persons should also be allowed to engage in foreign trade'.[14] Furthermore, natural persons have been largely involved in trade in technology or services, or in border trade. As a result, Article 8 of the FTL (2004) expands the types of FTO to 'natural persons, legal persons and other associations engaged in the business activities of foreign trade in accordance with [the PRC Foreign Trade Law]'.

2.1.3.2 The Implementing Measures

In order to implement the WTO commitments, MOC (formerly MOFTEC) has issued several implementing measures. Table 2-1 illustrates the progress of liberalisation. In this table, the '2001 Provisions' refer to the *Provisions on Administration of Qualification for Import and Export Business* (issued on 10 July 2001), the '2001 FIEs Circular' refers to the *Circular on Expanding the Import and Export Trading Rights of FIEs* (issued on 2 July 2001), and the '2003 Circular' refers to the Circular on Adjusting the Qualification for Import and Export Business and the Procedures for Verification (issued on 30 July 2003).

12 See, for example, M Williams and Zhong Jianhua, 'The Capacity of Chinese Enterprises to Engage in Foreign Trade: Does Restriction Help or Hinder China's Trade Relations?' (1999) 8 *Journal of Transnational Law & Policy* 204 *et seq*.

13 Before the WTO accession, licenced foreign trade companies, state manufacturing enterprises, commercial/material enterprises, science research institutes and high-tech companies, private manufacturing enterprises and science research centres were entitled to foreign trading rights. Except for licenced foreign trade companies, a common feature for other FTOs was that they must be of either manufacturing or of high-tech nature. For a detailed discussion of the route of expansion and the relevant Chinese laws, see Xin Zhang, above n 1 at 1255–61.

14 Above n 11.

Table 2-1 reveals the 'top-up' feature of WTO commitments in connection with trading rights. First, all domestic enterprises, whether state-controlled or private-owned, shall be granted foreign trading rights within three years of accession. Second, the current restriction on manufacturing enterprises to export their own products and import relevant materials must be abolished. An enterprise with trading rights is entitled to import and export the whole range of products, either manufacturing by itself or by others, except for goods subject to designated or state trading or subject to other legal restrictions. In the aspects of minimum registered capital for Chinese enterprises, the government has implemented the commitments generally one year ahead of the schedule. For example, in July 2001 (before the accession), this threshold was reduced to RMB5 million for foreign trade companies (or RMB3 million for manufacturing enterprises), and in July 2003, these were further reduced to RMB1 million or RMB0.5 million. The committment schedule was for November 2002 and November 2004 respectively.

On the other hand, the commitments to grant trading rights to FIEs within three years of accession[15] only adds some marginal rights. The most significant point is that the FIEs, even without a manufacturing nature, will be entitled to import and export goods, with the same rights as domestic enterprises. However, the government seems to have failed to comply with the commitments in this respect, because no rules were issued to grant trading rights to FIEs with minority foreign shareholding by November 2002 and to FIEs with majority foreign shareholding by November 2003. In contrast, the applicable 2001 FIEs Circular only allows limited trading rights by eligible FIEs with an annual export turnover exceeding USD10 million. The Chinese government obviously breaches the accession commitments to grant trading rights to FIEs.

Although China technically breaches its accession commitments to grant FIEs trading rights during the transition period, it will be remedied by the draft FTL under which all enterprises residing in China (including FIEs) will be eligible for trading rights upon registration. More importantly, FIEs have already enjoyed the right to export their own products, which is the most relevant factor to FIEs' operation, so it appears that few FIEs really care for the right to carry out full foreign trade as mandated in China's accession commitments.

2.1.3.3 The Registration System: History

Under a registration system, all applicants satisfying the prescribed conditions must be automatically granted trading rights through registering at the competent authority, unless the refusal was otherwise justified.

From as early as January 1997, five Special Economic Zones ('SEZs') implemented the pilot test of the automatic registration system applicable to

[15] The Accession Protocol, para 5(2), see n 10 above.

Table 2-1 Trading Rights: The WTO Commitments and the Implementing Measures (2001–2004)

Year	The 2001 Provisions	The 2001 FIEs Circular	The 2003 Circular	The FTL (2004)	WTO Commitments
2001	1. Trading rights for foreign trade companies: licencing (minimum capital RMB 5m). 2. Trading rights for manufacturing companies for own products: registration (minimum capital RMB 3m).	Eligible FIEs (eg annual export turnover exceeds USD 10m) to export products not subject to quota or designated trading and to bid for export quota for its own products.			Trading rights for Chinese enterprises, foreign enterprises and individuals by Nov 2004; Trading rights for Chinese enterprises: minimum registered capital reduced to RMB 5m by Nov 2002, to RMB 3m by Nov 2003, to RMB 1m and full liberalisation of trading rights by Nov 2004*; Trading rights to FIEs: full rights to FIEs with minority foreign shareholding by Nov 2002, full rights for FIEs with majority foreign shareholding by Nov 2003, full rights for wholly-owned foreign enterprises by Nov 2004.**
2002					

2003		1. Trading rights for foreign trade companies: licencing (minimum capital RMB 1m). 2. Trading rights for manufacturing companies for own products: registration (minimum capital RMB 0.5m).	
2004			Trading rights for all FTOs (enterprises, natural persons and other associations) upon registration.

*The Working Group Report, para. 83(b).
**The Working Group Report, para. 83(c).

all types of manufacturing enterprises situated within SEZs, regardless of the ownership nature.[16] This practice was formally expanded to all manufacturing enterprises, wherever located, by the 2001 Provisions. Most of the criteria for registration were formal requirements (for example, having the Business Licence and the Tax Registration Certificate), except for the minimum threshold of registered capital (RMB3 million). After submission of all documents, the competent authority was obliged to accept the application and decide within 10 working days whether to register or not, and if the latter, must explain the reasons for refusal.[17] The 2003 Circular further reduced the threshold to RMB0.5 million.

2.1.3.4 The Registration System: Current Regime under the FTL (2004)

MOC issued the Measures on Registration and Filing of Foreign Trade Operators ('FTO Registration Measures')[18] on 19 June 2004, effective from 1 July 2004, evidencing the full liberalisation of the Chinese foreign trading rights regime. MOC is still the competent authority for the grant of foreign trading rights to all applicants (including legal persons and non-legal persons such as sole proprietors and Chinese branches of foreign companies),[19] but designates the power to its local branches to take charge of the registration and filing of applicants within their territorial jurisdiction.[20] The registration system is now computer-based. These authorised local branches must have the fixed office premise necessary for the registration, the full-time staff in charge of the administration, filling in, technical support and maintenance of the computer network linked to the MOC FTOs Filing and Registration System (an on-line application system).[21]

The registration system applies to trade in goods and trade in technology. Without the due registration, Customs will not allow the clearance of imported goods and technologies. An applicant only needs to submit the basic application documents to the relevant branch: the application form and one copy of the Business Licence and the Organisation Code Certificate.[22] FIEs shall also submit a copy of the FIE Approval Certificate. More importantly, foreign trading rights are now formally extended to non-legal persons,

[16] See *Interim Measures on Automatic Registration of Foreign Trading Rights of Own Products for Manufacturing Enterprises Resident within SEZs* (*jingji tequ shengchan qiye zhiying jingchukouquan zhidong dengji zhanxing banfa*), MOFTEC, effective from 22 January 1997.

[17] *Provisions on Administration of Qualification for Import and Export Business*, MOFTEC, issued on 10 July 2001, ('The 2001 Provisions'), para 2.

[18] *Measures on Registration and Filing of Foreign Trade Operators* (对外贸易经营者备案登记办法), issued by MOC on 19 June 2004 and effective from 1 July 2004 ('FTO Registration Measures').

[19] Ibid, Art 3.

[20] Ibid, Art 4(2).

[21] Ibid, Art 4(3).

[22] For an FIE, a copy of the approval certificate must be submitted. These requirements are applicable to legal persons. A sole proprietor must submit the notarised documents to prove his assets; the Chinese branch of a foreign company must submit the notarised evidence for its funds and credit status. FTO Registration Measures, Art 5(3), see n 18 above.

without any requirement on capital threshold. A sole proprietor must submit notarised proof of his assets, and a Chinese branch of a foreign company must submit notarised proof of its funding and credit.[23] Thus, the applicant only needs to satisfy the minimum requirement and ensure the completeness, accuracy and genuineness of the information and documents it submits, and assume no onerous capital threshold or other qualification requirements. Domestic enterprises, individuals and FIEs are now enjoying equal treatment in this area.

The authorised local branch must complete the registration and filing process within five working days of receipt of the application documents by sealing the approval-stamp on the application form.[24] The applicant will bring this stamped application form within 30 days to local Customs, quarantine, foreign exchange and tax authorities to complete the necessary procedures for carrying on foreign trade.[25]

In the event that any particulars on the application form are changed, the FTO is obliged to apply for the change of the application form within 30 days, the failure of which will cease the effect of the application form automatically. The authorised local branch must handle such a change at the time of application. Undoubtedly, the application form will be automatically revoked at the time of de-registration of the FTO status or of the cancellation of its business licence. In addition, if MOC prohibits an FTO from carrying on foreign trade business due to its illegal behaviour for a period between one to three years, the authorised local branch will also revoke the application form. When the trade prohibition period expires, that FTO can re-apply for the registration of foreign trading rights.[26]

In conclusion, the coming into effect of the FTO Registration Measures from 1 July 2004 is the symbol for a full liberalisation of China's general foreign trading rights regime as a WTO accession commitment.

2.1.4 Critical Review under the GATT

A notable feature for the pre-2004 FTL era was that the regulator tended to prescribe certain conditions for the applicants under the automatic registration system – an 'entrance qualification' approach. Whilst the FTL (2004) and the latest FTO Registration Measure have abolished this approach, it is worth exploring its conformity with the GATT commitments. The under-

[23] *Measures on Registration and Filing of Foreign Trade Operators* (对外贸易经营者备案登记办法) , issued by MOC on 19 June 2004 and effective from 1 July 2004 ('FTO Registration Measures'), Art 5(2).

[24] *Ibid*, Art 6.

[25] However, if all these procedures have not been completed within this 30-day period, the application form will cease to be effective automatically. This implies that other relevant governmental authorities must ensure that their procedures are capable of being completed as a requirement within this period.

[26] FTO Registration Measures, Arts 9 and 10, see n 23 above.

lying rationale is if this approach does not violate the GATT commitments, it could still be a potential regulatory instrument available to Chinese trade regulators in the future. When a certain degree of regulation is deemed as necessary by MOC, it may return to this approach.

Historically, the regulator applied three core qualifications: first, the requirements for a certain amount of registered capital; second, the sufficient premises, funds and personnel to engage in foreign trade; third, the requirements for export performance and prior experience requirements, in particular, on FIEs (for example, the requirement of USD10 million annual export turnover).

The first two conditions can be collectively referred to as 'prudential requirements' because of their nature and relevance to the safety of business. The underlying rationale was the special characters of foreign trade, such as the risks for cross-border business, the larger amount of capital involved than in domestic trade, and the special transaction knowledge and expertise. Under the registration system, the prudential requirements would play a more significant role in regulating foreign trading rights, so as to control the quality of entrants and indirectly protect the foreign trade order.

It is submitted that these entrance qualifications are valid under the WTO Agreement. China's WTO commitment is to grant trading rights to all domestic enterprises, 'without prejudice to China's right to regulate trade in a manner consistent with the WTO Agreement'. Therefore, the government is entitled to regulate the grant of trading rights in accordance with its social, economic and political considerations, given that the regulation is WTO-consistent. The WTO Agreement contains no prohibition or restriction on a Member's ability to regulate the qualifications of entities that enter into one particular field of business from a corporate law perspective, unless such a regulation imposes more onerous conditions on foreign companies or adversely affects the sale of imported products. As a result, Chinese government can continue the prudential requirements in foreign trade business. Examples include a capital verification certificate issued by an accounting firm, a business plan and some basic information of the applicant demonstrating its eligibility and expertise.

On the contrary, the requirements for export performance and prior experience directly conflicted with the GATT commitments. The government expressly commits that:

> [U]pon accession, China would eliminate for both Chinese and foreign-invested enterprises any export performance, trade balancing, foreign exchange balancing and *prior experience requirements*, such as in importing and exporting, as criteria for obtaining or maintaining the right to import and export.[27] [emphasis added]

[27] *Report of the Working Party on the Accession of China*, issued by the Working Party on the Accession of China, WT/ACC/CHN/49, adopted 1 October 2001 (01–4679) ('The Working Party Report'), para 83(a).

Thus, the annual export turnover requirement on FIEs to obtain the right to export in the 2001 Circular was unambiguously inconsistent with this commitment. Despite the general sound process of implementation, it is evidence of non-compliance with the WTO Agreement by the PRC government – although this has been corrected after the FTL (2004).

2.1.5 Foreign-invested Holding Companies

In spite of the trend of liberalisation, MOC issued an administrative rule titled 'Provisions Relating to the Establishment of Investment Holding Companies by Foreign Investors'[28] in February 2004, under which a foreign-invested holding company was only entitled to import as an agent the equipment or raw materials required by its invested companies and to export the products manufactured by such invested companies.[29] This restriction on trading rights of the holding company was justified at the time of issuance, but is clearly inconsistent with the full liberalisation under the FTL (2004). Since this restriction has not been abolished by MOC, it creates a difficult situation when a foreign-invested holding company now relies on the new law to apply for full trading rights. In my view, MOC cannot refuse such application because the new principle contained in the FTL (2004), a law with a higher status than the said administrative rule and issued afterwards, must prevail over the above restriction.

There is no official explanation for the less favourable treatment of FIEs' foreign trading rights, nor is there a public complaint or litigation brought by one FIE against MOC in this regard. It is submitted that this non-compliance may be caused by two reasons. The first is the lack of co-ordination within MOC in drafting different ministerial rules. It is also likely that MOC has taken the selective approach, that is, delaying the implementation of GATT commitments in favour of FIEs and adopting a 'wait and see' attitude to the possible response from FIEs or other Members – indeed, due to the short transition period, FIEs were only exposed to a limited period of less favourable treatment before the FTL (2004) came into effect, and nobody seemed to have interests in challenging the Chinese government for this WTO-inconsistent practice. Second, realising the competition of domestic FTOs upon the liberalisation of trading rights, MOC might attempt to give them a little longer breathing time by deliberately discounting the treatment of FIEs and thus delaying the emergence of more competitors. So, international society must closely monitor a potentially dangerous trend – whether or not the Chinese government might be more responsive to the pressure from domestic

[28] *Rules on Investment Company Established by Foreign Investors* (关于外商投资举办投资性公司的规定), issued by MOC on 13 February 2004 and effective after 30 days of the issuance.

[29] *Ibid*, Art 10(2)(i).

interest groups and adopt protectionist measures against foreign competitors (including FIEs).

Finally, MOC issued new *Rules on Investment Company Established by Foreign Investors*[30] in November 2004. Under Article 11(1) of the new Rules, a foreign-invested holding company can engage in export and import of goods and technology after completing the registration procedure under the FTO Registration Measures. This provision removes the restriction on general trading rights of foreign-invested holding companies. As a result, these companies can also engage in foreign trade in their own names, without restrictions on the scope of products to be traded, so long as they register such rights with the local MOC branches.

2.1.6 Tax Policy on Small Trade Operators

Since the new FTL has come into effect from 1 July 2004, many small foreign trade operators have been registered within a short time.[31] However, the State Administration of Taxation ('SAT'), the competent authority of taxation in the PRC, issued an *Urgent Notice on Strengthening the Collection of Value Added Tax on Newly-Established Commercial and Trade Companies* ('VAT Notice') on 1 July 2004.[32] While not directed at small FTOs, the application of this VAT Notice has some materially adverse effects on their operation.

In accordance with the VAT Notice, all newly-established small trade companies – exactly covering these small FTOs that usually have a small scale operations – can only be treated as a normal VAT payer after reaching the threshold of an annual, actual turnover of RMB1.8 million. Under the old rules, a small trade company could apply for the status of normal VAT payer on the basis of *estimated* annual turnover. Only by obtaining this status can a trade company claim for the VAT refund for exported goods from the Chinese government, usually amounting to six per cent to seventeen per cent of the turnover. Bearing in mind that the average gross profit rate for the export business in the current period is only three per cent to five per cent of the turnover, without the VAT refund there is no profit to the trade companies at all.[33] However, under the VAT Notice, the small FTOs can only

[30] *Guangyu waishang touzi juban touzixing gongsi de guiding*, issued by MOC on 17 November 2004 and effective from 16 December 2004.

[31] Cai Yanhong, 'Xin waimaofa shishi hou siqi zhuce jizeng' (Private enterprises registered under the new Foreign Trading Law significantly increased) *Legal Daily* (22 August 2004) 3, 'Private Economy'.

[32] *Urgent Notice on Strengthening the Collection of Value Added Tax on Newly-Established Commercial and Trade Companies* (关于加强新办商贸企业增值税征收管理有关问题的紧急通知), issued by SAT on 1 July 2004, Guo Shui Fa Ming Dian [2004] No 37.

[33] See 'Guoshui xinzheng yu waimaofa dizhu, geren waimao qiye zhao doutou liangshui' (A

be treated as the normal VAT payers after they reach the annual export performance threshold – before that, they can only operate in deficit.

Consequently, without amending the stringent VAT Notice, the benefits of the FTL (2004) for small FTOs set up by individuals are seriously undermined or even rendered meaningless in practice. SAT purports to prevent illegal traders from falsely claiming for the VAT refund without an actual export record, a reasonable policy objective. However, it has not sufficiently considered the adverse impact on normal trade companies (especially those newly-established small FTOs) that cannot survive without the support of VAT refund. From available information, SAT has no intention of changing this policy anytime soon.[34] This case shows a lack of communication between the ministries and necessary coordination of policies – a challenge of the capacity of the Central Government to coordinate trade-related policies and achieve the optimal benefits of trade liberalisation.

After complaints by many small FTOs, as well as, the communications between MOC and SAT, SAT seems to realise the adverse effects of the VAT Notice on small FTOs' normal operation and tax refunding. On 1 December 2004, SAT issued a Supplemental Notice on Strengthening the Collection of Value Added Tax on Newly-Established Commercial and Trade Companies,[35] aiming to reduce the adverse effects to some extent. In accordance with the Supplemental Notice, if a small FTO has a fixed business premise and the relevant personnel and can prove the sources or channels of the goods or products to be traded (by providing the evidence from the suppliers and the supply contract or letter of intent), with estimated annual sales exceeding RMB1.8 million in value, the tax authority may consider granting the status of normal VAT payer to such FTO after reviewing its documents, interviewing its legal representative and carrying out the onsite inspection.[36] As a result, those small FTOs that have a normal business plan and suppliers, can still obtain the normal VAT payer status and need not have to wait for a one year actual operation period to prove their capacity to reach the RMB1.8 million threshold. However, the tax authority still has some discretion to refuse to grant such status if it is not satisfied with the documents or evidence provided by the small FTO. To the small FTOs, this is an uncertain factor that they have to take into account when starting up a business.

conflict between the newly issued tax rule and the new Foreign Trade Law makes individual FTOs difficult to survive), at http://news.homeway.com.cn/detail.aspx?lm=1693&id=799987 (28 August 2004).

34 *Ibid*.

35 *Supplemental Notice on Strengthening the Collection of Value Added Tax on Newly-Established Commercial and Trade Companies* (关于加强新办商贸企业增值税征收管理有关问题的补充通知), issued by SAT on 1 December 2004, Guo Shui Fa Ming Dian [2004] No 62.

36 *Ibid*, para 1.

2.2 STATE TRADING RIGHTS

2.2.1 Background

As discussed above, China committed to liberalise foreign trading rights by the end of 2004. However, the general trend of liberalisation is subject to one exception: state trading and designated trading. These are two special types of trading rights. Under these schemes, the government licences a limited number of Chinese domestic enterprises to export and import specific goods in a monopoly or quasi-monopoly status. The source of such privilege is not from application or bidding, but from designation by the government. The FTL (2004) provides that the State can implement a state trading administration on the import and export of certain types of goods, only to be carried out by authorised enterprises (Article 11).

From the view of trading rights, designated trading and state trading are similar in nature. The division between the two types reflects a distinction made by the Chinese government between those goods, in respect of which it is intended to maintain state monopolies (through state trading) and those goods in which trade is in the process of being liberalised (through designated trading).[37]

2.2.2 Definition

The term 'state trading' has two meanings: state trading countries (such as the former Soviet Union, Eastern European countries and China in the early 1980s), and state trading enterprises (either owned or controlled by the government). Foreign trade had been a state monopoly in China for decades under the planning economy, when foreign trade companies ('FTC') were virtual instruments of the government to handle within the export and import arena.

In the current context, 'state trading' in China refers to the second meaning, that is, those FTCs that are authorised to monopolise the trade of specific types of goods. This distinguishes them from other FTCs that may also be state-owned but operate in normal market competition conditions. In the following text, these FTCs with such special trading rights are named as 'state trading enterprises' or STEs.

[37] See B Williams, 'China's Accession to GATT and the Control of Imports of Goods by State Trading Enterprises in China', the Working Paper, at http://law.anu.edu.au/china-wto/seminars/seminar1/C&WT0no1.htm (21 October 2002).

2.2.3 Concerns

The status of state trading and STEs may be easily abused by the government , purporting to erect an effective trade barrier. This potentiality is more particular in China, if we take into account the historical link between the government and STEs, as well as the fact that these STEs are either state-owned or state-controlled.

The Chinese government could use the STEs to implement its international trade regulation mainly in two ways. First, the government could influence the decisions of STEs regarding the quantity of imported or exported goods, so as to indirectly influence the trade flow. Second, it could influence the decision of STEs on the mark-up of prices of imported or exported goods[38] in the downstream distribution line, so as to limit the quantity of trade flow below what consumers would demand at that price. Whereas these kinds of influences are rarely expressed in a formal way (such as in a regulation or an administrative rule), they can usually be well disguised by informal controls through administrative practice and guidance.[39] The effect is that the government achieves the same function as other trade barriers (such as tariff or quota) and controls the trade in specific goods.

2.2.4 The WTO Rules

Article XVII:1 of GATT specifically deals with state trading. Each Member undertakes that if it establishes or maintains a state enterprise, wherever located, or grants to any enterprises, formally or in effect, exclusive or special privileges, such enterprise as STEs must, in its *purchase* or *sales* involving either imports or exports, act in a manner consistent with the general principles of non-discriminatory treatment prescribed in GATT for governmental measures affecting imports or exports by private traders.[40] STEs must make any such purchases or sales solely in accordance with *commercial* considerations (including price, quality, availability, marketability, transportation and other conditions of purchase or sale), and must afford the enterprises of other Members adequate opportunities, in accordance with customary business practice, to compete for participation in such purchase or sale.[41] However, the rules do not apply to 'imports of products for immediate or ultimate con-

[38] The percentage mark-up represents the profit margin of the STEs.

[39] In an extreme circumstance, the government official can give a call or have an oral conversation with the managers of STEs who will act in the way suggested. There will be no evidence of the administrative intervention at all.

[40] General Agreement on Tariffs and Trade 1994, one document of Annex 1A to the Marrakesh Agreement Establishing the World Trade Organization, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994 ('GATT'), Art XVII:1(a).

[41] *Ibid*, Art XVII:1(b).

sumption in governmental use and not otherwise for resale or use in the production of goods for sale', which excludes the procurement activities by STEs for their own consumption.[42]

The rules for state trading are also related to other WTO principles. A panel has ruled that Article XVII covers the obligations in both Article I (MFN treatment) and Article III (national treatment).[43] As a result, STEs of one Member cannot discriminate between goods from different Members (ie MFN obligation), nor against foreign goods vis-à-vis domestic goods (ie national treatment). In addition, Article II:4 prohibits Members from operating monopolies 'so as to afford protection on the average in excess of the amount of protection provided for in [their] Schedule'. This rule limits the size of the mark-up that can be charged by an import monopoly, that is, the percentage mark-up cannot be more than the percentage bound tariff. Otherwise in practice, STEs may charge a higher margin of profit for the downstream distribution of imported goods, effectively off-setting the competitive advantage of the lower-price of imported goods.

GATT does not prohibit the existence of state trading or STEs, nor does it prohibit the practice of mark-up. Its objectives are two-fold: on the one hand, the Member cannot use the STEs as a disguised trade barrier to adversely affect trade flow that would otherwise have been without such undue intervention; on the other hand, the STEs must act as an independent entity and in accordance with commercial considerations, subject to the GATT rules (especially in tariff binding).[44] In order to achieve these objectives, GATT imposes an onerous obligation of transparency on the Members.[45] A Member must notify the Council for Trade in Goods of STEs, and must give notice to the Ministerial Conference of the products subject to state trading on an annual basis. If it establishes, maintains or authorises an import monopoly of a product, which is not the subject of a concession under Article II, it must inform the Ministerial Conference of the import mark-up on that product, provided that other Members having a substantial trade in the product concerned so request. Finally, the Ministerial Conference has the right to require one Member to supply relevant information of state trading upon another Member's request.[46]

2.2.5 China's WTO Commitments

Under the accession package, the following products are subject to state

42 *Ibid*, Art XVII:2.

43 Report of panel on *Korea – measures affecting imports of fresh, chilled and frozen beef*, WT/DS161R. WT/DS169/R, 2000, para 753.

44 If the STEs add a mark-up exceeding the percentage bound tariff, it is virtually equal to a tariff at such a rate.

45 See eg GATT, Arti XVII:4, n 40 above.

46 That other Member must believe that its interests under GATT are being adversely affected by the operations of a STE of the Member concerned.

trading: imports of grain, vegetable oil, sugar, tobacco, crude oil, refined petroleum products, chemical fertiliser, and cotton; and exports of tea, rice, corn, soy beans, tungsten ore and related tungsten products, coal, crude oil, refined petroleum products, silk, cotton, cotton yarn, woven cotton products, antimony, and silver.[47] For each product, the names of respective STEs are listed out ('STE List').

In addition to the general WTO rules (as above) that bind China, China assumes more onerous commitments in this respect. There are two onerous obligations: the erosion of state trading by granting special treatment to private trading companies, and the textual difference between Article XVII of GATT and the relevant paragraph in China's Accession Protocol.

The first obligation is actually the result of hard bargaining by other Members during the negotiation process. Traditionally, state trading was the exclusive territory of STEs and private traders had no chance to get involved. However, other Members were strongly suspicious about the possibility that STEs in China would use their discretion to limit the quantity of imports that would otherwise have been achieved. The solution to address such concerns was to impose an additional commitment on Chinese trade regulators (mainly MOC) to allocate a fixed portion of the total amount of state-traded goods to private traders. In this sense, the 'private traders' must be interpreted as those non-STEs, whether or not they are state-owned or controlled. In other words, 'private traders' include not only private-invested enterprises and FIEs (if applicable), but also state-invested enterprises that have not been granted state trading rights.

This favourable treatment of private traders can be found in two forms. First, private traders have gained rights to import a share of grains, soybean oil, cotton, and other products that are covered by China's agricultural tariff-rate quota (TRQ) commitments.[48] Second, China commits to allocate importing rights of minimum amounts of chemical fertiliser and of crude oil and refined petroleum products to private traders. The import of chemical fertiliser is also under a TRQ scheme, under which 10 per cent of the 2.7 million metric-ton initial access opportunity shall be given to non-state trading companies on accession. The quantity of this minimum opportunity is scheduled to rise by six per cent per year, and the share of that available for import by private traders will rise in equal steps to 49 per cent over eight years. Similarly, the import rights of private traders start at 4 million metric-tons and 7.2 million metric-tons, respectively, on accession and will grow at 15 per cent per year for the next 10 years.[49] As a result, private traders erode the state monopoly in the above stated goods or products to a certain extent.

[47] See The Accession Protocol, Annex 2A, see n 10 above.

[48] The TRQ and the rights of private traders will be discussed separately in ch 4 'Licencing and Quota'.

[49] The Accession Protocol, Annex 2A, see n 10 above.

The second aspect relates to the complex interpretative issue of the Accession Protocol. Paragraph 6 of the Accession Protocol provides:

> 1. China shall ensure that import purchasing procedures of state trading enterprises are fully transparent, and in compliance with the WTO Agreement, and shall refrain from taking any measure to influence or direct state trading enterprises as to the quantity, value, or country of origin of goods purchased or sold, except in accordance with the WTO Agreement.
> 2. As part of China's notification under the GATT 1994 and the Understanding on the Interpretation of Article XVII of the GATT 1994, China shall also provide full information on the pricing mechanisms of its state trading enterprises for exported goods.

Sub-paragraph 2 and the first part of sub-paragraph 1 are the same test as the corresponding GATT provisions. The textual difference exists in the second part of sub-paragraph 1: besides the generic term of 'purchases or sales', it prevents China from taking *any measure* to *influence or direct* STEs as to the *quantity, value, or country of origin* of goods purchased or sold. The issue is: whether these different words or phrases impose a higher obligation on China, or how it will help solve the problems of state trading in China.

At first glance, the wording of the Accession Protocol is more precise. It defines the scope of STE's behaviours that are subject to regulation. The quantity, value and country of origin are three major points where the government's influence could work on the decision of STEs. Any government measure in relation to the STE's choice of country of *origin* and *quantity* of imported goods is caught by Article XI:1 (for general prohibition of quantitative restrictions). It is submitted that sub-paragraph 1, the second part, expands the scope of obligations on China in two respects.

The first aspect of expansion is about the explicit reference to *value*. There are few GATT provisions regulating the value of import or export goods; instead, the cap of mark-up by STEs is indirectly deducted from Article II:4. Nevertheless, the governmental influence on value is more disguised, because the decision on the level of import or export prices appears to be within the ambit of the STEs' management discretion, whilst the effect may be to increase the import price (thus reducing the price advantages of foreign goods) or to decrease the export price (thus expanding the price advantages of Chinese goods in the international market). The addition of 'value' highlights the significance of pricing strategy in the regulation of state trading, and more importantly, provides a legal basis for other Members to attack this kind of intervention by the Chinese government.

The second aspect of expansion has resulted from the phrase 'influence or direct'. As mentioned above, the rule is to prohibit the abuse of STEs by the government to serve WTO-inconsistent regulatory purposes, rather than to prohibit the state trading itself. What falls foul is the 'government measures' that are caught by the relevant provisions. But there exists evidential diffi-

culty to prove that first, a government measure exists and second, it has the causation with the STE's ostensibly independent decision. In most cases, the 'government measure' takes an informal form, such as administrative guidance or practice. Although the WTO panels take a broad view of what constitutes 'governmental measure', they still require the complaint to identify particular actions of the government.[50] It is predicted that any complaint against the Chinese government regarding state trading practice cannot avoid this evidential challenge. However, this challenge is partly mitigated by the phrase 'influence or direct', which has a wider implication. It covers not only the results of decisions by STEs, but also the process of decision-making. The complaining Member is not obliged to prove that the government measure *causes* or *leads* to such decisions; rather, these measures in question can only be one of the factors that *influence* the outcome or *direct* such an outcome. From this perspective, it alleviates the burden of proof on the side of the complaining Member to a certain extent. Moreover, for the complaining Member it is easier to deduct in reverse that certain decisions by STEs may be 'influenced' or 'directed' by certain types of governmental measure, even if no direct evidence of such particular action is available. This result-oriented approach could also contribute to the solution of the difficult burden of proof in a state trading case.

As a result, China commits WTO-plus obligations for the regulation of state trading. The next section will then describe how China implements such commitments in domestic law, and whether these implementing measures comply with both the text and spirit of the WTO Agreement.

2.2.6 Regulation on STEs

2.2.6.1 General Rules

The *PRC Administrative Regulations on Import and Export of Goods* is the first piece of PRC law that regulates state trading. It sets out the basic regulatory principles. Any enterprises not in the STE List cannot engage in the import and export of specific goods subject to state trading.[51] There are two important rules in this regime. First, the state will allow non-state trading enterprises to import and export a certain amount of goods subject to the state trading regulation.[52] This provides the legal source in domestic law for allowing the erosion of the state trading regime by private traders within an

[50] See eg Report of the panel on *Japan – measures affecting consumer photographic film and paper*, WT/DS44/R, 31 March 1998, para 10.6*ff.*

[51] *PRC Administrative Regulations on Import and Export of Goods*, the State Council Decree No 332, effective from 1 January 2002 ('Regulations on Import and Export of Goods'), Art 51.

[52] *Ibid*, Art 47.

allowable scope and timetable. Thus, it can be viewed as a transitional provision that incorporates the relevant commitments into the domestic legal system. Second, STEs must carry out their business in accordance with 'normal commercial conditions', and cannot choose suppliers or refuse the entrustment for import or export by other enterprises or organisations[53] 'on the basis of non-commercial elements'.[54] These terms (such as 'normal commercial conditions' and 'non-commercial elements') are not defined, nor provided with any criterion or guidance. Their meanings depend on the facts of each case, as well as the objective test of reasonableness. How a reasonable trader will act, on the basis of its own commercial judgment and without any intervention from third parties (including the government), will be important evidence.

Even though the statutory basis was created in late 2001, immediately after China's WTO accession, the then MOFTEC did not issue more detailed implementation rules until August 2002. The delay meant that private traders who should have been able to participate in state trading of certain goods had no way to submit the application – the result was a tactical suspension of such rights to non-STEs for a limited period.[55]

2.2.6.2 State Trading of Certain Goods

On 18 August 2002, MOFTEC issued the *Interim Measures on Import of Crude Oil, Processed Oil and Chemical Fertilizer by State Trading* ('Measures').[56] It is a short administrative rule, with only 23 clauses. For the first time, it defines 'STE' as enterprises or organisations that obtain import rights of specific goods subject to state trading regulation, 'upon the franchise by the State'.[57] This definition reveals the nature of state trading: a state franchise or in other words, the privilege granted by the government. The list of STEs must be ascertained, adjusted and published by MOFTEC, after due consultation with the State Economic and Trade Commission ('SETC').[58] After the creation of MOC, this regulatory power is assumed by MOC. The Measures also recognise that non-STEs are allowed to import a portion of

[53] According to the Chinese foreign trade agency system, if one enterprise or organisation has no right to import or export the state-traded goods, it can entrust a qualified STE to act as its agent. That STE will sign the contract with foreign parties in its own name. See PRC Foreign Trade Law (2004), Art 12. But the significance of the agency system has dramatically reduced nowadays thanks to the liberalisation of foreign trading rights.

[54] *PRC Administrative Regulations on Import and Export of Goods*, Art 52, see n 51 above.

[55] I doubt whether such a delay was a deliberate act to deprive private traders rights, even if on a temporary basis. It is more sensible to view the delay as a normal regulatory process for Chinese trade regulators to accumulate experience and draft the rules. Any way, there was only an eight month gap, which may not have a substantial impact on the whole scheme.

[56] *Interim Measures on Import of Crude Oil, Processed Oil and Chemical Fertilizer by State Trading* (原油、成品油、化肥国营贸易进口经营管理试行办法), MOFTEC Decree No 27, effective from 18 August 2002.

[57] *Ibid*, Art 4.

[58] *Ibid*, Art 5.

state-traded goods – in this case, crude oil, processed oil and chemical fertiliser. It also clarifies the route for such non-STEs to apply for state trading rights. All enterprises with foreign trading rights and the capacity to engage in the business of state-traded goods can register with MOFTEC (now MOC) and then become 'non-STEs' in this context.[59] MOC must issue the guidance on relevant qualifications for such registration.[60]

The Measures have one specific provision on the operation of STEs in relation to state trading activities. Article 9 provides that, 'STEs shall carry out the state trading business under the guidance of MOFTEC and SETC' (now MOC). There are no details on how this guidance is to be carried out. In practice, it may relate to import price, quantity and country of origin. Particular attention shall be paid to the pricing policy, subject to the regulation of the National Development and Reform Commission ('NDRC'). For example, NDRC issued an administrative guidance to China National Chemical Import & Export Co, one of the two designated STEs in state trading of chemical fertiliser, concerning the Cost, Insurance and Freight ('CIF') prices of certain types of fertiliser under the national import scheme.[61] In this guidance, the importer has the discretion to float five per cent above or below the guiding prices.

The critical issue is whether the MOC or NDRC guidance conforms with the WTO rules and commitments. From a literal point of view, these administrative guidelines fall within the scope of government measures 'influence or direct' the STEs' purchases or sales, and the practices show a more specified influence – on the import price. Therefore, it is a prima facie inconsistency with the WTO Agreement. More importantly, the existence of Article 9 of the Measures may shift the burden of proof from the complaining Member to China in the case against China's state trading before a WTO panel. Since Chinese law expressly identifies the relationship between STEs and governmental authorities and recognises the latter's guidance function, it can to a great degree solve the evidentiary difficulty that might be met by other Members to prove the existence of government influence and the causal link between this influence and state trading practice. Arguably, this is a strong presumption of the existence of governmental influence because PRC law has the above provisions. In the event that the STEs' activities are abnormal or deviate from the ordinary commercial consideration or practices, it is the burden of China to prove that the government has not *actually* exercised the undue influences. This time, it will cause evidential difficulty on the Chinese side.

It is unlikely that Chinese trade regulators will revise the Measures because of this one point, for example, by deleting Article 9. From their perspective, it

[59] *Ibid*, Art 7. This proves the understanding of 'private traders', as discussed above.

[60] *Ibid*.

[61] *Notice Concerning the CIF Port Prices of Chemical Fertilizer under Portion of National Import Scheme* (关于部分中央进口化肥港口交货价格的通知), issued by SDPC on 23 July 2002.

is perfectly reasonable to have this provision and indeed it describes, correctly, the relationship between STEs and the trade regulator. Apart from the potential evidential consequence in future disputes, the existence of administrative guidance in paper and in practice shall be acceptable if the regulator is fully aware of the constraints by the WTO Agreement. So far as STEs act in accordance with commercial considerations and the regulator does not influence or direct STEs to act inconsistently with the WTO Agreement (for example, in violation of the non-discrimination principle), the likelihood of the Measures being challenged merely because of Article 9 (on paper) is slim.

To import chemical fertiliser (within the TRQ),[62] processed oil and crude oil, any *state-trading quota holder* must entrust the respective STEs to import the goods.[63] Since the government allocates a portion of import to non-state traders,[64] it will also issue the import quota in relation to this portion (the 'private trader quota'). For those *private trader quota holders*, they can choose to entrust either STEs or non-STEs with such import rights to import the goods on their behalf. If a private trader quota holder is itself a non-STE with import rights, it can import the goods by itself.[65] The goods must clear customs by submitting, respectively, the Certificate for Chemical Fertilizer Import TRQ, or the Import Licence for Processed Oil, or the Automatic Import Licence for Crude Oil to customs.[66]

2.2.7 Regulation on Non-STEs

2.2.7.1 Disguised Protectionism?

Non-STEs may be a state-controlled FTC, a private company and when FIEs are allowed to access the distribution service by the end of 2004, a FIE. They will compete, to a limited extent, with the STEs in the import of state-trading goods. Non-STEs are subject to the same regulation as STEs after being granted state trading rights. For non-STEs, their primary concern is how to apply for the qualification of state trading, whether the threshold is impractically high and whether the grant of qualification is on a fair and transparent

[62] State trading of chemical fertiliser is confined to the amount of imports within the TRQ. For the amounts outside the TRQ, any enterprises with trading rights for chemical fertiliser can freely engage in the business of import.

[63] *Interim Measures on Import of Crude Oil, Processed Oil and Chemical Fertilizer by State Trading*, Arts 13(1), 14(1) and 15(1), see n 56 above.

[64] For chemical fertiliser, the amounts outside of the TRQ bind can be imported by any enterprise; for crude and processed oil, a minimum amount of import must be allocated to non-state traders.

[65] *Interim Measures on Import of Crude Oil, Processed Oil and Chemical Fertilizer by State Trading*, Arts 13(2), 14(2) and 15(2), see n 56 above.

[66] *Interim Measures on Import of Crude Oil, Processed Oil and Chemical Fertilizer by State Trading*, Arts 13(3), 14(3) and 15(3), see n 56 above.

basis. It is possible for the government to create some barriers to entry by non-STEs into this franchised regime. When there are insufficient numbers of non-STEs, the purpose of preventing the abuse of state trading by introducing some competition from private traders would be severely undermined. The reason is straightforward: foreign exporters may have no other choice than dealing with STEs.

There are a number of methods that can potentially discriminate against the applicants. For example, the procedure would be more onerous, the timeline would be much delayed unjustifiably, or in a more simple way, the regulator just refuses the application without giving a reason. Some of these methods relate to the manner of regulation, or the due regulatory process. Among them, the criteria for applying state trading rights to non-STEs needs special attention.

2.2.7.2 The Practice

MOFTEC issued a circular concerning the conditions, documentation and procedures for non-STEs to apply for qualification of state trading for crude oil, processed oil and chemical fertiliser in August 2002 ('Circular').[67] It is the first time that the regulator gives details on the conditions and procedures for granting state trading rights to non-STEs. The conditions for state trading of crude oil, processed oil and chemical fertiliser are quite similar, namely as follows: first, the applicant has the status of legal person, with a registered capital no less than RMB50 million; second, it has foreign trading rights and the respective business scope for the imported state-trading goods; third, it has the channels for purchase and distribution of such goods, as well as the knowledge of domestic or foreign market conditions; fourth, it has a sound credit (rated as an A-level enterprise[68]) and has no records for smuggling, tax evasion, evasion of foreign exchange control or any other violation of regulations; and last but not least, it owns an operating capacity relevant to the import of the goods in question ('operation capacities').

For the last condition, the requirements for importing each type of good is different by taking account of the character of each business. For import of crude oil, the applicant must own the import docks (capacity of which shall not be less than 50,000 tons) and storage space not less than 200,000 tons, must maintain a deposit of crude oil not less than ten per cent of the amount of its business needs, and must have the expertise for inspection, measure-

[67] *Circular on the Conditions, Documentation and Procedures for Application of Import Qualifications for Crude Oil, Processed Oil and Chemical Fertilizer by Non-STEs* (关于原油、成品油、化肥非国营贸易进口经营企业资格备案申请条件、申报材料和申报程序的公告), issued by MOFTEC on 15 August 2002 ('The Circular').

[68] This is the system for rating Chinese domestic enterprises. Class A is a high rate for sound credit status.

ment, storage and fire safety.[69] For processed oil, the applicant must have the capacity for receiving and discharging the goods, including owning either the water dock for transportation (capacity of which shall not be less than 10,000 tons) or special pipe lines or railways, must own a storage warehouse (capacity of which shall not be less than 50,000 cubic meters), and must have the expertise for storage, transportation and fire safety.[70] For chemical fertiliser, the applicant must own the storage and transportation facilities with appropriate scale, as well as have the ability to engage in such import business.[71]

The Circular lists the documents necessary for the application. In summary, the following types of documents are essential: the application report by the applicant, stating basic company information, its compliance with the conditions for application, reason(s) for application, business plan for the purchase from foreign suppliers and distribution to domestic users and so on; a copy of the Business Licence for Enterprise Legal Persons and the PRC Qualification Certificate for Import-Export Enterprises, which shall pass the annual examination by the competent authority; a set of documents, issued respectively by customs (to prove the applicant has no record of smuggling during the past three years – in the Circular's context, from 1999 to 2001), by the tax authority (to prove the applicant has no record of evading tax within the past three years), by the exchange administration department (to prove the applicant has no record for evading foreign exchange administration during the past three years), and by the account bank (to prove the applicant is with sound credit and reaches the Class A rate during the past three years)[72]; and the evidence or documents to prove its operation capacities. For example, the applicant for import of crude and processed oil shall submit the legal documents certifying its title to the relevant docks, storage and transportation facilities, either for the ownership or for the usage rights.[73] These requirements are more or less applicable nowadays in relation to those goods still subject to the state trading regime.

The Circular also clarifies the procedure of application. It distinguishes between the so-called 'local enterprise' (the enterprise subject to the administration of local government) and 'central enterprise' (the enterprise subject to the administration of the Central Government). If the applicant is a local enterprise, it shall submit the application package to the provincial local

[69] *Circular on the Conditions, Documentation and Procedures for Application of Import Qualifications for Crude Oil, Processed Oil and Chemical Fertilizer by Non-STEs* (关于原油、成品油、化肥非国营贸易进口经营企业资格备案申请条件、申报材料和申报程序的公告), issued by MOFTEC on 15 August 2002 ('The Circular'), para 1(1)(v).

[70] *Ibid*, para 2(1)(v).

[71] *Ibid*, para 3(1)(v). The second condition – the ability to engage in import business of chemical fertilisers – seems unclear and too flexible. Generally, if the applicant has such a business scope and the record of engaging in this business, it would be acceptable evidence.

[72] These documents are issued by the local competent authority at the place of the applicant.

[73] *Circular on the Conditions, Documentation and Procedures for Application of Import Qualifications for Crude Oil, Processed Oil and Chemical Fertilizer by Non-STEs* ('The Circular'), paras 1(2)(iv), 2(2)(iv) and 3(2)(iv), above n 69.

branch of MOFTEC (now MOC). The provincial local branch is responsible for verification of the completeness and accuracy of application documentation, and then forwards the application to MOFTEC (now MOC) for consideration.[74] If the applicant is a central enterprise, it shall apply directly to MOFTEC (now MOC).[75] After receipt of the application, the regulator shall register the application a slot and issue the name list for such non-STEs.[76] Upon registration and filing, such non-STEs are entitled to engage in the import business for state trading goods.

2.2.7.3 Critical Comments

The Circular is of a temporary status, because it only relates to the application in the year of 2002. Its status is less formal and much more flexible than an administrative rule. However, no replacing circular has been issued in the years of 2003 and 2004, nor has the Circular been expressly renewed. It is understood that the Circular is still followed in practice. From a legal point of view, the form of administrative rule is more formal and less discretionary than the form of circular. For a circular, there is no assurance that MOC will follow this year's conditions in subsequent years. It is likely that these conditions may be changed in accordance with economic needs or regulatory purposes in one particular year as long as MOC views such a change desirable. However, from the regulator's perspective, it would prefer the form of circular as the regulatory instrument for it gives more discretion and powers to the regulator. The conditions of qualification could be used as a regulatory tool to adjust the numbers of eligible entrants – or in other words, competitors – in the regime of state trading.

Apart from the form of regulation, there are two particular issues to consider: first, whether the conditions for the applicants are valid under the WTO Agreement; second, what are the exact criteria for registration and how they can be applied in a non-discriminatory manner.

Among the conditions, the requirements for foreign trading rights, business scope, sound records, purchase and distribution channels and operation capacities do not conflict with the WTO Agreement. However, problems may arise in the requirements for legal person status and a higher threshold of registered capital. As discussed above, general trading rights are also available to individuals (including partnerships and sole proprietors) now under the FTL (2004). Will this general rule have one exception in state trading? The regulator has to justify this exception because it ostensibly deviates from the normal

[74] *Ibid*, para 4(1). The local regulator shall report the application to SETC as well.

[75] *Ibid*, para 4(2). It is more complex if the applicant is a subsidiary or a so-called 'subordinated enterprise' of one central enterprise. Under that circumstance, the subsidiary shall submit the application documents to its parent company, which will verify the documents and forward the application to MOFTEC. It will also report to SETC.

[76] *Ibid*, para. 4. This requirement is not applicable after the creation of MOC which takes over the responsibility of SETC.

rule as prescribed by China's accession commitments (as well as the implementing measures). It would be a strong argument that the import of crude oil, processed oil and chemical fertilisers have some special features, as evidenced by the requirement for the operation capacities. In particular, it has a higher requirement for storage, transportation and safety, which can hardly be satisfied by small enterprises and non-legal persons. Therefore, the limitation of state trading rights (of STEs and non-STEs) to legal persons may ensure the safety of transaction in a more effective way.

This argument also applies to the higher amount of registered capital. However, it is necessary to look at the application of this particular requirement to STEs and non-STEs. If the STEs need not reach this threshold while the non-STEs have to, it is a kind of discrimination against non-STEs (especially those private companies). When FIEs are involved, such differential treatment may also violate the National Treatment Principle under the Accession Protocol of China. China expressly committed to national treatment in trading rights. There is no specific law or regulation requiring a STE to have a registered capital no less than RMB50 million. When a private company or a FIE is subject to a more onerous entrance condition, this condition may be prima facie inconsistent with the WTO Agreements.

There are two ways for the regulator to comply with the WTO Agreement. First, the regulator may increase the requirement of minimum registered capital to STEs, and apply a uniform standard to STEs and non-STEs. It means that all entrants must satisfy this condition equally, and not be discriminated against on the basis of ownership or the timing of being qualified. Second, the regulator may eliminate the higher requirement on non-STEs and focus on the operation capacities. If these conditions are administered in a due regulatory process, it will satisfy the WTO Agreement even if it constitutes a virtual barrier to small enterprises.

Another problem is about the criteria of regulation. Since it is a kind of registration and filing with MOC, rather than an approval for licencing, the regulator must register the application once all required documents are submitted and checked as being consistent with the conditions. It does not necessarily mean that the regulator has no discretion at all, but the degree of discretion has to be much lower than in the licencing process. The issue is how the regulator will exercise the discretion and whether it would constitute a disguised barrier or discrimination against applicants. For example, the applicant needs to supply the business plan for import and down-stream sale. Is the regulator entitled to refuse the registration, suppose it views such a plan as non-feasible or inappropriate? In theory, the business plan is within the business discretion of the applicant and should not be linked with the grant of trading rights. Other laws will govern any illegal behaviour by the applicant after it imports the goods (for example, dumping in the domestic market or distorting the market conditions), but this possibility cannot be used as a justification to refuse the grant of state trading rights to this applicant in the first

place. Therefore, the manner of regulation is the benchmark. If the regulator administers the review process in an objective, impartial and justifiable way, gives reasons of refusal and provides the chance of seeking independent reviews (either administrative or judicial reviews), the decision of declining the registration per se shall not be a violation of WTO rules.

2.2.8 Prospects

State trading goods are either of strategic importance or of basic need to the Chinese economy. Hence, it is reasonable to presume that the government would more or less influence the decisions of STEs. This practice is undoubtedly inconsistent with the WTO Agreement. However, the biggest challenge to foreign exporters or Member governments is the evidence – how to find tangible evidence for the existence of any unjustifiable governmental intervention. While it is arguable that some provisions of the applicable rules might be interpreted in favour of the complaining Member and shift the burden of proof to the Chinese government, the collection and construction of evidence will still be listed as a top concern. Foreign exporters or other Members need to rely on the market investigation in China to assemble all relevant data (including internal policy, guideline, circular or communication between or within the government and STEs) to overcome the evidential hurdle.

One loophole in Article XVII of the 1994 GATT may be well exploited in China. This article only prohibits the mark-up by STEs that exceeds the bound tariff, but does not prohibit the mark-up by downstream distributors in the supply line. As a result, while the flexibility of mark-up by STEs during the chain of import is subject to the WTO rule, the distributors who purchase the imported goods from STEs (as a wholesaler) can mark up the price at their discretion. Where the distributors for state trading goods are controlled by the state, there is potential for governmental intervention to exist not in the import stage but in the chain of distribution. This achieves the same objective: the price of imported goods would be the same as or even higher than the price of domestic like goods. Nevertheless, the danger will be gradually reduced when the distribution service sector is liberalised. If there are sufficient distributors entering into this market and most of them are acting on independent commercial decisions, the artificial distortion of prices will be reduced to the minimum degree. In accordance with China's commitments in distribution services, the wholesale trade services for the distribution of crude oil, processed oil and chemical fertilisers will be open to foreign companies within five years of accession (up to December 2006) whilst retailing services for chemical fertilisers will be liberalised within five years of accession. Arguably, the envisaged problem for mark-up in the downstream distribution line may be temporary and gradually eliminated by the increase of private and foreign participation in the distribution sector.

2.3 DESIGNATED TRADING

2.3.1 Nature

Designated trading has the same nature as state trading: the government grants the franchise to a limited number of trading companies (the majority as state-controlled) for import and export of certain types of goods. The key difference between state trading and designated trading is that designated trading will be phased out after a certain period. Eventually, all companies with general trading rights can engage in the trade of these regulated goods. From this perspective, designated trading can be viewed as 'temporary state trading' for such goods. It represents the different attitude of the trade regulator towards state trading goods and designated trading goods. The former are of higher strategic significance to the nation, so the government prefers to control their trade in a stricter manner by limiting the numbers of eligible traders. The latter are of important significance, but the degree would be less than those of state trading goods. This explains why the regulator adopts a strict but gradually liberalised approach for the regulation of a designated trading regime.

2.3.2 The WTO Commitments

Annex 2B of the Accession Protocol lists the goods subject to designated trading: natural rubber, timber, plywood, wool, acrylic and steel. For those goods, China commits to 'phase out limitation on the grant of trading rights pursuant to the schedule in that Annex' and shall 'complete all necessary legislative procedures to implement these provisions during the transition period'.[77] The phase-out period is three years after the accession, that is, up to December 2004.

Since Annex 2B does not identify the names of companies that are franchised to trade the designated goods, it implies that the application to this trading right is open to all eligible companies upon the satisfaction of prescribed criteria. The Chinese government acknowledges that the current criteria for enterprises under the designated trading regime include registered capital, import and export volume of designated products in the previous year, bank credit rating and profits and losses.[78]

The text of the Accession Protocol does not specify how designated trad-

[77] The Accession Protocol, para 5(1), see n 10 above.

[78] Report of the Working Party on the Accession of China, issued by the Working Party on the Accession of China, WT/ACC/CHN/49, adopted 1 October 2001 (01–4679) ('The Working Group Report'), para 85.

ing rights shall be liberalised. Suppose the regulator grants these trading rights to certain companies in the first year and then waits until the end of the three-year transition period to allow access of all other companies, this does not technically breach the WTO commitments. Nevertheless, this practice would undermine the spirit of the provision and circumvent the obligation to gradually liberalise the designated trading regime. In the Working Group Report, China further commits that:

> In responding to questions raised by some members of the Working Party, the representative of China confirmed that China would progressively liberalize the right to trade in such goods by increasing the number of designated entities permitted to import goods in each of the three years of the transition period specified in Annex 2B. The representative of China added that China would eliminate import and export volume as a criterion for obtaining the right to trade these products, reduce minimum capitalization requirements and extend the right to register as designated importing and exporting enterprises to enterprises that used such goods in the production of finished goods and enterprises that distributed such goods in China. At the end of three years, all enterprises in China and all foreign enterprises and individuals would be permitted to import and export such goods throughout the customs territory of China. During the transition period, none of the criteria applicable under the designated trading regime would constitute a quantitative restriction on imports or exports. The Working Party took note of these commitments.[79]

This commitment has several meanings. First, it confirms that the government will liberalise the designated trading regime in a gradual manner. It indicates that the number of eligible traders for the regime will increase annually until the expiration of the phase-out period, rather than the 'wait policy' as envisaged above. Second, the threshold for accessing this regime will be lowered by eliminating the requirement for past trade volume and reducing the higher registered capital. This is essential to expand the scope of eligible applicants, especially for those newly incorporated companies or private companies with less capital injection. Third, it confirms that both distribution enterprises (for the wholesale or retail of these goods) and manufacturing enterprises (for the consumption during the production process) are entitled to trading rights for designated goods after the transition period. Last, it clarifies that all enterprises in China (including FIEs) and all foreign enterprises and individuals (not registered or resident in China) can engage in the trade of designated goods after three years of China's WTO accession, and makes this regime in line with the application of general trading rights. From this perspective, this commitment supplements the text of the Accession Protocol and gives more comprehensive requirements on the implementation process. It can be viewed as the implementing rules for the Protocol text.

[79] *Ibid*, para 86.

There are two challenges in relation to the implementation of designated trading commitments by the regulator: first, to design a set of criteria and procedure for granting designated trading rights to eligible enterprises; second, to design and administer an equitable and workable mechanism for the gradual expansion of such trading rights to eligible enterprises. For these processes, the elements of due regulatory process – transparent, reasonable and objective – are essential, because the trade regulator may face a number of applicants and has to choose among them. This feature makes the manner and the process of selection more significant.

2.3.3 The Designated Trading Rule

PRC Administrative Regulations on Import and Export of Goods summarily provides that the trade regulator may subject specific goods to designated trading administration within a certain period, 'for the purpose of maintaining the sound trade order for import and export [of the designated goods]', and authorises the trade regulator to 'enact, adjust and publish' the list of import and export goods subject to the designated trading regime (Article 49). In order to implement the WTO commitments and the above regulation, MOFTEC issued a rule titled *Administrative Measures on Designated Trading of Import Goods* on 20 December 2001 ('the Designated Trading Rule'),[80] stipulating the detailed criteria and procedure for granting this kind of trading right. However, the regulator has not issued a similar rule applying to exports. The different regulatory approach implies that China envisages the designated trading regime as more relevant to import, or in other words, to restrict the import of specific goods by controlling the number of eligible importers. In contrast, export is always the priority of the government, and only a few types of goods are subject to an export quota or licencing.

The Designated Trading Rule explicitly sets out the basic rule: only enterprises designated by MOFTEC (now MOC) can import the goods subject to designated trading.[81] MOFTEC (now MOC) is the primary regulator in this respect, and is obliged to ascertain the designated trading enterprises on a 'fair, transparent and equitable' basis.[82] This Rule also expresses that the number of designated trading enterprises shall increase annually, although it does not set up any quantitative benchmark. This feature makes two issues uncertain: the total number of eligible enterprises in each year (or any floor or cap within the three-year transition period), and the minimum number of enterprises to be increased each year. From the negotiation point of view, it would be a loophole that the Accession Protocol or the Working Group

[80] MOFTEC Decree No. 21, dated 20 December 2001.
[81] *Ibid*, Art 3.
[82] *Ibid*, Art 4.

Report does not specify this point.[83] The regulator has the discretion to decide these numbers and allocate them to provinces.

The criteria for eligible applicants are set out as follows. First, the applicant must be a legal person and with registered capital no less than RMB10 million (or RMB5 million for enterprises registered in SEZs, Shanghai Pudong New Zone, and the Central-Western region); second, it must have the relevant channels to purchase and distribute the goods; third, it has obtained general foreign trading rights for more than two years, and has no record for violation of laws and regulations in the business.[84] There are two notable features of the criteria. The first feature is that the criteria actually set out a higher capitalisation threshold than ordinary FTCs (registered capital not less than RMB 500,000). The second feature is that it eliminates the requirement for past trade history in designated trading goods and the performance requirement. The latter feature shows a good intention to implement the WTO commitments from the beginning, whereas the former represents somewhat of a restriction with the effect of opting out small or inexperienced enterprises. As for the requirement of a two-year history of general trading rights, it may be viewed as a trade-off for the relaxation on performance requirements.

The applicant shall submit the following materials to the trade regulator: (1) the prescribed application form; (2) a copy of the Business Licence (annually examined); (3) a copy of the Qualification Certificate for Export-Import by PRC Enterprises (annually examined, for FIEs, the FIE Approval Certificate); and (4) a report analysing the market supply-demand and conditions for the designated trading goods and its purchase and distribution channels.[85] Among these application materials, the last one – the report – would be the centre of attention. Arguably, a well-drafted report may convince the regulator more and then make the approval of application more promising. However, the Designated Trading Rule does not give a format for reference, nor does it list the minimum information as necessary in that report. The rough coverage of the report – the market conditions and the applicant's capacity for purchase and distribution – would be too flexible and uncertain. The law does not provide any objective criteria or benchmark to assess the report. Potentially, this is a chance for the regulator to use the report as an excuse to refuse the application.

[83] There may be a number of reasons for this situation, such as compromise. It is also possible that the negotiating parties believed that there existed a number of eligible enterprises and then it was less necessary to require China to commit the minimum number of eligible enterprises to be increased annually or cumulatively.

[84] The Designated Trading Rule, Art 5, see n 80 above. The last criteria, ie the 'other criteria prescribed by MOFTEC', is a general drafting technique in Chinese legislation. Unfortunately it makes the application of law more uncertain. It is a good practice to enquire or consult with MOFTEC about whether it has set up some new criteria.

[85] The Designated Trading Rule, Art 6, see n 80 above.

2.3.4 Comments

After the phase-out of designated trading rights by the end of 2004, the regime of foreign trading rights in China comprises two types of trading rights: general trading rights, which are with a relatively low threshold and available to all eligible enterprises and individuals; and state trading rights, which are only available to a limited number of traders but subject to stringent regulation. The latter – state trading rights – requires more international attention and supervision.

3

Trade Restrictions and Prohibitions: General Rules

3.1 BACKGROUND

3.1.1 General Rules

The basic principle of China's international trade regulation is to 'encourage the development of foreign trade and maintain fair and free foreign trade orders'.[1] Under PRC law, the State allows free trade in goods unless otherwise prescribed by applicable laws or administrative regulations.[2] This complies with the fundamental WTO rationale for worldwide free trade. When China liberalises the foreign trading rights regime, the regulator cannot restrict foreign trade by limiting the scope of eligible Chinese foreign traders. Thus, there are three main ways for trade regulation in the post-WTO era to have an effect on controlling the quantities of foreign trade: tariff rates, quantitative restrictions, and health and safety standards. This chapter and chapter four 'Licencing and Quota' will analyse the quantitative restrictions. Chapter five 'Customs' will cover tariffs and other Customs regulatory regimes, and chapter six 'Health and Safety Regulation' will cover the health, environmental and safety standards in relation to international trade.

Under limited circumstances, the State can restrict or prohibit the import or export of relevant goods (that is, the quantitative restrictions).[3] MOC is responsible for formulating, publishing and adjusting catalogues for such goods that are subject to trade restrictions or prohibitions (the 'regulated goods'), after consulting with other ministries or commissions.[4] Quota and licencing, as a regulatory instrument, apply to these regulated goods.[5] This

1 *The PRC Foreign Trade Law*, *Zhonghua Renmin Gonghe Guo Duiwai Maoyi Fa* (中华人民共和国对外贸易法), promulgated on 12 May 1994 by the Seventh Meeting of the Standing Committee of National People's Congress of the PRC and taking effect from 1 July 1994, as amended on 6 April 2004 and taking effect from 1 July 2004, ('FTL (2004)'), Art 4.

2 *Ibid*, Art 14.

3 *Ibid*, Art 16.

4 *Ibid*, Art 18.

5 *Ibid*, Art 19.

chapter will analyse the general rules for trade restrictions and prohibitions under PRC law as well as its legality under the WTO Agreements, but it leaves the detailed discussion of China's quota and licencing system to chapter four.

In accordance with the FTL (2004),[6] trade restrictions and prohibitions can be based on the following grounds:

(1) necessary to safeguard national security, social and public interests or public morals;
(2) necessary to protect human, animal or plant life or health and to protect the environment;
(3) necessary to implement the measures relevant to trade in gold or silver;
(4) relating to local short supply or to the conservation of exhaustible natural resources;
(5) relating to a limited market capacity in the target country or region;
(6) relating to a serious chaos in the export trade order;
(7) necessary to establish or accelerate the establishment of specific domestic industries;
(8) essential to any agricultural, stockbreeding or fisheries product;
(9) necessary to safeguard the State's international financial status and the balance of payment;
(10) relating to atomic substance or military material;
(11) as required by the laws or administrative regulations or the international treaties or agreements signed or entered into by China.

The above listed items may be categorised as applicable to three scenarios: general trade, import and export: items (4), (5) and (6) relating to export only, items (7), (8) and (9) relating to import only, and the remaining items relating to both export and import. Notably, this is not an exhaustive list for all heads of trade restrictions in China, as it does not cover the restrictions on the import of products under foreign trade remedial measures (for example, on the grounds of anti-dumping, anti-subsidies, safeguard measures, trade diversion and so on).

The majority of these grounds basically mirror the corresponding clauses in the 1994 GATT, in particular, Article XI 'General Elimination of Quantitative Restrictions' (for items (4) and (8)), Article XII 'Restrictions to Safeguard the Balance of Payment' (for item (9)) and Article XX 'General Exceptions' (for items (1), (2) and (3)). They are consistent with the WTO rules from a textual perspective. However, each item is a highly summarised principle but does not contain the full wording of the relevant GATT clauses (including their qualifications or exceptions). From this perspective, the implementation of the WTO rules on trade restrictions and prohibitions cannot be regarded as complete under PRC law. When Chinese trade regulators rely on these

[6] Arts 16 and 17.

principles, they must apply the full text and spirit of the WTO rules or face the risk of being challenged by other Members before a WTO panel.

3.1.2 Nature and Purpose

As the grounds for trade restrictions and prohibitions are based on the 1994 GATT (in particular Article XX 'General Exceptions'), the relevant WTO rules may be a good reference to understanding how the Chinese trade regulators must apply these grounds in practice.

Article XX 'General Exceptions' of the 1994 GATT is linked with all of the obligations under the 1994 GATT, including the national treatment obligation and the MFN obligation.[7] In *US – Shrim*p, the Appellate Body described the nature and purpose of Article XX as a balance of rights and duties 'between the right of a Member to invoke an exception under Article XX and the duty of that same Member to respect the treaty rights of the other Members.'[8] For example, under Article XX, a Member may to some degree prescribe unilaterally a policy for conditional access by other Members' exporters to its domestic market 'because the domestic policies embodied in such measures have been recognized as import and legitimate in character'.[9] Nevertheless, the Member imposing trade restrictions or prohibitions must prove its justification under Article XX as well as its necessity to the objectives or policies pursued, and then the complaining Member shall rebut this prima facie case, if established.[10]

Chinese trade regulators can rely on these prescribed grounds – the underlying, prevailing legitimate policies – to apply measures inconsistent with the national treatment or MFN principles in the trade regulatory process, subject to the introductory clause (the chapeau) of Article XX that discrimination between exporters from other Members cannot be arbitrary or unjustifiable, or such measures act as a disguised restriction on international trade.[11] In this regard, the purpose and effect of these trade restrictions or prohibitions must be assessed to decide its legality under the WTO rules.

A two-tier test applies to the analysis on whether a PRC trade measure is consistent with the general exceptions as prescribed in Article XX of the 1994 GATT: first, the measure at issue must come under one or another of

7 Appellate Body Report on *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, 1996 ('*US – Gasoline*'), 24.

8 Appellate Body Report on *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, 1998 ('*US – Shrimp*'), para 156.

9 *Ibid*, para 121.

10 See, for example, *US – Gasoline* at 22, n 7 above.

11 In *US – Gasoline*, the Appellate Body held that the concepts of 'arbitrary or unjustifiable discrimination' and 'disguised restriction on international trade' were related concepts that 'imparted meaning to one another'. Appellate Body Report on US – Gasoline at 25, see n 7 above.

the particular exceptions; second, it must also satisfy the requirements imposed by the chapeau of Article XX.[12] Notably, the FTL (2004) does not contain similar wording of the chapeau of Article XX. If this implies that Chinese trade regulators need not take into account of the basic principles of the chapeau, they would risk being challenged by other Members before a WTO panel. Thus, it is recommended that these regulators must justify the trade restrictions and prohibitions under both PRC law and the WTO rules as a good governance manner.

3.2 GENERAL TRADE RESTRICTIONS AND PROHIBITIONS

3.2.1 National Security, Social and Public Interests and Public Morals

This principle is partly based on Article XX, paragraph (a) of the 1994 GATT which reads as 'necessary to protect public morals', but expands to national security or social and public interests. Neither of these terms has a statutory definition under PRC law, nor will the WTO cases help much. These highly abstract principles must be assessed in the context of China's social, political and economic contexts, on a case-by-case basis. Chinese trade regulators assume the burden of proof to justify the necessity for invoking this principle in a trade restriction or prohibition.

It is notable that both the FTL (2004) and Article XX, paragraph (a) of the 1994 GATT use the word 'necessary' as a condition for relying on the ground of public policy. As a WTO rule, the use of different words (such as 'necessary', 'essential', 'relating to', 'for the protection of', 'in pursuance of' and 'involving') in different heads of exception implies 'a different kind or degree of connection or relationship between the measure under appraisal and the state interest or policy sought to be promoted or realized.'[13] The word 'necessary' may mean a relatively higher degree of connection between the trade measure and the public policy to be protected, and also imply a kind of causal link between the restricted or prohibited trade and the adverse impact on the public policy in China. This requires Chinese trade regulators to raise convincing evidence to justify their actions under this exception.

3.2.2 Human, Animal and Plant Life or Health

This principle is based on Article XX 'General Exceptions', paragraph (b) of the 1994 GATT. It is the main basis for, and the purpose of, the health and

[12] *US – Gasoline* at 30–1, see n 7 above.
[13] *US – Gasoline* at 17, see n 7 above.

safety regulation. Chapter 6 'Health and Safety Regulation' will give a detailed analysis, whilst this section will analyse some high level principles for the application of this principle.

The Panel on US – Gasoline presented a three-tier test in respect of Article XX (b):

> [A]s the party invoking an exception the United States bore the burden of proof in demonstrating that the inconsistent measures came within its scope. The panel observed that the United States therefore had to establish the following elements:
>
> (1) that the policy in respect of the measures for which the provision was invoked fell within the range of policies designed to protect human, animal or plant life or health;
>
> (2) that the inconsistent measures for which the exception was being invoked were necessary to fulfil the policy objective; and
>
> (3) that the measures were applied in conformity with the requirements of the introductory clause of Article XX.
>
> In order to justify the application of Article XX(b), all the above elements had to be satisfied.[14]

Importantly, the focus of analysis should be put on whether the inconsistent measures are necessary to fulfil the policy objective, rather than on the result of such measures (for example, the less favourable treatment to foreign exporters resulted from the application of these measures or the effect of such measures).[15]

The trade restrictions or prohibitions adopted under this principle must be based on scientific data and risk assessment, acting as the justification for their invocation. However, as the Appellate Body pointed out in EC – Asbestos:

> In justifying a measure under Article XX(b) of the GATT 1994, a Member may also rely, in good faith, on scientific sources which, at that time, may represent a divergent, but qualified and respected, opinion. A Member is not obliged, in setting health policy, automatically to follow what, at a given time, may constitute a majority scientific opinion.[16]

There is no clear guidance on what constitutes a 'qualified and respected' opinion. Should it be an opinion with international qualification and respected by the international academic community, or should it be sufficient to be qualified and respected within the Member State? Suppose one distin-

[14] Panel Report on *US – Gasoline*, WT/DS2/R, adopted 20 May 1996, para 6.20. This part was not reviewed by the Appellate Body.

[15] *US – Gasoline* at 16, see n 7 above.

[16] Appellate Body Report on *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, 2001 ('*EC – Asbestos*'), para 178.

guished Chinese scientist proved that Californian oranges may pose a risk to human health, with allegedly sufficient evidence and gaining respect from his Chinese colleagues, but the majority of scientists in the US disagreed. Will this be a qualified and respected opinion to justifying the Chinese ban on the import of Californian oranges? US scientists may rebut the evidence and the conclusions of the Chinese scientist's report, but the problem is: should Chinese trade regulators be obliged to listen to the different opinions, especially those from US scientists? Even if the answer is yes, it is difficult to prove that the regulators deliberately ignore US scientists' opinions – if the Chinese scientist's opinion is also well argued and founded. This leaves room for the regulators to shop for an opinion as the basis of their policy, in a way that may fully comply with the WTO rules.

In *EC – Asbestos*, the Appellate Body confirmed that a measure is 'necessary' within the meaning of Article XX (b) 'if an alternative measure which [a Member] could reasonably be expected to employ and which is not inconsistent with other GATT provisions is [not] available to it.'[17] In other words, if there is a 'reasonably available' alternative measure that is consistent with other GATT provisions, the trade regulators' choice of the trade restrictive or prohibitive measures cannot be viewed as 'necessary'. In order to assess whether a measure is 'reasonably available' or not, one important factor is the extent to which the alternative measure contributes to the realisation of the end pursued.[18] However, a measure does not cease to be reasonably available simply because the alternative measure involved administrative difficulties for the regulators.[19] After the Chinese trade regulators justify the adoption of trade restrictions or prohibitions based on the principle of protection of human, animal and plant life or health, a further step is to query whether they can have a reasonably available measure to achieve the same policy goal. The difficulties for the regulators to formulate or implement such an available measure cannot be an excuse for restricting international trade.

3.2.3 Environmental Protection

Environmental protection is a ground for trade restrictions and prohibitions under Article 16(2) of the FTL (2004). Similar to the analysis of trade restrictions or prohibitions on the ground of protection of human, animal and plant life or health, environmental protection should be based on scientific analysis and risk assessment. The basic rules discussed above also apply to this area. As

[17] WTO Analytical Index – Guide to WTO Law and Practice, Vol 1 (1st ed), published by the WTO (2003), ('WTO Analytical Index') p 354, para 511.

[18] Appellate Body Report on *Korea – Measures Affecting Import of Fresh, Chilled and Frozen Beef*, WT/DS161/AB/R, WT/DS169/AB/R, 2001, paras 166 and 163.

[19] Panel Report on *US – Gasoline* at paras 6.26 and 6.28, see n 14 above.

a basic rule, Chinese trade regulators cannot use this ground for the purpose of trade protectionism.

Further to the above general principle, there are some specific laws in the PRC in respect of regulating import and export of certain substances with a potentially adverse impact on the environment. Two typical areas are the import of solid waste materials and the import or export of substances consuming the ozone layer.

3.2.3.1 Import of Solid Waste Materials

Import of solid waste materials is subject to strict regulation. Basically, PRC law prohibits the dumping, storage and disposal of overseas solid waste materials within the territory of China,[20] as well as the import of solid waste materials that cannot be used as raw materials.[21] For those usable as raw materials, a restricted import regime applies.[22]

The competent authority for trade regulation in this area is the State Environmental Protection Administration (SEPA), which upon consultation with MOC is in charge of the formulation, adjustment and publication of a catalogue of the types of solid waste materials that can be imported but subject to restrictions.[23] Originally, any solid waste materials not covered by such a catalogue could not be imported.[24] However, the policy seems to have been changed in 2002 by SEPA in a circular, under which the import of solid waste materials is now categorised into three groups: those covered by the Catalogue for Prohibited Import Goods; those covered by the Catalogue for Restricted Import Goods as Waste Materials Usable for Raw Materials (the 'Restricted Waste Materials'); and those not covered by the above two catalogues. For the third category, the principle of free trade now applies,[25] which implies a transition to the negative list approach by the regulator. This is consistent with the free trade principle embedded in the current import regime. The same circular also requires the import of several types of solid waste materials (such as waste paper, waste crushed cotton, aluminium and steel) to be subject to the automatic import registration system. Whilst the reform of trade regulation in the import of solid waste materials is geared toward a sound policy direction, its legal position is less certain – after all, a law passed by the Standing Committee of NPC has been substantially changed in this

20 *PRC Environmental Protection Law for the Pollution by Solid Waste Materials* (中华人民共和国固体废物污染环境防治法), effective from 1 April 1996, Art 24.

21 *Ibid*, Art 25(1).

22 *Ibid*.

23 *PRC Environmental Protection Law for the Pollution by Solid Waste Materials* (中华人民共和国固体废物污染环境防治法), effective from 1 April 1996, Art 25(2).

24 *Ibid*.

25 *Circular on the Adjustment of Administration of Environmental Protection for Import of Waste Materials* (关于调整废物进口环境保护管理工作的通知), jointly issued by SEPA, MOFTEC, the General Customs and AQSIQ, Huan Fa (2002) No 2, 18 January 2002.

respect by a circular in the joint names of several ministries and this way of change should not be constitutionally effective under the hierarchy of PRC law. It is suggested that the relevant law must be revised by the Standing Committee to conform to the current policy.

For Restricted Waste Materials, the import must be approved by SEPA in advance, by issuing an Approval Certificate for Import of Waste Materials (with a one-year validity) within ten working days of receipt of the application.[26] The importer must be an enterprise with legal personality and with the capacity for utilising imported Restricted Waste Materials and having corresponding equipment for prevention of pollution.[27] The application for the Approval Certificate must be accompanied by the environmental risk assessment report for such import.[28] However, the law is less clear in respect of the detailed criteria for eligible importers and for the environmental risk assessment report, which effectively means that SEPA has a higher degree of discretion on approving or disapproving an application. There is a risk that the regulatory process will not be as transparent and fair as it should be, an area to be improved by SEPA upon reform in this area.

More strictly, the SEPA regulation on Restricted Waste Materials extends from the chain of import upstream to the establishment of an enterprise engaging in the business of import, operation or processing of these materials. Without SEPA's approval, the State Administration of Industry and Commerce ('SAIC') and its local branches must not accept an application for the establishment of such an enterprise.[29] This means that SEPA approval, separate from the issuance of approval certificates for import, is a condition for engaging in this kind of business by any enterprise. Failure to obtain SEPA approval will result in serious consequences, including the refusal by Customs of the clearance of imported Restricted Waste Materials, the forfeiture of foreign trading rights by MOC and the cancellation of the business licence by SAIC.[30]

[26] *Interim Regulations on Administration of Environmental Protection for Import of Waste Materials* (废物进口环境保护管理暂行规定), jointly issued by SEPA, MOFTEC, the General Customs, SAIC and AQSIQ, 1 April 1996, Arts 8, 18 and 20. Notably, any Restricted Waste Materials without an Approval Certificate will be refused by Customs to enter into the territory of the PRC and subject to penalties by Customs ranging from RMB100,000 to RMB 1 million or even criminal liability for smuggling. If such materials have already entered into the territory of the PRC, Customs still have the above enforcement rights; moreover, the importer is obliged to clean up any pollution caused.

[27] *Interim Regulations on Administration of Environmental Protection for Import of Waste Materials* (废物进口环境保护管理暂行规定), jointly issued by SEPA, MOFTEC, the General Customs, SAIC and AQSIQ, 1 April 1996, Art 10.

[28] *Ibid*, Arts 11–15.

[29] *Ibid*, Art 26.

[30] *Ibid*, Art 30.

3.2.3.2 Trade in Substances Consuming the Ozone Layer

China is under international obligations to control trade in substances consuming the ozone layer. Accordingly, SEPA, MOC and the General Customs are jointly responsible for maintaining a Catalogue for Import and Export by China of Controlled Substances Consuming the Ozone Layer.[31] Trade in listed substances is subject to the quota and licencing requirements. MOC and SEPA will cooperate to determine the annual quota for import and export of these controlled substances[32] and jointly issue the Approval for Import and Export for the purpose of application for the relevant import or export licences.[33] The quota and licence cannot be transferred or sold by the holders.[34]

3.2.4 Gold or Silver

The restrictions or prohibitions on trade in gold or silver are based on Article XX 'General Exceptions', paragraph (c) of the 1994 GATT. Gold and silver are special goods, with a nature more like financial assets than ordinary products. This nature determines a special regulatory regime applicable to the trade in these two precious metals.

As early as 1983, the State Council issued the PRC Administrative Rules on Gold and Silver (effective from 15 June 1983). The People's Bank of China (PBOC), the Chinese central bank, is the competent authority for the approval of import and export of gold or silver by Chinese entities or individuals.[35] There is no quota on trade in gold or silver, so PBOC has the sole, non-transparent discretion on approving or refusing the application for import or export. From 1 January 2004, the approval by PBOC for trade in gold or silver for the purpose of the processing trade has been abolished. The reason is that under the processing trade, the imported products will be exported after the processing procedure within China, and vice versa for the exported products, unlike a normal import or export involving the actual

[31] *Administrative Measures on Import and Export of Substances Consuming the Ozone Layer* (消耗臭氧层物质进出口管理办法), jointly issued by SEPA, MOFTEC and the General Customs, Huan Fa (1999) No 278, 3 December 1999, Art 3.

[32] *Ibid*, Art 5.

[33] *Ibid*, Art 6.

[34] *Ibid*, Art 9.

[35] *PRC Administrative Rules on Gold and Silver* (中华人民共和国金银管理条例), Arts 25 and 26; Circular on Strengthening the Administration on Import of Gold and Gold Products (关于对进口黄金及其制品加强管理的通知), jointly issued by PBOC and Customs, 26 November 1988, para 2. Originally, there were no quantitative restrictions on the inflow of gold or silver under the *PRC Administrative Rules on Gold and Silver* (Art 25), but the position has been changed to a stricter regulation on both inflow and outflow of gold or silver to or from China.

increase or decrease of the deposit of gold or silver in China. Nevertheless, PBOC still controls the normal trade in gold or silver.

More detailed rules on trade in silver have been issued by PBOC and the then MOFTEC. An approval system applies to the import of silver, with PBOC acting as the competent authority.[36] For the normal trade and the domestic sale of silver originally imported under the processing trade, PBOC will issue a Silver Import Permit, without which Customs will treat the relevant trade as smuggling of silver.[37] This rule also applies to an individual who brings into China silver or silver products beyond the reasonable amount for his or her own personal use, as well as the donation of silver or silver products to Chinese entities (including FIEs). For the export of silver, a quota and licencing system applies from 1 January 2000, which involves the allocation of quota by PBOC and the issuance of the export licence by MOC.[38] MOC maintains a short list of eligible Chinese exporters for silver, reviewed every 12 months.[39]

3.2.5 National Security

Compared to the old FTL (1994), the FTL (2004) adds a new clause on trade restrictions for the purpose of national security. Article 17 of the FTL (2004) provides that the State can adopt any necessary measures on trade of goods or technologies relating to fissionable materials or the materials from which they are derived or to arms, ammunition and other military materials, so as to ensure national security. For example, any import or export of nuclear materials, equipment or non-nuclear materials for reactors and the relevant technologies must be reviewed and approved in advance by the State Defence Science and Technology Industrial Commission and if necessary, by the State Council.[40] A nuclear import or export licencing system applies. For the

36 *Interim Administrative Rules on Import of Silver* (白银进口管理暂行办法), jointly issued by PBOC and Customs, effective from 1 January 2000, Art 3.

37 *Ibid*, Art 7. For imported silver or silver products for the purpose of the processing trade, the processed products must be fully exported, or must comply with the PBOC approval requirement if sold-on in the Chinese domestic market (which mainly requires the payment of originally-exempted tariffs to Customs). See Art 5.

38 *Interim Administrative Rules on Export of Silver* (白银出口管理暂行办法), issued by MOFTEC and effective from 1 January 2000, Arts 3 and 5. For the import of silver for the processing trade, enterprises must obtain the approval for such trade by the local branches of MOC at the provincial level and are subject to supervision on export of the processed products. See Art 7.

39 *Interim Administrative Rules on Export of Silver* (白银出口管理暂行办法), issued by MOFTEC and effective from 1 January 2000, Art 4. For example, there were only two eligible Chinese exporters in the year 2000: China Banknote Printing and Minting Company and China Group Company for Bronze, Zinc and Lead. Other enterprises holding the export quota can only appoint these companies as the agent for export of silver.

40 *Administrative Measures on Nuclear Import and Export and Safeguarding and Supervision of External Nuclear Cooperation* (核进出口及对外核合作保障监督管理规定), jointly issued by the State Defence Science and Technology Industrial Commission, the Ministry of Foreign Affairs and MOFTEC and effective from 1 March 2002, Arts 2–4 and 6.

export of nuclear materials and relevant technologies with both military and civil uses, the exporter must be the designated Chinese entities and the end user must undertake that it will not use these materials for the purpose of nuclear explosion, or for a nuclear facility not subject to international supervision, nor will they transfer such materials and relevant technologies to any third party without the prior consent of the Chinese government.[41] A similarly strict control is in place for trade in military materials.[42] The Chinese exporter of missiles and relevant technologies must be registered with MOC, and the licence for export is to be issued upon the approval by MOC or if necessary, jointly with other ministries of the State Council and the Central Military Commission.[43]

This ground is based on Article XXI (Security Exceptions) of the 1994 GATT. The core is the 'necessity' test for a Member relying on the security exceptions. Since the full phrase in Article XXI is 'any action which [one Member] considers necessary for the protection of its essential security interests', China must assume the burden to prove that it 'considers' necessary trade restrictions or prohibitions on this ground. 'Essential security interest' is also a wide enough concept to be fully explored to defend trade sanctions in this respect.[44] Nevertheless, prompt and full notification of any trade sanction must be served on other Members whose trade with China in these areas will be affected.

3.2.6 Other Laws, Administrative Regulations and International Treaties

This catch-all provision is typical in Chinese legislation, aiming to grant the State and its trade regulators as much flexibility as possible.[45] However, only

41 *PRC Administrative Rules on Nuclear Export* (中华人民共和国核出口管制条例), issued by the State Council and effective from 10 September 1997, Arts 2 and 5; *PRC Administrative Rules on Export of Dual Purposed Nuclear Materials and Relevant Technologies* (中华人民共和国核两用品及相关技术进出口管制条例), issued by the State Council, effective from 10 June 1998, Arts 5 and 6.

42 See, for example, *PRC Administrative Measures on Export of Military Materials* (中华人民共和国军品出口管理条例), issued by the State Council, effective from 1 January 1998 and revised on 15 October 2002. A licencing system applies to this kind of export, and the competent authority is the military regulatory body apart from civil government.

43 *PRC Administrative Rules on Export of Missiles and Relevant Materials and Technologies* (中华人民共和国导弹及相关物项和技术出口管制条例), issued by the State Council and effective from 22 August 2002, Arts 3–10; *PRC Administrative Measures (Interim) on Registration of Export Operation of Missile-related Materials and Technologies* (中华人民共和国导弹相关物项和技术出口经营登记(暂行)管理办法), issued by MOFTEC and effective from 2 September 2002, Arts 2–3.

44 Two hypothetical examples would be that the importer of Chinese nuclear equipment or missiles supports Taiwan's declaration of independence, and the exporter of military materials to China also exports such materials to Taiwan. Under both scenarios, Chinese trade regulators may claim that the trade could be a threat to China's essential national interests.

45 FTL (2004), Art 16(10), see n 1 above.

three legal sources are allowed to impose on trade restrictions or prohibitions: laws passed by the NPC and its Standing Committee, administrative regulations passed by the State Council, and international treaties to which China is a party and either recognises their direct effect on the domestic legal system or transforms such treaties into domestic law. Notably, trade regulators, in particular MOC, cannot issue a ministerial rule or circular to create new grounds for trade restrictions or prohibitions, but only have the power to implement the relevant laws, regulations and international treaties. Where a trade restriction or prohibition cannot be based on a ground identifiable within any of these three legal sources, it is a prima facie violation of the FTL (2004) as well as China's WTO commitments on free trade.

3.3 EXPORT RESTRICTIONS AND PROHIBITIONS

3.3.1 Local Short Supply or Exhaustible Natural Resources

This ground is provided under Article 16(4) of the FTL (2004). It is a textual combination of two GATT rules: Article XX, paragraph (g) relating to exhaustible natural resources and paragraph (j) relating to the acquisition or distribution in general or local short supply. However, it only partly incorporates these GATT rules into PRC law because Chinese legislators deliberately ignored some important qualifications on these rules under the 1994 GATT. For the arm of local short supply, Article XX, paragraph (j) has a proviso:

> Provided that any such [trade restrictive or prohibitive] measures shall be consistent with the principle that all contracting parties are entitled to an equitable share of the international supply of such products, and that any such measures, which are inconsistent with the other provisions of the Agreement shall be discontinued as soon as the conditions giving rise to them have ceased to exist.

For the arm of exhaustible natural resources, the trade restrictions or prohibitions should be made effective 'in conjunction with restrictions on domestic production or consumption'. This suggests an 'even-handed' treatment in restricting both the domestic use of such natural resources and the export of products using the same resources.[46] In other words, the regulators cannot prohibit the export of a resource on the basis of paragraph (g) on the one hand, but allow the domestic producers to consume this resource without any limitation on the other hand. The absence of these qualifications under the FTL (2004) implies that the regulators have a larger degree of regulatory discretion on imposing trade restrictions or prohibitions on the export of Chinese products consuming certain exhaustible natural resources, which

[46] Appellate Body Report on *US – Gasoline* at 20, see n 7 above.

might fall foul with the GATT rules and arouse a complaint by other Members before a WTO panel.

PRC law does not define what constitutes 'exhaustible natural resources'. It may be useful for the regulators to look at the relevant WTO cases when exercising their regulatory powers to assess such factors. In *US – Shrimp*, the Appellate Body noted the need to interpret this term 'in the light of contemporary concerns of the community of nations about the protection and conservation of the environment' and emphasised the fact that 'the generic term "natural resources" in Article XX(g) is not "static" in its content or reference but is rather "by definition, evolutionary"', thus concluding this term must embrace both living and non-living resources (such as minerals).[47] More importantly, a trade restrictive or prohibitive measure 'relating to' protection of exhaustible natural resources can be such a measure 'primarily aimed at' this objective, that is, not the sole purpose or reason.[48] Whether or not a natural resource is exhaustible and how the protection of such resource concerns the environmental protection of China are factual issues to be discussed in each case, on a scientific and objective basis.

Similarly, the regulators must scientifically and objectively justify trade restrictions or prohibitions on the ground of local short supply, and maintain an equal treatment to all importing countries in the allocation of limited quantity of the exported goods or products.

3.3.2 Limited Market Capacity

This ground reflects to some extent a residual feature of foreign trade 'planning' in China.[49] The rationale is that the target foreign market may have a limited capacity for consuming a specific type of Chinese good or product. The regulators have the power to intervene when the supply significantly exceeds the demand, causing a decrease of price of such goods or products and eventually making a loss for the Chinese exporters as a whole.[50] A typical example is the quota on export of livestock to Hong Kong and Macau, because these regions rely on Mainland China to supply livestock but have a limited market.

However, the rationale behind trade restrictions or prohibitions on the ground of limited market capacity may be able to be challenged under the WTO rules, as it is not consistent with the basic principle of free trade. Under a pure free market theory, the State should not intervene in the export market

47 Appellate Body Report on *US – Shrimp* at paras 128–31, see n 8 above.
48 Appellate Body Report on *US – Gasoline* at 18, see n 7 above.
49 FTL (2004), Art 16(5), see n 1 above.
50 Huang Dongli and Wang Zhengmin (eds), *Zhonghua Renmin Gonghe Guo Duiwai Maoyi Fa: Tiaowen Jinjie ji Guoji Guize* (Understanding PRC Foreign Trade Law and Related International Rules) (Beijing, The Law Press, 2004) 91–2.

which has full competition and should leave the market to self-regulate any deviation from the basic pricing rules. For instance, the increase of export to one target market will result in a larger supply than demand, either resulting in the general reduction of price or forcing out some less-competitive exporters. When the target market has an oversupply, the exporters can only reduce the price further to a breaking point at which they have no profits – when they should consider moving to other markets or to other products. Despite of the above theory, trade restrictions or prohibitions on this ground may arouse few challenges if they are carried out in a fair, transparent and equal manner to all importing Members. It is interesting to observe whether other Members may claim this ground as unjustified trade discrimination under PRC law before a WTO panel.

3.3.3 Export Trade Order

This is another ground reflecting the strong intervening powers available to Chinese trade regulators.[51] Chapter seven 'Foreign Trade Order' will give a full discussion of this issue.

3.4 IMPORT RESTRICTIONS AND PROHIBITIONS

3.4.1 Establishment of Specific Domestic Industries

This ground[52] is partly based on Article XVIII (Governmental Assistance to Economic Development) of the 1994 GATT. The Panel on India – Quantitative Restrictions explained the function of Article XVIII as follows:

> It is clear from these provisions that Article XVIII, which allows developing countries to maintain, under certain conditions, temporary import restrictions for balance-of-payments purposes, is premised on the assumption that it 'may be necessary' for them to adopt such measures in order to implement economic development programmes. … Article XVIII:B of GATT 1994 thus embodies the special and differential treatment foreseen for developing countries with regard to such measures.[53]

A full analysis of Article XVIII is beyond the scope of this book. However, the FTL (2004) simply provides that the State may restrict imports 'necessary to establish or accelerate the establishment of specific domestic industries', but

[51] FTL (2004), Art 16(6), see n 1 above.
[52] FTL (2004), Art 16(7), see n 1 above.
[53] The WTO Analytical Index, p 318, para 426, see n 17 above.

ignores the flesh of Article XVIII such as those stringent conditions and qualifications on its application.

Most importantly, Article XVIII applies to developing countries only. Although China always claims itself as a developing country, the international community has not universally accepted this claim. Therefore, the base stone for China's incorporating this exceptional rule into domestic law may be loose. It is envisaged that the status of 'developing country' will be a major point to be argued by other Members against the WTO consistency of any import restrictions by China on the basis of the establishment of a specific domestic industry.

In practice, the chances for application on this ground would not be high due to two reasons. First, the trigger of this import restriction largely depends on the actions of the relevant specific industry, which in turn relies on the sound organisation of such industry and the strong lobbying powers. The current industrial or trade associations are still less developed in China. If the submission of this application to the government incurs costs, it is possible that the majority of industrial members will take a 'free-rider' approach by waiting for others to submit such application. After all, any import restriction will benefit the whole industry rather than those active members only. Second, it will be a difficult task for MOC to investigate, analyse and justify the trade restriction – notably, not a prohibition – for the needs of domestic specific industry. It is foreseeable that other Members, especially those whose exports to China are subject to the restriction, will react strongly to such restriction and also be highly likely to bring a WTO case against China. As a result, the combing effect of these factors might negate the initiatives for either Chinese trade regulators or Chinese specific industries to rely on this ground.

3.4.2 Agricultural, Stockbreeding or Fisheries Product

This ground[54] is based on Article XI (General Elimination of Quantitative Restrictions), paragraph 2(c) of the 1994 GATT. Again, it does not mirror the text of Article XI, paragraph 2(c) completely and misses three conditions on triggering this exceptional rule to restrict (rather than prohibit) the import of agricultural, stockbreeding or fisheries product (collectively as 'agricultural product'), in a way that is 'necessary to the enforcement of governmental measures which operate':

(i) to restrict the quantities of the like domestic product permitted to be marketed or produced, or, if there is no substantial domestic production

[54] FTL (2004), Art 16(8), see n 1 above.

of the like product, of a domestic product for which the imported product can be directly substituted; or

(ii) to remove a temporary surplus of the like domestic product, or, if there is no substantial domestic production of the like product, of a domestic product for which the imported product can be directly substituted, by making the surplus available to certain groups of domestic consumers free of charge or at prices below the current market level; or

(iii) to restrict the quantities permitted to be produced of any animal product the production of which is directly dependent, wholly or mainly, on the imported commodity, if the domestic production of that commodity is relatively negligible.

Only reading this exceptional rule relating to agricultural product in conjunction with these conditions can give it a full, correct understanding. The true reasons for imposing such import restrictions are to support the governmental measures mainly directed at the restriction on the marketing or production of 'the like domestic product' or the removal of temporary surplus of such 'like domestic product'. However, without a link to the restrictions on the like domestic product, the current wording of the FTL (2004) looks like a blank authorisation to the trade regulators to restrict 'if necessary' the importation of the agricultural product in any form for any reason. This is a serious distortion of the wording and the spirit of the relevant WTO rule, which means that the implementation of the WTO Agreement in this area is flawed. More dangerously, Chinese trade regulators are empowered under domestic law to restrict the import of agricultural product for unlimited reasons and with utmost discretion, thus making China open to other Members' complaints before the WTO. Therefore, it is submitted that the trade regulators must be very careful in exercising regulatory powers in this area and can only take action in the context of the full corresponding GATT clauses.

Where Chinese trade regulators apply this ground to restrict the import of certain agricultural product from other countries, they must satisfy the following conditions: first, it must restrict, not prohibit, the import; second, the import restriction must be directed at an agricultural product; third, they must have a domestic restriction on the production or marketing of the like domestic product, the same as or similar to the import restriction; fourth, the import restriction must be necessary.[55] In addition, the regulators must publish the aggregate quantity or value of such restricted product that can be imported within specific future periods.[56]

[55] General Agreement on Tariffs and Trade 1994, one document of Annex 1A to the Marrakesh Agreement Establishing the World Trade Organization, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994 ('GATT'), Art XI, para 2(c).

[56] *Ibid*.

Two factors are key to the application of this exceptional rule: the determination of 'like domestic product' and the test of 'necessity' for the import restriction to enforce the domestic restriction. In some GATT cases before the establishment of the WTO, the panels held that the 'like domestic product' in this context should be interpreted stricter than in the general circumstances where this term refers to competitive products.[57] Notably, the restricted foreign product and the like domestic product must be both perishable and in an early stage of processing.[58] As for the test of 'necessity', an objective test applies. The trade regulator has the burden to prove that the import restrictions are necessary in nature and in effect to support the domestic restrictive measures on production or marketing of the like domestic product. These GATT/WTO rules make reference to Chinese trade regulators for their imposition of trade restrictions on agricultural products.

3.4.3 State's International Financial Status and the Balance of Payment

This ground[59] is based on Article XII (Restrictions to Safeguard the Balance of Payment) of the 1994 GATT.[60] Similar to the import restrictions for agricultural products, the FTL (2004) is not a full reflection of the corresponding text of Article XII. More importantly, it ignores the conditions for the application of this 'balance of payment' exception. Under Article XII, this exceptional rule is only applicable provided that the import restrictions shall

> not exceed those necessary (i) to forestall the imminent threat of, or to stop, a serious decline in [the State's] monetary reserves, or (ii) in the case of a contracting party with very low monetary reserves, to achieve a reasonable rate of increase in its reserves.

In practice, unless China's monetary reserves are deteriorating to such an extent that the only available measure is the trade restriction, this 'balance of payment' exception is less likely to be triggered.[61] Since there are many conditions under the GATT rules on the application of this exception, the trade regulators may be more cautious in this respect.

[57] Huang and Wang at 97–9, see n 50 above.
[58] GATT, Article XI, para 2(c), see n 55 above.
[59] FTL (2004), Art 16(9), see n 1 above.
[60] Art XVIII (Governmental Assistance to Economic Development), Section B of the 1994 GATT also has similar wording to Art XII, so these two articles overlap where a Member, as a developing country, relies on trade restrictions for balance of payment.
[61] By the end of 2003, China has foreign exchange reserves amounting to about USD400 billion. Unless extremely adverse changes occur to China's foreign trade, the possibility of serious decline of such reserves in the near future is not significant. See 'Expert predicts a small deficit in trade in the year of 2004' http://www.chinanews.com.cn/n/2003-12-09/26/378667.html (4 July 2004).

3.5 CONCLUSIONS

The FTL (2004) provides a more detailed and complete list of grounds for trade restrictions and prohibitions. Chapter four 'Licencing and Quota' will analyse two main regulatory instruments – licencing and quota – for restricting foreign trade in China.

From the above analysis, it is notable that the government has based the vast majority of the grounds for trade restrictions and prohibitions on the corresponding WTO rules (especially the provisions of the 1994 GATT), some of which are even a Chinese translation of the GATT provisions. However, serious problems also exist under the FTL (2004) in respect of the WTO implementation in some aspects. The typical problem is that the FTL (2004) tends to distort the true meaning and spirit of some corresponding provisions of the 1994 GATT, by ignoring the qualifications and conditions on the application of these provisions (especially on the grounds for import restrictions and prohibitions). Through this implementation model, the trade regulators virtually have a blank authorisation to restrict the import or export at its discretion under domestic law. This is inconsistent with the general WTO rules on free trade as well as the purpose of trade regulation in the PRC. The potential risk may be a large number of WTO suits brought by other Members against China if Chinese trade regulators do not adopt a self-restrained approach in interpreting and applying its wide-scope regulatory powers under the FTL (2004).

It is admitted that the Chinese style of legislation drafting prefers the simplistic, catch-all style, so the literally wide regulatory powers do not necessarily mean the abuse of such powers by Chinese trade regulators. Undoubtedly, the trade regulators are obliged to provide a more predictable, objective and transparent regulatory environment to foreign traders and other Members' governments. From this perspective, I suggest that either an administrative regulation by the State Council or a set of implementing ministerial rules by MOC and other regulators must be enacted in this regard so as to create a comprehensive regulatory framework for trade restrictions and prohibitions in China. The restructured framework must replace the simplistic style of legislative drafting by a detailed and comprehensive style with appropriate reference to, and incorporation of, the applicable GATT provisions. Other rules that set out the WTO case law can also be incorporated in order to give more specific guidance to the application of this framework.

4

Licencing and Quota

4.1 BACKGROUND

Foreign trade was once heavily regulated in China and the import or export of almost every good was covered by the licencing and quota system.[1] One sign of the trade liberalisation in China is the gradual recession of licencing or quota requirements on foreign trade. The WTO accession has a particular impact on this area, as the Chinese government has committed to phase out the majority of quantitative restrictions on foreign trade (in the forms of licencing and quota) within three to four years of accession (that is, up to the end of 2004 or 2005), especially in relation to the import licencing and quota system.[2] As a result, this chapter will not describe detailed rules that have or will have less application in the practice of foreign trade regulation after 2004 or 2005. Instead, it will outline the legal and regulatory framework for licencing and quota under PRC law, analyse its compliance with the WTO Agreement, and discuss one licencing system that will not be phased out – automatic licencing.

4.1.1 Definitions of 'Licencing' and 'Quota'

There are no statutory definitions of 'licencing' and 'quota' under PRC law. The FTL (2004) and the *Regulations on Import and Export of Goods* appear to draw a distinction between a licence and a quota on the basis of quantitative restriction, but recognise that both licencing and quota are only applicable to the goods 'subject to limitations on' import or export ('restricted goods'). A quota is required where China imposes a quantitative

1 For details of China's foreign trade system in an early stage, especially from 1979 to 1991, see Cheng Yuan, *East-West Trade: Changing Patterns in Chinese Foreign Trade Law and Institutions* (New York, London and Rome, Oceana Publications Inc, 1991).

2 In order to ascertain whether a product is subject to the licencing and quota system after China's WTO accession and how it will be phased out, readers must refer to Annex 3 (Non-tariff Measures Subject to Phased Limitation) of the Accession Protocol. This annex is not exhaustive, so it should be read in conjunction with the relevant trade regulations. In theory, where a good is not listed under Annex 3, Chinese trade regulators have the discretion to impose the licencing and quota requirement on the import or export of such good.

restriction on trade in restricted goods (for example, only a certain volume of one restricted good can be imported into or exported from China each year), whilst a licence is used in the context where no quantitative restriction applies to restricted goods.[3] As a result, the basic rules applicable to licencing and quota are similar to each other to a great extent.

In the absence of statutory definitions of 'licencing' and 'quota', the definition of 'licencing' under the WTO Agreement may be a useful reference. The *Agreement on Import Licensing Procedures* (the 'Licencing Agreement') defines 'import licencing' as:

> administrative procedures … requiring the submission of an application or other documentation (other than that required for customs purposes) to the relevant administrative body as a prior condition for importation (Article 1.1).

Any administrative procedure with such features is covered by that agreement, even when not being labelled as a licencing requirement. Thus, 'licencing' and 'quota' under PRC law are broadly covered by the single definition of 'licencing' under the Licencing Agreement, because both of them involve the application (based on certain documents) to the competent authorities for an approval (in the form of a licence or a quota certificate) 'as a prior condition for importation'.[4]

4.1.2 Governmental Authorities Involved

A practical difference exists between a licence and a quota. A licence is necessary for the import or export of first, goods subject to the licencing requirement and second, goods subject to the quota requirement (as a kind of quantitative restriction). For the first type, the competent authority ('Issuing Authority') is responsible for issuing a licence. For the second type, apart from the Issuing Authority, there exist other governmental authorities in charge of the approval for the quota application prior to the application for a licence ('Approving Authority'). For example, in order to import a good subject to the quota requirement, the applicant shall apply to an Approving Authority to obtain a quota certificate or a quota approval in the first instance, and then turn to the Issuing Authority to apply for a licence. In con-

[3] *The PRC Foreign Trade Law*, *Zhonghua Renmin Gonghe Guo Duiwai Maoyi Fa* (中华人民共和国对外贸易法), promulgated on 12 May 1994 by the Seventh Meeting of the Standing Committee of National People's Congress of the PRC and taking effect from 1 July 1994, as amended on 6 April 2004 and taking effect from 1 July 2004 ('FTL 2004'), Art 19; *PRC Administrative Regulations on Import and Export of Goods*, the State Council Decree No 332, effective from 1 January 2002 ('Regulations on Import and Export of Goods'), Art 11.

[4] FTL (2004), Art 19(2) see n 3 above. (Goods and technologies subject to the administration of licencing or quota cannot be imported or exported unless permitted by the competent authorities designated by the State Council.)

trast, the import of a good subject to the licencing requirement (that is, no quantitative quota restriction) only needs a licence issued by the Issuing Authority.

The Quota and Licencing Affairs Bureau of MOC (the 'Licencing Bureau') is the national competent authority in charge of the issuance of licences. It authorises the Special Commissioner's Offices of MOC (located in some important cities) and the provincial local branches of MOC to issue licences to the applicants located within their respective territorial jurisdiction. The Licencing Bureau and various local MOC branches and Special Commissioner's Offices are collectively referred as 'Issuing Authority'. In respect of a licence, an Issuing Authority is also responsible for reviewing and approving the application. For example, MOC has issued a Catalogue of Goods under the Administration of Import Licencing and a Catalogue of Classification of Issuance of Licences for Goods under the Administration of Import Licencing on an annual basis.[5] Similarly, there are catalogues applicable to export of goods under the licencing requirement. These catalogues list all goods that are subject to the licencing and quota requirements, and divide the powers among the Issuing Authorities for approval of relevant applications. Notably, one exception is the import of electronic and mechanical products ('E&M products'). In relation to E&M products, almost every ministry of the State Council, each province and certain important cities have set up an Office for Import and Export of E&M Products which shares some regulatory powers on trade in these products.[6]

Comparatively, there are different Approving Authorities for the quota depending on the types of restricted good. This shows the division of regulatory powers among the line management of ministries. An applicant must apply to the relevant Approving Authority for the import or export of specific types of goods subject to the quantitative restriction. Upon the approval, it is only a formality for the Issuing Authority to issue a licence, because the Issuing Authority now has no power to reject the issuance of licence as long as there is a valid approval by a competent Approval Authority in advance. The following section on the quota system will discuss various Approving Authorities empowered to allocate quotas in respect of restricted goods.

4.1.3 Types of Licencing

China currently applies a licencing system to the import and export of

[5] For example, in respect of the year 2005, the most recent catalogues were applicable to import licencing in the year of 2004. Even if there is no new publication in respect of 2005, these 2004 catalogues can be applied in practice.

[6] This is largely due to historical reasons, as E&M products were of high value. Each ministry or province has tightly controlled the import and export (mainly the import) of these products within its jurisdiction.

restricted goods. A straightforward categorisation of the licencing system in China is as follows: import licence, import quota, export licence, and export quota. The following sections will follow this structure and discuss each of these four types of licencing.

A more important categorisation is based on the degree of discretion exercised by the Approving Authority or the Issuing Authority in respect of the issuance of a licence or a quota: 'non-automatic licencing' and 'automatic licencing'. The Licencing Agreement defines automatic licencing as 'where approval of the application for [import licencing] is granted in all cases'. It is usually applied for the purpose of information collection or other administration, rather than as a restriction on trade. The Issuing Authority obviously has no discretion to accept or reject the applications and must grant the licence in all cases, provided that the applications are consistent with the prescribed conditions. In contrast, non-automatic licencing means that the Issuing Authority (for non-quantitative restriction) or the Approving Authority (for quantitative restriction) has the discretion to approve or reject the application after taking into account all factors prescribed in the applicable law and the specific facts of an application.

From the perspective of a foreign exporter, he must have more concerns for the regulation of non-automatic licencing in China, as there is potential for the Chinese government to administer this licencing system in a protectionist way by restricting the import of foreign products that may compete with domestic like products. This is why China is committed under the Accession Protocol to finally eliminate the non-automatic licencing system for foreign trade. After the expiration of the transition period, more attention must be paid to the automatic licencing system applied by the government, especially whether the application will have an effect of disguised protectionism.

4.1.4 WTO Rules

The WTO Agreement provides rules on substantive and procedural aspects of licencing, mainly import licencing.

The Licencing Agreement governs the procedural aspects of administering the import licencing system by a Member. It is important to note that it only concerns the procedures of import licencing, that is, the manner and ways for trade regulators of Members to operate the import licencing regimes. In *EC – Bananas III*, the Appellate Body indicated that:

> By its very terms, Article 1.3 of the *Licensing Agreement* clearly applies to the *application* and *administration* of import licensing procedures, and requires that this application and administration be 'neutral … fair and equitable'. Article 1.3 of the *Licensing Agreement* does not require the import licensing *rules*, as such, to be neu-

tral, fair and equitable. … As a matter of fact, none of the provisions of the *Licensing Agreement* concerns import licensing *rules*, *per se*.[7]

The core criteria are transparency (for the publication and administration of relevant rules), neutrality (for the application to all applicants or in respect of one good imported from all countries), fairness and equity (for the manner of operation), 'with a view to preventing trade distortions that may arise from an inappropriate operation of [import licencing] procedures'.[8] These criteria are also applicable to the due regulatory process for export. They are benchmarks to evaluating the Chinese practice.

Article XIII of 1994 GATT provides for some substantive requirements on the import quota. The most important requirement is that a Member shall apply import restrictions with an aim to achieve 'a distribution of trade [in restricted goods] approaching as closely as possible the shares which the various [Members] might be expected to obtain in the absence of such restrictions'.[9] It further requires the transparency of the quota system, for example, fixed amounts of quota, public notice of the total quantity of restricted goods to be imported during a specified future period, and the maximum use of import licences or permits without a quota.[10] Whether and to what extent China's import licencing law complies with these requirements will be discussed in detail below.

4.2 IMPORT QUOTA

4.2.1 Approving Authorities

The general rule is that there is only one authority accepting the application for the import quota, as a single access point to facilitating the application.[11]

The National Development and Reform Commission ('NDRC') and MOC have been two traditional Approving Authorities for restricted goods such as natural rubber, processed oil and rubber tyres used in automobiles. However,

7 Report of Appellate Body on *EuropeanCommunities – Regime for the importation, sale and distribution of bananas*, WT/DS135/AB/R, adopted 9 September 1997 ('*EC – bananas III*'), paras 197–8.

8 *Agreement on Import Licencing Procedures*, one document of Annex 1A to the *Marrakesh Agreement Establishing the World Trade Organization*, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994 ('The Licensing Agreement'), Art 1(2) and (3).

9 *General Agreement on Tariffs and Trade 1994*, one document of Annex 1A to the *Marrakesh Agreement Establishing the World Trade Organization*, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994 ('GATT'), Art XIII:2.

10 *Ibid*.

11 *Regulations on Import and Export of Goods*, Art 20(2), see n 3 above.

Table 4-1 Goods or Products Subject to Quota

Goods or Products	Approving Authority	Quota Document
Certain E&M products	MOC	The Quota Certificate for Import of E&M Products
Supervised chemical products	The Steering Office for Implementation of the Treaties on Prohibition of Chemical Weapons	The Verification Note for Import of Supervised Chemical Products
Easily-made toxic chemical products	MOC	The Approval Note for Import of Easily-Made Toxic Chemical Products
Substance destroying ozone	The Administration Office for Import & Export of Substance Destroying Ozone	The Approval Note for Import of Controlled Substance Destroying Ozone

the import of these goods was released from the quota requirement upon the expiration of the phase-out period (for example, by the end of 2002 or 2004). There are a limited number of goods or products that are still subject to quota without an express phase-out period.[12] Table 4-1 lists these goods or products and the relevant approving authority. Some goods are restricted in accordance with China's international obligations under relevant international treaties or agreements.

4.2.2 WTO Commitments

China's basic commitment is that during the phase-out period, it will not increase the size, scope and duration of import licencing, nor apply any new measures, except for those products listed in Annex 3 to the Accession Protocol.[13] This standstill provision has imposed a cap on the government's capacity to regulate the import of restricted goods by licencing, which must be carried out by the Central Government or its authorised local governments so as to ensure uniform application nationwide.[14] The minimum duration of import licence shall be six months.[15] More importantly, these

12 *Administrative Measures on Import Licence for Goods* (货物进口许可证管理办法), issued by MOC on 10 December 2004, MOC Decree [2004] No 27, effective from 1 January 2005, Arts 12 and 16.
13 The Protocol on the Accession of the People's Republic of China ('The Accession Procotol'), dated 10 November 2001, para 7(1).
14 *Ibid*, para 7(4).
15 *Ibid*, para 8(1)(d).

commitments decide the direction of reform: to design a simple and transparent procedure for the full use of quotas.[16] While the requirement for transparency may be well satisfied in practice, the argument – as the following part will discuss – rests on the 'simplicity' of the procedure.

Another specialty is that China gives quantitative commitments on the increase and allocation of quotas among applicants. This is an unusual practice, and is suppose to make the accession commitments more comprehensive and 'biting' in this respect. If the government fails to reach these ratios, it would be a prima facie valid ground for a complaint before the WTO panels. Through such import requirements, other Members enjoy a higher degree of supervision over China's implementation process. The complex structure for the allocation (when application exceeds the amount of quota) is described as follows.[17] First, in the case that the average imports for the restricted goods during 1998 to 2000 do not exceed 75 per cent of the relevant quota, the allocation of quota in the current year will be based on the historical performance including the production or processing capacity, and experience and ability in producing and distribution. Second, in the case that the above imports exceed 75 per cent, 10 per cent of the quota in the year of 2002 must be allocated to those applicants who failed to receive the quota in previous years, as well as the majority of any quota growth in subsequent years. Third, in the year of 2002, 25 per cent of total quota must be allocated to those failing to receive quota in previous years; in the year of 2003, the government must give priority consideration to FIEs with minority foreign shareholding in the allocation of quota growth and any unused quota in 2002; and in the year of 2004, such priority consideration must be given to FIEs with majority foreign shareholding. More stringently, the government cannot decrease the amount of quota allocated to one applicant who also received the quota in the previous year; in other words, the quota allocation to one applicant can only increase annually.

However, it is arguable that the quantitative structure may fail to achieve its purposes due to some ambiguities in the text of the Accession Protocol. First, this structure may not accord with the purpose of effective use of quotas. The government is obliged to allocate a certain percentage of total quotas to formerly failed applicants, but it does not ensure the amounts requested by such applicants can be satisfied. It is likely that they can only receive a portion of the requested amount. This does not satisfy the applicants' demands and might lead to the non-use of these quotas in their hands. From another point, other eligible applicants may not be able to receive the full allocation of the quotas they have applied for. Hence, the ostensible protection to failed applicants cannot work out in practice. Second, unless the government publishes

[16] *Report of the Working Party on the Accession of China*, issued by the Working Party on the Accession of China, WT/ACC/CHN/49, adopted 1 October 2001 (01–4679), ('The Working Group Report'), para 127.

[17] *Ibid*, para 130.

the names of all quota recipients and their amount, it is impossible for other Members to assess whether the ratio increase is met and whether failed applicants are listed and allocated collectively the prescribed percentage of total quotas as required under the Accession Protocol. Because China has no obligation to publish such information, the 'teeth' of this structure is less strong than in the text. Third, the requirement for priority consideration to FIEs has no details on the manner and criteria for this consideration. It renders this requirement more like a paper commitment and totally within the discretion of the regulators. Fourth, the requirement for no decrease of allocated quota to one applicant has a desirable purpose, but the operation may have a side effect. Suppose the regulator is not able to satisfy the higher request by one applicant in the current year, nor to maintain the allocation level in the previous year, this requirement virtually encourages the authority to refuse the application in the current year altogether – rather than grant a portion of the requested amount. In summary, the structure aims to create more specific obligations on China, but the drafting cannot serve this purpose in most cases. The only effect is straightforward: in any event, inserting these requirements into the text is better than nothing.

4.2.3 Criteria for Allocation of Quota

An Approving Authority must take account of the following criteria for the allocation of quota: the import performance of the applicant; whether the allocated quota has been fully utilised in the past; the production capacity, scale of business and sales of the applicant; new applicants; the amount of quota to be allocated and so on.[18] Other ministerial rules issued by MOC (or formerly MOFTEC) also list similar criteria for consideration of the quota allocation.[19]

These criteria are not inconsistent with the WTO rules per se. However, a critical evaluation is required: whether and to what extent the Approving Authorities, after taking into account these criteria, can achieve a result as required by the WTO Agreement? The rationale of the WTO rules is,

> to minimize the impact of a quota or tariff quota regime on trade flows by attempting to approximate under such measures the trade shares that would have occurred in the absence of the regime.[20]

[18] *Regulations on Import and Export of Goods*, Art 16, see n 3 above.

[19] Some rules have a preference toward one criterion. For example, the *Implementation Rules for Import Quota Administration of Mechanical and Electronic Products* (机电产品进口配额管理实施细则, MOFTEC Decree No 23, issued on 20 December 2001) specifies the priority considerations for applicants with strong capacities of producing, marketing and servicing and for the new applicants, and takes into account the applicant's import performance in the past three years (Art 9).

[20] Panel Report on *European Communities–Regime for the importation, sale and distribution of bananas*, WT/DS27/R, adopted 22 May 1997, ('Panel Report, *EC – Bananas III*'), para 7.68.

Therefore, a fundamental, inherent rule for China's import licencing regime appears to be that the administration of this regime will not distort the trade flow and result in trade shares that are disproportionate to such shares 'that would have occurred in the absence of the regime'.

Arguably, the criteria listed under PRC law cannot ensure the non-distortion of trade flows. The focus of the criteria is on the trade performance (including the utilisation of quota allocated in the past) of the applicants (the importers). However, poor trade performance may owe to the lack of operational capacity of the importers. The reduction of quota to be allocated to an importer means that the relevant foreign exporter has to find another Chinese importer, and the failure of finding an appropriate importer may result in the reduction of export to China by that exporter. Thus, the overall effect of the trade performance requirement might lead to a distortion of trade flows under the import licencing regime, just what the WTO rules try to avoid. Moreover, even if the purpose of using past trade performance is to approximate the shares in the absence of the licencing system, the Approving Authority must not exclude the import from a non-WTO Member.[21] This factor has been ignored under PRC law.

It is submitted that the PRC import licencing law needs to be revised in accordance with the text and spirit of the WTO rules. The non-distortion of trade flows must be listed as an overriding principle, and more detailed guidance on the allocation of quotas must make it clear that past trade performance of one importer cannot affect the shares of quotas to be allocated to imports from particular countries of restricted goods in the absence of the import licencing regime.

4.2.4 Process

There is a clear timetable for the application procedure. The Approving Authority must publish the total amount of quotas for the next calendar year before 31 July of each year, and the application period is from 1 August to 31 August. The Approving Authority shall allocate the quota before 31 October, that is, to complete the processing procedure within 60 days.[22] Within the rules applicable to specific goods, the timetable may be slightly different in the starting and expiration dates, depending on different practices in each Approving Authority. As a general practice, the Approving Authority considers all applications simultaneously after the expiration of the quota application period. It cannot reject the application due to trivial or non-mate-

[21] Appellate Report on *European Communities–Measures affecting the importation of certain poultry products*, WT/DS69/AB/R, adopted 13 July 1998 ('*EC – Poultry*'), para 106.

[22] *PRC Administrative Regulations on Import and Export of Goods*, the State Council Decree No 332, effective from 1 January 2002 ('Regulations on Import and Export of Goods'), Art 15. This provision corresponds with Art 3(5)(f) of the Licencing Agreement.

rial mistakes in the application documentation.[23] After an applicant obtains the permit from the Approval Authority, it may then present the documents to the Issuing Authority which is obliged to issue the import licence within three working days.

One notable point is that the regulation requires a quota holder to return the unused quota to the relevant Approving Authority before 1 September of each year, and the failure of return will result in a corresponding reduction of the quota to be allocated to that holder in the following year.[24] Nevertheless, Article XIII:2(c) of 1994 GATT does not allow a Member to link the utilisation of an import licence with the importation of restricted goods from a particular country or source, except where the quota is allocated among supplying countries. As a result, if the Approving Authority required as a practical matter that the quota holder must use up the quota for the importation of restricted goods in question from a particular country, or the unused quota has to be returned to that authority, with an effect to reduce the importation from such country and to discriminate against all other countries, this practice may be viewed as a breach of the relevant WTO rules.

4.3 TARIFF QUOTA

4.3.1 Basic Rules

Under the tariff quota system, import of goods within the amount of the quota is subject to the 'tariff quota rate' whilst import of goods exceeding the amount of the quota is subject to a higher normal tariff rate.[25] Through this system, China commits to import a minimum quantity of restricted goods up to the amount of the quota in question, with a lower tariff rate applicable to such import.

The Approving Authority must publish the total amount of tariff quota for the next year between 15 September and 14 October of each year. The applicant will apply for the tariff quota between 15 October and 30 October of each year.[26] When the Approving Authority decides to allocate the tariff quota among all applicants in a uniform way (rather than a first-come, first-served way), it must publish the decisions before 31 December of each year.[27] This means that the Approving Authority has at least two months to decide the allocation. Although the law does not provide the criteria for consideration of the allocation of tariff quota, the criteria discussed in Section 4.2.3 in respect of the allocation of import quotas may apply as a reference.

23 *Ibid*, Art 20(3).
24 *Ibid*, Art 18.
25 *Ibid*, Art 26.
26 *Ibid*, Art 27.
27 *Ibid*, Arts 28 and 29.

Provided that a tariff quota holder does not use up its tariff quota of the current year, it has to return the unused quota to the Approving Authority before 15 September of this year. In the event that it does not return this quota but fails to use it up by end of the year, the Approving Authority has the discretion to correspondingly reduce the quota to be allocated to that applicant in the following year.[28] However, the law does not require the Approving Authority to allocate the returned, unused tariff quota within the current year to other quota holders who have used up or will use up their quota by end of this year. This effectively reduces the amount of the import at the lower tariff quota rate and then may have a trade protectionist effect in practice.

4.3.2 Agricultural Goods: Basic Rules

China has issued three specific rules on tariff quota, respectively applicable to fertiliser, natural rubber and agricultural goods. The quota on fertiliser and natural rubber were phased out by end of 2002 and 2004 respectively, so only the tariff quota for agricultural goods is applicable now.

The tariff quota for agricultural goods (the 'Agriculture Tariff Quota' or 'ATQ') must be established on a 'uniform, fair, open, transparent, predictable and non-discriminatory' basis.[29] The ATQ as committed under the Accession Protocol will be the amount of those regulated agricultural goods that have access to the Chinese market within one calendar year, which links the ATQ to China's WTO commitments.[30] The agricultural goods subject to an ATQ system include: wheat, corn, rice, soybean oil, palm oil, colza oil, sugar, cotton, wool and wool top.[31] A notable feature is that the state trading rule applies to the trade of wheat, corn, rice, soybean oil, palm oil, colza oil, sugar and cotton, while the designated trading rule applies to the trade of wool and wool top. For those state-traded goods, the ATQ is further divided as a state trading ATQ (which can only be imported through those state trading companies)[32] and a non-state trading ATQ (which can be imported through all entities, including the end-users, with foreign trading rights).[33] In this way,

28 *Ibid*, Art 31.

29 *Interim Measures on Administration of Tariff Quota for Agricultural Goods* (农产品进口关税配额管理暂行办法), issued by MOC and NDRC on 27 September 2003 ('ATQ Interim Measures'), Art 1.

30 *Ibid*, Art 2.

31 *Ibid*, Art 3.

32 For example, in the year of 2004, the ATQ for wheat was 9.636 million tons, with 90% for state trading; for corn, 7.2 million tons, with 60% for state trading. The non-state trading part for wheat and corn is respectively 10% and 40%. See *Rules on Tariff Quota Amounts, Application Conditions and Principles for Allocation for Import of Food and Cotton in 2004*, issued by NDRC on 30 September 2003, para 1.

33 *Interim Measures on Administration of Tariff Quota for Agricultural Goods* (农产品进口关税配额管理暂行办法), issued by MOC and NDRC on 27 September 2003 ('ATQ Interim Measures'), Art 4.

the ATQ has a correlation with China's state and designated trading rules, which could increase the level of control by the government over the volume of import.

An ATQ must be a global quota.[34] This means that imports of the regulated agricultural goods in question from all countries and regions are subject to a single amount of ATQ, avoiding more complex arrangements for segregated export markets. Any form of trade of these goods is caught by the ATQ regulation, including ordinary import, processing trade, barter trade, border trade with small amounts, and import for aid and for donation.[35]

There are two Approving Authorities for ATQs: MOC (for soybean oil, colza oil, palm oil, sugar, wool and wool top) and NDRC (for wheat, corn, rice and cotton).[36] This shows the allocation of regulatory powers between these two governmental authorities, for example, NDRC being responsible for the import of food with strategic importance that must be put under a national-level control. The application period for ATQs is 15 October to 30 October of each year on a pooled basis (except for wool and wool top which are subject to the 'first-come, first-served' rule).[37] Each Approving Authority is obliged to publish the information on the application for the goods falling within their mandate, including the total amount of ATQ, criteria for the applicants and the applicable tariff rates, not later than one month before the application period both online and in national newspapers.[38] Each Approving Authority authorises its municipal local branches to accept the applications from applicants located within their relevant jurisdiction and forward these applications to it before 30 November of each year. It must review the applications and decide the issuance of the ATQ Certificate to successful applicants (as end-users)[39] before 1 January of the next year.[40] Criteria for considering the applications by Approving Authorities comprises the amount applied, past import performance, production capacity of the applicant and 'other relevant commercial standards'.[41]

An ATQ Certificate is valid for one calendar year starting from 1 January,[42] and can be used as many times as the end-user needs for the purpose of custom clearance to import the relevant agricultural good within that year.[43]

34 *Ibid*, Art 5.
35 *Ibid*, Art 6.
36 *Ibid*, Art 7.
37 *Ibid*, Art 10.
38 *Ibid*.
39 'End-users' is defined as the manufacturers, traders, wholesalers and distributors who successfully obtain the ATQ upon application. This means that the foreign trading companies only acting as agents for import cannot be end-users to apply for ATQ.
40 *Interim Measures on Administration of Tariff Quota for Agricultural Goods* (农产品进口关税配额管理暂行办法), issued by MOC and NDRC on 27 September 2003 ('ATQ Interim Measures'), Arts 12–14.
41 *Ibid*, Art 13. The minimum amount of allocation will be determined by the amount of commercially viable shipment for the relevant agricultural goods.
42 *Ibid*, Art 15.
43 *Ibid*, Art 19. This is called the 'One Certificate for Multiple Batches' rule. Each shipment cannot overload more than 5% of the scheduled quantity.

For the ATQ Certificates for wool and wool top subject to the 'first-come, first-served' rule, the valid period is six months from the date of issuance.[44] If a shipment before the end of one year can only arrive at the Chinese ports in the following year, the end-user can apply for an extension of the respective ATQ Certificate up to the end of February of the following year.[45]

There is a complex adjustment mechanism in the case of non-full use of allocated ATQ. For those state trading ATQ allocated to end-users (rather than to the state trading companies as end-users), if the state trading companies have not entered into import contracts before 15 August of the year in question, the end-users can apply to the relevant Approving Authority for an approval for engaging in any foreign trading company (or by themselves if with general foreign trading rights) to import.[46] Thus, the state trading companies cannot deliberately delay the process of imports, with an effect to rejecting the import of agricultural goods for the protectionist purpose. End-users who cannot use up the allocated ATQ within the calendar year must return the unused quota to the Approving Authority before 15 September, and the Approving Authority will re-allocate the unused ATQ among other eligible applicants before 30 September.[47] The application period for such re-allocated ATQ is from 1 September to 15 September, but only those end-users having used up the allocated ATQ by the end of August of that year are eligible applicants for the re-allocation. The 'first-come, first served' rule applies to this application.[48] Suppose an end-user does not use up the allocated ATQ nor returns the unused quota to the Approving Authority before 15 September, the amount of ATQ to be allocated to that end-user in the following year will be proportionately reduced.[49]

4.3.3 Agricultural Goods: Specific Rules

MOC and NDRC are required to publish the volume of ATQs and the application criteria on an annual basis for the application in the immediately following year. For example, MOC and NDRC duly published the implementation rules for ATQs in relation to all regulated agricultural goods in September 2003, for the year of 2004. These rules provide for detailed criteria on applicants and conditions for application.

[44] *Implementation Rules on Administration of Import Tariff Quota for Wool and Wool Top in 2004*, issued by MOC on 28 September 2003, Art 14.

[45] *Interim Measures on Administration of Tariff Quota for Agricultural Goods* (农产品进口关税配额管理暂行办法) , issued by MOC and NDRC on 27 September 2003 ('ATQ Interim Measures'), Art 16.

[46] *Ibid*, Art 22.

[47] *Ibid*, Arts 23 and 24. The Approving Authorities must publicise the information on re-allocation one month before 1 September.

[48] *Ibid*, Art 26.

[49] *Ibid*, Art 30. For those failing to return unused quota in two successive years, the ratio of reduction will be determined by the ratio of unused quota in the second year (Art 31).

The basic WTO rule is that licencing procedures for tariff quotas fall under the provisions of the Licencing Agreement, because

> the fact that the importation of [a regulated good] is possible at a high out-of-quota tariff rate without a licence does not alter the fact that a licence is required for importation at the lower in-quota tariff rate.[50]

While the basic ATQ rules as abovementioned are generally WTO-consistent, parts of these implementation rules may be questionable under the WTO rules.

These rules provide for the qualification and eligibility for applying for an ATQ. Common qualification requirements for an applicant include: as an enterprise registered with SAIC; with sound financial status and records for tax payment in the preceding two years; no breach of rules issued by Customs, SAIC, the tax authority and the quality inspection authority; having passed the annual examination of the immediately preceding year. These requirements are quite basic for the normal operation of an enterprise, and should not be viewed as disguised barriers for the applicants. However, there are usually stricter requirements on the eligibility of an applicant in two aspects: first, the applicant must either have obtained the ATQ in the immediately preceding year and had records of import of the relevant regulated goods[51]; or alternatively, if without records of import, have reached a threshold of turnover or volume of consumption in respect of the products made from such regulated goods.[52] It is possible that the eligibility requirements on the applicants may prevent some small enterprises from taking part in the application procedure and thus might result in a de facto control by the government on the import.

The same concern may exist in the criteria for the ATQ allocation. Except for the ATQs on wool and wool top to which a 'first-come, first-served' rule applies, the allocation for ATQs on other agricultural goods will give a priority to those applicants with past import performance, and then on a proportionate basis among the remaining applicants without import performance. While the linkage with past import performance does not violate the WTO rules, the problem is the lack of detailed mechanisms to ensure the allocation of ATQs to the applicants in a manner that the regulated goods would have been imported had there been no ATQs. In this respect, the Chinese rules may be susceptible to other Members' challenges before a WTO panel.

Another potential area of concern is the quantitative restrictions on the amount of ATQs on wool and wool top that could be allocated to an appli-

[50] Appellate Body Report on *EC – Bananas III*, para 193, see n 7 above.

[51] This links the allocation of ATQs to the import performance of the applicants in past years.

[52] For example, for the ATQ on wool and wool bar, the applicant must be a manufacturing enterprise with a turnover over RMB 50 million for products made from wool or wool top in the immediately preceding year. For the ATQ on corn, the amount of consumption by an applicant is 50,000 tons for feed-manufacturing enterprises or 100,000 tons for other enterprises.

cant. For an applicant with import records in the year of 2003, the amount that he could apply for before 30 September 2004 must not exceed the amount of actual import in 2003, or if such amount of actual import was below 300 tons, then 300 tons. Without the import records, the applicant would only able to get an ATQ for a maximum of 300 tons.[53] The rationale may be that the ATQs should only be allocated to those applicants who had the capacity to import the relevant goods, rather than being wasted. However, the availability of one year's ATQ is now capped to the extent of the last year's actual import, ignoring the possibility of the applicants' expansion of business, and arguably could not achieve an optimum usage of the ATQ system. Also, it may constitute a quantitative import restriction and must be assessed in the light of China's WTO commitments and the general WTO rules, which may further cast some doubts on its legality. In addition, there is no explanation why the cap has been set at 300 tons, a sign for the lack of due regulatory process in this regard.

4.4 IMPORT LICENCE

4.4.1 Non-automatic Licencing

An import licence is valid proof for the import of restricted goods, issued by the Issuing Authority. Where the goods are subject to the quota system, the applicant must obtain the quota first and then apply for the import licence. Under this circumstance, the Approving Authority for the quota plays a key role, as the Issuing Authority will not review the application on a substantive basis once the quota has been allocated to the applicant and must issue the licence within three working days of receipt of application.[54]

For those restricted goods not subject to the quota system, the Issuing Authority must decide within 30 days of receipt of the application whether it will issue the import licence to the applicant.[55] In practice, this period seems to have been reduced to three days (or maximum 10 days for special cases).[56] There are no express provisions on the criteria for the issuance of import licences under the applicable rules, so the Issuing Authority has greater dis-

53 *Implementation Rules on Administration of Import Tariff Quota for Wool and Wool Top in 2004* (2004年羊毛、毛条进口关税配额管理实施细则), issued by MOC on 28 September 2003, MOC Decree [2003] No 52, Art 9.

54 *PRC Administrative Regulations on Import and Export of Goods*, the State Council Decree No 332, effective from 1 January 2002 ('Regulations on Import and Export of Goods'), Art 17.

55 *Ibid*, Art 19.

56 *Administrative Measures on Import Licence for Goods*, *Administrative Measures on Import Licence for Goods* (货物进口许可证管理办法), issued by MOC on 10 December 2004, MOC Decree [2004] No 27, effective from 1 January 2005, Art 19.

cretion in this process. This may cast some doubts on the fairness and transparency of its operation in line with the WTO rules.

An import licence is valid for one year and can be extended once by a maximum of three months.[57] It cannot be amended without the approval of the Issuing Authority, nor be transferred or assigned to a third party. The basic rule for the use of such licence is the so-called 'one licence for one Customs and one licence for one batch' rule, which means that one licence can only be used to clear the import through Customs in one place (rather than in several places) and only for one time of such clearance (rather than being used repeatedly).[58]

Some special rules apply to the processing trade and the trade of FIEs. For the import of restricted goods to be used for the processing trade, the general rule is that no import licence is required unless otherwise expressly required by applicable laws. The rationale is that the goods to be used for the processing trade, usually as input materials, will be exported after the manufacturing or processing stage within the PRC, which will not enter into the Chinese domestic market. For FIEs, the import of equipment or materials as the contribution by foreign investors or for their own use will not be quantitatively controlled by the import licencing system; instead, the Issuing Authority will usually issue the import licences upon review of the documents evidencing the status of FIEs. However, FIEs' import of products subject to the quota system still requires a quota certificate in the first instance – in this regard, the regulation on FIEs' import of these quota-governed goods is similar to that on other types of importers.

4.4.2 Automatic Licencing

Under the automatic licencing system, the purpose of licencing is not for the quantitative control of the import of restricted goods but for the needs of monitoring the import of such goods for some administrative purposes. The list of restricted goods subject to the automatic licencing regime must be published by MOC not later than 21 days prior to its taking effect.[59] This system also applies to the import of certain listed key industrial products.

The application for an automatic import licence must be accompanied by the following documents: the application form, the Import Contract, a copy of the Business Licence proving foreign trading rights, and the evidence of the end use or the end user of the imported goods (if required).[60] Once the application documents submitted are formally complete and with correct

[57] *Ibid*, Art 21.

[58] *Ibid*, Art 18. If an import licence is not a 'one licence for one batch', it can be used for Customs clearance more than one time (maximum 12 times within the valid period).

[59] *Administrative Rules on Automatic Import Licencing of Goods* (货物自动进口许可管理办法), issued by MOC and the General Administration of Customs (GAC) on 9 December 2004 and effective from 1 January 2005, Art 3.

[60] *Ibid*, Art 8.

contents, the Issuing Authority must issue the licence as quickly as administratively practical and within a maximum of 10 days in any case.[61] In short, the Issuing Authority has no discretion to refuse the issuance of the Automatic Import Licence where the above two criteria-–'formally complete' and 'with correct contents' – on the application documents are satisfied. An automatic import licence has a six-month validity period and also applies the 'one licence for one batch' rule.[62] Similarly, the import of regulated goods for the processing trade is exempt from automatic licencing, as well as the import of sample products or products for advertisement.[63]

The WTO rules require that automatic import licencing cannot be used as a disguised measure for the quantitative control of imported goods. This is also the benchmark to assessing the Chinese automatic licencing system. From this perspective, the Chinese system is basically consistent with the WTO rules on paper. However, there is one point which might be abused by the Issuing Authority in practice – whether the application documents have 'correct contents'. An objective test should be applied here, but the Issuing Authority has somewhat of a discretion to decide whether and to what extent the contents of all application documents are correct. For example, it may simply suspect the correctness of one item in one document and require the applicant to provide additional proof or documents. This can hardly be said to be an abuse of the process if there is a genuine reason, but does delay the import. It is difficult to find evidence for the Issuing Authority's intention to delay in this kind of cases.

4.5 IMPORT OF E&M PRODUCTS

4.5.1 Basic Rules

E&M products[64] are subject to a special import regime. A quota and licencing system apply to the import of regulated E&M products, while an automatic licencing system applies to other such products. Thus, the import of E&M products contains all features of Chinese import regulation. The general rules discussed above apply to this regime in most cases.

MOC is the national competent authority responsible for the import of E&M products, mainly in respect of the administration of the list of regu-

[61] *Ibid*, Art 10.

[62] *Ibid*, Arts 18 and 19.

[63] *Ibid*, Art 12. If an automatic import licence is not a 'one licence for one batch', it can be used for the Customs clearance for no more than six times within the valid period.

[64] 'E&M products' is defined as machinery equipment, electronic equipment, transportation tools, electronic products and appliance and apparatus and their spare parts. *Administrative Rules on Import of E&M Products* (机电产品进口管理办法), issued by MOFTEC, GAC and AQSIQ on 20 December 2001 and effective from 1 January 2002, Art 3.

lated products (together with the General Administration of Customs or GAC), the determination of the amount of annual quota and the issuance of the Quota Certificate for Import of E&M Products. However, the Office for Import and Export of E&M Products at each ministry or at the local level will inspect and supervise the implementation of the quota for E&M products within their jurisdiction.[65] The Issuing Authority will issue a Licence for the Import Quota upon receipt of the above Quota Certificate, to be used for the customs clearance. For those restricted products without a quota system, MOC acts as the Issuing Authority to issue an E&M Products Import Licence (with a one-year validity period) within 30 days of receipt of the application.[66]

An interesting point for the import of E&M products is the link with the health, safety and environmental standards (the 'HSE standards'). Chinese law expressly requires that the imported E&M products must comply with the relevant HSE standards and other quality or technical standards.[67] Thus, it is possible for the Approving Authority or the Issuing Authority to refuse the grant of quota or licence to certain products on the basis of HSE standards, an area of concern for disguised protectionism. In particular, the import of used E&M products and second-hand complete sets of equipment that may affect national security, environment or health must have a pre-ship inspection and supervision on loading clause in the import contract.[68]

In line with the general import control rules, two types of import of E&M products are exempt from the regulation. First, the processing trade (that is, import of such products to be exported in a later stage) is exempt. Second, the import of such products by FIEs as capital contribution or for their own use, as the general rule, are not subject to the import licencing requirements.[69]

4.5.2 Quota and Licencing

MOC must publish the quota amount for the next year's import of E&M products before 31 July. The application will be submitted between 1 August and 31 August, and MOC will issue the Quota Certificate for Import of E&M

[65] *Implementing Rules on the Administration of Import Quota for E&M Products* (机电产品进口配额管理实施细则), issued by MOC on 20 December 2001, MOFTEC Decree [2001] No 23, effective from 1 January 2002, Art 4(2).

[66] *Implementing Rules on the Administration of Import of Specific E&M Products* (特定机电产品进口管理实施细则), issued by MOFTEC and GAC on 20 December 2001 and effective from 1 January 2002, Art 8. The application form must be verified by the responsible Office for Import and Export of E&M Products, depending on the nature of the applicant: for an entity administered by a ministry, such Office in that ministry; for a local entity, such relevant Office in its location.

[67] *Administrative Rules on Import of E&M Products* (机电产品进口管理办法), issued by MOFTEC, GAC and AQSIQ on 20 December 2001 and effective from 1 January 2002, Art 4.

[68] *Ibid*, Art 22.

[69] *Ibid*, Art 31.

Products to successful applicants before 31 October.[70] The quota holders must return the unused quota to MOC before 1 September of every year, which will be re-allocated within 10 working days from 1 September.[71] The criteria for the applicants are similar to those for a general import quota, except for three additional conditions. First, the applicant must have a consecutive three-year record for actual import and sale of the relevant E&M products. Although new applicants may be exempt from this requirement, it is difficult to evaluate the effect on the outcome of their application. Second, the applicant must have a corresponding capacity for manufacturing, sale, maintenance, service and supply of spare parts. Third, the applicant should have a sound financial status – a term not defined under the applicable rule but at least referring to the financially solvent status of the applicant.[72] Obviously, these criteria set a higher threshold for applicants for the import of E&M products and make it more difficult to enter into this market for those without a history of import. Some criteria (such as the 'corresponding capacity' and 'sound' financial status) are ambiguous or subjective in nature, so may cause some concern in practice.

The principles for allocation of the import quota suggest that priority goes to the applicants with a strong capacity for manufacturing, sale and service, as well as to those with an actual import history in the preceding three years.[73] If one applicant uses up the quota in the immediately preceding year, the amount allocated will be 'appropriately' increased in the current year; in contrast, if the quota in the immediately preceding year was not used up nor returned to MOC within the prescribed period, the amount for the current year will be reduced. Although the law requires the allocation of 'a percentage' of quota to new applicants, MOC has discretion to decide how big such percentage will be and on what basis these quota will be allocated to new applicants.

Similar criteria for applicants and principles for the allocation of quota apply to the issuance of an E&M Products Import Licence.[74]

4.6 EXPORT QUOTA

4.6.1 General Rules

As a general rule, most principles and rules of the import quota regime also

[70] *Implementing Rules on the Administration of Import Quota for E&M Products* (机电产品进口配额管理实施细则), issued by MOC on 20 December 2001, MOFTEC Decree [2001] No 23, effective from 1 January 2002, Arts 5 and 7.

[71] *Ibid*, Art 8.

[72] *Ibid*, Art 6.

[73] *Ibid*, Art 9.

[74] *Implementing Rules on the Administration of Import of Specific E&M Products*, Arts 4 and 6, see n 66 above.

apply to the export quota regime *mutadis mutandis*. So the following discussions focus on the different features of an export quota.

The first feature is that MOC is the Approving Authority for the quota of the export of most types of restricted goods. The Issuing Authority for the Export Licence is the same authority as that for the issuance of an Import Licence. MOC maintains a Catalogue for Goods Subject to the Export Quota Administration (the 'Export Quota Catalogue') for the purpose of export quota regulation and a Catalogue for Issuance of Export Licences by Classification (the 'Export Licence Catalogue') for the purpose of export licence regulation. However, the quota system is based on an allocation of regulatory powers between MOC and its local branches. MOC must publish the volume of quota for the next year before 31 October, accept the applications from local branches and from those enterprises directly governed by the Central Government between 1 November and 15 November, and then allocate such quota to local branches and those directly-governed enterprises before 15 December.[75] The local branches are responsible for accepting the applications from local enterprises[76] and allocating the quota received from MOC to respective local applicants within their territorial jurisdiction.[77] Local enterprises holding a quota must return the unused portion to the respective local branches which may re-allocate these portion within the territory or if not, return to MOC before 31 October of the year of quota.[78] The failure by a local branch to observe this timetable for returning unused quota will result in a corresponding reduction of quota to be allocated to that branch in the next year[79] – an indirect punishment on local applicants, even though they may not be directly liable for such failure.

The second feature is a more complex adjustment mechanism for the allocation of export quota. Where the international market is unstable, MOC has the right to allocate the quota for the next year in two times, rather than in one time as usual. The first time of allocation should be before 15 December for not less than 75 per cent of the quota, and the second time should be before 30 June of the current year for the remaining part of the quota.[80] More significantly, MOC can adjust the quota already allocated to local branches or those directly-governed enterprises in the following circumstances: material changes in the relevant international market; material changes in the status of domestic resources; and the the situation when those local areas or directly-governed enterprises have used significantly more or

75 *Administrative Measures on Export Quota for Goods* (出口商品配额管理办法), issued by MOFTEC on 20 December 2001 and effective from 1 January 2002, MOFTEC Decree [2001] No 12, Arts 11, 16 and 18.

76 For those enterprises directly governed by the Central Government, they should apply to MOC directly. See *Administrative Measures on Export Quota for Goods* (出口商品配额管理办法), issued by MOFTEC on 20 December 2001 and effective from 1 January 2002, MOFTEC Decree [2001] No 12, Art 14.

77 *Ibid*, Art 17.

78 *Ibid*, Art 22.

79 *Ibid*, Art 23.

80 *Ibid*, Art 18(2).

less quota compared to the speed of use as estimated at the time of application.[81] The rationale for MOC having a stronger power in adjusting the quota allocation (even for those already allocated) by MOC is to improve the efficiency of the export quota system, so to avoid the waste of quota by some incapable applicants. Nevertheless, the law does not define what constitutes 'material' changes or 'significant' non-balancing and leaves this to the discretion of MOC, which might potentially allow MOC to manipulate the export amount or target markets of certain goods. Bearing in mind that the goods subject to export quota are generally those relating to national security or resources with a limited supply, the export quota may be a trade weapon. When any express or implicit restriction on the allocation of export quota results in a discrimination against one specific country or region, such country or region may rely on the MFN treatment principle in Article XIII(1) of the 1994 GATT to challenge MOC's behaviour before a WTO panel.[82]

Similar to the import quota, the criteria for allocation of the export quota also put some focus on the export performance of the applicant within the past three years and the utilisation rate for such quota.[83]

4.6.2 Passive Quota on Textile

A passive quota system applies to the export of textile by Chinese companies. Considering that China has been the biggest supplier of textile in the world market and that other Members are seriously concerned for the influx of Chinese textile products, this system is not only more complex than the general quota system on other products but also has a closer link with the WTO Agreement on Textile and Clothing and the relevant commitments under the Accession Protocol. In fact, the passive quota on textile has been established 'in accordance with the WTO Agreement on Textile and Clothing and the relevant trade arrangement for textile after China's accession to the WTO'.[84]

4.6.2.1 Basic Regulatory Framework

Broadly speaking, the export of Chinese textile products can be categorised as the export to those countries or regions that impose a quantitative restriction on such export and the export to those countries or regions that do not

81 *Ibid*, Art 20.

82 This provision requires that no prohibition or restriction shall be applied to the export of a product unless 'the exportation of the like product to all third countries is similarly prohibited or restricted'.

83 *Administrative Measures on Export Quota for Goods*(出口商品配额管理办法), issued by MOFTEC on 20 December 2001 and effective from 1 January 2002, MOFTEC Decree [2001] No 12, Arts 11, 16 and 18, Art 19.

84 *Administrative Measures on Passive Quota on Textile* (纺织品被动配额管理办法), issued by MOFTEC on 20 December 2001, MOFTEC Decree [2001] No 28, effective from 1 January 2002, Art 1.

impose a quantitative restriction. The former is named as 'Restricted Countries', including the USA, Canada, the EC and Turkey,[85] while the latter is named as 'Non-restricted Countries'. The basic rule for exporting textile to a Restricting Country is that the exporter must obtain a quota and a licence for the export, supervised by Customs.[86] Thus, the Chinese trade regulator faces a challenging task: on the one hand, it must facilitate or even promote the export of Chinese textile that has been playing an indispensable role in China's export; on the other hand, it must comply with the quantitative restrictions imposed by other countries or regions and observe the relevant WTO rules.

MOC and its authorised local branches[87] are the Approving Authority for the export quota on textile.[88] The highest Issuing Authority for the Textile Export Certificate (the 'Textile Export Certificate') is the Quota and Licencing Affairs Bureau of MOC, which authorises the local branches to issue and manage the Textile Export Certificate after the applicants obtain the export quota.[89] The Textile Export Certificate is on a 'one certificate for one batch' basis and is not transferable; in addition, no alteration to the contents of such Certificate is allowed except for the issuance of a new Textile Export Certificate.[90]

There are three routes for applying for an export quota on textile: the bidding route (see Section 4.6.3 below), the application by exporters (the 'application route') and allocation in accordance with export performance (the 'export performance route').

4.6.2.2 The Application Route

The application route applies to the export of certain types of textile product which 'Customs' clearance rate for quota' during 1 January to 31 August of the quota year and 'Customs' clearance rate in the previous year' are below 40 per cent. For such types of textile, a total amount of quota will be allocated by MOC to the nation, and all exporters can apply for such quota on their

85 These countries or regions have notified the Textile Monitoring Body of the WTO of the imposition of the limit. *Ibid*, Art 2(2).

86 *Ibid*, Art 6. The export of textile to Non-restricting Countries is therefore not subject to the quota system.

87 MOC is responsible for the policies and rules of the export quota and allocate the quota to designated local branches, and these local branches are responsible for accepting the application from local enterprises and allocating the relevant quota accordingly. The designated local branches include the provincial branch of MOC plus the local bureau in eight provincial capital cities (including Ha Erbin, Changchun, Shenyang, Xi'an, Nanjing, Wuhan, Chengdu and Guangzhou). In the following discussion in this section, the local branches have such special meaning.

88 *Administrative Measures on Passive Quota on Textile* (纺织品被动配额管理办法), issued by MOFTEC on 20 December 2001, MOFTEC Decree [2001] No 28, effective from 1 January 2002, Art 3.

89 *Ibid*, Art 4.

90 *Ibid*, Art 9.

own initiative. The term 'Customs' clearance rate' means the ratio of the actual export of a type of textile product (evidenced by the record of the customs clearance to one Restricting Country or of the issuance of import licences by such Country to replace the Chinese export quota) against the total export quota for such product.[91] The higher the Customs' clearance rate is, the more quantity of the textile product in question has been actually exported to that Restricting Country. Two similar concepts are the 'export performance' or the 'the feedback quantity of the Restricting Country's Customs' from the quantitative perspective. Thus, the types of textile products falling within the application route are those products with a relatively poor export record, which needs promotion by opening the quota to all potential applicants.

Under the application route, MOC will publish the total volume of export quota for the following year (that is, the quota year) in September of the current year, and allocate the relevant quota (with a volume not less than two times the volume of the Customs' feedback quantity for the current year) to local branches.[92] Local branches must allocate the quota, and issue the Textile Export Certificate, to local applicants within the volume of such relevant quota.[93] Where a local branch has issued 90 per cent of the relevant quota, it can apply to MOC for an increase of the quota.[94] However, it is possible that an applicant deliberately applies for the export quota but does not intend to export the product. For example, it may only want to hold the quota in advance for possible expansion of business or to act as the export agent for other real exporters. Thus, MOC is empowered to inspect the utilisation rate of the relevant quota by all applicants from time to time – once it finds out the above deliberate behaviour, it has the discretion to disqualify such applicants from entering into the application route.[95]

An applicant must check with the local branch before signing the export contract on the issue of whether or not there is a volume of quota sufficient for its export. If the feedback is positive, the applicant must apply for the quota immediately after signing the export contract.[96] Thus, the foreign importer needs to ensure that the Chinese exporter can obtain the export quota prior to entry into a binding contract.

If the utilisation rate of the export quota for a textile product increases (for example, the Customs' clearance rates exceeding 40 per cent), the export performance route will replace the application route. This means that there are

[91] *Ibid*, Art 2(10).
[92] *Ibid*, Art 13.
[93] *Ibid*, Art 14. Moreover, for an applicant with the export performance in the previous year, local branches shall give a six-month priority period to the applicant for an amount not less than the amount of the export performance.
[94] *Ibid*, Art 16. MOC has the discretion to approve the application on the basis of Customs' clearance rate for the relevant quota.
[95] *Ibid*, Art 17.
[96] *Ibid*, Art 15.

sufficient exporters and the quota may not satisfy everyone's needs – another stricter method has to be applied now.

4.6.2.3 The Export Performance Route

Under the export performance route, the export quota for certain types of textile product must be allocated on the basis of the export performance by local regions and by the enterprises directly governed by MOC in the previous year. There are two sub-routes: one for the export quota for the Restricting Countries (sourced from the volume of quota as provided in the bilateral or multilateral trade arrangements with the Restricting Countries in the current year), and the other for the export quota for the global Non-restricting Countries (sourced from the annually increased export quota under the bilateral or multilateral trade arrangements, the quota returned by local branches or those directly-governed enterprises and other unused quota).

For the quota for the Restricting Countries, MOC implements a complex, but delicate allocation mechanism. The first preliminary allocation will be in October of the current year (the year before the quota year), based on the export performance to the Restricting Countries during 1 January to 31 August.[97] The second preliminary allocation will be in December of the current year, based on the export performance to the Restricting Countries during 1 January to 30 November.[98] The final allocation will be in March of the quota year, based on the export performance to the Restricting Countries in the current year (that is, up to the end of February of the quota year).[99] Through this mechanism, MOC aims to match the quota to the export performance of applicants from various local regions as closely as possible. Before the final determination, an applicant can enter into export contracts on the basis of the preliminarily allocated quota.[100] However, the law does not specify the validity of these contracts if they exceed the quota finally allocated to the applicant. Presumably, these contracts will not be invalidated, but the applicant must obtain the quota from other sources for the export – if unsuccessful, it may have to claim that the export contract cannot be performed due to the lack of export quota.

For the quota for the global Non-restricting Countries, a more complex formula applies.[101] This quota for a type of textile product to be allocated to a local branch is equal to the 'global export performance' of such product multiplying a 'global ratio'. The 'global export performance' is the aggregate of

[97] *Ibid*, Art 20(2). The export performance shall multiply a ratio representing the adjustment of export. However, the law does not express the ratio, nor how will it be calculated. MOC has a policy on the calculation of this ratio, even though it is not disclosed to the public.

[98] *Ibid*, Art 20(3).

[99] *Ibid*, Art 20(4).

[100] *Ibid*, Art 20(5).

[101] *Ibid*, Art 21.

(a) 100 per cent of the amount of the export of such product in the form of general trade and (b) 30 per cent of the amount of the export of such product in the form of the processing trade. The 'global ratio' is the ratio for the export performance of such product by exporters in that MOC local branch's jurisdiction divided by the export performance of such products by all exporters in the nation. In this way, MOC aims to ensure a fair allocation of the quota among its various local branches on the basis of the export performance by local exporters under their respective territory.

4.6.2.4 Return and Transfer of the Quota

The unused quota by local applicants must be returned to MOC through the relevant local branches, or for those directly-governed enterprises, directly to MOC. The time of return cannot be later than 31 October of the quota year. For the quota that has neither been returned after this date nor been issued with the Textile Export Certificate, MOC has the right to forfeit such quota for re-allocation.[102]

In order to promote the utilisation rate, the holder can transfer the export quota to an exporter with the real capacity to export the textile product. For the intra-territory transfer – the transfer by a holder to a transferee within the same local area, the local MOC branch has the right to approve the transfer[103]; for the inter-territory transfer – the transfer by a holder to a transferee outside the holder's local area, the approval by MOC is necessary.[104]

4.6.2.5 Rules of Origin

The Restricting Countries usually require the exported product to be originated from China, rather than be trans-shipped from another country aiming to avoid quantitative restrictions. If an exporter violates the rules of origin of a Restricting Country by illegally using another country's certificate of origin or export licence to circumvent the above restrictions, MOC has the power to reduce correspondingly the volume of the export quota allocated to that exporter for the same type of textile product in the quota year or the next year. Where the illegal trans-ship involves an amount less than USD 5 million, the exporter will be disqualified from the import and export business for six months; if equal to or exceeding USD 5 million, the exporter's foreign trading rights will be forfeited.[105] MOC aims to prevent Chinese exporters from breaching the passive quota on textile from the Restricting Countries by way

[102] *Ibid*, Art 33.
[103] *Ibid*, Art 34(3).
[104] MOC shall approve and register the transfer within two working days of receipt of the transfer application. *Ibid*, Art 34(4).
[105] *Ibid*, Art 37.

of circumvention, so as to ensure compliance with the relevant WTO rules and bilateral or multilateral trade commitments made by China.

4.6.3 Bidding

Bidding is a competitive procedure in applying for the export quota. It applies to the export quotas on the following Chinese goods: non-renewable resources; goods dominating the international market and with a low price sensitivity; goods with a greater supply than demand easily resulting in dumping in international markets; and goods subject to the quota regulation under bilateral or multilateral agreements with other countries.[106] MOC is the competent authority for this regime, acting through its Export Goods Quota Bidding Committee (the 'Bidding Committee').[107] MOC exercises the most important power – deciding the types of goods that will be subject to the bidding requirement, whilst the Bidding Committee is responsible for designing and supervising the bidding procedure. The bidding office of the relevant trade association for regulated goods undertakes the task of organisation and implementation of the bidding procedure.

The bidding may be publicly available to eligible applicants or privately negotiable between the applicants and the relevant bidding office. Generally, all entities (including FIEs)[108] with foreign trading rights, being a member of the relevant trade association (for FIEs, a member of the China FIEs Association) and having achieved a threshold of export amount, are eligible to attend the bidding procedure for regulated goods organised by the relevant trade associations.[109] Thus, it is necessary to check with these trade associations for up-to-date information on the bidding eligibility requirements and procedures.

Local branches of MOC undertake a preliminary qualification review on all applicants coming from their respective jurisdiction. The bidding offices of trade associations undertake a formal review and then the Bidding Committee of MOC will have a final decision on the eligibility of applicants.[110]

In a public bidding, an eligible applicant can decide the bidding price on its own discretion. However, if the bidding price significantly deviates from the normal market price of the exported product, the relevant bidding office can

106 *Measures on Bidding for Export Quota on Goods* (出口商品配额招标办法), issued by MOFTEC on 20 December 2001, MOFTEC Decree [2001] No 11, effective from 1 January 2002, Art 6.

107 *Ibid*, Art 7.

108 Whether an individual (including the partnership and the sole proprietor) can bid for the export quota on a specific product depends on the detailed procedures for that product.

109 *Measures on Bidding for Export Quota on Goods* (出口商品配额招标办法), issued by MOFTEC on 20 December 2001, MOFTEC Decree [2001] No 11, effective from 1 January 2002, Art 11.

110 *Ibid*, Art 11.

treat it as an invalid bid.[111] The purpose is to prevent an applicant from bidding at an unusually high price to obtain the quota, thus impeding other applicants who operate in a normal way. Nevertheless, the bidding office has an uncontrollable discretion in this regard as there is no clear guidance on how to judge the price deviation or the significance of such deviation. Alternatively, the Bidding Committee may decide to publish the lowest bidding price, so as to give clearer guidance to the applicants. In order to do so, the Bidding Committee must take account of the average profits of the exported product, the international market and the prices for successful bids in previous years.[112] An applicant must submit the bid via electronic forms before the deadline and only has one chance to bid for each product.[113]

The successful applicants in a public bidding will be decided by their bidding prices. In contrast, the successful applicants in a privately negotiable bidding will be those applicants whose bidding prices exceed the minimum price published by the Bidding Committee. Thus, the quota allocated to a successful applicant in the public bidding is the quantity such applicant has applied for in their bids,[114] whilst the quota to a successful applicant in a privately negotiable bidding is decided by its proportion in the aggregate volumes and value of all applicants.[115]

The export quota is valid within the current quota year.[116] It is not free, because the successful applicants must pay a success fee and a bond for successful bids, which are to be paid into the Central Foreign Trade Development Fund.[117] Notably, the fee and the bond are not refundable. When the Bidding Office receives these payments, it will issue the quota certificate to a successful applicant for its application for the export licence.

Where a successful applicant cannot use up the quota, the applicant may either return the quota to the relevant bidding office or transfer the quota to other users at a price as agreed between them. The successful applicant must have paid up the fee before the transfer of the quota, and the transfer is subject to the approval of the bidding office.[118] From this perspective, the export quota itself can be a valuable property in China.

A potential problem is that some applicants may manipulate the bidding procedure in some disguised way. For example, several big players may obtain the majority of the quota (even at a higher price) and then sell-on these quota

[111] *Ibid*, Art 16.
[112] *Ibid*.
[113] *Ibid*, Art 18.
[114] To prevent one successful applicant from obtaining all available quota (if it bids the highest price) or each of a large number of applicants from obtaining a small quantity (which increases the administrative burden and has no economies of scale for the export), the Bidding Committee can require a maximum and a minimum quantity in the applicants' bidding. *Ibid*, Art 17.
[115] *Ibid*, Arts 19 and 20.
[116] *Ibid*, Art 32.
[117] *Ibid*, Art 24.
[118] *Ibid*, Art 29.

to other unsuccessful applicants who really need the quota for their business. This might indirectly increase the price of exported products and distort the international market, an especially serious concern for those Chinese originated, non-replaceable goods.

In addition, MOC issues three separate implementing rules on the bidding for the export quota on certain industrial products,[119] on E&M Products[120] and on agricultural goods.[121] These detailed rules are basically in line with the general rules analysed above, although they are also matched to some special features on the export of their regulated goods. There are two significant points: first, the relevant Bidding Committee and bidding offices may be composed of officials from ministries other than MOC, representing a share of regulatory power between ministries in this area[122]; second, these detailed rules provide for more workable operational rules (for example, the years of export performance to be assessed in relation to an applicant[123] and the percentage of the bond for successful applicants[124]).

4.7 EXPORT LICENCE

The Issuing Authority is responsible for issuing the export licence upon receipt of the application documents, including the application form, the Export Contract, the Export Quota Certificate issued by the relevant Approving Authority, and the certificate for the applicant's foreign trading rights.[125] Where the applicant has obtained the Export Quota Certificate, the issuance of the export licence is more of a formality. For the export licences on those goods not subject to the export quota regulation, the Issuing Authority shall rely on any approval document for export issued by the relevant

[119] *Implementing Rules on Bidding for Export Quota on Industrial Products* (工业品出口配额招标实施细则), issued by MOFTEC and effective from 8 November 2001.

[120] *Rules on Bidding for Export Quota on E&M Products* (机电产品出口招标办法), issued by MOFTEC on 20 December 2001, MOFTEC Decree [2001] No 19, effective from 1 January 2002.

[121] *Implementing Rules on Bidding for Export Quota on Agricultural Goods* (农产品出口配额招标实施细则) , issued by MOFTEC and effective from 3 December 2001.

[122] For example, the Bidding Committee for E&M Products comprises the officials from MOC, China E&M Products Import & Export Association and China FIEs Association. This conforms to the special features for trade regulation on E&M Products. *Rules on Bidding for Export Quota on E&M Products*, Art 5, see n 120 above.

[123] For agricultural goods, it is two or three years preceding the current quota year. See *Implementing Rules on Bidding for Export Quota on Agricultural Goods*, Art 8(2), see n 121 above.

[124] For agricultural goods, the bond is 10% to 60% of the fee for successful bidding. *Implementing Rules on Bidding for Export Quota on Agricultural Goods*, Art 20(1), see n 121 above.

[125] *Administrative Measures on Export Licence of Goods* (货物出口许可证管理办法), issued by MOC on 20 December 2004, MOC Decree [2004] No 28, effective from 1 January 2005, ch 2.

competent authority to issue such licence. Similar to the import licence, the operation of export licence is generally on the 'one licence for one Customs' and 'one licence for one batch of export' basis.[126]

Interestingly, the old rule required that the export prices must comply with such prices as 'coordinated by the [relevant] trade associations' – in case the export price was below this coordinated price, the Issuing Authority would refuse to issue the export licence.[127] This is the most obvious evidence for the government's efforts to control the export price, though acting indirectly through trade associations. In China's current political context, these trade associations (some of which were the successors to the former ministries in charge of the manufacturing and export of relevant products) are more like a semi-governmental authority. This kind of governmental control on the export prices might not be consistent with the general WTO rules on free trade, but more precise observations or evidence must be sought before other Members bring this control to a WTO panel. The most recent rule seems to delete this provision in order to avoid a controversy.

Since the export quota has a valid period up to 31 December of the current year that such quota is allocated, the successful applicants must apply for the export licence before the end of the current year.[128] The Issuing Authority will start issuing the export licence for the next year (the 'licence year') from 16 December of the current year, and the date of issuance will be 1 January of the licence year.[129] Generally, the valid period for the export licence on regulated goods subject to the export quota regulation will be six months,[130] unless otherwise renewed or replaced by the Issuing Authority.[131]

4.7.1 Automatic Export Licencing for Textile Products

From 1 March 2005, MOC implements an automatic export licencing rule for textile products.[132] MOC has also published a catalogue for types of tex-

[126] Some licences are on a 'one licence for more than one batch of export' basis and can be used for the Customs clearance for 12 times in the licence year.

[127] See the old version of the *Administrative Measures on Export Licence of Goods* (2001), issued by MOFTEC and effective from 1 January 2002 (abolished by the new version of the Administrative Measures on Export Licence of Goods from 1 January 2005), Art 16.

[128] *Administrative Measures on Export Licence of Goods* (货物出口许可证管理办法), issued by MOC on 20 December 2004, MOC Decree [2004] No 28, effective from 1 January 2005, Art 28.

[129] *Ibid*, Art 29.

[130] For those licences to be used beyond 31 December of the licence year, they must expire by the end of next February. *Ibid*, Art 30. The valid period for the export licence to those goods not subject to the export quota regulation depends on the applicable rules issued by MOC and the relevant competent authority for such export.

[131] *Ibid*, Art 31. The Issuing Authority will cancel the old licence and issue a new licence to the effect of renewal or replacement.

[132] *Interim Rules on Automatic Export Licencing of Textile Products* (纺织品出口自动许可暂行办法), issued by MOC on 6 February 2005, MOC Decree [2005] No 3, effective from 1 March 2005, Arts 1 and 2.

tile product that are subject to the automatic export licencing requirement.[133] MOC, acting through the Quota and Licencing Affairs Bureau and its local branches to issue the Automatic Export Licence for Textile Products to the exporters for the types of textile product under the catalogue. The Issuing Authority must issue such a licence to an applicant within 10 working days of receipt of a 'complete and contents correct' application.[134] An automatic licence is valid for three months and relevant to the export of one batch of the product in question from one customs.[135] As the applicable rule indicates, the implementation of this automatic licencing requirement is only for 'statistical analysis and supervision of the export of textile products and to issue warning messages on the export of textile products to exporters ',[136] so there is not much room for MOC to exercise discretion to control the export of textile products under this regime.

4.8 CASE STUDY: CHINA–EU HARD COKE DISPUTE

An interesting case in relation to China's export quota and licencing system is the amicably solved trade dispute between China and EC on the export quota on Chinese-origin hard coke.[137] Export of hard coke is regulated jointly by NDRC and MOC: the former to decide the annual export quota and the latter to issue the export licence. As an important fuel for the steel industry, the export of hard coke means the allocation of limited resources between Chinese users and foreign users. This is also the reason why China's exported hard coke in 2003 was only 10 per cent of the annual output.

In early May 2004, EC alleged that the export quota and licencing on hard coke violated the WTO rules and threatened to bring this case to the WTO.[138] The direct reason was that the Chinese government declared in early 2004 that the export quota for hard coke in 2004 would be reduced from 12 million tons (in 2003) to nine million tons, as an effort to secure the normal supply of coke to the domestic steel industry which had also suffered from the shortage of fuel supply in the past several years. Since China is the biggest exporter of hard coke in the world (for example, around 60 per cent

133 *Catalogue for Automatic Export Licencing for Textile Products* (纺织品出口自动许可目录), issued by MOC on 6 February 2005, MOC Decree [2005] No 7, effective from 1 March 2005.

134 *Interim Rules on Automatic Export Licencing of Textile Products* (纺织品出口自动许可暂行办法) , issued by MOC on 6 February 2005, MOC Decree [2005] No 3, effective from 1 March 2005, Art 7.

135 *Ibid*, Art 10.

136 *Ibid*, Art 1.

137 For the facts of this trade dispute, see 'Sino-EC Dispute over Hard Coke', http://news.homeway.com.cn/detail.aspx?lm=5&id=656483 (8 May 2004).

138 Ironically, EC launched an anti-dumping investigation on Chinese exported hard coke and terminated the investigation on 18 March 2004. Within less than two months, it had a total reverse of the policy: urging more export of hard coke by China.

of the worldwide aggregate export in 2003), the steel industry of EC has been heavily relying on Chinese hard coke.[139] The reduction of coke export will have a direct impact on the steel industry in EC. For example, the price for hard coke was increased from USD 79 per ton in 2001 to USD 350 per ton in early 2004.

After the threat by EC, China entered into a negotiation with EC. Finally, China announced on 31 May 2004 that a short term agreement had been reached with EC under which China committed to export at least 4.5 million tons of hard coke to EC in the year of 2004, 'without charges on or delay for [the issuance of export quota and licence]'.

As this dispute was not brought to the WTO, it is not possible to have full access to the reasons of EC's allegation and to assess its legal merits under the WTO rules. However, the quantitative adjustment by the Chinese government in early 2004 was fully justified under PRC law, as MOC is mandated to consider 'the development plans, objectives and policies' and 'the international and domestic needs and the production and sale status' of the relevant regulated goods when deciding the amount of export quota.[140]

One point of dispute seems to have some connection with the fees for the export licence, which amounted to about USD 180–200 per ton. These fees may not have resulted fully from the charges by NDRC or MOC, but may be indirectly incurred through the chain of export (for example, as a mark-up by the trading companies as exporters). In addition, the issuance of export licences by MOC seemed to slow down in the first four months of 2004, another reason for EC's complaint.[141] Thus, it is likely that EC's complaints may relate to the regulatory manner and methods for the export quota of hard coke, rather than the export quota system itself. Undoubtedly, the administration of this system must comply with the WTO requirements, that is, in a transparent, impartial and reasonable manner. The failure to satisfy these criteria would also cause China to lose the case before the WTO panel.

4.9 CRITICAL REVIEW

4.9.1 Text and Spirit

Does the Chinese quota and licencing system comply with both text and spirit of the WTO Agreement? The key is whether and to what extent the system satisfies the spirit of the relevant WTO rules (especially on import) – the crite-

139 In 2003, EC imported about 4.4 million tons of hard coke from China (around 31% of its annual consumption).

140 *Administrative Measures on Export Quota for Goods* , Art 10(3) and (4), see n 83 above.

141 See 'China and EC Reached a Short Term Agreement on the Dispute over Hard Coke', available on http://digest.icxo.com/htmlnews/2004/05/31/228848.htm (5 June 2004).

ria of simplicity, transparency and equity. In other words, is the system market-friendly?

A critical review of the current system casts some doubts on its efficiency. First of all, more than one regulator[142] shares the power of quota application based on the type of imported goods. This involves an additional level of approval before the issuance of import licences by MOC. It is apparently not as simple as a one-stop policy, and may cause unpredictable delays. This practice itself does not violate the Agreement on Import Licencing Procedures which allows the maximum of three administrative bodies for processing.[143] In the case of China, where the quota control on one specific product is phased out, the relevant Approving Authority will recede from the scene. However, it is more likely that the government will maintain the quota on some key products (such as processed oil, tyres, natural rubber, mechanical and electronic products, and agricultural products) until the expiration of the transition period. Thus it is predicted that the division of regulatory power would exist for a period.

Second, there are neither detailed guidelines nor checks and balances on exercising the regulatory powers for approval or refusal of quota application. Despite of several criteria listed out, the process of deliberation and discretion – especially when the application exceeds the fixed amount of quota – is still in a black box. The regulators may have done well in the publication of information and results, but the regulatory process itself lacks transparency. Another concern is the delay during the process, especially when the application needs to go through more than one authority. For example, US exporters complained about the procedural difficulties in applying for quotas due to inadequate transparency of application requirements in 2002.[144] Where the implementing measures comply with the WTO Agreement, it is more significant if the regulatory process applying such measures satisfies the WTO criteria and then the spirit of rules. The aborted EU-China dispute on the export of hard coke is a good example.

Third, the implementing measures do not fully address the quantitative commitments for the allocation of import quotas. The government may leave them to the policy consideration, and presumably the ministries will take into account such commitments when deciding the applications. However, the lack of corresponding implementation in domestic law has two problems: on the one hand, the denial of the direct effect of WTO agreements means private parties have no legal basis to challenge in the Chinese courts the governmental failure to meet up with these commitments; on the other hand,

[142] Three major regulators have been MOFTEC, SETC (now merged as MOC) and NDRC.

[143] *The Licencing Agreement*, Art 1(6), see n 8 above.

[144] The United States – China Business Council, 'China's WTO Implementation Efforts: An Assessment of the First Nine Months of China's WTO Membership', available at: http://www.uschina.org/public/testimony/testimony13.pdf (19 August 2005).

it makes the monitoring of compliance more difficult due to lack of information.

In summary, China's quota and licencing system cannot guarantee the full application of the spirit of WTO rules. In particular, the regulatory process – in other words, the practical application of implementing measures – would be the centre of argument.

4.9.2 Regulatory Discretion

Another critical issue is how to restrain the discretion of regulators, in particular, during the exercise of power in relation to the quota allocation. The implementing measures present a set of criteria for the judgment, but there lacks a tailor-made rule of checks and balances to constrain the potential abuse of regulatory discretion to serve protectionist purposes. Therefore, the greatest concern of foreign exporters would be in this respect.

There is no clear evidence that the regulators intentionally abuse the system to discriminate against foreign products, though the complaints of procedural delay or lack of information always exist.[145] However, the manner of exercising the quota control over some key or high-valued products reveals two controversial issues. The first is whether it is WTO-consistent to require a tender offer for the quota, and the second is how to regulate the behaviour of bidders. The case study of the quota for imported automobiles provides a good example.

The government has traditionally imposed a strict quota control over the import of automobiles – a luxury product for consumption. In order to avoid the 'black-box' of quota allocation, Fujian province, Shenzhen SEZ and Chongqing had an experiment in 2002: to adopt a tender offer for the import quota by all qualified dealers.[146] In essence, the quota of imported automobiles then had a market price.

A thorny issue is whether or not the tender offer complies with the GATT rules. In my view, the tender offer is a prima facie breach of the national treatment principle. The price of quota, resulting from the public bidding, means the increase of the final prices of imported automobiles, because the dealer will transfer such costs to the end-user. The quota costs are a kind of 'internal charge' affecting the 'internal sale' of imported automobiles, falling within the ambit of Article III of GATT. The increase of prices of imported automobiles changes the competitive conditions between them and the domestic

[145] Some Brazilian exporters even claimed that the Chinese government had not issued the promised quotas for import of soybean from Brazil but they had no redress at all. This claim has not been confirmed with other sources. Interview with Ms Shen Xiaolin (currently working in a Brazilian law firm) on 24 February 2004.

[146] Li Jiange, 'Jinkou che xukezheng zhaobiao weihe "cusi"?' (Why a 'sudden death' of the tender offer for quota of imported automobiles?) *21st Century Economic Report* (16 December 2002) 1, 'Report of Industry & Economy'.

'like' automobiles. Although the Chinese government may argue that the 'aims' of tender offer is not to discriminate against imported automobiles but for other legitimate purposes (such as increase of transparency and fairness of quota allocation), the argument is not so convincing considering the substantial adverse 'effects' on the imported automobiles. More importantly, the increase of transparency and fairness may be achieved by alternative methods other than the quota costs – for example, a better set of criteria and more supervision over the Approval Authority. In balance, the tender offer, even with a sound motive, is more likely to violate the WTO Agreements. The former MOFTEC seemed to realise this issue and stopped the trial after several months.

More problems occurred during the process of tender offer. One typical problem was that one or several bidders – all as the state-owned enterprises ('SOEs') – tendered abnormally higher bids to win the quota, resulting in a quota cost higher than the market price.[147] After squeezing out other competitors, the SOEs negotiated with the local government to get a discount for the quota costs.[148] Thus, the actual costs paid by such SOEs were even lower than the bidding price of other competitors. This practice is an obvious violation of every applicable law and extremely unfair to other competitors – especially to private enterprises without a strong connection with government officials. It also shows how a sound-motivated reform may be manipulated in practice to serve the benefits of special groups.

After stopping the practice of tender offer, the old quota allocation procedure was resumed. It is not less evil if the regulators arbitrarily allocate the quota or act in favour of one group of applicants during this process. How to check the regulatory discretion of the quota administration is therefore a key issue to both foreign exporters and domestic enterprises. Again, the due regulatory process is vital to redress the potential abuse of regulatory powers in trade regimes.

[147] For example, the highest bidding price in Chongqing was RMB 110,000 per quota, whereas the normal market value was around RMB 50,000. *Ibid.*

[148] *Ibid.*

5

Customs

5.1 REGULATORS

5.1.1 The Tariff Commission of the State Council

The tariff commission of the State Council (the 'Tariff Commission'), as an organisation under the State Council, is the decision-making body for tariff-related issues in the PRC.

The State Council issues two basic documents comprising the regulatory system for tariff: the *PRC Tariff Schedule on Import and Export of Goods* (the 'Tariff Schedule') and the *PRC Schedule on Import Duty Rate for Items Entering into the PRC* (the 'Import Duty Schedule').[1] The former applies to the imported or exported goods, whilst the latter applies to the luggage brought by individuals or post mailed into the territory of the PRC. This chapter only discusses the tariff system on imported or exported goods.

The Tariff Commission has the following regulatory powers: to adjust and interpret taxable items, the codes in the Tariff Schedule and the tariff rate (subject to the State Council's approval); to decide the categories of goods that are subject to interim tariff rates and the term for such rates; to decide the tariff quota rates; to decide the collection of anti-dumping tariffs, anti-subsidies tariffs, safeguarding tariffs, retaliatory tariffs and other relevant tariff measures; to decide the application of tariff rates under special circumstances; and to perform other duties imposed by the State Council.[2] From the regulatory perspective, the Tariff Commission's powers cover all tariff-related issues, either under the jurisdiction of Customs for ordinary types of tariffs or under the jurisdiction of MOC that proposes the imposition of anti-dumping tariffs, anti-subsidies tariffs, safeguarding tariffs and retaliatory tariffs as trade remedies.

1 *PRC Import-Export Tariff Regulations* (中华人民共和国进出口关税条例), issued by the State Council on 29 October 2003, the State Council Decree No 392, effective from 1 January 2004, Art 3.

2 *Ibid*, Art 4.

Tariff concession is a key part of China's WTO accession commitments.[3] Nevertheless, this part is relatively easily monitored by the WTO and other Members, as the Tariff Schedule is straightforward in respect of the level of tariffs and the schedule of concession. Thus, concerns of the international society must be put on how Chinese Customs exercise their powers in the process of tariff collection or in relation to the rule of origin and the customs valuation, and on whether the exercise of regulatory powers may constitute disguised trade protectionism against imported goods.

5.1.2 Customs

Customs are the implementing organ in charge of the collection of tariffs 'in accordance with legal powers and procedures'.[4] The highest organ is the Customs General Administration of the PRC (the 'General Customs'), in charge of all Customs in the nation. The State sets up local Customs in the cities that are open for import and export or where it is necessary for Customs' supervision.[5]

A special character of Customs is the so-called 'vertical administration' system, which means that local Customs are accountable to General Customs and each local Custom usually covers more than one city. More importantly, this system ensures that local government has no personnel or fiscal control on local Customs situated within its jurisdiction and thus has less influence on the performance of duties by that Customs (for example, in a way of local protectionism). To date, there are 42 local Customs and two special commissioners in Tianjin and Shanghai.

5.1.3 MOC

As mentioned above, MOC has a power to propose the imposition of anti-dumping tariffs, anti-subsidies tariffs and safeguarding tariffs to the Tariff Commissions. Part III 'Trade Remedies' will give a thorough discussion on such tariffs recommended by MOC.

[3] For details, see The Protocol on the Accession of the People's Republic of China ('The Accession Procotol'), dated 10 November 2001, Annex 8 'Schedule CLII – People's Republic of China' for the tariff concessions.

[4] *PRC Import-Export Tariff Regulations*, Art 6, see n 1 above.

[5] *PRC Customs Law* (中华人民共和国海关法), issued on 1 January 1987 and revised on 8 July 2000, Arts 3 and 4.

5.2 TARIFFS

5.2.1 Definition

PRC law has no statutory definition of 'tariff'. In general, tariff means a duty or a fee charged by Customs on the imported or exported goods by multiplying Customs Prices by the applicable tariff rate under the Tariff Schedule.[6] The issue is whether this practical definition of 'tariff' is open-ended, for example, whether other fees or charges by Customs may also be categorised as a 'tariff' and thus subject to the concession commitment. For example, a WTO case concluded that the imposition of tariffs and the increased bonding requirements on certain imported goods in order to secure the collection of import duties in future are 'legally distinct measures'.[7] This may suggest that the scope of 'tariff' may be narrowly interpreted in practice. Thus, it would be possible for the Chinese Customs to impose some levies or fees on the imported goods, not under the name of the tariff but using other labels such as bonding or tariff payment deposits, in order to fulfil its task of tariff collection.

5.2.2 Types

5.2.2.1 Import Tariffs

Under PRC law, there are six types of import tariff rate: MFN rate, treaty rate, preferential rate, ordinary rate, tariff quota rate and interim rate.[8]

The first three types of tariff rate relate to international trade treaties or agreements entered into by China with other countries or regions. The MFN rate applies to goods originating from the WTO Members, or from the countries or regions that have entered into bilateral trade agreements with China with a clause on mutual MFN treatment, or from the Hong Kong Special Administrative Region ('HK') and the Macau Special Administrative Region ('Macau').[9] The treaty rate applies to goods originating from the country or region that has entered into a regional trade agreement with China

[6] *PRC Import-Export Tariff Regulations*, Art 36(1) (for *ad valorem* tariffs), see n 1 above. Some goods are levied on the basis of the quantity, so the formula will be: the chargeable tariffs = taxable quantity of the imported/exported goods × applicable tariff rate.

[7] Appellate Body Report on *United States – Import Measures on Certain Products from the European Communities*, WT/DS165/AB/R, 2001, para 104.

[8] *PRC Import-Export Tariff Regulations* (中华人民共和国进出口关税条例), issued by the State Council on 29 October 2003, the State Council Decree No 392, effective from 1 January 2004, Art 9.

[9] *Ibid*, Art 10(1).

with a clause on tariff preferential measures.[10] The preferential rate applies to goods originating from a country or region that has entered into a trade agreement with China with a special tariff preferential clause.[11] For these three types of tariff rate, an interim rate may apply respectively for a specified period under certain circumstances. Where there is an interim rate on the imported goods scheduled to the MFN rate, the interim rate shall apply; where such interim rate applies to the imported goods scheduled to the treaty rate or the preferential rate, whichever is lower shall apply.[12] However, the law is silent on the conditions for the Tariff Commission to apply an interim rate. In practice, the interim rate usually applies to the circumstances of the schedules of tariff concession as committed under the WTO accession package.

Any imported goods originating from a country or region that falls outside the application scope of the above three treaty-related tariff rates are scheduled to the ordinary rate.[13] In addition, a tariff quota rate applies to the import of those goods subject to the tariff quota system (see chapter four 'Licencing and Quota'). Notably, interim rates do not apply to goods subject to the ordinary rate and the tariff quota rate.[14]

5.2.2.2 Export Tariffs

There is only one type of tariff rate on exported goods: the export tariff rate. An interim rate (either higher or lower than the scheduled export tariff rate) may apply for a specific period for certain goods, for example, for the purpose of promotion or restriction of such export.[15]

5.2.3 Tariff Payers

Under PRC law, the assignee of imported goods is the person responsible for the payment of import tariff, whilst the shipper of exported goods is the person responsible for the payment of export tariff.[16] The assignee or the shipper is generally the party disclosed in the shipping documents (for example, the bill of lading).

This rule means that the Chinese importers or exporters are usually the tariff payers. It is possible for a commercial arrangement between the Chinese party and the foreign party in relation to the indemnity of Chinese tariffs by

[10] *Ibid*, Art 10(2).
[11] *Ibid*, Art 10(3).
[12] *Ibid*, Art 11.
[13] *Ibid*, Art 10(4).
[14] *Ibid*, Art 11.
[15] *Ibid*, Art 9(2).
[16] *Ibid*, Art 5.

that foreign party to the Chinese party, but the Customs will only look at the Chinese party for the purpose of tariff collection.

5.2.4 Tariff Classification

The classification of imported or exported goods is key to the application of correct tariff rates – different rates apply to different types of goods. An importer or an exporter might manipulate the classification system in the declaration of import or export to Customs, for example, by deliberately classifying the goods from a high tariff rate category to a low tariff rate category, in particular when the classification of the goods is not clear due to their complex nature.

Under PRC law, it is the duty of the tariff payer – the Chinese importer or exporter–to classify the imported or exported goods in accordance with the classification of the Tariff Schedule. Customs have the right to review and determine the classification and if necessary, to require the tariff payer to provide the documents for this purpose. Where Customs doubt the classification proposed by the tariff payer, they can carry out a physical inspection or a chemical examination to determine the basis of classification.[17] If the tariff payer is not satisfied with Customs' classification, it has the right to bring an administrative review to Customs at an immediately higher level and finally, an administrative litigation before the courts.[18] While PRC law does not expressly stipulate the criteria or conditions on Customs classification, the practice – especially those consistent with the prior classification practice by Customs – may be of great importance to the interpretation of tariff concessions.[19]

In order to facilitate the import and export and customs' clearance of goods, General Customs have issued an *Interim Measures on the Advanced Classification of Imported and Exported Goods*, effective from 1 April 2000. Under these Interim Measures, a tariff payer can apply to Customs for a classification of the goods before they are actually imported or exported, by submitting the relevant documents and (if necessary) sample products.[20] The application form must describe in detail the specifications, structure, functions, components, processing and analysis methodology, to ease the review and decision by Customs. Customs in charge of the tariff collection on the applied goods will decide the classification and issue a decision with the valid-

[17] *Ibid*, Arts 31 and 32.
[18] *Ibid*, Art 64.
[19] Appellate Body Report on *European Communities – Customs Classification of Certain Computer Equipment*, WT/DS62/AB/R, WT/DS48/AB/R, 1998, paras 92–3.
[20] *Interim Measures on the Advanced Classification of Imported and Exported Goods* (中华人民共和国海关进出口商品预归类暂行办法), issued by Customs General Administration of the PRC, Customs Decree [2000] No 80, effective from 1 April 2000, Art 2.

ity for one year.[21] When the goods are actually imported or exported for customs clearance, the tariff payer should submit the decision on classification to Customs, which will check the consistency between the imported or exported goods and the goods subject to advanced classification.[22] Overall, the advance classification system is in effect a trade facilitation measure and can save time on customs clearance when the goods are actually imported or exported.

5.2.5 Collection

5.2.5.1 Time of Declaration

There are two legal implications for the time of declaration to Customs by tariff payers. First, it is the legal requirement for a tariff payer to declare the import or export to Customs within a specified period for the purpose of tariff collection, the failure of which will be subject to Customs' penalties. Second, the time of declaration will determine the time of acceptance of the declaration by Customs, which is in turn the time to decide applicable tariff rates. Although most tariff rates may not be frequently changed in practice, the timing of declaration will be a key issue when there does happen to be such a change.

For the imported goods, the tariff payer must declare the import to the Customs located at the place of import within 14 days of the 'declaration by the transportation facility' that carries such goods.[23] The starting point is the time of the declaration to Customs by the transportation facility (for example, the ship for an ocean transportation, the train for a transportation by train or the car by road transportation). Under the *PRC Customs Law*, the person in charge of a transportation facility (for example, the master of a ship or the operator of a train or a car) is obliged to declare to the Customs located at the place of its arrival in the PRC by surrendering to the supervision and inspection by Customs, and cannot leave the place without the consent of Customs.[24] Therefore, after the declaration by the transportation facility, the tariff payer (the Chinese importer) must declare the import to Customs within 14 days. Where the tariff payer fails to declare the import to Customs on time, it is liable to pay a penalty on a daily rate of 0.05 per cent of the tariff payable.[25] In the event that the tariff payer fails to declare to Customs within three months from the date of the customs declaration by the transportation

[21] *Ibid*, Arts 12–13.
[22] *Ibid*, Art 14.
[23] *PRC Customs Law*, Art 24(2), see n 5 above; *PRC Import-Export Tariff Regulations*, Art 29, see n 8 above.
[24] *PRC Customs Law* (中华人民共和国海关法), issued on 1 January 1987 and revised on 8 July 2000, Art 14.
[25] *Ibid*, Art 24(3).

facility, Customs have the right to dispose of these unclaimed goods (which have been stored in the Customs' warehouse since unloaded from the transportation facility) and return the balance of the disposal proceeds, after deduction of transportation, unloading, storage costs and tariffs payable, to the assignee upon its application within one year after the date of disposal. However, where the goods need a licence to import but the assignee cannot produce such an import licence, Customs will forfeit the balance of the disposal proceeds into the Treasury.[26]

For the exported goods, the tariff payer (the Chinese exporter) must declare the export to the Customs located at the place of export within a period of 24 hours before loading into the transportation facility, after such goods arrive at a Custom-supervised cargo handling area.[27] This is straightforward in practice. The law does not require the payment of a penalty for delayed declaration of the export, because without a declaration the goods cannot clear through Customs and thus cannot be exported.

5.2.5.2 Applicable Tariff Rate

The applicable tariff rate is the rate in force as of the date of the acceptance by Customs of the declaration by the tariff payer.[28] Where Customs verify the advanced declaration for imported goods before they actually arrive at the import place, the applicable rate will be the rate in force as of the date of the declaration to Customs by the relevant transportation facility.[29]

While the date of the declaration by the transportation facility can be objectively determined, the date of the 'acceptance by Customs of the declaration' seems to be an uncertain and flexible criterion under the control of Customs. The *PRC Customs Law* is silent on the period within which Customs must accept the declaration. One possible consideration may be the capacity of Customs to clear the import or export, because the large quantity of goods may exceed their capacity to handle the clearance procedure (including the inspections) on a timely basis. This is one reason for not stipulating a statutory period of acceptance, but still leaves the discretion to Customs. That said, the acceptance of the declaration is not a complex or time-consuming procedure in practice for most cases, and usually takes a few working days under the normal circumstances.

26 *Ibid*, Art 30.
27 *Ibid*, Art 24(2); *PRC Import-Export Tariff Regulations*, Art 29, see n 8 above.
28 *PRC Import-Export Tariff Regulations* (中华人民共和国进出口关税条例), issued by the State Council on 29 October 2003, the State Council Decree No 392, effective from 1 January 2004, Art 15(1).
29 *Ibid*, Art 15(2).

5.2.5.3 Payment of Tariffs

Customs will review the documents in relation to the imported or exported goods and physically inspect such goods if necessary, decide the customs valuation and apply the appropriate tariff rate. They will then issue a Tariff Payment Notice to the tariff payer, who is obliged to pay up the tariff within 15 days of receipt of this notice. A daily penalty rate at 0.05 per cent of the tariff payable for late payment is applicable from the due date.[30] Both tariffs and penalties shall be paid in the Chinese legal currency, RMB.

Where a tariff payer is unable to pay up the tariff on time due to force majeure or the adjustment of national tariff policies, it may apply for a suspension of the tariff payment subject to the approval by General Customs, for a maximum period of six months.[31] Although the force majeure or the change of tax law or policy is a ground for suspension of tariff payment, the application procedure and the approval by the highest organ – General Customs – usually impose a hurdle to potential applicants.

It is possible that Customs do not collect a full amount of tariff, for example, due to their own mistakes in classification or calculation. Where Customs find the under-collection or non-collection of tariffs payable, it has a right to require the tariff payer to pay up such tariffs within one year of the clearance of the goods. However, if the under-collection or non-collection is caused by the actions of the tariff payer, the period for claim-back extends to three years from the date of customs clearance, plus a daily penalty rate at 0.05 per cent of the tariff payable accrued from that date.[32] On the other hand, if Customs find the over-collection of tariffs, they must immediately notify the tariff payer to claim back the over-paid tariffs within three months of the receipt of the notice. Alternatively, there is a one-year statutory period for the tariff payer to claim back the over-paid tariffs plus accrued interest.[33] The above strict statutory periods have the nature of a limitation period, the expiry of which suggests an extinction of the rights of Customs or the tariff payer under the relevant circumstances.

5.2.5.4 Enforcement Powers of Customs

All imported or exported goods are subject to Customs' inspection. The tariff payer must attend Customs' inspection and be in charge of the movement of those inspected goods or de-packing or re-packing the goods. Customs are also entitled to inspect or collect a sample of the goods without the tariff payer's being present, if it is deemed necessary. Upon approval by General Customs, the tariff payer may apply for exemption from inspection of its

30 *Ibid*, Art 37.
31 *Ibid*, Art 39.
32 *Ibid*, Art 51.
33 *Ibid*, Art 52.

imported or exported goods. Undoubtedly, unless such tariff payer has track records for the customs declaration, clearance and tariff payment, the approval for exemption from the inspection cannot be granted by General Customs.

Customs have a wide range of enforcement powers to secure the tariff collection. Where the tariff payer exhibits 'apparent signs' to transfer or hide the imported or exported goods or its other assets before paying up the tariffs, Customs can require the tariff payer to provide a guarantee by a third party or create a security to secure the tariff payment. This grants a great degree of discretion to Customs to decide what constitutes 'apparent signs', as the law does not provide any guidance in this respect. When the tariff payer fails to provide a guarantee or security, Customs can request the account banks of the tariff payer to freeze an amount in its banking accounts up to the amount of the tariff payable or even attach the tariff payer's goods or other assets up to the value of the tariff payable.[34] Where the tariff payer fails to pay the tariffs after three months of the due date, Customs can deduct an equal amount from its banking accounts, dispose of the imported or exported goods and use the disposal proceeds to pay up the tariffs, and attach and dispose of its other goods or assets up to the value of the tariff payable.[35]

5.2.6 Tariff Exemption and Suspension

5.2.6.1 Exemption

Under PRC law, the following imported or exported goods are exempted from tariffs: goods with a value lower than RMB 50; goods for the purpose of advertisement or samples without a commercial value (which means that such goods are not sellable to independent third parties); goods donated by foreign governments and international organisations; goods that have been damaged before the completion of the customs clearance (which means the responsibility is on Customs for such damage as the goods are under its supervision before released); and necessary fuels, supplies and foods to be consumed by the transportation facility during the voyage.[36] In addition, if any law provides for a tariff exemption, Customs will also apply this law. For example, imported equipment as the capital contribution by a foreign investor into a FIE within the PRC or for their own use of that FIE are exempted from tariffs.[37]

[34] *PRC Customs Law*, Art 61, see n 5 above; *PRC Import-Export Tariff Regulations*, Art 40(1), see n 28 above.

[35] *PRC Customs Law*, Art 60, see n 5 above; *PRC Import-Export Tariff Regulations*, Art 40(2), see n 28 above.

[36] *PRC Import-Export Tariff Regulations*, Art 45, see n 28 above.

[37] See, for example, *Implementing Measures on the PRC Sino-Foreign Joint Ventures* (中华人民共和国中外合资经营企业法实施条例), issued by the State Council on 20 September 1983 and revised from time to time (the latest revision by the State Council on 22 July 2001 under the State Council Decree No 311), Art 61.

Apart from the above normal grounds for tariff exemption, where the imported goods are returned to the foreign exporter within one year of import due to the reasons of quality or specifications, such returned goods are exempted from the export tariff (if any). Similarly, the import tariff (if any) is also exempted for the returned goods within one year of export.[38]

5.2.6.2 Suspension

There are two grounds for a tariff suspension. First, the import or export of the goods in question has a temporary nature because they will finally be returned to where they came from after a specific period. Second, the imported raw materials, components or equipment for the manufacturing of products are to be exported later (so as to promote the export from China), or just for temporary storage within the customs' territory of the PRC for transhipment, are also suspended from paying the tariffs. The second ground is the rationale for the tariff preferential policy to the processing trade (and the processing trade areas) and the bonded areas (see below).

For the first ground, the tariff suspension applies to the goods to be exhibited or used in exhibitions, trade fairs or conferences, the sample of the goods, the equipment or apparatus for installation and testing of equipment, the container for goods, equipment or instruments for research, teaching and medical activities, and other goods for a non-commercial purpose. However, the condition for the tariff suspension is that the tariff payer will pay a deposit equal to the tariff payable or other security interest to Customs. Where such goods are sent back to where they came from within six months, the tariff payer has no obligation to pay the suspended tariffs.[39] However, suppose these goods fail to be sent back within this six-month period, the suspended tariff becomes payable with an applicable tariff rate as of the date of the acceptance of the declaration by Customs.[40]

5.2.7 Tariff Disputes

The tariff payer may not agree with a specific administrative act of Customs in relation to tariff issues. There is a wide scope of specific administrative acts by Customs, including, for example: the determination of tariff payer and customs valuation, the classification of imported or exported goods, the determination of the country or region of origin, the applicable tariff rate, the decisions on tariff reduction or exemption (or refusal of such application),

[38] *PRC Import-Export Tariff Regulations* (中华人民共和国进出口关税条例), issued by the State Council on 29 October 2003, the State Council Decree No 392, effective from 1 January 2004, Art 43.
[39] *Ibid*, Art 42(1).
[40] *Ibid*, Arts 42(2) and 16(3).

the collection of under-paid or unpaid tariffs, the claim back of over-paid tariffs, the collection of late payment penalties, the determination of the methods for calculation of tariffs payable and of the place for paying tariffs. Under this circumstance, the tariff payer is still obliged to pay up the tariff due to Customs in the first instance and can then bring an administrative review against Customs that makes such a challengeable decision. If it does not agree with the result of the administrative review, as an internal remedy within the Customs system, it can bring this dispute to the courts as an administrative litigation. Chapter fourteen 'Trade Disputes' will give a detailed analysis on the systems of administrative review and administrative litigation.

5.3 PROCESSING TRADE AND EXPORT PROCESSING ZONES

5.3.1 Processing Trade

5.3.1.1 Overview

Processing trade plays an important role in China's expansion of export.[41] It takes advantage of cheap labour costs in China. Under PRC law, the term 'processing trade' is defined as the import of the whole or part of raw materials, spare parts, components and packaging materials (collectively as 'processing materials') by a processing trade enterprise within the PRC ('processing enterprise') and the export of end-products after the processing or assembling of such processing materials.[42] Where the foreign supplier provides the processing materials and the processing enterprise only collects a processing fee for the processing or assembling services (other than purchasing these materials), this type of processing trade is called 'processing of materials from foreign suppliers'.[43] Where the processing enterprise purchases the processing materials and exports the end products to the foreign company that places an order for such processing, this is called 'processing of imported materials'.[44] Under the former type, the processing enterprise need not pay for the processing materials and thus does not involve the foreign exchange control. Under the latter type, the processing enterprise needs to purchase the processing materials from the foreign supplier at first – a type of

[41] From January to October 2004, the total amount of processing trade reached USD 257.9 billion, representing an increase of 34.7% compared to the same figure in 2003. Information from the website of the Ministry of Finance, available at: http://gcs.mofcom.gov.cn/article/200411/20041100312640_1.xml (5 December 2004).

[42] *Measures on the Supervision of Processing Materials in the Processing Trade by the PRC Customs* (中华人民共和国海关对加工贸易货物监管办法), Customs Decree No 113, effective from 1 April 2004, Art 3(1).

[43] *Ibid*, Art 3(2).

[44] *Ibid*, Art 3(3).

normal trade and manufacturing activity. In other words, the processing enterprise assumes the risk of damages or losses to the processing materials under its control and of the non-performance of the purchase contract by that foreign supplier after the completion of processing.

From the perspective of Customs regulation, a special rule applies to the processing trade – the suspension of the payment of import tariffs. Although the processing enterprises technically import the processing materials (either supplied by the foreign supplier or purchased by the processing enterprise from that supplier), the purpose of the trade is to process or assemble the processing materials into the required end products and then to export these end products. The imported processing materials will generally not be sold within the PRC or be used as materials for such end products that will be sold within the PRC. Therefore, the *PRC Customs Law* provides that the processing enterprise can suspend the payment of import tariffs by filing the import with Customs and exporting the end-products within the period as approved by Customs. At the time of export, the original filing will be cancelled after verification by Customs and no import tariffs will be payable by the processing enterprise.[45] Nevertheless, even the imported process materials that are exempt from the payment of import tariffs, their end products are still subject to the payment of export tariffs where such tariffs apply.[46] Similarly, as a result of the export nature of processing trade, normal rules on the control of import in the form of licence or quota do not apply to the import under the processing trade.[47]

In some cases, the processing enterprise itself has no capacity to process or assemble the processing materials, and has to sign a processing agreement with another enterprise within the PRC that is capable of doing so ('operating enterprise'). Under this model, the operating enterprise is also subject to Customs' regulation as it actually carries out the processing activities and plays an indispensable role in the trade.

5.3.1.2 Trade Regulation

The qualifications of a processing enterprise and the entry into and performance of processing trade contracts are subject to approval by the Ministry of Commerce or its authorised local branches ('Approving Authority'). The processing enterprise must obtain approval by the Approving Authority before it engages in the processing trade. An applicant needs to submit the following documents for the application: the Processing Trade Application

45 *PRC Customs Law*, Art 33, see n 5 above. Sometimes Customs will collect the import tariffs in advance and refund the tariffs to the processing enterprise upon the cancellation of filing at the time of export. Also see *Measures on the Supervision of Processing Materials in the Processing Trade by PRC Customs*, Art 5, see n 42 above.

46 *Measures on the Supervision of Processing Materials in the Processing Trade by PRC Customs*, Art 6, see n 42 above.

47 See ch 4 'Licencing and Quota' for details.

Form (stamped with the common seal of the applicant); a copy of the Business Licence; the evidence of its foreign trading rights; the Processing Capacity Certificate (issued by the local branch of MOC at or above the county level at which the processing enterprise is situated); an original copy of the processing trade contract; an original copy of the processing agreement between the processing enterprise and the operating enterprise (if any).[48] Upon approval, the Approving Authority will issue a Processing Trade Business Approval Certificate, which serves as the basic document for the capacity of the processing enterprise to enter into this business and for the import of processing materials.

Depending on the types of processing material, the Approval Authority categories them as 'Prohibited' (such as those goods prohibited from import under the FTL (2004)), 'Restricted' (such as those goods which have a large value but are not easy to be monitored by Customs) and 'Allowed', subject to the changes of the published list from time to time. Similarly, the processing enterprises are categorised into four groups: 'A Category',[49] 'B Category', 'C Category'[50] and 'D Category'.[51] No approval will be issued in respect of 'Prohibited' processing materials or 'D Category' processing enterprises. A bank deposit system applies to 'Restricted' processing materials or 'C Category' processing enterprises, as well as to 'Category B' processing enterprises but which need not deposit the cash in the account, while 'A Category' processing enterprises are not subject to this requirement as the least regulated type of processing trade.[52]

The Approving Authority has two regulatory concerns in respect of the approval of a processing trade contract. Due to the suspension of import tariffs, the processing trade may be used as a kind of smuggling operation in practice. For example, some smugglers register a shell company to engage in the processing trade business. After obtaining the approval by deceit, they will import processing materials free of tariffs and then sell them in the market. Usually, such a shell company has neither a processing factory or equipment nor workers. In order to address this issue, the Approving Authority requires the submission of the Processing Capacity Certificate issued by its lower level branch.[53] Another common method of 'smuggling' is to increase

[48] *Interim Rules on the Administration of Approval of Processing Trade* (加工贸易审批管理暂行办法), issued by MOFTEC, effective from 1 June 1999, Art 10.

[49] Examples include a processing enterprise with an annual amount of process trade export beyond USD 10 million or an annual amount of export and import beyond USD 30 million, a processing enterprise with an IT connection with Customs' supervision system, or an enterprise engaging in aircraft or ship building.

[50] Examples include a processing enterprise that has violated the relevant regulations and been subject to the penalties by Customs.

[51] Examples include a processing enterprise that uses the prohibited processing materials.

[52] *Interim Rules on the Administration of Approval of Processing Trade*, issued by MOFTEC, effective from 1 June 1999, Arts 18–20.

[53] *Ibid*, Art 13. The lower level branch must check the information provided by the processing or operating enterprise, including the information on factories, equipment, number of workers and production capacity.

the unit consumption standards of the processing materials for end products. For example, the processing of one shirt uses three square meters cloth in accordance with the industry standards, but the processing enterprise may claim for five square meters cloth per shirt. Those additional two square meters cloth – imported free of tariffs – can either be sold secretly in the market or be used to produce other shirts to be sold domestically (which means a lower cost). In order to address this issue, the Approving Authority must carefully examine the unit consumption standards proposed by the applicant in the Processing Trade Application Form.[54] Customs, former SETC and the relevant ministries in charge of industries to which the processed products belong have issued a series of unit consumption standards for the processing trade that are uniformly applicable within the PRC. The Approving Authority can only approve a processing trade contract that conforms to the applicable standards with regard to the unit consumption. Where there exists no published standards for one processed product, the Approving Authority will consult with Customs and the relevant ministry before approving that contract.[55]

The Processing Trade Business Approval Certificate specifies a period for the export of end products by the processing enterprise, usually in line with the same period under the processing trade contract with the foreign supplier. But this approved period will not exceed one year. Upon approval by the Approving Authority, this period may be extended in principle up to two times and each extension will usually be no longer than six months.[56]

5.3.1.3 Customs Supervision

The competent Customs authority in charge of the supervision of a processing trade contract is Customs at the place where the operating enterprise is situated, or if the processing enterprise also carries out the processing activities by itself, at the place where the processing enterprise is situated.[57]

The processing enterprise is the party responsible for filing the processing trade contract with the competent Customs authority. For the purpose of filing, the processing enterprise must submit the following documents: the Processing Trade Business Approval Certificate duly issued by the Approving Authority; the Processing Capacity Certificate; the processing agreement with the operating enterprise (if applicable); and the processing trade contract with the foreign supplier. The competent Customs authority will accept the filing within five working days of the submission, and issue a Processing

54 *Ibid*, Art 16.
55 *Ibid*.
56 *Interim Rules on the Administration of Approval of Processing Trade*, Arts 21–3, see n 52 above.
57 *Measures on the Supervision of Processing Materials in the Processing Trade by PRC Customs* (中华人民共和国海关对加工贸易货物监管办法) , Customs Decree No 113, effective from 1 April 2004, Art 10.

Trade Manual to the processing enterprise, which records the information of the approved processing trade contract.[58] However, the competent Customs authority will refuse the filing in the following circumstances: the imported processing materials or the exported end-products are prohibited from being imported into or exported from the PRC; the processed products are prohibited from being manufactured within the PRC; the processing materials are not eligible for Customs' supervision; the processing enterprise or the operating enterprise is not allowed to engage in the processing trade; or the processing enterprise fails to close the expired Manual.[59]

The Processing Trade Manual ('Manual') is the key document for the processing trade. The processing enterprise must produce the Manual and the special customs clearance form to the competent Customs authority when it imports the processing materials or exports the end products.[60] Customs will record the information of import or export in the Manual. Within 30 days of the export of the last end products as provided under the Manual is exported or of the expiration of the Manual, the processing enterprise must apply to the competent Customs authority for the closure of the Manual. Upon the verification and approval by Customs, it will issue a Notice of Cancellation and Closure of Processing Trade Contract to the processing enterprise. This marks the full performance of the recorded processing trade contract in the Manual.[61]

As mentioned above, sometimes the processing enterprise will outsource the processing activities to a capable operating enterprise. Where the operating enterprise is not in the same place as the processing enterprise, this involves the transfer of the imported processing materials. Because the competent Customs authority for the region of the processing enterprise supervises the processing materials, the supervisory power should now be transferred to the competent Customs authority for the region of the operating enterprise in line with the physical movement of the processing materials. The processing enterprise needs to apply for approval by its competent Customs authority for the outsourcing.[62] Upon approval (which is a routine exercise), the processing enterprise can either apply for the filing of the processing trade contract at the competent Customs authority for the region of the operating enterprise, or authorise the operating enterprise to apply for the filing.[63] A similar system applies to the transfer of processing materials across the regions supervised by different competent Customs

58 *Ibid*, Arts 12–13.

59 *Ibid*, Art 14.

60 *Ibid*, Arts 20–5.

61 *Ibid*, Art 30.

62 *Administrative Measures on the Processing Trade at Different Regions by the PRC Customs* (中华人民共和国海关关于异地加工贸易的管理办法), issued by Customs, effective from 1 October 1999, Art 5.

63 *Ibid*, Arts 6–7.

authorities, for the purpose of 'deep processing'.[64] This rule puts some stringent requirements on the processing enterprise that accepts the transferred materials, including the filing with its competent Customs authority within 20 days after the processing enterprise transfers out the materials filed with that enterprise's competent Customs authority.[65]

Another type of outsourcing relates to certain processing activities outsourced by the processing enterprise to an operating enterprise. Unlike the outsourcing of the whole processing activity to the operating enterprise, the operating enterprise is not engaging in a full processing trade but only acting as a link in the chain of processing. Thus, Customs' supervision on this type of outsourcing is less stringent than on the whole outsourcing. As a general rule, the processing enterprise can apply to the competent Customs authority for approval of the partial outsourcing.[66] Under this type of outsourcing, the processing enterprise cannot sell the processing materials to the operating enterprise and the operating enterprise cannot contract out the processing to a third party. However, the competent Customs authority may not approve the outsourcing under the following circumstances: the processing enterprise or the operating enterprise is subject to investigation by Customs for suspicions in smuggling or breach of Customs regulations; the processing enterprise intends to outsource the major processing activities[67]; the production and management of the processing enterprise or the operating enterprise does not conform to Customs' supervisory requirements (such as lack of IT systems monitoring the consumption of processing materials or lack of experienced staffs or workers).[68]

5.3.1.4 Sale of Processing Materials or End Products to the Domestic Market

While the main purpose of processing trade is for the export of end products by the processing enterprises to earn processing fees, it is not unlikely that under certain circumstances the processing enterprises have to sell the processing materials or end products to the domestic market instead of export, or to use the processing materials for end products to be sold in the domestic market. PRC law allows this exception, but imposes strict conditions on its application. A processing enterprise can only apply to the Approving Authority for this domestic sale or use of processing materials within the processing

[64] *Administrative Measures on the Transfer of Processing Materials Across Regions of Competent Customs for Deep Processing* (中华人民共和国海关关于加工贸易保税货物跨关区深加工结转的管理办法), issued by Customs, Customs Degree No 109, effective from 1 March 2004.

[65] *Ibid*, Art 7.

[66] *Measures on the Supervision of Processing Materials in the Processing Trade by the PRC Customs*, Art 23, see n 57 above.

[67] This is subject to Customs' discretion on what constitutes the major processing activities due to the lack of guidance under the applicable rules.

[68] *Measures on the Supervision of Processing Materials in the Processing Trade by the PRC Customs*, Art 25, see n 57 above.

period as prescribed in the Manual under several limited circumstances. For example, the foreign supplier terminates the processing trade contract and it is difficult to enter into the processing trade contract on similar terms and conditions with a third party, or the processing enterprise may suffer significant losses due to the decrease of the international price for such end products and the foreign supplier agrees to terminate the processing trade company. Similarly, if the end products cannot reach the required quality standards and thus cannot be exported, they can only be sold to the domestic market. Sometimes there are remaining materials reasonably saved from the processing process (such as, due to technology innovation). Alternatively, the processing trade contract cannot be performed due to force majeure.[69] If satisfying one of the above circumstances, the Approving Authority may approve the application and issue an approval certificate for the domestic sale or use.

Upon the production of the approval certificate, the competent Customs authority will collect the suspended import tariffs (plus accrued interest) on the processing materials and then verify the closure of the Manual.[70] However, if the imported processing materials are imported under applicable import licence or quota, the Approval Authority will not issue an approval certificate in this case. Rather, the processing enterprise needs to submit the evidence of relevant import licence or quota to the competent Customs authority and pay the suspended tariffs. Where the processing enterprise cannot obtain the import licence or quota for the processing materials, there is one alternative way: the competent Customs authority is entitled to charge a penalty equal to an amount between 30 per cent to 100 per cent of the value of such processing materials.[71] Strictly speaking, the failure to obtain the import licence or quota means that the processing materials cannot be imported – however, as a practical matter, these materials are already within the PRC and cannot be used for exports under some special circumstances. The compromise, therefore, is to charge a penalty on the processing enterprise with an economic effect to set off any possible gains arising from the import of such processing materials without a licence or quota. From another perspective, where the end products can be sold at a high price in the domestic market, the penalty may be absorbed by the processing enterprise, which can still earn a profit for using the imported processing materials (which could not be imported in the first instance due to lack of licence or quota by that enterprise). This is somehow unfair to other competitors that may not be able to import such materials under the normal trade mode.

69 *Interim Measures on the Administration of Approval for Domestic Sale of Imported Tariff-Free Materials and Components in the Processing Trade* (加工贸易保税进口料件内销审批管理暂行办法), issued by MOFTEC, effective from 1 June 1999, Art 4.

70 *Ibid*, Art 7.

71 *Ibid*, Art 8.

The processing enterprises must strictly follow the approval requirements for the domestic sale or use of imported processing materials. The failure may subject that enterprise to the penalties by Customs, the deprivation of the processing trade business qualification or if serious enough, criminal liability of smuggling.[72]

5.3.1.5 Bank Deposit System

Since 1995, trade regulators have implemented a bank deposit system for processing enterprises, aiming to curb smuggling or tax evasion in processing trade activities. Under this system, a processing enterprise was required to deposit a certain amount of cash at a designated bank (or to provide a standby letter of credit issued by a PRC bank), as the security for the payment of suspended import tariffs if otherwise required by the competent Customs authority. When the processing enterprise duly performed the contract by exporting all end products, the cash (and accrued interest) was refunded to that enterprise by the designated bank.[73] The disadvantage of this system was the increase of cash flow pressures on all processing enterprises. Thus, the application of this system was gradually relaxed. After 1999, only the import of 'Restricted' processing materials or 'Category C' processing enterprises were required to deposit the full amount of suspended import tariff into a bank account. For the import of 'Allowed' processing materials by 'Category B' processing enterprises (which have a sound record with Customs), the bank deposit system still applied but under which those enterprises need not deposit the real cash. For 'Category A' processing enterprises or processing enterprises situated at the bonded areas, this system did not apply.[74]

The bank deposit system formally expired from 1 April 2004. Under the new regulatory regime, Customs can only require a processing enterprise to deposit the cash into the designated bank or to provide a bank guarantee with an equivalent amount, as a security for the payment of suspended import tariffs, under limited circumstances.[75] These circumstances are as follows: the processing enterprise is subject to investigation by Customs; the processing

72 See *Measures on the Punishments on Illegal Domestic Sale or Transfer of Tariff-Free Goods in the Processing Trade by the PRC Customs* (中华人民共和国海关关于违法内销或者转让加工贸易保税货物处罚办法), issued by Customs, effective from 1 October 1999.

73 See *Interim Measures on the Pilot Implementation of Bank Deposit Account for Imported Materials and Components in the Processing Trade* (关于对加工贸易进口料件试行银行保证金台帐制度暂行管理办法), jointly issued by eight ministries (including MOFTEC and Customs), effective from 27 November 1995.

74 *Circular on the Further Strengthening of the Bank Deposit Account System for the Processing Trade* (关于进一步完善加工贸易银行保证金台帐制度意见的通知), issued by the State Council, Guo Ban Fa [1999] No 35 on 5 April 1999, paras 1–3.

75 *Measures on the Supervision of Processing Materials in the Processing Trade by the PRC Customs* (中华人民共和国海关对加工贸易货物监管办法), Customs Decree No 113, effective from 1 April 2004, Arts 15–16.

enterprise is ordered by Customs to rectify irregularities; the processing enterprise rents factory or equipment to perform the processing trade contract; the processing enterprise has not engaged in processing trade business before; the Manual has been extended twice or more than twice; the processing enterprise intends to outsource the whole processing activities to an operating enterprise situated within the region of another competent Customs authority. Only after the provision of cash deposit or bank guarantee will the competent Customs authority for the region of the processing enterprise accept the filing of the relevant processing trade contract.[76]

5.3.2 Export Processing Zones

5.3.2.1 Establishment

The Chinese government approved the establishment of various economic and technology development zones, bonded zones or free trade zones since the early 1980s, as an important part of the 'open door' policy. These zones had the nature of export processing zones more or less, for example, by providing tariff suspension or exemption treatment to the establishment of processing enterprises within the zones, or more favourable Customs clearance procedures and facilities.

From April 2000, the State Council decided to establish the export processing zones ('EPZ'), mainly aiming to comply with the WTO Agreement in respect of EPZs. An EPZ is a special area within the territory of the PRC because it is outside the Chinese Customs' territory and subject to a special set of Customs regulations. Up to September 2004, the State Council has approved 39 EPZs, 29 of which are situated in coastal areas (such as Shanghai, Jiangshu Province and Shangdong Province) and 10 of which are situated in the Central-Western Region of the PRC.[77] In 2003, the aggregate amount of import by these zones amounted to USD 10 billion, and the aggregate amount of export reached USD 8 billion.[78]

From April 2004, the State Council has implemented a strict policy on the establishment of EPZs in order to prevent local governments from setting up too many EPZs across the country and further eroding Customs' regulation and tariff collection.[79] The establishment of a new EPZ or the expansion of the area of an existing EPZ can now only be applied for by the provincial gov-

76 *Ibid*, Art 15.
77 A detailed list is available at http://www.cadz.org.cn/kfq/jgq.asp (5 December 2004).
78 See 'Chinese Export Processing Zones Estimate to Have an Annual Export and Import Amount of USD 30 Billion', available at http://gov.finance.sina.com.cn/zsyz/2004-09-03/24652.html (5 December 2004).
79 See *Approval Standards and Procedure on Establishment of Export Processing Zones*, jointly issued by nine ministries (including Customs, NDRC, MOC, Ministry of Finance), Shu Jia Fa [2004] No 102, effective from 8 April 2004.

ernment and approved by the State Council.[80] An EPZ can only be established within a development area approved by the State Council, and one development area can only have one EPZ.[81] In principle, the development area must have an annual aggregate amount of import and export for the processing trade ('Annual Processing Trade Amount') not less than USD 100 million.[82] If a province reaches an Annual Processing Trade Amount below USD 1 billion, it may only be eligible to have one EPZ; if this threshold is satisfied, that province is eligible to apply for an additional EPZ besides the existing one.[83] If the Annual Processing Trade Amount of one EPZ reaches certain thresholds, it can apply to the State Council for an expansion of the area.[84]

An EPZ shall complete the construction within two years of approval, or be subject to revocation by the State Council for failure of completion within three years of approval.[85] After the operation of an EPZ, there is a minimum performance requirement – if the EPZ fails to attract one investment project within three years of operation, or the Annual Processing Trade Amount is below USD 1 million, Customs will give a warning; if that EPZ still fails to satisfy such requirement after one year, the State Council may revoke it.[86]

5.3.2.2 Customs' Special Regulation of EPZs

Customs only allow the existence of limited types of entities within an EPZ: the Management Commission (exercising the governmental functions), export processing enterprises, storage enterprises that provide storage services to such export processing enterprises, and transportation enterprises that provide transportation services to such export processing enterprises. These supporting enterprises cannot serve other enterprises outside the EPZ. Further, any enterprise within the EPZ cannot engage in other business than export processing, such as retail, general trade or transhipment trade.[87]

80 *Ibid*, para 2.

81 Development areas are established not only for processing trade but also for attraction of FDI projects. Up to December 2004, there are 54 development zones approved by the State Council. A detailed list of such zones is available at http://www.cadz.org.cn/kfq/jjjs.asp (5 December 2004). The State Council has also approved 15 Bonded Zones which may be eligible for the establishment of EPZs.

82 *Approval Standards and Procedure on Establishment of Export Processing Zones*, jointly issued by nine ministries (including Customs, NDRC, MOC, Ministry of Finance), Shu Jia Fa [2004] No 102, effective from 8 April 2004, para 1(2).

83 *Ibid*, paras 1(3)–(4).

84 *Ibid*, para 1(5). The threshold for EPZs situated in the Eastern Coastal Region is USD 50 million of the Annual Processing Trade Amount. A similar threshold applies to EPZs situated in the Central Region (USD 20 million) or the Western Region (USD 10 million).

85 *Ibid*, para 1(7).

86 *Ibid*, para 1(8).

87 *Interim Measures on the Supervision of Export Processing Zones by the PRC Customs* (中华人民共和国海关对出口加工区监管的暂行办法), Customs Decree [2000] No 81, issued by Customs on 24 May 2000 and revised on 21 June 2002 and 2 September 2003, Arts 5–6.

All enterprises established within an EPZ must be registered at the competent Customs authority in charge of this EPZ. For a processing enterprise within the EPZ, the general supervision by the filing, recording and cancellation of the Manual does not apply to its processing trade activities within the EPZ.[88] Compared to normal processing enterprises situated outside the EPZ, this means a more convenient business environment. Thus, a processing enterprise within the EPZ only needs the approval of the qualification for the processing trade by the Approving Authority,[89] which usually specifies the period for, and the list of, processing materials to be imported and end products to be exported. Upon the umbrella approval, this enterprise needs no approval by the Approval Authority for each processing trade contract falling within the approved list and period.[90] Instead, the processing enterprise or the storage enterprise only needs to report semi-annually to the competent Customs authority for a verification and cancellation of relevant filings in a lump sum manner.[91] In addition, processing within the EPZ is not subject to the VAT applicable in the PRC because the EPZ is treated as a territory outside China's tax territory.[92]

Any import or export of goods between an enterprise within the EPZ and an overseas entity or individual must be filed at the competent Customs authority, but is neither treated as entering into the PRC Customs' territory nor subject to the PRC import or export licencing and quota system.[93] As a result, the import tariffs and other PRC taxes applicable to imported goods (such as the VAT or the consumption tax) will be exempted for the following goods flowing from overseas to the EPZ: machine, equipment or materials for the construction of the EPZ infrastructure facilities or of the production or storage houses; machine, equipment, models or spare parts for the production of an enterprise within the EPZ; a reasonable quantity of stationery used by the Management Commission and the enterprises within the EPZ. For raw materials, components, spare parts, packaging materials and other consumption materials for the processing of exported end products by a processing enterprise in the EPZ, the import tariff and other taxes will be suspended by Customs depending on whether or not the end products will be exported upon the completion of processing. If the end products or the processing materials cannot be exported due to some special reasons and have to be sold

[88] *Ibid*, Arts 7 and 10.

[89] The Approval Authority is the provincial branch of MOC. However, the approval powers are designated by such authority to the Management Commission of one EPZ. See *Interim Rules on the Administration of Processing Trade in Export Processing Zones* (出口加工区加工贸易管理暂行办法), issued by MOFTEC, Wai Jing Mao Guan Fa [2001] No 141, effective from 1 April 2001, Art 5.

[90] *Ibid*, Arts 6–9.

[91] *Ibid*, Art 33.

[92] *Interim Measures on the Supervision of Export Processing Zones by the PRC Customs*, Art 12 see n 87 above.

[93] *Interim Rules on the Administration of Processing Trade in Export Processing Zones*, Arts 14–16, see n 89 above.

to the domestic market or used for domestic products, this will be treated as an import subject to normal tariff and applicable taxes at that moment. Despite the above tariff exemption or suspension treatment, import tariffs and other taxes applicable to transportation vehicles or living consumptions for their own use by the Management Commission and the enterprises within the EPZ are still payable and cannot be exempted or suspended.[94]

On the other hand, any goods that are transported from the EPZ to another territory outside the EPZ constitute an import of such goods into the PRC Customs' territory.[95] Normal customs clearance procedure, import licencing and quota system, and import tariffs and taxes will apply to this case. Similarly, any machine, equipment, raw materials, spare parts or packing materials entering into the EPZ from other territory of the PRC constitute an export to the EPZ and thus are subject to normal export controls, as well as any applicable export tariff. For China-made exported goods, the competent Customs authority will issue a tax refund clearance form to the Chinese exporter who can then apply to the tax authorities for the refund of collected VAT during the manufacturing process of such goods.[96]

The purpose of EPZ is to expand the processing trade, rather than to serve as a mere trade port. In order to serve this regulatory purpose, PRC law requires the 'substantial processing' of goods purchased from other Chinese entities outside the EPZ, before such goods can be exported to overseas.[97] Similarly, without substantial processing, a processing enterprise within the EPZ cannot sell the imported raw materials or spare parts to any outside territory within the PRC.[98] The relevant regulations neither specify what constitutes 'substantial processing' nor provide how the competent Customs authority will exercise its discretion to prevent such non-substantially processed goods from export or import. In practice, Customs usually rejects the application for customs clearance under these circumstances and requires the processing enterprise to carry out 'real' processing activities on the raw materials and spare parts.

[94] *Interim Rules on the Administration of Processing Trade in Export Processing Zones*, Art 17, see n 89 above.

[95] One exception is the transfer of these goods from one EPZ to another EPZ. While still subject to Customs' supervision, this transfer will not be treated as an import of such goods into the PRC Customs' territory by the latter EPZ.

[96] *Interim Rules on the Administration of Processing Trade in Export Processing Zones* (出口加工区加工贸易管理暂行办法) , issued by MOFTEC, Wai Jing Mao Guan Fa [2001] No 141, effective from 1 April 2001, Art 27.

[97] *Ibid*, Art 29.

[98] *Ibid*, Art 32.

5.4 RULES OF ORIGIN

5.4.1 General Rules

5.4.1.1 Overview

China reformed the regulatory regime on rules of origin in 2004. The State Council issued the *PRC Rules of Origin for Imported and Exported Goods* ('*PRC Rules of Origin*') on 18 August 2004.[99] Under the new regime effective from 1 January 2005, a single set of rules apply to both import and export and ends the distinction of two rules respectively applicable to import and export.

More significantly, the PRC Rules of Origin comply with the WTO Agreement on Rules of Origin to a greater extent. Although the WTO Agreement on Rules of Origin is a framework agreement and the Members are still negotiating for the harmonisation of rules of origin, the PRC Rules of Origin has transplanted as many texts or principles as possible from that WTO agreement. It even provides that 'before the implementation of the WTO Rules of Origin', Customs will consult with MOC and the State General Administration for Quality Supervision and Inspection and Quarantine ('AQSIQ') for the issuance of specific standards for the substantial transformation applicable in the PRC.[100] This does not necessarily mean that the WTO Rules of Origin will automatically have a direct effect in China once implemented, but shows the intention of the PRC trade regulators to apply the relevant WTO rules once available. In the following discussion, clauses in the PRC Rules of Origin that mirror the text of the corresponding provisions in the WTO Agreement on Rules of Origin will be identified.

The application of the PRC Rules of Origin covers various areas such as most-favoured nation treatment, anti-dumping and anti-subsidies, safeguard measures, origin marking requirements, country-based quantitative restrictions, tariff quota, government procurement and trade statistics.[101] It only applies to goods imported from 'non-preferential countries' (that is, countries that cannot enjoy preferential tariff arrangements with the PRC). For goods from preferential countries or regions, separate rules as prescribed under the applicable international treaty or regional arrangement shall apply.

[99] *PRC Rules of Origin for Imported and Exported Goods* (中华人民共和国进出口货物原产地条例), the State Council Decree No 416, effective from 1 January 2005.
[100] *Ibid*, Art 6(5).
[101] *Ibid*, Art 2. This mirrors the text of Art 1(2) of the WTO Agreement on Rules of Origin.

5.4.1.2 Rules of Origin

The basic principle of origin under PRC law is consistent with the WTO Agreement on Rules of Origin, that is, the origin of a particular good is either the country (or region) where the good has been wholly obtained or, when more than one country is concerned in the production of the good, the country (or region) where the last substantial transformation has been carried out.[102]

The PRC Rules of Origin further elaborate several circumstances under which a particular good can be ascertained as being wholly obtained from one country or region. These circumstances include:

(1) live animal born and raised in that country or region;
(2) animals obtained from hunting, fishing or collection in that country or region;
(3) unprocessed products obtained in that country or region from live animals;
(4) plants or vegetable products harvested or collected in that country or region;
(5) mineral products mined or extracted in that country or region;
(6) natural products obtained in that country or region outside the scope of paragraphs (1) to (5) as listed above;
(7) waste and scrap articles which are produced from processing or manufacturing operations in that country or region and are fit only for the abandonment or recovery for raw materials;
(8) waste and scrap articles collected in that country or region which are either non-reparable or only fit for recovery of components or raw materials;
(9) fish and other marine products obtained by fishing conducted in the high sea by vessels legally flying the national flag of that country or region;
(10) products obtained from the processing of products set out in paragraph (9) aboard vessels legally flying the national flag of that country or region;
(11) products obtained from the sea bed or the soil of the sea bed, the exclusive exploration rights of which belong to that country or region; and
(12) goods completely obtained through processing in that country or region of products set out in paragraphs (1) to (11).[103]

However, minor processing treatment will not be taken into account in determining whether or not the goods are wholly obtained from one country or region. Such minor processing treatment includes the processing or treatment for transportation or storage of goods or to facilitate packaging and delivery of goods, or such as packaging or display for distribution and sale of

[102] *Ibid*, Art 3. This mirrors the text of Art 3(b) of the WTO Agreement on Rules of Origin.
[103] *Ibid*, Art 4.

goods.[104] As a result, even if certain minor processing to one product falling within the above scope has occurred outside the country or region of its origin, such processing will not change the origin of that product.

For the 'substantial transformation' rule applicable to the goods processed in more than one country or region, the PRC Rules of Origin provide for three criteria of judgment. The priority must be given to the 'change in tariff heading' criterion, which refers to the processing and manufacturing operation of non-originating materials carried out in that country or region which result in a product of a different tariff heading under the PRC Import and Export Tariff Codes.[105] This change means the substantial transformation of the nature of a good. Where the 'change in tariff heading' criterion cannot reflect such change of nature, there are two supplemental criteria: 'value-added content' and 'manufacturing or processing operations'. The 'value-added content' criterion refers to the total value added by the processing and manufacturing of non-originating raw materials by that country or region being greater than a specific ratio of the goods derived from the processing or manufacturing.[106] This criterion allows the processing of a good in another country with a limited degree of value adding effect. From 1 January 2005, the total value added in one country or region must exceed 30 per cent of the costs of the product in question in order to make that product originated from such country or region.[107] The 'manufacturing or processing operations' refers to the principal manufacturing or processing operations carried out in the area of one country or region, which confer essential characteristics to the goods derived after the operations. This criterion looks at the essential characteristics of the goods in order to assess where such characteristics have been obtained through the processing or operation procedures.

The PRC Rules of Origin only set out three criteria for the judgment of 'substantial transformation', but does not provide much detailed guidance on what constitutes essential characteristics or what ratio is the threshold for the change of origin of the goods in the value-added chain. Instead, it designates the regulatory powers in this regard to Customs, which can consult with MOC and AQSIQ to issue specific rules on the application of these criteria.[108] Customs will have a great degree of discretion in exercising these powers, but at the same time, will also be subject to stringent supervision by foreign exporters and their governments. Any failure to exercise the powers in a 'consistent, uniform, impartial and reasonable manner' would expose the PRC government to complaints before WTO panels.[109] More importantly,

[104] *Ibid*, Art 5.

[105] *Ibid*, Arts 6(1) and (2).

[106] *Ibid*, Art 6(3).

[107] *Rules on the Standards of Substantial Change in Non-preferential Rules of Origin* (关于非优惠原产地规则中实质性改变标准的规定), issued by General Customs on 30 November 2004 and effective from 1 January 2005, Customs Decree No 122, Art 6.

[108] *PRC Rules of Origin*, Art 6(1), see n 99 above.

[109] The WTO Agreement on Rules of Origin, one document of Annex 1A to the *Marrakesh Agreement Establishing the World Trade Organization*, adopted in the final session of the

the rules of origin cannot be manipulated as a disguised trade protectionist instrument to discriminate against the import from one country or to control the import of certain types of good.[110]

The origin of a good will not be influenced by the origin of other inputs or supplements to that good. For example, the origin of the machine, equipment, energy or factory site will not be taken into account when determining the origin of the good they have been used to process or manufacture.[111] Similarly, the packaging materials or containers will not affect the origin of the good if these materials or containers will be treated as one part of that good. If the tariff is also payable in respect of such packaging materials or containers, they will be levied by the tariff separately.[112]

5.4.1.3 Pre-determination of the Origin of Goods

Before the import, the importer or other relevant persons with a justifiable reason (such as the end-users) are entitled to request of Customs a pre-determination of the origin of the goods to be imported. Customs shall issue the pre-determination within 150 days of the receipt of the application and all supporting documents and publish the decision.[113] Within three years of the pre-determination, if the imported goods are consistent with the goods pre-determined by Customs, Customs will not decide the origin of such goods on a case-by-case basis.[114] In addition, other importers can also apply in writing to Customs for the publication of the pre-determination of the origin of one good, and the published determination will apply to the import of such good by all other importers.[115] This mechanism extends the pre-determination from the applicant to all import of the same good and can greatly facilitate the import process.

5.4.2 Regional Trade Arrangements

5.4.2.1 Overview

China has entered into several regional trade arrangements with neighbouring countries or regions, under which preferential tariff rates are

Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994, Art 2(e).

110 *Ibid*, Art 2(c).

111 *PRC Rules of Origin for Imported and Exported Goods* (中华人民共和国进出口货物原产地条例), the State Council Decree No 416, effective from 1 January 2005, Art 7.

112 *Ibid*, Arts 8–9.

113 *Ibid*, Art 12. This mirrors the text of Art 3(f) of the WTO Agreement on Rules of Origin.

114 *Ibid*, Art 13.

115 *Ibid*, Art 15.

offered to imports originated from these countries or regions. Since international agreements or treaties have no direct effect under PRC law, Customs has issued the relevant implementation measures to incorporate the rules of origin under these regional trade arrangements into Chinese domestic law, basically by mirroring the original text contained in these arrangements.

In 2002, China signed the *Framework Agreement on China-ASEAN Comprehensive Economic Cooperation*, marking the efforts to set up closer trade and investment relationships between China and ASEAN. Customs has applied the *Implementation Measures for China-ASEAN Rules of Origin* from 1 January 2004, applicable to goods originated from ASEAN countries for the purpose of preferential tariff rates.[116] China also became a party to the *First Agreement on Trade Negotiations Among Developing Member Countries of ESCAP* ('the Bangkok Agreement')[117] from 23 May 2001 and has implemented the Bangkok Agreement from 1 January 2002. Accordingly, Customs has also applied the *Implementation Measures for China-ASEAN Rules of Origin* to goods originated from the parties to the Bangkok Agreement from 1 January 2002.[118]

The most notable development in this respect is the conclusion of the *Closer Economic Partnership Arrangement* ('CEPA') between the Mainland China and the Hong Kong Special Administrative Region ('Hong Kong') on 29 June 2003 and between the Mainland China and the Macau Special Administrative Region ('Macau') on 17 October 2003. The text of the two CEPAs is almost the same, so the following analysis will only look at the CEPA with Hong Kong. Correspondingly, Customs has applied the relevant implementation measures for the rules of origin applicable to goods originated from Hong Kong and Macau as contained in the text of these CEPAs.[119] While Hong Kong and Macau are only two special administrative regions under the sovereignty of the PRC, these arrangements have

[116] *Implementation Measures for China-ASEAN Rules of Origin* (中华人民共和国海关关于执行《中华人民共和国与东南亚国家联盟全面经济合作框架协议》项下《中国–东盟自由贸易区原产地规则》的规定), Customs Decree No 108, effective from 1 January 2004.

[117] As of December 2004, the parties to the Bangkok Agreement include Bangladesh, Lao, Korea, India, Sri Lanka and China.

[118] *Implementation Measures for China-ASEAN Rules of Origin* (中华人民共和国海关关于《亚洲及太平洋经济和社会理事会发展中国家成员国关于贸易谈判的第一协定》项下进口货物原产地的暂行规定), *Customs Decree No 94,* effective from 1 January 2002. However, the preferential tariff rates do not apply to Lao as of December 2004.

[119] *Implementation Measures for the Rules of Origin under the Mainland China and Hong Kong CEPA* (中华人民共和国海关关于执行《内地与香港关于建立更紧密经贸关系的安排》项下《关于货物贸易的原产地规则》的规定), Customs Decree No 106, effective from 1 January 2004; *Implementation Measures for the Rules of Origin under the Mainland China and Macau CEPA* (中华人民共和国海关关于执行《内地与澳门关于建立更紧密经贸关系的安排》项下《关于货物贸易的原产地规则》的规定), Customs Decree No 107, effective from 1 January 2004.

treated them as the party to a regional trade arrangement with the Central Government of the PRC (which only represents the Mainland China in this sense).

5.4.2.2 CEPA with Hong Kong

Under the CEPA with Hong Kong, Hong Kong-originated goods can enjoy much more favourable tariff rates than the same goods from other countries or regions. Thus, the rules to determine whether a good is wholly obtained within Hong Kong or whether the last substantial transformation has occurred within Hong Kong are the most important under the CEPA regime in respect of trade in goods.

Annex 2 'Rules of Origin for Trade in Goods' to the CEPA with Hong Kong sets out in detail the rules of origin applicable under this arrangement. The provisions are almost identical (with only a slight, non-substantial difference) to the corresponding provisions in the PRC Rules of Origin as discussed above.[120] The most significant difference is that under the CEPA the 'value-added content' criterion applies a ratio of 30 per cent.[121] This means that the value of raw materials, component parts, labour costs and product development costs exclusively incurred within Hong Kong shall be greater than or equal to 30 per cent of the free on Board ('FOB') value of the exporting goods – otherwise, such goods cannot be treated as originating from Hong Kong and enjoy the preferential tariff rate under the CEPA regime. The term 'product development' is further defined as 'product development carried out in [Hong Kong] for the purposes of producing or processing the exporting goods' and the development expenses include 'fees payable for the development of designs, patents, patented technologies, trademarks or copyrights' ('IP Rights') paid by the exporter itself, or to someone else within Hong Kong for undertaking development of the IP Rights, or even for the purchase of the IP Rights from a person situated within Hong Kong. This provision is favourable to the Hong Kong exporters, because it recognises the importance of IP Rights in the development of trade. In practice, a Hong Kong exporter can design a structure to obtain the optimal benefits of the CEPA regime by setting up a company holding the necessary IP Rights and purchasing such rights from that company as an intra-group transaction. This will technically satisfy the 30 per cent value-adding criterion under the CEPA for the purchaser to qualify its processed goods as being originated from Hong Kong.

The goods must be directly imported from the Hong Kong exporter.[122] Annex 2 does not define what constitutes a 'direct import' – so far as the

[120] See paras 2–8 of the CEPA with Hong Kong, see n 119 above.
[121] The CEPA with Hong Kong, para 5(4), see n 119 above.
[122] The CEPA with Hong Kong, para 2, see n 119 above.

goods are directly transported into the Mainland China, this condition should be satisfied. In theory, it is possible for the Hong Kong exporter to ship the goods to a third country and then re-ship them to the Mainland China. But this will not be a big concern in practice because Hong Kong is adjacent to the Mainland China and it is not commercially viable for the transhipment via a third country.

The issuing authorities of certificates of Hong Kong origin are the Hong Kong Trade and Industry Department and the 'approved bodies' specified in the 'Protection of Non-Government Certificates of Origin Ordinance' (Chapter 324, Laws of Hong Kong). Annex 2 also attaches a format of the certificate of Hong Kong origin. This certificate is prima facie evidence of the Hong Kong origin of a good.

5.4.2.3 Other Regional Trade Arrangements

The rules of origin under the China-ASEAN trade arrangement and the Bangkok Agreement are very similar to those under the CEPA with Hong Kong. There are only two significant differences.

The first difference is about the ratio prescribed in the applicable 'value-added content' criterion. This ratio is 40 per cent under the China-ASEAN trade arrangement,[123] whilst it is increased to 50 per cent under the Bangkok Agreement (which is reduced to 40 per cent when applicable to Bangladesh as one least developed country).[124]

The second difference is the 'direct shipment rule'. This rule is relevant here because the shipment from ASEAN countries or the parties to the Bangkok Agreement to the PRC may involve the transhipment in a third country or region during the journey. The basic rule is that the goods must not pass through the territory of a non-treaty country or region (that is, directly to the Chinese importer or only passing through the territories of ASEAN members or the parties to the Bangkok Agreement). However, the passing through the territory of a non-treaty country or region will not be treated as a violation of this direct shipment rule if it satisfies the following conditions: first, it is purely due to geographical reasons or the requirements of commercial transportation; second, the goods have not been traded or consumed in the territory of that non-member country or region; and third, the goods have not been processed in the territory of that non-member country or region

[123] *Implementation Measures for China-ASEAN Rules of Origin* (中华人民共和国海关关于《亚洲及太平洋经济和社会理事会发展中国家成员国关于贸易谈判的第一协定》项下进口货物原产地的暂行规定), *Customs Decree No 94, effective from 1 January 2002*, Art 5.

[124] *Ibid*, Arts 3(2) and 8.

except for the purpose of loading and unloading or keeping a good status of the goods.[125]

5.4.3 Origin Marks

Where a Chinese exporter needs to prove the China origin of goods, it must register at the local AQSIQ or the China International Trade Promotion Commission (or its authorised local branches) at its place of business and apply for a certificate of China origin from such authorities.[126]

5.5 CUSTOMS VALUATION

5.5.1 The WTO Impact

Under PRC law, the 'dutiable value' of imported and exported goods is the basis of tariff collection and directly related to the amount of tariff that Customs can impose on these goods. Customs valuation is not only important to traders but also imperative to the fiscal benefits of the PRC. It is also one key power of Customs in the regulation of international trade.

Before the WTO accession, the customs valuation by the PRC Customs adopted some alternative methods when the valuation of imported goods could not be objectively determined. One method was to use the international price of identical or similar goods that was available to the public. The other method was to use the price of identical or similar goods in the Chinese domestic market, after deducting 20 per cent of the price as an amount equivalent to import fees, costs and profits. The remainder was the estimated price of the imported goods for the purpose of customs valuation. Obviously, the 20 per cent deduction rate applied as a rule of thumb to all imported goods that had no objective and quantitative analysis to support it.

Upon the WTO accession, Customs acknowledged that the above two methods were inconsistent with the WTO Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 ('the WTO Agreement on Customs Valuation'). From 11 December 2001 (the date of accession), these methods were abolished in practice for the purpose of

[125] *Ibid*, Arts 4 and 10.
[126] *PRC Rules of Origin*, Art 17, see n 99 above.

full compliance with the WTO Agreement on Customs Valuation.[127] On 31 December 2001, the *Measures on Valuation of the Dutiable Value of Imported and Exported Goods* by the PRC Customs were issued with effect from 1 January 2002 ('the PRC Customs Valuation Measures').[128] This new rule incorporates the WTO Agreement on Customs Valuation into Chinese domestic law. The *PRC Import-Export Tariff Regulations* (2003) also has a separate chapter on the customs valuation rules (Chapter 3 'Determination of Dutiable Prices of Imported and Exported Goods'), which are almost identical with the relevant provisions under the WTO Agreement on Customs Valuation and the PRC Customs Valuation Measures. That said, Chapter 3 of the *PRC Import-Export Tariff Regulations* (2003) sets out basic principles and some detailed rules on the customs valuation, but is still less comprehensive than the PRC Customs Valuation Measures. As a result, the 2003 regulations do not replace the PRC Customs Valuation Measures that is effective from 1 January 2002; rather, they are working together to regulate this regime.

5.5.2 Import

5.5.2.1 Basic Rules

Under PRC law, the dutiable price of imported goods shall be determined on the basis of the aggregate of 'transaction value' and 'associated costs'.[129] Associated costs include transportation costs, other relevant costs (such as loading and handling charges) and costs of insurance up to the place of importation within the PRC. The determination of these associated costs are relatively easy, because the exporter or the importer can usually provide the invoice or other evidence for incurring such costs. The key point is how to determine the transaction value.

The transaction value means the price actually paid or payable by the Chinese importer for the goods when sold by the foreign exporter for the export to the PRC, as adjusted in accordance with the prescribed rules ('Adjustment Factors'), including prices paid or payable both directly and indirectly to the exporter.[130] It must satisfy four conditions. First, there are no restrictions as to the disposition or use of the goods by the buyer.[131]

[127] Customs Decree [2001] No 18, dated 10 December 2001.

[128] *Measures on Valuation of the Dutiable Value of Imported and Exported Goods* (中华人民共和国海关审定进出口货物完税价格办法), Customs Decree No 95, issued on 31 December 2001 and effective from 1 January 2002.

[129] *PRC Import-Export Tariff Regulation* (中华人民共和国进出口关税条例), issued by the State Council on 29 October 2003, the State Council Decree No 392, effective from 1 January 2004, Art 18(1). This provision corresponds with Art 1 of the WTO Agreement on Customs Valuation.

[130] *Ibid*, Art 18(2).

[131] However, the restrictions imposed or required by laws or administrative regulations, or limiting the geographical area in which the goods may be resold, or without substantial effect on the value of the goods, are allowed.

Second, the transaction value is not subject to some conditions for which a value cannot be determined. Third, no part of the proceeds of any subsequent resale, disposal or use of the goods by the importer will accrue directly or indirectly to the exporter, or such accrued proceeds can be adjusted accordingly. Fourth, the exporter and importer do not have a 'special relationship',[132] or such relationship does not affect the transaction value.[133] For example, if part of the proceeds of resale by the importer must be paid to the exporter as arranged under the sale, these proceeds would be the indirect price payable by the importer, forming a part of the dutiable price under PRC law.

There are positive and negative Adjustment Factors. Positive Adjustment Factors must be added in the transaction value of imported goods. These factors include the commissions or brokerage assumed by the importer (except buying commissions), the cost of containers which are treated as being one for customs purposes with the imported goods; the cost of packing and packaging materials assumed by the importer; the value of certain goods and services (including materials, components, parts, tools, dies, moulds and similar items and development and design undertaken outside the PRC) as appropriately apportioned, which are supplied directly or indirectly by the importer free of charge or at a reduced cost for use in connection with the production and sale for such goods within the PRC; royalties that shall be paid by the importer as a condition of resale within the PRC[134]; part of the proceeds of any subsequent resale, disposition or use of the goods by the importer that will accrue directly or indirectly to the exporter.[135]

In contrast, negative Adjustment Factors are those expenses and costs that will not be computed as transaction value, even if they are listed as part of the purchase price for imported goods. These factors include: the construction,

[132] The following circumstances constitute a 'special relationship' between the importer and the exporter: they are family members; they are senior management or directors of one another's businesses; one party is directly or indirectly controlled by the other party, or both parties are directly or indirectly controlled by a third party, or both parties directly or indirectly control a third party; one party directly or indirectly owns, controls or holds not less than 5% of outstanding voting shares or equity interest of the other party; one party is another party's employee, senior management or director; both parties are members of one partnership. If one party is another party's sole agent or distributor or assignee, they will have a special relationship if one of the above grounds is satisfied. See *Measures on Valuation of the Dutiable Value of Imported and Exported Goods* by the PRC Customs, Art 42, see n 128 above. This definition is basically the same as the definition of 'related persons' under the WTO Agreement on Customs Valuation.

[133] *PRC Import-Export Tariff Regulations*, Art 18(3), see n 129 above. These provisions are almost identical to Art 1 of the WTO Agreement on Customs Valuation.

[134] 'Royalties' include the royalties or licence fees for patent, trademark, copyright and know-how and the fees for distribution or the right of resale, or other similar fees. See the *Measures on Valuation of Royalties of Imported Goods by the PRC Customs* (中华人民共和国海关关于进口货物特许权使用费估价办法), Customs Decree No 102, effective from 1 July 2003.

[135] *Ibid*, Art 19. This provision basically mirrors Art 8 of the WTO Agreement on Customs Valuation.

installation, processing, maintenance and technical service costs and fees for the imported factories, equipment or machines; the transportation costs, other associated costs and costs of insurance incurred after the unloading of imported goods at the place of importation within the PRC; import tariffs and other Chinese taxes imposed on the imported goods.[136]

5.5.2.2 Alternative Methods

Where the transaction value of imported goods cannot satisfy four conditions as mentioned above, or cannot be decided, Customs can apply some alternative methods in a descending order, after the consultation with the importer:

(1) The transaction value of identical goods sold for export to the PRC and exported at or about the same time as the goods being valued;
(2) The transaction value of similar goods sold for export to the PRC and exported at or about the same time as the goods being valued;
(3) The unit price of the wholesale in the greatest aggregate quantity to an unrelated party of the goods being valued, or the identical or similar goods, and sold at or about the same time as the goods being valued, after deducting the normal profits, general expenses and commissions, transportation costs, other relevant costs and costs of insurance, and import tariff and other Chinese taxes applicable to such goods;
(4) The aggregate of the costs of materials and the processing charges of the goods being valued, the normal profits and general expenses when sold to the PRC, and the transportation costs, other relevant costs and costs of insurance incurred up to the unloading at the place of importation within the PRC;
(5) The price that is determined by other reasonable methods.[137]

Upon the application by the importer after providing necessary information, method (3) and method (4) can be applied in a reverse order.

The PRC Customs Valuation Measures provide more detailed rules on the application of the above five alternative methods. These rules are usually the translation of the relevant provisions under the WTO Agreement on Customs Valuation. For example, under methods (2) and (3), the Measures require Customs to apply the transaction value of the identical or similar goods at the same commercial level and in substantially the same quantity as the goods being valued, subject to the different transportation distances and modes. Where these conditions can be met, the transaction value of such identical or similar goods at a different commercial level or with a different quantity of

[136] *Ibid*, Art 20.
[137] *Ibid*, Arts 21 and 22. These provisions are consistent with the principles of Arts 2–7 of the WTO Agreement on Customs Valuation.

import may be used.[138] Customs must use the transaction value of the goods produced by the same exporter for the customs valuation purpose as far as possible. In case no such transaction value can be found, the transaction value of the identical or similar goods produced by the same country or region of exportation will be used.[139] In addition, the Measures give more guidance on how to apply the 'reasonable method' as a last resort to determine the dutiable price by applying the data obtained within the PRC, and provides that the following prices cannot be used for this purpose: the selling price in the PRC of goods produced in the PRC; the higher of two alternative values; the price of goods on the domestic market of the country of exportation; the cost of production other than the cost of raw materials and the processing charges when applying method (4); the price of the goods for export to a third country or region; and minimum price or arbitrary or fictitious values.[140]

5.5.2.3 Other Special Rules

There are some special rules in relation to the import of goods other than under the normal trade model. One typical example is the imported goods under the processing trade. When the import tariff is payable on such goods (for example, when sold to the domestic market), the dutiable price is basically determined by the price of such goods claimed by the processing enterprise to Customs at the time of importation or at the time of application for the domestic sale.[141] This means that the value added during the processing will be counted as a part of the dutiable price where the processed products are to be sold to the domestic market rather than to be exported to foreign suppliers.

Some leased goods or equipment are also subject to the payment of the import tariff. The dutiable price for leased goods or equipment is the rental payable during the lease period.[142]

5.5.3 Export

The dutiable price for exported goods is the aggregate of the transaction value and the transportation costs, other relevant costs and costs of insurance incurred up to the place of exportation within the PRC, excluding the export

138 *Measures on Valuation of the Dutiable Value of Imported and Exported Goods* (中华人民共和国海关审定进出口货物完税价格办法), Customs Decree No 95, issued on 31 December 2001 and effective from 1 January 2002. Art 8.
139 *Ibid*, Art 8(3).
140 *Ibid*, Art 11.
141 *Ibid*, Art 12.
142 *PRC Import-Export Tariff Regulations* (中华人民共和国进出口关税条例) , issued by the State Council on 29 October 2003, the State Council Decree No 392, effective from 1 January 2004, Art 23.

tariff payable.[143] The transaction value is the price paid or payable by the foreign importer to the Chinese exporter when the goods are sold. Where the transaction value of exported goods cannot be determined, Customs can apply the following alternative methods in a descending order: the transaction value of identical or similar goods exported to the same country or region; the costs, profits and expenses for the production of identical or similar goods within the PRC plus transportation costs, other relevant costs and costs of insurance incurred within the PRC; other reasonable methods.[144] The application of these alternative methods in practice usually takes reference to those more detailed rules applicable to the imported goods.

5.5.4 Administration

The importer or the exporter has a duty to report the true transaction value of imported or exported goods to Customs, together with the invoice, contract, list of goods and other documents or electric data to prove the completeness and correctness of the reported value. If Customs have doubts on the reported value or the relationship between the importer and the exporter, they have the right to issue a written notice requiring the parties to provide further information or clarify certain points. If the parties fail to act in compliance with this notice within 15 days of issuance, Customs can use one of the alternative methods to determine the transaction value of the goods in question.[145] Moreover, where Customs decide to use the transaction value of identical or similar goods, they can enter into a price consultation with the parties.[146] This consultation is more about the collection of necessary information or the justification of certain data by the parties. If the importer or the exporter cannot agree with Customs' alternative methods, they can provide a guarantee or a bond to Customs for the release of goods being valued, and Customs will decide the dutiable prices within 90 days of release.[147]

In order to increase the transparency of Customs' administration of the valuation process, Customs now allows the importer or the exporter to apply in writing to Customs for an explanation on how they have determined the dutiable prices of the goods in question. Customs will provide its explanation in the form of a Customs Valuation Notice, informing the relevant party of

[143] *Ibid*, Art 26.
[144] *Ibid*, Art 27.
[145] *Measures on Valuation of the Dutiable Value of Imported and Exported Goods* (中华人民共和国海关审定进出口货物完税价格办法), Customs Decree No 95, issued on 31 December 2001 and effective from 1 January 2002, Arts 33 and 34.
[146] *Ibid*, Art 35.
[147] *Ibid*, Art 37.

the reasons and methods for the valuation.[148] However, the law does not prescribe a period within which Customs must give the explanation. In practice it is possible that this process will be delayed or Customs will not provide enough information to justify its determination. Under this circumstance, the importer or the exporter can apply for an administrative review by Customs at the immediately higher level on the decision or even bring an administrative litigation before a court.

[148] Customs Decree [2002] No 1, effective from 1 January 2002. The purpose is 'to regulate the Customs valuation and increase the transparency' after 'the full implementation of the WTO Agreement on Customs Valuation by the PRC Customs'.

6

Health and Safety Regulation

6.1 BACKGROUND

6.1.1 Trade Discrimination

The discrimination of foreign goods may be explicit (de jure) or covert (de facto). The former expressly conflicts with the WTO rules, and is easier to be discerned and challenged by other Members. So nowadays such explicitness is uncommon.[1] The current trend is to design a set of measures that make no distinction between imported and domestic goods – that is, origin-neutral, but which have a disproportionately adverse impact on foreign goods in application. Such kinds of regulatory measures[2] are labelled as 'regulatory protectionism',[3] 'de facto or implicit discrimination'[4] or 'indirect discrimination'.[5] They appear to be non-discriminatory on their face, but have the effect of tilting the scales against the imported goods due to various marketing conditions or circumstances.[6]

Health and safety regulation by Chinese trade regulators for the protection of human being, animal and plant and environment are justified under the WTO Agreements. This is a highly technical area and detailed analysis of technical standards goes beyond the scope of this book. Instead, this chapter aims to give a general description of the regulatory regime and then discusses whether or how the regulators may apply it as a covert discrimination against foreign goods.

1 E McGovern, *International Trade Regulation* (Exeter, Globalfield Press, 1996) para 8.13.

2 They are usually found in the areas of health and safety, environmental protection and labour standards.

3 AO Sykes, 'Regulatory Protectionism and the Law of International Trade' (1999) 66 *University of Chicago Law Review* 1 at 3–4.

4 JH Jackson, *The World Trading System: Law and Policy of International Economic Relations* (2nd edn) (Cambridge, Mass and London, The MIT Press, 1997) 216–18.

5 McGovern, above n 1 at para 8.13.

6 Jackson, above n 4 at 216.

6.1.2 Regulators

There are two major regulators in the regime of health and safety regulation. One is the State General Administration of the PRC for Quality Supervision and Inspection and Quarantine ('AQSIQ').[7] This organ was established by merging the former CIQ-SA (for regulation of health and quarantine of imports and exports) and CSBTS (for regulation of quality inspection for domestic products).[8] From the WTO perspective, AQSIQ is now the primary regulator in respect of sanitary and phytosanitary measures ('SPS') and technical barriers to trade ('TBT') in the PRC. The local branches of AQSIQ are responsible for inspection of importation and exportation within their relevant geographical jurisdictions.

The other regulator is the Certification and Accreditation Administration of the PRC ('CNCA').[9] CNCA is the designated governmental authority in charge of China's TBT measures, responsible for issuing mandatory technical standards on products and administering certification and accreditation activities in the PRC. This regulation is mainly through the approval and authorisation by CNCA of eligible certification and accreditation institutions ('CAIs') and personnel to engage in the certification and accreditation activities in the PRC. Where imported goods fall within the scope of products that are subject to China's mandatory certification requirements, the relevant local branch of AQSIQ at the place of importation will not allow such importation unless those goods comply with such requirements and obtain the applicable certification.[10]

6.2 COMMODITY INSPECTION FOR IMPORTATION AND EXPORTATION

6.2.1 Regulatory Framework and Purposes

There are two laws that empower AQSIQ and its authorised local branches to inspect the importation and exportation of commodity and goods: first, the revised *PRC Law on Import and Export Commodity Inspection*[11]; second, the

7 See AQSIQ's website at http: www.aqsiq.gov.cn.

8 CIQ-SA is the Chinese State Administration for Entry-Exit Inspection and Quarantine, and CSBTS is the China State Bureau of Quality and Technical Supervision of the People's Republic of China.

9 See CNAC's website at http: www.cnca.gov.cn.

10 *Administrative Measures on Inspection and Certification of the Entry of Civil Products under the Import Licensing System* (进口许可制度民用商品入境验证管理办法), issued by AQSIQ, Decree No 6, effective from 1 January 2002. It is noted that the term 'Import Licencing System' means the quality licencing system for imported goods, not the system of import licence and quota.

11 *PRC Law on Import and Export Commodity Inspection* (中华人民共和国进出口商品检验法), taking effect from 1 August 1989 and amended on 28 April 2002 with an effect from 1 October 2002.

PRC Law on Import and Export Animals and Plants Inspection.[12] This distinction was based on the separation of functions between the former CIQ-SA (for animals and plants inspection) and CSBTS (for other commodity inspection). These functions are now uniformly undertaken by AQSIQ, so the distinction of two laws is mainly caused by the historical reasons. It is submitted that these two laws can be consolidated into one single law governing the inspection of all types of commodity.

The revised *PRC Law on Import and Export Commodity Inspection* sets out the legislative purposes as 'protection of the health and safety of human, animal or plant life, of the environment, or for the prevention of deceptive practices and safeguarding of national security'.[13] These purposes are basically consistent with the WTO Agreement on Technical Barriers to Trade ('WTO TBT Agreement').[14] However, the Chinese law also lists national security as one ground of regulation. This ground is not objectionable, but may give some discretion to the regulatory regime because it is a wide concept and subject to the interpretation of regulators.

6.2.2 Scope of Application

From the perspective of the WTO TBT Agreement, the *PRC Law on Import and Export Commodity Inspection* does not specify what kinds of regulation constitute the technical regulation falling within its ambit. In accordance with the WTO TBT Agreement, 'technical regulation' means a 'document which lays down product characteristics or their related processes and production methods, including the applicable administrative provisions, with which compliance is mandatory', and may also exclusively include or deal with 'terminology, symbols, packaging, marking or labelling requirements as they apply to a product, process or production method'.[15] In *EC – Asbestos*, the Appellate Body clarified that a technical regulation must regulate the 'characteristics' of products, such as the means of identification, the presentation and the appearance, in a binding or compulsory fashion.[16]

Instead of laying down the definition of 'technical regulation', the *PRC Law on Import and Export Commodity Inspection* empowers AQSIQ to publish and maintain a list of commodities to be inspected by AQSIQ at the time

[12] *PRC Law on Import and Export Animals and Plants Inspection* (中华人民共和国进出境动植物检疫法), taking effect from 1 April 1992.

[13] *PRC Law on Import and Export Commodity Inspection*, Art 4, see n 10 above.

[14] *WTO Agreement on Technical Barriers to Trade*, one document of Annex 1A to the *Marrakesh Agreement Establishing the World Trade Organization*, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994 (the 'WTO TBT Agreement'), Preface, para 6.

[15] *Ibid*, Annex 1, para 1.

[16] Appellate Body Report on *European Communities – Measures Affecting Asbestos and Products Containing Asbestos*, WT/DS135/AB/R, adopted 12 March 2001 ('*EC–asbestos*'), paras 67–9.

of exportation or importation. While some commodities may be exempted from inspection under certain conditions, other commodities are subject to the mandatory inspection. Mandatory inspection means the assessment of the listed commodities on the compliance with mandatory requirements of national technical regulations.[17]

The same issue exists in the *PRC Law on Import and Export Animals and Plants Inspection*. Under the WTO Agreement on the Application of Sanitary and Phytosanitary Measures ('WTO SPS Agreement'), 'SPS measures' mean any measure applied to protect animal or plant life or human health and safety from risks arising from 'the entry, establishment or spread of pests, diseases, disease-carrying organisms or disease-causing organisms', from 'additives, contaminants, toxins or disease-causing organisms in foods, beverages or feedstuffs', or from 'diseases carried by animals, plants or products ' or 'the entry, establishment or spread of pests'.[18] Under PRC law, AQSIQ is generally empowered to take any action to inspect the entry or exit of animal and plant and protect humans and the environment from any harm caused thereby.[19]

The application of Chinese SPS and TBT measures is relatively straightforward. AQSIQ publishes and maintains the lists of goods and commodities that are subject to mandatory inspection based on the SPS and TBT measures. The relevant lists can be accessed at the website of AQSIQ or other technical sources. As a general rule, any listed good or commodity cannot be imported or exported without the inspection of AQSIQ's local branches at the place of importation or exportation. Usually it is the responsibility of the Chinese importer or exporter to apply to the relevant AQSIQ branch for inspection. There are detailed technical and timing criteria for the AQSIQ inspection, and AQSIQ will issue the inspection certificate for those goods that satisfy the mandatory standards. This certificate is one key document for Customs' clearance.

6.2.3 Regulatory Discretion

One particular concern for foreign exporters is the degree of regulatory discretion that AQSIQ may enjoy when exercising their inspection powers. One disguised trade barrier could be the unjustified delay in, or refusal of, the importation of foreign goods or commodities on the ground that they fail to comply with PRC mandatory SPS or TBT measures. For example, AQSIQ

[17] *PRC Law on Import and Export Commodity Inspection*, Arts 5 and 6, see n 10 above.

[18] *WTO Agreement on the Application of Sanitary and Phytosanitary Measures*, one document of Annex 1A to the *Marrakesh Agreement Establishing the World Trade Organization*, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994 (the 'WTO SPS Agreement'), Annex A, para 1.

[19] *PRC Law on Import and Export Animals and Plants Inspection*, Art 3, see n 11 above.

might apply the technical standards in an unreasonable or non-proportionate manner and refuse the importation on the basis of a very minor technical flaw that presents no harm to the health or safety of the human, animal or plant life. Although the foreign exporter or the Chinese importer may seek an administrative review or even administrative litigation to redress any regulatory misconduct, this still means costs, time and more importantly, the lose of access to the Chinese market. Therefore, the key point is how AQSIQ can improve the due regulatory process in a transparent, reasonable and justifiable manner.

One typical case is the prohibition of the importation of soybeans from Brazil by AQSIQ in May 2004. On 22 April 2004, AQSIQ's local branch in Xiamen, a coastal city of the Fujian Province, discovered that a cargo of Brazilian soybeans had poisonous seeds (with a red agent) that were harmful to human health and thus refused to issue the health certificate for the import. On 10 May 2004, AQSIQ issued an urgent circular to all Chinese ports prohibiting the import of any Brazilian soybeans with a red agent.[20] The prohibition of import on the basis of human health protection is justifiable under the WTO Agreements,[21] but AQSIQ seemed to exceedingly exercise its regulatory discretion by setting up a 'zero tolerance' standard – the whole cargo of soybeans could not be imported even if there only existed one poisonous seed.

In accordance with international standards in the soybean trade, every kilogram of soybean may have three poisonous seeds – it would be unreasonable to require a zero tolerance in this aspect.[22] In fact, the poisonous seeds with a red agent can be easily discovered by eyes and picked out by hands and will not poison other normal seeds.[23] Practically speaking, the 'zero tolerance' policy does not conform to the proportionate principle and may fall foul of the WTO Agreements in terms of a reasonable domestic regulation. Partly due to the pressures from Brazilian, Argentina and US governments, AQSIQ finally allowed the import of Brazilian soybeans after accepting a stricter quality assurance by the Brazilian government that every kilogram of soybeans will only have one poisonous seed.[24]

20 *Warning Circular on the Mixture of Poisonous Seeds in Imported Brazilian Soybeans* (Guanyu jinkou baxi dadou zhong hunyou zhongyiji dadou de jingshi tongbao), issued by AQSIQ on 10 May 2004.

21 *General Agreement on Tariffs and Trade 1994,* one document of Annex 1A to the *Marrakesh Agreement Establishing the World Trade Organization*, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994 ('GATT'), Art XX (b).

22 'Huifu jinkou baxi dadou, zhongguo jiejin baxi dudaodou de peihou' (China resumes the import of Brazilian beans: the story behind the prohibition on Brazilian poisonous soybeans), reported on 8 July 2004, available at http://news.163.com/2004w07/12607/2004w7_1089252647927.html (23 August 2004).

23 In July 2004, this author advised on one Xiamen importer's dispute with the Brazilian soybean exporter in respect of the rejection of a cargo due to the poisonous seeds in June 2004. These facts were informed by the importer to me. File with the author.

24 See n 21 above. A large number of Brazilian soybeans have been purchased and exported by US companies, which explains why the US government got involved in this dispute.

This case shows how the Chinese trade regulator could exercise the discretion in a non-proportionate way, but is also a good example for how international pressures from other Members are playing an increasing role in the formulation of policy by Chinese trade regulators.

6.3 TECHNICAL STANDARDS

6.3.1 Authentication

'Authentication' is defined as evaluation and assessment activities for the compliance by products, services and management systems of the applicable technical regulations or the mandatory criteria or requirements of such regulations in the PRC.[25] An authentication entity (having the status of legal person) can only engage in the authentication activities upon the approval by CNCA.[26] The personnel of an approved authentication entity who carry out the authentication activities must obtain the relevant qualifications and be licensed by CNCA.[27] From late 2003, China has established a set of rules governing the authentication activities.

6.3.2 Mandatory Authentication Requirements

From the business perspective, the key concern is the scope and operation of mandatory requirements for authentication. CNCA has the power to designate the types of products or goods that are subject to mandatory authentication requirements for the purposes of 'protection of national security, prevention of deceptive practices, prevention of the health or safety of human, animal and plant life, and of the environment'.[28] Up to March 2005, CNCA has issued the First Catalogue for Products Subject to Mandatory Authentication covering about 130 types of product.[29] A listed product cannot be produced, sold, imported or otherwise used in business activities without authentication by the relevant authentication entities and the labelling of the relevant authentication mark.[30]

[25] *PRC Rules on Authentication and Accreditation* (中华人民共和国认证认可条例), issued by the State Council and taking effect from 1 November 2003, State Council Decree No 390, Art 2(1).
[26] *Ibid*, Art 9.
[27] *Ibid*.
[28] *Ibid*, Art 28. This article mirrors the purposes article under the *PRC Law on Import and Export Commodity Inspection* (Art 4).
[29] This catalogue is available at the CNCA website at http: www.cnca.gov.cn/article.html?Id=3475, (27 December 2004).
[30] *PRC Rules on Authentication and Accreditation*, Art 28, see n 24 above.

The mandatory authentication requirement could be abused in several ways as a discrimination against certain products (for example, those originating from a foreign country or region). First, there are only a limited number of authentication entities that are eligible for the inspection and authentication activities. This means a long queue for the inspection and it may be potentially disadvantageous for foreign products causing a delay in their access to the Chinese market.[31] Second, the technical standards and assessment procedures may be different between authentication entities, which is virtually equal to a regional barrier. Third, the authentication entities may refuse to authenticate foreign products without a justifiable or reasonable reason.

To address the first concern, CNCA has now adopted a market-oriented approach. Before China's WTO accession, the authentication entities were usually attached to, or established by, the ministry that had the line management jurisdiction over the products in question. In foreign exporters' eyes, these entities had conflict of interests because the ministry in charge was also responsible for the development of the relevant domestic industry that was in direct competition with foreign like products.[32] Under the new regulatory regime after the WTO accession, the authentication industry has been liberalised and open to all types of investment (state-owned, private or foreign-invested), so far as the investors can meet some minimum qualifications. For example, the establishment of a domestic-invested authentication entity only requires the fixed premise and facilities for operation, the management system in compliance with the authentication requirements, the minimum amount of registered capital not less than RMB 3 million (approximately USD 370,000), and not less than 10 full-time authentication personnel.[33] For a foreign-invested authentication entity, two additional qualifications are first, the foreign investor shall have obtained the accreditation of its home country or region, and second, the foreign investor shall have more than three years experience in the authentication activities.[34] In addition, CNCA undertakes that there must be at least two authentication entities in the field of each listed product.[35] The increase of eligible authentication entities will create a relatively full competitive market and then reduce the opportunity of

[31] For example, the domestic producers may have easy access or even personal networking with the authentication entity and can request an early handling by that entity, whilst foreign producers can only wait in the queue.

[32] Some Members raised these concerns during China's WTO accession negotiation. See the *Report of the Working Party on the Accession of China*, issued by the Working Party on the Accession of China, WT/ACC/CHN/49, adopted 1 October 2001 (01–4679) ('The Working Party Report'), paras 177–97.

[33] *PRC Rules on Authentication and Accreditation* (中华人民共和国认证认可条例), issued by the State Council and taking effect from 1 November 2003, State Council Decree No 390, Art 10.

[34] *Ibid*, Art 11.

[35] *Ibid*, Art 32.

governmental manipulation of such entities with regard to the authentication of foreign products.

In order to address the second and the third concerns, CNCA has implemented the uniform rule in the regulation of authentication entities. Under the applicable regulation, CNCA has the obligation to issue the uniform catalogue, technical standards, assessment procedures, labels and fees for such listed products,[36] and indeed has issued a number of such uniform rules that are applicable to, and must be applied by, the authentication entities.[37] The purpose is to create a transparent and uniform environment under which all authentication activities can be carried out by the licenced entities, and to prevent such entities from abusing the authentication procedures in favour of certain producers and against other producers.

6.3.3 Accreditation

'Accreditation' means the recognition by the accreditation organs of the capacity and professional qualification of the authentication entities, inspection institutions, laboratories and the authentication personnel.[38] In other words, accreditation organs are the organs in charge of the 'authentication' of the authentication entities and personnel. Only CNCA has the power to designate an accreditation organ – without such designation, no entity can directly or indirectly carry out the accreditation activities and their results are accordingly void.[39] For authentication personnel, they cannot carry out the authentication activities unless they are registered at the relevant accreditation organs.[40]

After passing the accreditation, the authentication entity will receive an accreditation certificate, showing the scope, standards, fields and validity period of the accreditation.[41] It is notable that the accreditation is not a mandatory requirement on the authentication entities – the licencing by CNCA should be sufficient for its authentication activities. However, the accreditation by the authoritative accreditation organ in the field of authentication activities will increase the credibility of an authentication entity and ensure the stability and sustainability of its authentication activities. From this perspective, the endorsement by the accreditation organ has more practical meaning to the business of authentication entities falling within their respective jurisdiction – in other words, the accreditation organ is similar to a self-regulatory organ for such authentication entities and their personnel.

36 *Ibid*, Art 29.
37 These authentication rules are available at the CNCA's website at http: www.cnca.gov.cn.
38 *PRC Rules on Authentication and Accreditation* (中华人民共和国认证认可条例), issued by the State Council and taking effect from 1 November 2003, State Council Decree No 390, Art 2(2).
39 *Ibid*, Art 37.
40 *Ibid*, Art 39.
41 *Ibid*, Arts 44–6.

6.3.4 Import and Export

Besides the mandatory authentication requirements on certain listed products, AQSIQ also issues a specific administrative rule governing the *voluntary* authentication of goods and products to be imported or exported.[42] Under this rule, AQSIQ has the regulatory power to authorise accreditation organs in respect of the relevant accreditation activities and authentication entities in respect of the designated authentication, testing, inspection and training activities.[43] This means a double authorisation on the accreditation organs: one by CNCA for its general accreditation capacity and the other by AQSIQ for their particular capacity on the import and export.

More importantly, AQSIQ imposes a stricter regulation on the authentication entities engaging in the authentication activities relating to exported or imported products. It requires such authentication entities to obtain the accreditation by the relevant accreditation organ and then file the accreditation certificate with AQSIQ.[44] This approach is different from that under the *PRC Rules on Authentication and Accreditation* in that it does not impose a mandatory requirement on the accreditation. The *PRC Rules on Authentication and Accreditation* are issued by the State Council as an administrative regulation and has a higher ranking than the administrative rule issued by AQSIQ. However, there is no express prohibition on the imposition of mandatory accreditation requirements in respect of foreign trade under these Rules, so AQSIQ should have the administrative power to issue a detailed rule with a special applicability to foreign trade and having a stricter system per se.

6.4 TRANSGENOSIS BIOLOGY

6.4.1 Regulatory Framework

The State Council issued the *Safety of Agricultural Transgenosis Biology Management Regulation* ('TB Regulation') on 23 May 2001.[45] This regulation applies to the agricultural transgenosis biology activities such as research, experiment, production, processing and the business of export and import of transgenosis agricultural goods.[46] It does not distinguish the activities of

[42] *Administrative Measures on Authentication and Accreditation of the Quality of Imported and Exported Products* (进出口质量认证认可管理办法), issued by AQSIQ and taking effect from 1 April 2001.

[43] *Ibid*, Art 5.

[44] *Ibid*, Art 10.

[45] State Council Decree No 304 (农业转基因生物安全管理条例), issued by the State Council on 23 May 2001 and taking effect from the same day.

[46] *Safety of Agricultural Transgenosis Biology Management Regulation* ('TB Regulation'), State Council Decree No 304 (农业转基因生物安全管理条例), issued by the State Council on 23 May 2001 and taking effect from the same day. Art 2.

domestic developers and producers vis-à-vis foreign developers and producers of agricultural transgenosis bioses, so all activities irrespective of the origin are covered by this regulation.

The term 'agricultural transgenosis bioses' covers animals, plants, fish and microforms whose composition of genetic groups are changed by genetic engineering technology for the purpose of agricultural production or the processing of agriculture goods.[47] This is wide enough to cover all types of transgenosis-related activities and products. Notably, this regulation expresses that the 'safety' means the 'safety or potential safety caused to the human beings, animals and plants, microforms and eco-environment'. As a result, the wide net casts not only the actual threat but also any *potential* threat – from the regulatory perspective, the potential threat is always difficult to be defined and assessed and thus the regulators may have a great degree of discretion in this regard.

The primary regulator is the Ministry of Agriculture. Where transgenosis food is involved, the Ministry of Health will be the responsible regulator. Since the research, experiment, production and trade of agricultural transgenosis goods are controlled by the Ministry of Agriculture, the producers would expect that the approval by the Ministry of Agriculture should be sufficient to cover the downstream use of such products. An additional level of regulation by the Ministry of Health, which relates to more tests and approvals, would cause a serious concern to the producers. Where the government intends to strictly regulate the transgenosis goods, this two-level regulatory framework may be potentially abused to create more barriers. After all, agricultural transgenosis goods are directly or indirectly used for human consumption. Two Ministries delegate the regulatory powers down to their branches at the county level, which are in charge of relevant activities occurring within their respective jurisdiction.

The TB Regulation applies three systems for the administration of agricultural transgenosis bioses.[48] First, there is a system of administration and evaluation based on the grades of such bioses. These bioses are divided into four grades in accordance with the extent of danger caused to human beings, animals, plants and the eco-environment. The Ministry of Agriculture is responsible for the issuance of detailed classification standards. The second system is for the safety evaluation of agricultural transgenosis goods. The third system is for the labelling requirement on agricultural transgenosis goods. The Ministry of Agriculture will publish and adjust the list of such bioses subject to the labelling requirement, after consultation with the other relevant ministries of the State Council.

There are strict administrations on each step of the development, production and trade of agricultural transgenosis goods. Prior to the commencement

[47] *Ibid*, Art 3.
[48] *Ibid*, Arts 6–8.

of the research on Grade III and Grade IV agricultural transgenosis goods, a developer must report to the Ministry of Agriculture or its authorised local branches.[49] There are three stages for the testing of all grades of agricultural transgenosis goods: intermediate testing (small scale), environmental release testing (middle scale under natural conditions) and productive testing (large scale before production and application). Before the commencement of the intermediate testing, a report must be submitted to the Ministry of Agriculture. During the testing process, ministerial approval is required for the progress from the first stage to the environmental release testing and to the productive testing, after the Ministry's evaluation of safety.[50] Only after the success of the productive testing will the Ministry of Agriculture issue a Safety Certificate for Agricultural Transgenosis Bioses to the developer.[51] From the above rules, it seems that the Chinese government does not have a tight control on the research of agricultural transgenosis goods, as only a simple reporting system applies at this stage.[52] Bearing in mind China's huge population, any agricultural innovation should be welcome by the government so far as the biological and ecological safety can be assured. However, strict administration starts from the testing stage, because the evaluation of safety is now a key concern especially from the perspective of environmental release testing – once released into natural conditions, some harms may be irreversible.

After obtaining the Safety Certificate for Agricultural Transgenosis Bioses, the developer shall also obtain the relevant production and trading licences in respect of the types of agricultural transgenosis goods to be developed.[53] For example, the licences for seeds, animals and aquatic products are required under PRC law. The sale of listed agricultural transgenosis goods within the PRC must abide by the labelling requirement, with a distinct label showing this nature. Any such goods without proper labelling cannot be sold in the market. The label must include the name of major materials containing transgenosis elements and the special sale area (if applicable).[54] An advertisement for agricultural transgenosis goods cannot be published, broadcasted, placed and pasted without the approval of the Ministry of Agriculture.[55] From the perspective of the developer, the strict labelling requirements and the restriction on advertisement may be viewed as additional barrier to this market because it involves more costs and uncertainty of government approvals.

[49] *Ibid*, Art 12.
[50] *Ibid*, Arts 13–15.
[51] *Ibid*, Art 16.
[52] However, the MOA approval is necessary for establishing a foreign-invested enterprise within the PRC for the research and testing of agricultural transgenosis goods. *Ibid*, Art 18.
[53] *Ibid*, Arts 19 and 26.
[54] *Ibid*, Arts 28 and 29.
[55] *Ibid*, Art 30.

6.4.2 Importation

A foreign exporter, who intends to export transgenosis plant seeds, animals, agricultural chemicals, veterinary medicines and addictive products made by agricultural transgenosis bioses or containing agricultural transgenosis bioses, must apply to the Ministry of Agriculture for an approval of entry into the PRC. The Ministry will only approve the application if certain conditions are satisfied: first, the exporting country or region has approved the use of such transgenosis goods and the sale in the market; second, the exporting country or region has gone through scientific experiments to prove that such goods are not harmful to human beings, animals and plants, microforms and the eco-environment; third, the exporter has relevant safety administration and prevention measures.[56] Only after approval can the testing materials be imported into the PRC for three stages of testing as discussed above. After the completion of the productive testing, the Safety Certificate for Agricultural Transgenosis Bioses will be issued to the foreign exporter. Then, the exporter can go through other approval or licencing procedures applicable to the import of its goods under PRC law. At the time of importation, the importer or the exporter must first supply the above Safety Certificate to the relevant AQSIQ for an import commodity inspection[57] and, after passing the inspection, apply to Customs for clearance. A similar safety appraisal and approval system applies to the export of agricultural transgenosis goods to a Chinese purchaser as the processing materials for end products.[58] In addition, the AQSIQ approval is required even for the transhipment of agricultural transgenosis goods via the territory of the PRC.[59] In accordance with the TB Regulation, the Ministry of Agriculture and AQSIQ should decide the approval or refuse the application for importation into, or transhipment via, the PRC of agricultural transgenosis goods within 270 days of receipt of the application.[60]

From the foreign exporters' view, China's transgenosis regulations are a potential trade barrier. Although Chinese laws and policies do not prohibit the importation of agricultural transgenosis goods and the TB Regulation does not expressly conflict with the WTO Agreement, it is still generally viewed as creating a high access threshold to foreign exporters. For example, the 270-day approval period may be too long from a business point of view and more importantly, the Ministry of Agriculture's criteria for approval are

56 *Ibid*, Art 32.
57 The applicable administrative rule is the *Administrative Measures on Inspection and Quarantine of Entry and Exit of Transgenosis Goods* (进出境转基因产品检验检疫管理办法), issued by AQSIQ and take effect from 24 May 2004, AQSIQ Decree No 62.
58 *Ibid*, Art 33. Of course, since the imported transgenosis goods are only used for processing, there is no need for the three-stage testing process for production purposes.
59 *Ibid*, Art 35.
60 *Ibid*, Art 36.

neither comprehensive and detailed nor transparent. There are great uncertainties with regard to the application. It is not unlikely that the Ministry of Agriculture may tend to delay the approval or even refuse the application without justification for the purpose of protecting domestic farmers and competitive goods. Unless this Ministry publishes detailed, justifiable and workable guidance and rules on the safety evaluation, approval and labelling requirement, the suspicions of foreign exporters and their home governments cannot be reduced.

China and the US had an acrid debate for the biotechnology safety, testing and labelling rules set up by the TB Regulation. As the US claimed, these rules failed to provide adequate time for the completion of mandated field trials and the issuance of permanent safety certificates, with a particularly adverse effect on the export of US soybeans to China. The US Government had to engage high-level pressure on the Chinese government which in turn, twice delayed the implementation of these rules until September 2003. Despite the tremendous international pressure, however, the Ministry of Agriculture has not initiated the revision of these rules to date in order to fully address the complaints by other WTO Members.

The above example shows a typical minimalist approach in relation to the implementation of the WTO Agreement. Under this approach, where the provisions of domestic law are not clearly in violation of the WTO Agreement as the Chinese government interprets, the government will take no legislative action. This can be applied generally where a domestic law has no apparent conflict with the WTO Agreement in the literal or textual aspects, but nevertheless has the trade-restrictive effects not compatible with their spirit. In simple words, the Chinese government may wait to see if in fact violations develop and whether other Members will challenge it to the WTO, and if so, what the result would be.[61]

6.4.3 Exportation

Where a Chinese exporter is required to provide the certificate of agricultural transgenosis goods by the importing country or region, the exporter shall apply to the AQSIQ branch at the place of exportation for the issuance of the relevant certificate. The AQSIQ branch will examine the Safety Certificate of Agricultural Transgenosis Bioses issued by the Ministry of Agriculture and inspect the export goods before issuing the certificate.[62]

61 See the United States Trade Representative, '2002 Report to Congress on China's WTO Compliance', available at http://www.abanet.org/intlaw/hubs/programs/SPRing0315.09-thru-15.13.pdf (19 August 2005), 31, '2002 Report to Congress on China's WTO Compliance'.

62 The TB Regulation, Art 37, see n 45 above.

7

Trade in Technology

7.1 GENERAL REGULATORY FRAMEWORK

7.1.1 Scope of Application

The term 'trade in technology' means the transfer of technology between onshore and offshore entities or individuals, that is, the import and export of technology by Chinese entities or individuals from or to offshore entities or individuals.[1] While this 'trade' relates to the transfer of either ownership or usership of intangible goods, it is recognised as one form of 'foreign trade' under the *Foreign Trade Law* (2004).

The regulation of trade in technology applies to the transfer of patent and patent application rights, the licencing of patents, the transfer of know-how, technical service and all other contracts that involve the import or export of technology.[2] From the text of the law, it is not clear whether technology consultation contracts fall within the ambit of regulation. It seems that a consultation contract not involving technology import or export should be excluded. However, a technology consultation contract will more or less relate to technical issues so that the provision of consultation or advice in relation to those issues could always be viewed as an import of 'technology' – in the form of advice, opinion or know-how on the technology under consultation. Based on this consideration, MOC, the competent authority in charge of trade in technology, takes the view that the technology consultation contract falls within the scope of regulation.[3]

Besides the transfer of technology by way of contracts, another form of technology import is the contribution by foreign investors to registered capital of FIEs. Since the laws on foreign direct investment have specific

1 *PRC Administrative Rules on Import and Export of Technology* (中华人民共和国技术进出口管理条例), issued by the State Council on 31 October 2001 and taking effect from 1 January 2002, the State Council Decree No 331, Art 2(1).

2 *Ibid*, Art 2(2); *Administrative Measures on Registration of Technology Import and Export Contracts* (技术进出口合同登记管理办法), issued by MOFTEC on 30 December 2001 and taking effect from 1 January 2002, MOFTEC Decree No 17, Art 2.

3 File with the author dated 22 December 2004.

provisions on this form of technology transfer, the trade regulation will not apply.[4] On the contrary, where a Chinese entity contributes the technology as the registered capital of its invested overseas company, the regulation on export of technology will apply in the same way as applicable to a technology export contract.

7.1.2 Regulators

The primary regulator of trade in technology is MOC. It authorises the provincial branches to take charge of such trade occurring within their relevant jurisdiction – usually, by such entities or individuals that are incorporated or resided within their jurisdiction. In addition, the Ministry of Science and Technology (MOST) also plays an important role because the subject matter of this trade – technology – falls within its general regulatory competence. Some other ministries or commissions may also be involved if the technology in question falls within their respective line management jurisdiction.

7.1.3 Listed Approach

Technology transfer was a historically sensitive regime to the government. One key objective of China's 'Open Door Policy' to outside world since the late 1970s was to import advanced foreign technology and management skills. The government had imposed a strict regulation in this regard – virtually every contract for technology import or export could not take effect unless government approval was obtained. This ensured the utmost degree of control by the government over the flow of technology and knowledge into or out of the territory of the PRC.

With the general trend of trade liberalisation, the regulation on trade in technology has also been reformed to a 'listed approach'. Under the new regime, technologies are categorised as 'allowed', 'restricted' and 'prohibited'. MOC shall publish and maintain a Catalogue for Technologies Prohibited or Restricted from Import and a Catalogue for Technologies Prohibited or Restricted from Export,[5] which make the regulation more transparent and straightforward. Any prohibited technology cannot be imported or exported by Chinese entities or individuals.[6] Any restricted technology cannot be imported or exported by Chinese entities or individuals

4 *PRC Administrative Rules on Import and Export of Technology*, Art 22, see n 1 above.

5 For example, the catalogue for prohibited or restricted technology for export can be found at the following website at http://tech.ec.com.cn/pubnews/2004_09_08/101923/1047272.jsp (28 December 2004).

6 *PRC Administrative Rules on Import and Export of Technology* (中华人民共和国技术进出口管理条例), issued by the State Council on 31 October 2001 and taking effect from 1 January 2002, the State Council Decree No 331, Arts 9 and 32.

unless they have the licence issued by MOC, and the contracts can only be valid under PRC law from the date of issuance of such licence.[7] On the other hand, any unlisted technology can be freely imported or exported without the need of government licence or approval – instead, a contract will take effect automatically upon signing and the registration of such signed contract at MOC or its local branches is sufficient.[8] In this way, the relatively limited scope of prohibited or restricted technologies provides the degree of trade liberalisation with regard to all unlisted technologies.

After obtaining the licence or completing the registration, MOC will issue a certificate to the Chinese importer. The importer must produce this certificate for the purpose of going through foreign exchange application, taxation and banking procedures and Customs' clearance.

7.2 IMPORT OF TECHNOLOGY

7.2.1 Licencing

Originally, MOFTEC and SETC were in charge of the licencing of import of restricted technologies.[9] After merging these two organisations into MOC from March 2003, MOC has taken over this regulatory power for licencing the import of technology.

A Chinese importer may choose one of two procedures for the application for licence. The first route is to submit an Application for Import of Technology Restricted by the PRC ('Application Form') to MOC before signing the technology import contract. MOC will review the application from the perspective of trade and technology and decide whether or not to approve the import within 30 working days.[10] The trade review will cover such points as whether the technology to be imported is consistent with Chinese trade policies and with any international obligations assumed by the PRC, whilst the technical review will cover such points as whether the technology to be imported would cause any harm to national security or public interest, or to the life or health of human beings or to the eco-environment, or would comply with the development strategies for industrial and social policies and encourage the upgrading of industries in the PRC.[11] These points are all high level and subject to discretionary interpretation by MOC, so it would be difficult to assess the firm conclusion to be reached by MOC in one particular

7 *Ibid*, Arts 10, 16, 33 and 38.
8 *Ibid*, Arts 17 and 39.
9 *Administrative Measures on Import of Prohibited and Restricted Technologies* (禁止进口限制进口技术管理办法), issued by MOFTEC and SETC on 28 December 2001 and taking effect from 1 January 2002, Decree No 18, Art 4.
10 *Ibid*, Arts 5 and 6.
11 *Ibid*, Arts 7 and 8.

case. In this respect, the communications between the importer and MOC are the most important factor to secure a successful application.

If MOC approves the application, it will issue a PRC Technology Import Licence Letter of Intent ('Intent Letter') to the importer. Upon the receipt of such Intent Letter, the importer can sign the contract with the foreign exporter. After signing the contract, the importer shall submit the Intent Letter, a copy of the signed contract and evidence of the legal status of two parties (for example, the Certificate of Incorporation, the Business Licence, the Certificate of Good Standing and the Articles of Association) to MOC for the application of the technology import licence. MOC will review the contents of the contract and if there is no objection, will issue the PRC Technology Import Licence ('Import Licence') to the importer within 10 working days of receipt of the application.[12] The contract will only take effect under PRC law from the date of issuance of the Import Licence.[13] Nevertheless, if the contract is governed by a foreign law (such as English or New York law), it may be effective from the date of signing under the governing law – but the significance of the validity under PRC law cannot be underestimated because the contract may otherwise not be enforceable by a Chinese court against the Chinese importer within the PRC due to the public policy concern in the PRC.

The second route is for the importer to sign the technology import contract with the foreign exporter first, and then to apply to MOC for the licence. This route combines two steps under the first route (that is, respectively for the submission of the Application Form and for the application of the Import Licence) into one step, but the importer assumes the risk of failing to obtain MOC approval and licence (which now takes 40 working days in total).[14] In practice, where the importer obtains the Intent Letter from MOC, the issuance of the Import Licence is more like a formality after the signing of the import contract. But this degree of certainty disappears under the second route, so it is likely that two parties sign the import contract but later find out that MOC refuses to approve it – clearly a waste of transaction costs and management time. As a result, unless the importer has confidence that MOC approval can be secured, the choice of the first route is always preferred. Undoubtedly, from a contractual perspective, the contract under either route should state clearly that the issuance of the Import Licence is a condition precedent for that contract to take effect.

After the issuance of the Import Licence and the signing of the import contract, the importer shall register the contract online with the PRC Technology Import and Export Contract Management System.[15] If there is any change to

[12] *Ibid*, Arts 9, 10 and 11.
[13] *Ibid*, Art 13.
[14] *Ibid*, Art 12.
[15] *Ibid*, Art 14. This online management system is maintained at China International Electronic Commerce Network (http: www.ec.com.cn).

the contents of technology import (such as the importer, exporter, mode of import, and technology to be imported), the licencing procedure as discussed above must be followed in respect of these changes.[16]

7.2.2 Registration

As mentioned above, the import contracts for unlisted technologies will be valid at the time of signing and only need an easy on-line registration.[17] The law does not specify the period within which the contracts must be registered after signing, but from the compliance perspective, it is recommended that the contract should be immediately registered after it becomes effective. A practical reason for the immediate registration is that the Chinese importer must produce the registration certificate to the local State Administration of Foreign Exchange ('SAFE') branch when it applies for the purchase of foreign exchange by RMB to perform payment obligations to the foreign exporter under the contract.

MOC is in charge of the registration of technology import contracts in 'major projects'. 'Major projects' means those projects using the funds from national budget, foreign government or international financial institutions (such as the World Bank or International Finance Corporation) or approved by the State Council.[18] MOC shall verify the registered contents within three working days and issue the Technology Import Contract Registration Certificate ('Registration Certificate').[19] For other technology import contracts falling outside the scope of 'major projects', MOC designates the regulatory powers (including the registration) to its provincial branches which can further delegate the registration function to their lower branches at the municipal level. The reviewing period for the registration by local branches is also three working days.[20]

For the purpose of registration, the importer shall submit the following documents to MOC or its local branches: the application for technology contract registration, a copy of the technology import contract, and the evidence for the legal status of two parties.[21] The registration only covers the key information of the contracts, including the contract number, the title, the exporter/supplier, the importer, the user, the summary of the contract, the amount, the payment methods and the financing methods (if applicable).[22]

16 *Ibid*, Art 16.
17 *Administrative Measures on Registration of Technology Import and Export Contracts* (技术进出口合同登记管理办法), issued by MOFTEC on 30 December 2001 and taking effect from 1 January 2002, MOFTEC Decree No 17, Art 3.
18 *Ibid*, Art 4.
19 *Ibid*.
20 *Ibid*, Art 5.
21 *Ibid*, Art 4.
22 *Ibid*, Art 7. The registration department will assign a code of registration with 17 letters/numbers to the registered contract.

Any change of the above registrable contents must be re-registered.[23] In addition, the suspension or termination of a registered contract during the process of performance must also be filed with the registration department – MOC or its local branches.[24]

The above registration system also applies to technology export contracts.

7.2.3 Some Contractual Issues

In theory, the parties to a technology import contract should have the freedom to agree on the terms of the contract. But the Chinese government still imposes some mandatory requirements on certain contractual clauses, with the effect of giving the Chinese importer more bargaining power during the negotiation. For example, the importer can assert these mandatory requirements as a ground to refuse any draft provision that may conflict with such requirements. Indeed, MOC has the power to review the signed contract, so it can refuse to issue the Import Licence for those restricted technologies. It is not clear under the law whether or not MOC or its local branches can refuse the registration of an unlisted technology contract if such contract contains a provision that violates the mandatory requirements under PRC law. Since the registration is not a condition for the contract to take effect, there is little practical meaning for this refusal. In my view, the registration department should only verify the accuracy of the information to be registered by checking the signed contract and should ignore any inconsistency with PRC mandatory requirements. When there is a dispute arising from these contracts, the importer can always raise the mandatory requirements as a ground to invalidate that contract – subject to the court's judgment. The registration is only for the purpose of formal review.

In respect of the supplied technology, the foreign exporter (that is, as the transferor or the assignor) shall warrant that it is the legal owner of the supplied technology or is entitled to transfer or assign such technology. If the importer (that is, as the transferee or the assignee) uses the technology in a way that conforms to the contract but still infringes the legal benefits of third parties (which means that such infringement is due to the reasons of the foreign exporter), the exporter shall be liable for any damages.[25] In addition, the exporter shall warrant that the supplied technology is complete, accurate and valid and can achieve the agreed technical objectives.[26] PRC law also aims to restrict the scope of confidentiality obligations assumed by the Chinese importer, by providing that any technology being made public during the confidential period due to a reason not attributable to the Chinese importer

23 *Ibid*, Art 9.
24 *Ibid*, Art 10.
25 *PRC Administrative Rules on Import and Export of Technology*, see n 1 above, Art 24.
26 *Ibid*, Art 25.

will terminate its confidentiality obligations.[27] Furthermore, any development of the technology in question during the contract period must belong to the party who makes such development – this means that the Chinese importer can develop the supplied technology and obtain the ownership to any new technology developed on such basis.[28] It is unlikely that an attempt to exclude or restrict the liability in this respect will be supported by Chinese courts.[29] In addition, the parties to the contract may negotiate on the basis of fairness and reasonableness the ongoing use of the supplied technology after the expiry of the contract.[30] While PRC law does not impose a mandatory provision in this respect, this illustrates a strong preference by the regulators for ensuring the availability of the supplied technology.

More importantly, PRC law expressly prohibits seven types of restrictive business practice that are usually found in technology import contracts.[31] These practices include: first, to require the importer to accept supplemental conditions unnecessary to the import of the technology in question (including the purchase of unnecessary technology, raw materials, products, equipments or services); second, to require the importer to pay the licence fees or assume other obligations for the technology that has expired the patent protection period or has been declared a void patent right; third, to restrict the importer to make improvement on the supplied technology or to use such improved technology; fourth, to restrict the importer to obtain from other sources the technology similar to, or competing with, the supplied technology; fifth, to unreasonably restrict the sources or channels for the importer to purchase raw materials, spare parts, products or equipments; sixth, to unreasonably restrict the quantity, types of the products to be manufactured by the importer using the supplied technology, or the sale price of such products; finally, to unreasonably restrict the export channels of the importer for the products using the supplied technology. While the legal text is straightforward in respect of these practices, it is always a difficult task to judge whether one provision constitutes one of these practices because it may be disguised to conceal the true effects.

Among the above seven prohibited practices, the last three are subject to a reasonableness test. In other words, 'reasonable' restrictions on the sources or channels for input materials or the production or sale of output products using the supplied technology are allowed under PRC law. The means a rec-

27 *Ibid,* Art 26.
28 *Ibid*, Art 27.
29 When a foreign law (such as English or New York law) is the governing law of the contract, whether or not an exclusion clause can be effective in respect of this warranty will be decided under the governing law, but the courts are still very likely to take into account the PRC mandatory rule in this respect.
30 *PRC Administrative Rules on Import and Export of Technology* (中华人民共和国技术进出口管理条例), issued by the State Council on 31 October 2001 and taking effect from 1 January 2002, the State Council Decree No 331, Art 28.
31 *Ibid*, Art 29.

ognition of the certain degree of control by the technology exporter on the Chinese importer's capacity to use the technology in question, which is also consistent with international practices for technology transfer contracts. The law does not specify what constitutes 'reasonable' restrictions, so the effectiveness of relevant clauses must be analysed on a case-by-case basis. Usually, the market practice (including the international practice) for the supplied technology and the output products is an important criterion to be followed by both parties during the negotiation of a technology import contract.

7.3 EXPORT OF TECHNOLOGY

7.3.1 Licencing

The licencing power for the export of restricted technology is shared by MOC and MOST. The Chinese exporter shall submit the application to MOC, which will work with MOST respectively for trade and technical reviews and decide if the approval is given or not within 30 working days of receipt of the application. Similar principles apply to the trade and technical reviews as those to the import of restricted technologies.[32]

Upon approval, MOC will issue a PRC Technology Export Licence Letter of Intent to the applicant, with a valid period ranging from one year to three years extendable upon request to MOC not later than 30 days prior to expiration.[33] Different from the import of restricted technologies, the Chinese exporter cannot enter into any substantive negotiation with the foreign importer or issue any binding commitment in respect of such export before receiving such Letter of Intent.[34] After signing the export contract, the applicant is required to apply for the PRC Technology Export Licence from MOC. MOC will review the accuracy of the export contract and then decide whether to issue such licence within 15 working days of receipt of the application. The export contract will only be effective under PRC law from the date of issuing the licence.[35]

7.3.2 Export of Software

The Chinese government encourages the export of software. The export of software may take the form of physical carriers (such as the CD-Rom or the

32 *Administrative Measures on Export of Prohibited and Restricted Technologies* (技术进出口合同登记管理办法), issued by MOFTEC and MOST on 12 December 2001 and taking effect from 1 January 2002, Decree No 14, Arts 5 and 6.

33 *Ibid*, Arts 9 and 11.

34 *Ibid*, Art 10.

35 *Ibid*, Arts 13 and 14.

floppy disk) for Customs' clearance or of online transmission. The software can also be a part of the exported equipment or system. All services relating to information and data, such as the development of data, processing, the design of programmes and the maintenance of computers, are also categorised as a kind of software export.[36]

There are some incentives or favourable policies applicable to the export of software.[37] The exporters can apply to MOC for the medium-small enterprises fund or the international market development fund as a support for their export of software. They can also apply to MOC for the funding of authentication fees (such as those for GB/T1900-ISO9000 and Capability Maturity Model (CMM)). There are some other incentives in respect of export credit, insurance and tax refunds for the software export business.

The government maintains an Administrative Centre for Online Registration of Software Export Contracts (website: www.scrcentre.gov.cn). After the export contract takes effect, the export shall register the contract online at that Centre and shall also obtain the Registration Certificate for Software Export Contracts from MOC's local branch at the place of its incorporation.[38] Only after registration and obtaining the Registration Certificate can the exporter enjoy the relevant incentives or policies in favour of the export of software.

It is a question whether or not the above incentives or favourable policies granted to Chinese-incorporated software exporters would conflict with the WTO Agreement. These incentives are similar to those applicable to the export of integrated circuits developed within and exported from China. The US brought a complaint to the WTO panel against China's value-added tax refunding preferential policy on integrated circuits in March 2004. Chapter eleven 'Trade Promotion' will give a detailed analysis of this case, the results of which may also help the assessment of the WTO legality of these software export incentive measures.

[36] *Measures on the Management and Statistics of Software Exports* (软件出口管理和统计办法), issued by MOFTEC and MOST etc, taking effect from 25 October 2001, Wai Jing Mao Ji Fa [2004] No 604, Art 2.

[37] *Circular on the Issues Relevant to the Export of Software* (关于软件出口有关问题的通知), issued by MOFTEC, Ministry of Information Industry etc, Wai Jing Mai Ji Fa [2000] No 680, para 1 'Relevant Policies Applicable to the Export of Software'.

[38] *Measures on the Management and Statistics of Software Exports*, Arts 4, 5 and 6, see n 36 above.

Part III

Trade Protection and Remedies

8

Trade Retaliation and Investigation

8.1 OVERVIEW

The FTL (2004) has a specific chapter on trade remedies. Chapter 8 of the FTL (2004) titled 'Foreign Trade Remedies' has eleven articles (from Article 40 to Article 50), covering basic principles of anti-dumping, anti-subsidies, safeguard measures and anti-avoidance. From this legislative structure, there are three pillars of the trade remedy system under PRC law: anti-dumping, anti-subsidies and safeguard measures. Anti-avoidance is a general principle on the prevention of any measures for the purpose of avoiding the application of trade remedy measures, but PRC law has no separate regulations or rules on this issue.

This chapter discusses two basic issues of trade remedies in the PRC: trade retaliation and foreign trade investigation.

8.2 TRADE RETALIATION

8.2.1 Basic Principle: Article 7 of the FTL (2004)

The FTL (2004) expressly empowers the State and MOC as the primary trade regulator to engage in trade retaliation. Article 7 provides that,

> if a country or region adopts sanctions, restrictions or other similar measures of a discriminatory nature in regards to trade against [China], [China] may adopt corresponding measures against such country or region in accordance with actual circumstances.

It is the statutory basis for trade retaliation by the Chinese government (usually acting through MOC).

Article 7 sets out the principle of retaliation as well as basic conditions. First, one country or region must adopt some measures against the trade relationship with China (either export of goods, services or technology to China or import of goods, services or technology from China). These trade

measures may take the form of prohibitions and restrictions of trade in accordance with the laws of that country or region.

Second, these trade measures must be of a 'discriminatory' nature. This is the key to applying Article 7. An immediate question is: who will judge whether or not these trade measures are 'discriminatory' and by what standards. From the text of Article 7, obviously it is up to the judgment of the Chinese government. Since Article 7 does not specify the standards of judgment, the reasonable deduction is that the Chinese government will use PRC law (in particular, the FTL (2004)) and international treaties to which China is a party (in particular, the WTO Agreement) to judge whether or not these trade measures are 'discriminatory' against trade with China. The second question is whether or not the 'discriminatory' nature represents a kind of discrimination per se or an absolute discrimination. If the former, as long as that country adopts a trade measure that discriminates against trade with China in accordance with the judgment standards, the Chinese government is entitled to retaliate. If the latter, as long as that country adopts a trade measure that is uniformly applicable to trade with all other countries (including China), that is, in a way similar to the Most-Favoured Nation Treatment Principle, the Chinese government should not retaliate. Only if trade with China is discriminated against while the trade with other countries are not discriminated against can the retaliation be justified under Article 7. While there is no authoritative interpretation on this issue, it is submitted that the latter view is more appropriate and indeed conforms to the spirit of the FTL (2004) and the WTO Agreement. Article 7 does not mean to unconditionally empower the Chinese government to enter into trade wars with other countries. If one country adopts a trade measure applicable to trade with all other countries or regions in a uniform way, it is difficult to argue that trade with China is put at a disadvantage even if the measure is more restrictive than the one previously applied. Nevertheless, if the measure is ostensibly applicable to all other countries or regions but has an actual effect on trade with China only (for example, the restricted import of a product that is only sourced from China), it is arguable that this may be de facto discrimination against trade with China.

Third, Article 7 provides that '[China] may adopt corresponding measures against such country or region in accordance with actual circumstances'. This shows the discretionary nature of this article, because it does not require the government as an obligation to retaliate 'such country or region in accordance with actual circumstances'. In other words, the Chinese government may refrain from adopting a retaliatory measure due to other strategic or diplomatic considerations in relation to that country or region. The discretionary nature (rather than mandatory nature) of Article 7 is key to the analysis of its legality under the WTO Agreement.

8.2.2 Trade Remedies: Article 47 of the FTL (2004)

Article 47 of Chapter 8 'Foreign Trade Remedies' of the FTL (2004) provides that:

> Where a country or region that has concluded or jointly acceded to an economic and trade treaty or agreement with [China] violates the provisions thereof, leading to the loss of or damage to the interests that [China] is entitled to according to such treaty or agreement, or impediment of the realisation of goals thereof, the government of [China] shall have the right to request the government of the relevant country or region to adopt appropriate remedial measures, and may suspend or terminate the performance of relevant obligations according to such treaty or agreement.

Unlike Article 7 as a principle (also placed under Chapter 1 'General Provisions'), Article 47 has a specific scope of application: trade retaliation on the basis of international treaties. In particular, the WTO Agreement is the main international treaty in relation to the application of Article 47.

The first condition to apply Article 47 is that one country, as a contracting party to one international 'economic and trade' treaty or agreement (rather than other types of treaty or agreement such as in relation to political, human rights or territorial issues), violates that international treaty or agreement. The same question applies here: who will judge the violation and by what standards. From the text of Article 47, it seems that the Chinese government will judge whether or not the violation exists and the standards should be the provisions of that international treaty or agreement. The second condition is that the violation has led to 'the loss of or damage to the interests that [China] is entitled to according to such treaty or agreement, or impediment of the realisation of goals thereof'. In other words, the Chinese government must satisfactorily establish the (actual or expected) loss or damages and the causal link between the violation of the said international treaty or provision and such loss or damages.

Similar to Article 7, Article 47 is of a discretionary nature. It only provides that the Chinese government 'shall have the right' to request the government of that country or region to take remedial measures and to 'suspend or terminate the performance of relevant obligations according to such treaty or agreement'. This is not a mandatory obligation on the Chinese government to retaliate provided that the violation and the loss or damages can be established. But it reveals how the Chinese government will react under this circumstance. It will generally employ three measures: to request the government of that country or region to remedy the violation of the said international treaty or agreement; to suspend the performance of China's obligations under such treaty or agreement; and to terminate the performance of China's obligations under such treaty or agreement. In addition, if that country or region adopts a discriminatory trade measure on trade with

China by way of violation of an international treaty or agreement, Article 7 is also applicable.

8.2.3 Legality under the WTO Agreement

In the context of the WTO Agreement, Articles 7 and 47 of the FTL (2004) can be re-iterated as follows: if any Member adopts sanctions, restrictions or other similar measures of a discriminatory nature in regard to trade against China, China may adopt corresponding measures to retaliate; in particular, if any Member violates the provisions of the WTO Agreement, leading to the loss of or damage to the interests that China is entitled to under the WTO Agreement, or impediment of the realisation of goals of the WTO Agreement, the Chinese government shall have the right to request the government of that Member to remedy such violation, and may suspend or terminate the performance of the relevant WTO obligations assumed by China.

The key to assess whether or not Articles 7 and 47 are legal under the WTO Agreement is Article 23 (*Strengthening of the Multilateral System*) of the Dispute Settlement Understanding ('DSU').

Article 23 provides that:

> 1. When Members seek the redress of a violation of obligations or other nullification or impairment of benefits under the covered agreements or an impediment to the attainment of any objective of the covered agreements, they shall have recourse to, and abide by, the rules and procedures of [DSU].
>
> 2. In such cases, Members shall:
>
> (a) not make a determination to the effect that a violation has occurred, that benefits have been nullified or impaired or that the attainment of any objective of the covered agreement has been impeded, except through recourse to dispute settlement in accordance with the rules and procedures of [DSU], and shall make any such determination consistent with the findings contained in the panel or Appellate Body report adopted by the Dispute Settlement Body ('DSB') or an arbitration award rendered under [DSU];
>
> (b) follow the procedures set forth in Article 21 to determine the reasonable period of time for the Member concerned to implement the recommendations and rulings; and
>
> (c) follow the procedures set forth in Article 22 to determine the level of suspension of concessions or other obligations and obtain DSB authorisation in accordance with those procedures before suspending concessions or other obligations under the covered agreement in response to the failure of the Member concerned to implement the recommendations and rulings within that reasonable period of time.

If comparing the text of Articles 7 and 47 of the FTL (2004) and that of Arti-

cle 23 of the DSU, it is easy to conclude that Article 23 of the DSU exactly covers the scope of application of Articles 7 and 47 of the FTL (2004) and further invalidates the unilateral powers enjoyed by one Member to declare the violation by another Member of the WTO Agreement and adopt retaliations accordingly. These matters can only be determined by relying on the procedures of the DSU. Thus, it is a prima facie conclusion that Articles 7 and 47 of the FTL (2004) are not legal under the WTO Agreement (more specifically, Article 23 of the DSU).

However, the Chinese government may strongly argue that Articles 7 and 47 are of a discretionary nature rather than a mandatory nature, because they only provide that the government 'may' or 'shall have the right to' adopt trade retaliations where another Member adopts discriminatory measures against trade with China or violates the WTO Agreement and infringes the interests or benefits of China under the WTO Agreement. Due to the discretionary nature of these articles, the Chinese government has the discretion on whether or not to retaliate – it may also simply refrain from taking any retaliation. Therefore, unless the Chinese government does take retaliatory action under this circumstance, the mere existence of Articles 7 and 47 on paper should not violate the WTO Agreement.[1]

This argument is similar to that put by the US government in the *US – Section 301 Trade Act* case. The findings by the WTO panel and Appellate Body will help provide a better assessment of the legality of Articles 7 and 47 of the FTL (2004) under the WTO Agreement. In the *US – Section 301 Trade Act* case, the EC challenged sections 301-10 of the United States Trade Act of 1974, that is, the provisions per se and not their specific application were challenged. The US argued that under existing WTO rules only legislation mandating a WTO-inconsistency or precluding WTO-consistency could violate WTO provisions. The EC took the view that the distinction, though a good starting point in disputes involving legislation per se, needed to be revisited in the light of Article XVI:4 of the WTO Agreement and Article 3 of the Dispute Settlement Understanding.[2] Some third parties argued that the distinction does not hold well under the WTO and thus discretionary legislation may also violate WTO obligations.

The Panel held that the issue has to be decided on a case-by-case basis by construing the WTO provisions at issue. In essence it found that discretionary legislation could be challenged under certain WTO provisions depending on the nature of the obligations contained in those provisions.[3] For the challenge

1 For a general discussion of the effect of discretionary vis-à-vis mandatory legislation under the WTO Agreement, see Sharif Bhuiyan, 'Mandatory and Discretionary Legislation: the Continued Relevance of the Distinction under the WTO' (2002) 5 *Journal of International Economic Law* 571.

2 *Ibid* at 576–7.

3 *Ibid* at 578.

to the legislation per se rather than a specific act under such legislation, it concluded that:

> In treaties which concern only the relations between States, State responsibility is incurred only when an actual violation takes place. By contrast, in a treaty the benefits of which depend in part on the activity of individual operators the legislation itself may be construed as a breach, since the mere existence of legislation could have an appreciable 'chilling effect' on the economic activities of individuals.[4]

For the legality of discretionary legislation under the WTO Agreement, it took a flexible attitude:

> We do not accept the legal logic that there has to be one hard and fast rule covering all domestic legislation. After all, is it so implausible that the framers of the WTO Agreement, in their wisdom, would have crafted some obligations which would render illegal even discretionary legislation and crafted other obligations prohibiting only mandatory legislation? Whether or not Section 304 violates Article 23 depends, thus, first and foremost on the precise obligations contained in Article 23. ... [S]ince Article 23 may prohibit legislation with certain discretionary elements ... the very fact of having in the legislation such discretion could, in effect, preclude WTO consistency.[5]

As a result, even discretionary legislation can violate WTO obligations, depending on the nature of such WTO obligations. If these obligations may be interpreted to even prohibit the discretionary legislation to give the executive a power to violate them, the legislation in question – no matter of its nature – should be treated as illegal under the WTO Agreement. Since Article 23 of the DSU expressly prohibits the unilateral determination by one Member of another Member's violation of the WTO Agreement and adopting trade retaliation, it is submitted that Article 47 of the FTL (2004) is not legal under this rule because it gives the Chinese government a power to violate this prohibition at its own discretion. As for the legality of Article 7 of the FTL (2004) under the WTO Agreement, it depends on the standards to be taken by the Chinese government to justify the retaliation in a specific case: if it is the WTO Agreement, the prohibition of Article 23 of the DSU also applies and thus makes Article 7 illegal under the WTO Agreement; if it is other sources of domestic or international law than the WTO Agreement, arguably it falls outside the scope of Article 23 of the DSU. Thus, it is difficult to conclude the legality of Article 7 under the WTO Agreement without looking at the specific acts taken under this article.

[4] Panel Report on *United States – Sections 301–310 of the Trade Act 1974*, WT/DS152/R, adopted 22 December 1999,, para 7.81.

[5] *Ibid* at paras 7.53–7.54.

8.3 TRADE INVESTIGATION

8.3.1 General Rules

Compared to the FTL (1994), the FTL (2004) has a new chapter on foreign trade investigation (Chapter 7 'Foreign Trade Investigation'). Upon the results of investigation, MOC may adopt specific trade remedies as prescribed in Chapter 8 'Foreign Trade Remedies'.[6] From this perspective, the investigation procedures under specific trade remedial measures are also a kind of foreign trade investigation in a wider sense.

In order to protect China's foreign trade order, MOC may, independently or in cooperation with other ministries of the State Council, conduct foreign trade investigations for the following matters: first, impact of trade in goods, in services or in technology on the domestic industry and its competitiveness; second, trade barriers of other countries or regions; third, issues that require investigation for determining whether foreign trade remedies such as anti-dumping, anti-subsidies or safeguard measures shall be adopted; fourth, acts of evading foreign trade remedial measures; fifth, issues related to the security and interest of the State in foreign trade activities; sixth, issues that require investigation for implementing trade retaliation, trade-related IP protection, and monopoly and unfair competitive behaviours in relation to foreign trade; and seventh, other matters affecting foreign trade order that require investigation.[7] Among these types of foreign trade investigation, certain types are specific to trade measures or remedies (such as those relating to anti-dumping, anti-subsidies, safeguard measures, IP-related issues, monopoly and unfair competition behaviours and trade retaliation) whilst others have a general nature (such as impacts on domestic industry and competitiveness and trade barriers of other countries or regions).

One weak point of the foreign trade investigation regime is that the FTL (2004) does not specify whether a private party can trigger the investigation and how to do so. It only provides that MOC may investigate either independently or in cooperation with other ministries. While MOC is in a sensitive position and has access to a number of information sources for the purpose of investigation, it after all has limited resources and contacts and few incentives than affected private parties to start the investigation. In respect of the investigations under anti-dumping, anti-subsidies and safeguard measures, there are specific administrative regulations and rules to

6 *The PRC Foreign Trade Law* (2004), ('FTL (2004)') *Zhonghua Renmin Gonghe Guo Duiwai Maoyi Fa* (中华人民共和国对外贸易法), promulgated on 12 May 1994 by the Seventh Meeting of the Standing Committee of National People's Congress of the PRC and taking effect from 1 July 1994, as amended on 6 April 2004 and taking effect from 1 July 2004, Art 40.

7 *Ibid*, Art 37.

prescribe how a private party can apply to MOC for such investigations. A similar rule exists for foreign trade barrier investigation (see Section 8.3.2). But there is no specific rule on other types of foreign trade investigation or a general rule governing the application for the investigation by private parties. It is submitted that MOC should issue a rule to govern this area, by setting out basic conditions, procedures and MOC's role for the commencement of foreign trade investigation.

Under the FTL (2004), MOC is obliged to publish a circular to start an investigation.[8] It can send out written questionnaires, hold public hearings, carry out on-site inspection and entrust a third party to carry out the investigation.[9] Other investigation methods are also allowed as long as it is necessary and available to MOC. After the investigation, MOC should either publish an investigation report or issue a ruling to deal with the investigated matter, in the form of a circular.[10]

Any entity or individual within the PRC has an obligation to cooperate with and assist MOC's investigations. But the FTL (2004) does not provide any penalty for non-compliance with this obligation. In addition, MOC and other ministries and their officials have an obligation to keep state or business secrets known from the investigation confidential.[11]

8.3.2 Foreign Trade Barriers Investigation

MOFTEC issued the *Interim Rules on Foreign Trade Barriers Investigation* in 2002. On 2 February 2005, MOC formally issued the *Rules on Foreign Trade Barriers Investigation*, effective from 1 March 2005.[12]

MOC has the regulatory power for foreign trade barriers investigation and designates the Fair Trade Bureau under MOC to carry out the investigation.[13] 'Foreign trade barriers' means certain measures or actions taken or assisted by a foreign country or region with an adverse effect falling with the Rules on Foreign Trade Barriers Investigation. The first type are those measures or actions that violate international economic and trade treaty or agreement, or fail to perform the obligations under such treaty or agreement. The second type are those measures or actions that have a negative impact on the access of Chinese goods or services to that country or region's market, or cause or could cause damage to the competitiveness of Chinese goods or services in such market or the market of a third country or region, or cause or could cause an impediment or restriction on the export of that country or region's

8 *Ibid*, Art 38(1).
9 *Ibid*, Art 38(2).
10 *Ibid*, Art 38(3).
11 *Ibid*, Art 39.
12 *Rules on Foreign Trade Barriers Investigation* (对外贸易壁垒调查规则), issued by MOC and effective from 1 March 2005.
13 *Ibid*, Art 2.

goods or services to China.[14] As a result, the scope of foreign trade barriers is wide and almost covers every type of trade-related measure or action with a potential effect on trade between China and the country or region under investigation.

MOC can start the investigation either by its own initiative or upon application.[15] This allows a private party to start the investigation process. An applicant can be a domestic enterprise (whether as a Chinese-invested enterprise or as a FIE), a domestic industry, or an individual, legal person or other association that represents such domestic industry or a domestic industry.[16] There is no threshold on the output or the market share of a domestic enterprise, but an eligible domestic enterprise or industry must have a direct relationship with the product or service that is relevant to the foreign trade barriers under investigation. This kind of 'direct relationship' is easily satisfied – if a domestic enterprise is manufacturing, trading or supplying such product or service, it can apply to MOC for the investigation.

The application must be in writing. The application report should contain the following minimum contents: name, address and information of the applicant; the measure or action to be investigated and the relevant explanation; basic information of the relevant domestic industry; and negative impact that the applicant believes to be caused by the measure or action to be investigated.[17] While the rule requires the applicant to provide as far as possible the evidence and its source for the existence of the measure or action to be investigated and its negative impact, it also allows the applicant to provide a written explanation on the failure to provide such evidence.[18] This means that the applicant can even apply for the investigation on the basis of hearsay.

MOC must decide whether or not to accept the application for the investigation within 60 days of the receipt of the application report. If one of the following circumstances emerges, MOC can decide not to accept the application: first, the application is manifestly inconsistent with the facts; second, the materials are not completed and the applicant fails to supplement such materials as required by MOC; third, the measure or action under the application does not fall within the scope of foreign trade barriers in a manifest way.[19] As long as the application report conforms to the requirement under the rule and does not fall within one of the above circumstances, MOC shall decide to accept the application and investigate accordingly.[20] This means that MOC is under an obligation (rather than a discretion) to accept the application that satisfies the requirements of the rule. Upon the acceptance of the application, MOC will issue a circular describing the application and the

[14] *Ibid*, Art 3.
[15] *Ibid*, Art 4.
[16] *Ibid*, Art 5.
[17] *Ibid*, Arts 6 and 7.
[18] *Ibid*, Art 8.
[19] *Ibid*, Art 16.
[20] *Ibid*, Art 12.

investigation as envisaged (including the public comments period). The date of the circular is the date of the commencement of investigation.[21] After publishing the circular, MOC shall notify the commencement of investigation to the applicant, exporters and importers already known to MOC, the government of the country or region under investigation and all other interested parties.

During the investigation process, MOC can actively collect any relevant information and if necessary, set up an experts group for consultation. The experts group is responsible for advising on technical and legal issues involved in the investigation. MOC can also use questionnaires and hearings to collect information from interested parties and carry out the investigation. Upon the agreement by the government of the country or region under investigation, MOC can send officials to that country or region for an on-site investigation. It may also consult with the government of that country or region.[22] In addition, any interested party can apply to MOC for treatment of the documents or materials submitted by that party as confidential, and if accepted, provide a non-confidential version for any public use.[23]

Under the following circumstances, MOC may decide to suspend the investigation and publish the circular to that effect: first, the government of the country or region under investigation undertakes to eliminate or adjust the measure or action in question within a reasonable period; second, that government undertakes to provide appropriate trade compensations to China; third, that government undertakes to perform the obligations under the said international economic and trade treaty or agreement; and fourth, any other circumstance that MOC holds can justify the suspension.[24] If that government fails to perform the above undertakings, the relevant investigation can be resumed. If it indeed performs such undertakings, MOC will issue a circular to terminate the relevant investigation.[25] Alternatively, if the applicant applies for the termination of the investigation and in MOC's opinion this does not conflict with the public interests, or if the applicant does not cooperate with MOC during the investigation process, MOC can also terminate the investigation.[26]

As a general rule, the investigation must be completed within six months of commencement. Under special circumstances, the period may be extended to a maximum period of three months. After the completion of the investigation period, MOC shall issue a circular to publish the decision on whether or not the measure or action in question constitutes the foreign trade barrier as defined under the rule.[27] If MOC has an affirmative decision, it can enter into a bilateral negotiation with the government of that country or region under

21 *Ibid*, Arts 12, 13 and 15.
22 *Ibid*, Arts 18–22, and Art 25.
23 *Ibid*, Arts 23 and 24.
24 *Ibid*, Art 26.
25 *Ibid*, Arts 27 and 29.
26 *Ibid*, Arts 28 and 30(1).
27 *Ibid*, Arts 31 and 32.

investigation, or to start the DSU procedure, or to adopt other 'appropriate measures'.[28] As discussed in Section 8.2.3, the adoption of the first two options by MOC after the investigation is consistent with the WTO Agreement. But if MOC directly adopts retaliation against that country or region under investigation as a kind of 'appropriate measure' in its eyes, this may violate Article 23 of the DSU and thus constitute the WTO-inconsistent unilateral trade retaliation.

[28] *Ibid*, Art 33.

9

Anti-dumping and Anti-subsidies

9.1 OVERVIEW

9.1.1 Evolution

The expansion of trading rights, the reduction of tariff rates and the elimination of import quantitative restrictions may contribute to the surge of importation to the Chinese market. At the same time, the availability of regulatory instruments decreases. In this context, fair trading measures – anti-dumping, anti-subsidies and safeguard measures – must play a more important role to ensure fair competition between foreign and domestic goods in the Chinese market. The implementation and application of fair trading measures by China, after the WTO accession, are new focuses in the regulatory regime of international trade.

The preparation of Chinese anti-dumping legislation started in the early 1980s.[1] The first provisions appeared in the *PRC Foreign Trade Law* (1994), in which Article 30 gave a definition of dumping and an overall authorisation to the State to 'adopt necessary measures to eliminate or alleviate such damage or the threat of such damage or hindrance'. Although this Article, together with Article 29 (for safeguards) and Article 31 (for anti-subsidies), constructed the legal basis of the fair trading system, they were too simple to provide guidance in practical application. Consequently, not until the issuance of *PRC Regulation on Anti-dumping and Anti-subsidies* in 1997[2] did the Chinese anti-dumping system start operating. In a period of a little more than four years (up to the WTO accession), Chinese authorities initiated about 15 anti-dumping investigations and rendered decisions on such products as newsprint, cold-rolled silicon steel sheets, cold-rolled stainless sheets, polyester films, acrylates and dichloromethanes.[3]

There are a number of excellent works analysing China's pre-WTO

1 Wang Chuanli, 'Zhongguo fanqingxiao fa: lifa yu shijian' (Chinese Anti-dumping Law – Legislation and Practices) (1999) 6 *Zhongguo Faxue* (China Law Science) 93.

2 *Zhonghua renmin gongheguo fanqingxiao he fanbutie tiaoli*, issued by the State Council on 25 March 1997.

3 For a compilation, see TW Huang, 'The Gathering Storm of Antidumping Enforcement in China' (2002) 36 *Journal of World Trade* 255.

anti-dumping legislation and practices.[4] On the one hand, the commentators gave a high mark to overall compliance with the WTO agreements in relation to principles and substantive rules[5]; on the other hand, they also identified some deficiencies in the legislation. In summary, the criticisms focused on two grounds: first, some textual disparities existed between the anti-dumping law and the WTO Agreement, or some WTO rules were absent under PRC law; second, the investigation procedures were neither comprehensive nor transparent, which increased the discretionary or arbitrary nature of the Chinese anti-dumping system. Moreover, there was neither a separate anti-subsidies rule nor a safeguards measure, apparently distant from the GATT safeguarding system.

On 26 November 2001, the State Council issued *PRC Anti-dumping Regulations* and *PRC Anti-subsidies Regulations*, replacing the old 1997 *PRC Anti-dumping and Anti-subsidies Regulations*. There are two observations from the first glance at these two regulations. First, the drafting was prepared well before the WTO accession was sealed on 11 November 2001, a sign for the trade regulators' willingness to implement the WTO Agreement in these aspects as early as possible. Second, new regulations were more comprehensive and detailed than the old regulation by covering anti-dumping and anti-subsidies as two separate topics. This is more significant to anti-subsidies, because the old 1997 regulation only gave four provisions to anti-subsidies (Articles 36 to 39) and applied other anti-dumping rules *mutatis mutandis*.

On 31 March 2004, the State Council further amended the *PRC Anti-dumping Regulations* (2001) and the *PRC Anti-subsidies Regulations* (2001), both taking effect from 1 June 2004. This round of amendment was brought by the merger of SETC and MOFTEC, two primary regulators in these areas, into MOC in 2003. Originally, MOFTEC was in charge of the investigation of dumping and SETC was in charge of the investigation of damages. Now, these functions are consolidated into one regulator – MOC. Except for changing the references to SETC and MOFTEC under the 2001 regulations to MOC under the 2004 regulations, other provisions of the 2001 regulations are basically maintained.

As a general observation, all of the 1997 regulation, the 2001 regulation and the 2004 regulation are broadly in line with the *WTO Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994* ('WTO Anti-dumping Agreement') and the *WTO Agreement on Subsi-*

[4] For English literature, see, for example, T Huang: KW Almstedt and PM Norton, 'China's Antidumping Laws and the WTO Antidumping Agreement' (2002) 34 *Journal of World Trade* 75; Jianmin Shen, 'Anti-dumping and Countervailing Laws: An Emerging System in China' (1997) 4 *Asian Comparative Law Review* 135. For Chinese literature, see, for example, Wang Chuanli, above n 1 at 93; Zhang Xiaodong, 'Jiaru WTO yu xiugai zhongguo de fanqingxiao fa' (The WTO Accession and the Revision of Chinese Anti-dumping Law) (2000) 6 *Faxue Pinglun* (Law Review) 105.

[5] Zhang Xiaodong, above n 4 at 107.

dies and Countervailing Measures ('WTO Anti-subsidies Agreement'). In particular, the majority of key concepts and substantive issues are a textual translation or in a simpler form of the corresponding provisions in the WTO agreements. Consequently, some commentators claimed that the 1997 regulations at the outset were 'advanced' or 'scientific' in many areas to follow international standards.[6] However, a number of textual disparities or absences were still addressed under the 1997 regulations as evidence of non-compliance. One major task of the 2001 regulations (now the provisions under the 2004 regulations) was to overcome these textual gaps by making them conform to the WTO rules.

9.1.2 Basic Data

Up to 30 November 2005, China has brought about 40 anti-dumping investigations against various types of imported product. The first case – the *Newspaper* case (see below) was brought on 10 December 1997. MOC (or the former MOFTEC) has issued up to 30 preliminary rulings and up to 25 final rulings.

Up to November 2005, China has not brought an anti-subsidies investigation.

9.1.3 Research Approach

This chapter will focus on analysing the anti-dumping regulatory regime, both on the substantive provisions and on the procedures. Most analysis is also applicable to the anti-subsidies regulatory regime *mutatis mutandis*, so only different points in relation to the anti-subsidies will be discussed.

When analysing the substantive provisions of the anti-dumping and anti-subsidies regulations, a textual comparison will be made between the Chinese regulations and the relevant WTO agreements. As discussed below, the text of Chinese anti-dumping and anti-subsidies regulations is to a great extent consistent with the corresponding provisions in the WTO agreements. However, the consistency of, or similarity to, the WTO agreements does not necessarily secure the required clarity or certainty in the application of these Chinese regulations, because these regulations usually contain abstract or high-level principles. While every principle may be consistent with the provisions in the WTO Anti-dumping Agreement from a textual perspective, there is no detailed explanation of or guidance on the operation of such principles in practice. This makes it difficult to predict the possible actions to be taken

6 See, for example, Zhang Xiaodong, above n 4 at 107; Almstedt and Norton, above n 4 at 113.

by MOC or the possible results to be reached. Although the provisions of the WTO Anti-dumping Agreement are also abstract or of a high-level nature, there are plenty of WTO cases to interpret the meaning of particular words or sentences and give a relatively clear picture to the parties when facing similar situations. Fortunately, the number of Chinese anti-dumping cases has been increasing over years, which can serve as guidance on the application of the law by the regulator to real cases.

Based on the above consideration, the analysis of Chinese anti-dumping law and practice will take the following approach: first, the textual comparison of the provisions of the *PRC Anti-dumping Regulations* and the WTO Anti-dumping Agreement; second, a brief discussion of the WTO rules on each issue, especially those elaborated by WTO cases (only if significant to the Chinese practice); and third, the relevant Chinese case law (not as binding precedents but only with a persuasive value) on the same issue, with a comparison with WTO cases (if possible). This approach may give a better picture on the interpretation and application of the *PRC Anti-dumping Regulations*.

9.2 ANTI-DUMPING: SUBSTANTIVE ISSUES

9.2.1 Definitions

The FTL (2004) provides a basic rule on anti-dumping:

> Where products of another country or region imported into the market of China at prices lower than their normal value by way of dumping result in substantial injury or threat of substantial injury to a related domestic industry that has already been established, or substantially impede the establishment of a related domestic industry, the State may adopt anti-dumping measures to eliminate or mitigate such injury, threat of injury or impediment.[7]

This provision is consistent with the principle or rationale as set up by Article VI (Anti-dumping and Countervailing Duties) of the 1994 GATT.

The *PRC Anti-dumping Regulations* (2004) gives a more detailed definition on the key word 'dumping' as 'the entry into the PRC market by an imported product at an export price lower than its normal value in the ordinary course of trade'.[8] This definition is provided under the WTO Anti-dumping Agreement as follows:

[7] *The PRC Foreign Trade Law, Zhonghua Renmin Gonghe Guo Duiwai Maoyi Fa* (中华人民共和国对外贸易法), promulgated on 12 May 1994 by the Seventh Meeting of the Standing Committee of National People's Congress of the PRC and taking effect from 1 July 1994, as amended on 6 April 2004 and taking effect from 1 July 2004 ('FTL (2004)'), Art 41.

[8] *PRC Anti-dumping Regulations* (*Zhonghua Renmin Gongheguo Fanqingxiao Tiaoli* (中华人民共和国反倾销条例)), issued by the State Council on 31 October 2001, the State Council Decree No 328, revised by the State Council on 31 March 2004 (effective from 1 June 2004), the State Council Decree No 401 ('PRC Anti-dumping Regulations'), Art 3.

> [A] product is to be considered as being dumped, i.e. introduced into the commerce of another country at less than its normal value, if the export price of the product exported from one country to another is less than the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country.[9]

The key words under these two definitions are 'normal value', 'export price', 'domestic market' and 'ordinary course of trade'. Although the WTO definition of 'dumping' refers to the term 'like products' which is absent from the PRC definition of 'dumping', this term is incorporated under the provision on normal value under the *PRC Anti-dumping Regulations*. Combining the consequences of dumping, other key words include 'damages', 'threat of damages' and 'domestic industry'. The interpretation of these key words is the core of the application of anti-dumping laws.

MOC is the primary regulator to investigate and determine the dumping. There are two departments in MOC with direct relevance to trade remedy measures: the Bureau of Fair Trade for Import and Export (in charge of investigation of dumping) and the Bureau of Industry Injury Investigation (in charge of investigation of injury to the domestic industry).

9.2.2 Normal Value

9.2.2.1 PRC Law

The *PRC Anti-dumping Regulations* provide three routes to determine the 'normal value' of the imported product, as the benchmark of the existence of dumping.

The first route is to find out the comparable price in the ordinary course of trade for the like product in the domestic market of the exporting country or region.[10] This provision is consistent with Article 2.1 of the WTO Anti-dumping Agreement. However, PRC law does not define what constitutes the 'comparable price', 'ordinary course of trade', 'like product' and 'domestic market of the exporting country'.

The second route is to find out the comparable price of the like product when exported to an appropriate third country, where there are no sales of

[9] *WTO Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994*, one document of Annex 1A to the *Marrakesh Agreement Establishing the World Trade Organization*, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994 ('The WTO Anti-dumping Agreement'), Art 2.1.

[10] *PRC Anti-dumping Regulations*, Art 4(1), see n 8 above. The term 'country or region' is used in all PRC laws and regulations, aiming to cover not only countries but also regions without a country status but as a separate territorial entity (such as a separate tariff territory). As a simplified approach, the term 'country' is used instead in the following discussion to replace this loaded term.

the like product in the ordinary course of trade in the domestic market of the exporting country (which determines the first route as being non-applicable) or where the price or quantity of such like product cannot offer a fair comparison.[11] This provision is broadly consistent with Article 2.2 of the WTO Anti-dumping Agreement, except for three differences in wording. First, the WTO Anti-dumping Agreement specifies, under the second limb of unavailability of comparable price, that such unavailability be caused by 'the particular market situation or the loan volume of the sales in the domestic market of the exporting country'. It further clarifies that sales of the like product in the domestic market of the exporting country shall normally be considered a sufficient quantity if such sales constitute '5 per cent or more of the sales of the product under consideration to the importing Member'.[12] In contrast, these criteria are absent under PRC law, which makes the application of the second route less certain. The second disparity is that the WTO Anti-dumping Agreement requires a 'proper comparison', while PRC law requires a 'fair comparison'. Having said that, while there exists some delicate differences between 'proper' and 'fair', this disparity will not seriously affect the benefits or interests of the involved parties so long as the Chinese regulator fairly and reasonably compares the normal value under this circumstance. The third disparity is that the WTO Anti-dumping Agreement requires that the comparable price for the export to a third country must be 'representative'; in other words, an abnormal or incidental export price should not be deliberately selected to justify the normal value of the product in question. PRC law does not contain this qualification – in theory, there is potential that the regulator may cherry-pick some data for the export price when applying the second route.

The third route is to find out the cost of production of the imported product in the country of origin plus a reasonable amount for expenses and for profits ('cost-plus method').[13] This provision is consistent with Article 2.2 of the WTO Anti-dumping Agreement. The term 'expenses' under PRC law corresponds to the sentence 'administrative, selling and general costs' under Article 2.2 of the WTO Anti-dumping Agreement. This textual disparity is not a problem as long as the Chinese regulator adopts a wide interpretation of the elements of 'expenses' and makes it broad enough to cover various types of expenses and costs (including those highlighted under the WTO Anti-dumping Agreement).

From a textual perspective, the *PRC Anti-dumping Regulations* contain three routes to determine the normal value, consistent with the WTO Anti-dumping Agreement. However, these Regulations do not cover several issues

[11] *PRC Anti-dumping Regulations*, Art 4(2), see n 8 above.

[12] The WTO Anti-dumping Agreement, Art 2.2, fn 2, see n 9 above. This presumption can be rebutted if the evidence shows that domestic sales at a lower percentage are of sufficient magnitude to provide for a proper comparison.

[13] *PRC Anti-dumpingRegulations*, Art 4.2, see n 8 above.

that are instead elaborated in great detail under the text of the WTO Anti-dumping Agreement. The first issue is how to decide the boundary of 'ordinary course of trade'. PRC law has no definition on the 'ordinary course of trade' – presumably all sales of like products within the domestic market of the exporting country or to a third country in the business of the exporter could be a kind of ordinary trade. If such price is lower than the costs of production, it is difficult to assess whether or to what extent this constitutes a dumping or how this affects the determination of the 'normal value' when sold to the Chinese market under PRC law. Comparatively, the WTO Anti-dumping Agreement excludes those sales in the domestic market of the exporting country or to a third country at a price lower than per unit cost of production (including fixed and variable costs) plus reasonable costs from the scope of 'ordinary course of trade', provided that such sales are made within an extended period (usually one year but in no case less than six months) in substantial quantities[14] and are at prices which do not provide for the recovery of all costs within a reasonable period of time.[15] As a result, artificially low sale prices caused by some special reasons (for example, as a transfer price between the exporter and the purchaser in a third country) over a period of time will be not affect the choice of sample prices for the purpose of determining the 'normal value'. As the *PRC Anti-dumping Regulations* are silent in this respect, MOC must justify the above kind of exclusion in other ways – if the justification is not strong enough, it is potentially subject to the challenges by the affected exporter.

The second issue is that PRC law lacks detailed provisions on the calculation of various costs and profits to be taken into account under the third route. The WTO Anti-dumping Agreement, in contrast, provides some detailed guidance or rules on such calculation. As practice shows, there are few disputes regarding the general principles adopted in the anti-dumping investigations by one importing country, because these principles are after all well understood by the parties involved. Rather, disputes usually occur where people takes different views on the interpretation or application of some technical points (such as those relating to costs accounting and calculation). It is estimated that this absence may sooner or later bring China before the WTO panels for its anti-dumping investigations against foreign products.[16]

The third issue is that PRC law does not provide a back-up route to deter-

[14] The criterion of 'substantial quantity' will be satisfied if the weighted average selling price of the transactions under consideration is below the weighted average per unit costs, or the volume of such sales below per unit costs represents not less than 20% of the volume sold in transactions under consideration. The WTO Anti-dumping Agreement, Art 2.2.1, fn 5, see n 9 above.

[15] The WTO Anti-dumping Agreement, Art 2.2.1, see n 9 above. A presumption is if prices below per unit costs at the time of sale are above weighted average per unit costs for the period of investigation, such prices shall be deemed as providing for recovery of costs within a reasonable period of time.

[16] *Ibid*, Arts 2.2.1.1 and 2.2.2.

mine the normal value of the product in question when there is no export price or such export price is distorted because of affiliation (such as between the parent company and the overseas subsidiaries) or other arrangement (such as the compensatory arrangement for non-normal export prices) between the exporter and the importer or a third party. Article 2.3 of the WTO Anti-dumping Agreement provides that under these circumstances the export price can be constructed on the basis of the first re-sold price of the imported product to an independent buyer (which presumably reflects the arm's length price of such product in the market), or if no such independent buyer, on 'such reasonable basis as the authorities may determine'.[17] As the Panel on *US – Stainless Steel* explained the relationship between this Article 2.3 and the normal way of deciding the normal value under Article 2.1:

> When determining whether dumping exists, Article 2.1 usually requires a comparison of the *export price* with the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country. Article 2.3, however, authorizes a Member to *construct* the export price where, *inter alia*, the actual export price is unreliable because of association between the exporter and the importer.[18]

Where a product is not imported directly from the country of origin, its normal value shall be determined independently in accordance with the rules as discussed above at the exporting country. However, if the product is merely transshipped through the exporting country, or such product is not produced in the exporting country, or there is no comparable price for such product in the exporting country, the price of the like product in the country of origin may be used as a normal value.[19] This rule is consistent with Article 2.5 of the WTO Anti-dumping Agreement.

9.2.2.2 WTO Cases

WTO cases are key to the interpretation of certain key concepts or words in relation to the calculation of the normal value of the imported product under the anti-dumping investigation.

Under the WTO Anti-dumping Agreement, 'like product' should be interpreted to mean a product which is identical, that is, alike in all respects to the product under consideration, or in the absence of such a product, another product which, although not alike in all aspects, has characteristics closely resembling those of the product under consideration.[20] The Panel on *Indo-*

[17] *Ibid*, Art 2.3.

[18] Report of panel on *United States – Anti-dumping measures on stainless steel plate in coils and stainless steel sheet and strip from Korea*, WT/DS179/R, 2001 ('*US – Stainless Steel*'), para 6.90.

[19] *PRC Anti-dumping Regulations*, Art 4(2), see n 8 above.

[20] The WTO Anti-dumping Agreement, Art 2.6, see n 9 above.

nesia – Automobile further clarified that physical characteristics were the dominant, but not exclusive aspect of the concept of 'characteristics closely resembling'. The core would be the competitiveness and substitutability of products; in other words, two products would be 'alike' if they are competitive and substitutable with each other in the market pursuant to the customers' usual perceptions.[21] This rule provides clear guidance on how to judge whether or not the product subject to the anti-dumping investigation can find the 'like product' in the domestic market of the exporting country or a third country for the purpose of deciding the normal value. Comparatively, the *PRC Anti-dumping Regulations* define the 'like product' as the same product as the imported product or if such same product does not exist, the product with the most similar characteristics to those of the imported product.[22] This definition seems to emphasise more of the physical sameness of the like product, but as discussed below, MOC has adopted a wider view on what constitutes 'like product' in the anti-dumping investigations.

For the calculation of the normal value, if the comparable price for the sale of the like product within the domestic market of the exporting country or for the export to a third country can be identified, it is relatively straightforward to determine the normal value. A normal value is usually an average based on a series of domestic sales made during a determined period, and in many cases more than one normal value will be required.[23]

It is more likely that the investigation authorities have to deduct the normal value by using the cost-plus method. The WTO Anti-dumping Agreement provides that the amounts for general costs and for profits shall be based on 'actual data pertaining to production and sales in the ordinary trade of like product by the exporter or producer under investigation'.[24] In the event such actual data cannot be so determined, the amounts may be determined on the basis of:

> (i) the actual amounts incurred and realized by the same exporter or producer in respect of production and sales of 'the same general category of products' in the domestic market of the country of origin; (ii) the weighted average of the actual amounts incurred and realized by 'other exporter or producer subject to investigation' in respect of production and sales of the like product in that market; or (iii) any other 'reasonable method', provided that the amount for profit does not exceed that normally realized by other exporters or producers on sales of products of the same general category in that market.[25]

[21] Report of panel on *Indonesia – certain measures affecting the automobile industry*, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, 1998 ('*Indonesia – Automobile*'), paras 14.172 *et seq*.

[22] *PRC Anti-dumping Regulations*, Art 12, see n 8 above.

[23] E McGovern, *International Trade Regulation* (Exeter, Globefield Press, 1996) para. 12.23.

[24] The WTO Anti-dumping Agreement, Art 2.2.2, see n 9 above.

[25] The WTO Anti-dumping Agreement, Art 2.2.2(i), (ii) and (iii), see n 9 above.

There are some WTO cases in relation to the interpretation and application of these rules.

In respect of the priority of the three options listed above, the Panel on *EC – Bed Linen* concluded that,

> the order in which the three options are set out in Article 2.2.2(i)–(iii) is without any hierarchical significance and that Members have complete discretion as to which of the three methodologies they use in their investigations.[26]

The Appellate Body did not address this proposition in the appeal, so the Panel's view may reflect the legal position now.

Under the first option, the key is to decide the 'same general category of products'. In *Thailand – H-beams*, the Panel did not agree with the argument that the context of Article 2.2.2(i) required the use of broader rather than narrower categories. Usually, the broader the category is, the more products other than the like product will be included, and the more potential there will be for the constructed normal value to be unrepresentative of the price of the like product.[27] But the Panel held that 'use even of the narrowest general category that includes the like product is permitted', because 'the narrower the category, the fewer products other than the like product will be included in the category' which seems to be fully consistent with the rationale to obtain results that approximate as closely as possible the price of the like product.[28]

Under the second option, the key is to decide the 'weighted average' amounts deducted from the data from 'other exporters or producers' subject to the investigation, even though such data is not from the exporter or producer whose product is being investigated. The terms 'weighted average' and 'other exporters or producers' imply that it is not possible to calculate such average relating to only one exporter or producer. Thus, this option is only applicable to calculate the general costs and profits 'if data relating to more than one other exporter or producer is available'.[29] Further, the calculation must be based on *all* of 'the actual amounts incurred and realized' by other exporters or producers – so the investigation authority of one Member cannot exclude those sales that are not made in the ordinary course of trade from the calculation of the 'weighted average' under this option.[30]

Comparatively, the third option simply refers to 'other *reasonable* method', subject to a cap of the profit normally realised by other exporters or

[26] Report of Panel on *EC – Anti-dumping duties on imports of cotton-type bed linen from India*, WT/DS141/R, 2000 ('*EC – Bed Linen*'), para 6.62.

[27] Report of Panel on *Thailand – anti-dumping duties on angles, shapes and sections of iron or non-alloy steel and H-beams from Portland*, WT/DS122/R, 2000 ('*Thailand – H-beams*'), paras 7.114–7.115.

[28] *Ibid*, paras 7.112–7.113.

[29] Report of the Appellate Body on *EC–Anti-dumping duties on imports of cotton-type bed linen from India*, WT/DS141/AB/R, 2001, paras 74–5.

[30] *Ibid*, para 80.

producers in the ordinary course of trade. But the Panel on *EC – Linen* rejected the argument for a separate 'reasonableness test' applicable to the first and the second option. It stated that:

> [W]e conclude that the text indicates that, if a Member bases its calculations on either the chapeau or paragraphs (i) or (ii), there is no need to separately consider the reasonability of the profit rate against some benchmark. In particular, there is no need to consider the limitation set out in paragraph (iii). That limitation is triggered only when a Member does not apply one of the methods set out in the chapeau or paragraphs (i) and (ii) of Article 2.2.2. Indeed, it is arguable precisely because no specific method is outlined in paragraph (iii) that the limitation on the profit rate exists in that provision.[31]

9.2.2.3 Chinese Anti-dumping Investigations

As mentioned above, 30 anti-dumping investigations have been completed. There is enough data to analyse how MOC (or the former MOFTEC, together as 'MOC' for an easy reference) deals with the issue of normal value.

MOC has not found any difficulty in deciding the 'like product'. For example, in the first investigation – the *Newspaper* case, the final ruling dated 3 June 1999 simply indicates that the imported newspaper originated from the US, Canada and Korea is similar to the newspaper produced by domestic enterprises in terms of 'chemical elements, physical characteristics, technical features and functions', thus with 'similarity and comparability' as like product.[32] These factors have been applied in subsequent investigations. Regarding the determination of the same category of product, the regulators held in the second investigation – the *Cold-rolled Silicon Steel* case that,

> the main principles to assess whether different products belong to the same category include whether the physical characteristics are the same, the substitutability of the products, and the competitiveness in the market sales.[33]

So, when assessing whether two products belong to the same category or are alike, the regulators focus more on their substitutability and competitiveness. This approach is in line with the WTO cases.

When deciding the normal value, MOC has frequently applied the third route – the cost-plus method. The *Newspaper* case is a typical example. In this case, six exporters from Canada, Korea and US were investigated. The deci-

31 Panel Report on *EC – Linen*, paras 6.96–6.98, see n 26 above.

32 *Final Ruling of the Anti-dumping Investigation on Imported Newspaper Originated from Canada, Korea and US*, jointly issued by MOFTEC and SETC on 3 June 1999 ('the Newspaper case'), para 2(1).

33 *Final Ruling of the Anti-dumping Investigation on Imported Cold-rolled Silicon Steel Originated from Russia*, jointly issued by MOFTEC and SETC on 11 September 2000 ('the Cold-rolled Silicon Steel'), para 2(1).

sions of the normal value of the newspaper exported by such exporters or producers are as follows:[34]

(1) Howe Sound Pulp and Paper Limited (a Canadian company): this company indicated in the questionnaire that the product was not sold within the domestic market of Canada, so MOC decided to use the 'structured price' method (ie the cost-plus method) to determine the normal value, based on the production costs plus reasonable expenses and profits.
(2) Fletcher Challenge Canada Ltd (a Canadian company): this company provided a table comparing the structured price of the newspaper exported to China and Malaysia and that sold within the Canadian market, and claimed the domestic sale price was not comparable with the export price due to the different needs of the customers. But it failed to provide any evidence on such non-comparability, so MOC rejected relying on the data contained in this table. MOC further reviewed the financial statements produced by this company, but found out two inconsistent points: first, this report covered the period from July 1996 to June 1997, different from the investigation period (December 1996 to December 1997); second, the financial statement did not list the newspaper separately but included it within the category of 'special paper', which made MOC unable to determine the true costs and associated expenses relevant to the newspaper. Moreover, this company had a loss in the main business, so it was not possible to decide the profit rate of such business. Based on these reasons, MOC declined to use the data provided in the financial statement to calculate the structured price of the exported product. It finally chose the 'best information currently available' – the normal value of Howe Sound Pulp and Paper Ltd, as the normal value of the exported product of this company.
(3) Pacifica Papers Inc (a Canadian company): this company only provided the information of one or two sales either within the domestic market or to a third country. MOC decided that such data was not complete or sufficient and thus was not representative. Based on this consideration, MOC chose the 'best information currently available' – the normal value of Howe Sound Pulp and Paper Ltd.
(4) Avenor Inc (a Canadian company): this company provided the information of domestic sale between December 1996 and June 1997, but did not provide any information of sale after June 1997. Moreover, MOC found out that within the sale prices there 'existed significant differences and [were] subject to unpredictable fluctuations between different customers, between different periods of the same customer or even within the same period of the same customer'. This company did not provide any explanation on this phenomenon. The financial statements did not

[34] Final Rulings of the *Newspaper Case*, para 2(2)(i), see n 32 above.

contain comparable data either. Again, MOC chose the 'best information currently available' – the normal value of Howe Sound Pulp and Paper Ltd.

(5) Finlay Forest Industries Inc (a Canadian company): this company did not provide replies to the questionnaire in Chinese, and did not report any domestic sale nor attach the financial statements. Although MOC finally considered its replies written in English due to the fact that it was a small-medium company, MOC decided to choose the 'best information currently available' – the normal value of Howe Sound Pulp and Paper Ltd.

(6) Hansol Paper Co Limited (a Korean company): after the site inspection, MOC confirmed that this company sold a substantial quantity of products in the domestic market at a price not lower than the costs. So it chose the domestic sale prices of this company as the normal value.

In this case, MOC applied all three routes to calculate the normal value of the newspaper under investigation, but obviously relied more on the third route (applied to four out of six exporters under investigation). It refused the information or data from the exporters on several grounds: no information or data relating to the product in question; no explanation of the information or data provided or the comparability or non-comparability of prices; inconsistency of the period covered by the financial statement with the investigation period; no separate data or information on the product in question; insufficient or not enough information or data (to satisfy the 'representative' requirement); and no audited financial statements. These are generally the most likely grounds for MOC to reject the first and the second routes for the normal value and to choose the cost-plus method (in MOC's terminology, the structured price method), and have been applied from time to time in subsequent investigations.

Notably, MOC chose the normal value of the newspaper produced by one company – Howe Sound Pulp and Paper Ltd, as the 'best information currently available' with regard to the normal value of three other companies, either because they did not provide information or data to calculate the normal value of their own products or because the information or data provided was not sufficient or convincing. The key issue is whether this kind of 'second-best' approach complies with the WTO Anti-dumping Agreement. Article 2.2.1.1 of the WTO Anti-dumping Agreement provides that 'costs shall normally be calculated on the basis of records kept by the exporter or producer under investigation', while it is silent on the issue whether the normal value of one exporter can be used as the 'second-best' information to benchmark the normal value of another exporter. However, if it is not possible to determine the amounts for general expenses and for profits of one exporter or producer, the investigation authorities may use 'the weighted average of the actual amounts incurred and realized by other exporters or

producers subject to investigation' (which is the second option under Article 2.2.2). From this perspective, if we view the costs and profits of Howe Sound Pulp and Paper Ltd as such amounts 'incurred and realized by other exporters or producers subject to investigation', these amounts can indeed be the benchmark of similar amounts of other companies where original information or data is not available or non-convincing to MOC. Having said that, MOC did not explain whether or how it chose the 'weighted average' of the actual amounts incurred and realised by Howe Sound Pulp and Paper Ltd, but simply chose the structured price of this company as the benchmark – from this perspective, the reasoning in the final ruling is not sufficient nor convincing and the practice is not consistent with the WTO cases.

It seems that MOC also realised the problem of expressly using another exporter's data to deduce the normal value of other exporters under the same investigation. From the second investigation (the *Cold-rolled Silicon Steel* case in 2000), MOC has tended to use the term 'the best information available' or 'the best information available subject to [MOC's] discretion'. While this term is less controversial, MOC usually does not explain in detail what constitutes the so-called 'best information available'. It is most likely that MOC still uses the reliable information or data from one exporter as the benchmark of such 'best information available'. From this perspective, the change of the expression does not change the essence of the investigation practice.

Another trend seems to be that MOC focuses more on the domestic sales of the exporter or producer in recent investigations, or on how to justify the exclusion of the domestic sale prices even if the exporters or producers supply such information. For example, in the *Aclylate* case (the final ruling dated 10 April 2003), MOC investigated the domestic sale prices supplied by a few exporters or producers under the investigation. For LG Chem, Ltd (a Korean company) and BASF Petrons Chemicals Sdn Bhd (a Malaysian company), MOC decided that the domestic sale prices for certain products were lower than the prices of normal traders because of the affiliate relationship between that company as seller and the purchaser. In the calculation, MOC also included the financing costs but excluded other non-relevant costs such as the entertainment fee or the foreign exchange losses.[35]

In summary, MOC has applied three routes as listed above to determine the normal value of the product under investigation. It is cautious to adopt the domestic sale prices supplied by the exporters or producers and shows a critical attitude when reviewing the relevant information or data. The preference seems to be the cost-plus method, especially when the domestic sale prices or the export prices to a third country cannot be justified or convincing when pulled from the existing information. It also tends to use the most reli-

[35] *Final Rulings of the Anti-dumping Investigation on Aclylate Originated from Korea, Malaysia, Singapore and Indonesia*, issued by MOC on 10 April 2003 ('the Aclylate Case'), para 3(1).

able information and data from one exporter or producer to deduct the normal value of other exporters or producers under the same investigation. The weak point is that MOC's final rulings generally lack the detailed explanation on the deduction of the normal value and instead only provide some general principles or statements.

9.2.3 Export Price

9.2.3.1 PRC Law

If the normal value of the product in question is one pillar of the anti-dumping investigation, the export price of such product to the PRC is another pillar. The margin between the export price (as a lower figure) and the normal value is the margin of dumping such product into the Chinese market.

PRC law recognises two main principles for the determination of export price: first, the price actually paid or payable for the imported product shall be the export price; second, if there is no export price for the imported product (for example, the transactions between the overseas parent company and its PRC subsidiary) or the price is 'unreliable', the export price may be constructed on the basis of 'the price at which the imported product is first resold to an independent buyer' (the 'independent resale price method'). If there is no such independent resale price (for example, no such sale, no such independent buyer or the resold product being in another status after the processing), the export price may be determined on the basis of 'reasonable price deducted by MOC'.[36] These rules are consistent with the WTO Anti-dumping Agreement (Article 2.3).

In most cases, the export price of the product in question is easy to determine, because PRC Customs have maintained the necessary information. The Chinese applicants will also collect sufficient data before they formally launch the application for the anti-dumping investigation. As a result, the key points are first, how to decide the application of the independent resale price method when the export price is 'unreliable' and second, how to decide the 'reasonable price' as the last resort. The PRC anti-dumping regulations do not provide any clue, so it is necessary to analyse the MOC practice in anti-dumping investigations.

9.2.3.2 Chinese Anti-dumping Investigations

The exporters or producers usually provide the information of the export prices to MOC when they answer the questionnaire. MOC has a right to review and assess these prices and to decide if they are genuine and reliable. In

[36] *PRC Anti-dumping Regulations*, Art 5, see n 8 above.

various cases, MOC has rejected the alleged exported prices mainly on two grounds. First, the exporter does not provide the complete set of documents (such as invoices, bills of lading, freights, evidence for payment) to prove the export price. In the *Newspaper* case, one exporter only provided commercial invoices, which could not prove that the prices listed in those invoices were actually paid by the importers.[37] Second, the exporter does not provide enough data to prove the export price. For example, in the *Polyester Film* case, one exporter only provided the export price in one sale, but MOC decided that this data was not enough to prove the export price.[38]

MOC usually excludes the export prices for sales to an affiliated company of the exporter. But it seems not to take a strict approach in this regard. If the exporter provides sufficient information of the affiliated company (acting as the importer) and proves the arm's length price between them, this export price is also acceptable.[39] Where the export price to an affiliated company is not reliable, MOC will use the independent sale price. In the *Dichloromethane* case, MOC decided in the preliminary ruling that the export price of Samsung Fine Chemicals Co Ltd (a Korean company) should be the export price from that company to one affiliated company – Samsung Export Co Ltd because there was no special price arrangement between these two companies and the export price between them could represent the market price. However, Samsung Fine Chemicals Co Ltd argued that the proper export price should be the resale price to an independent purchaser by Samsung Export Co Ltd, rather than the price between these two affiliated companies. MOC accepted this argument in the final ruling and used the resale price within the PRC charged by Samsung Export Co Ltd to an independent purchaser as the export price.[40]

In certain cases, MOC simply refused the export price provided by the exporter by a statement that such information was not genuine, but did not explain the grounds of this statement.[41] From the perspective of due regulation, this is not satisfactory for the reasoning of the judgment.

[37] Final Ruling of the *Newspaper Case*, para 2(2)(ii), see n 32 above.

[38] *Final Ruling of the Anti-dumping Investigation on Polyester Film Originated from Korea*, jointly issued by MOFTEC and SETC on 25 August 2000 ('*the Polyester Film Case*'), para 3(2)(iv).

[39] See, for example, the *Final Ruling of the Anti-dumping Investigation on Stainless Cold-rolled Steel Plate Originated from Japan and Korea*, jointly issued by MOFTEC and SETC on 18 December 2000, para 3 (the discussion in relation to Sumitomo Metal Industries Ltd).

[40] *Final Ruling of the Anti-dumping Investigation on Dichloromethane Originated from UK, US, Netherlands, France, Germany and Korea*, jointly issued by MOFTEC and SETC on 20 June 2002 ('*the Dichloromethane case*'), para 4(4).

[41] See, for example, the Final Ruling of the *Polyester Film Case*, para 3(2)(iii), see n 38 above.

9.2.4 Comparability

9.2.4.1 PRC Law

To compare the normal value and the export price of the product in question, the condition is that these two figures must be comparable. The *PRC Anti-dumping Regulations* have one provision for the comparability issue. As a general principle, it requires MOC to consider all factors of comparability 'that affect the price' and to compare the export price and the normal value in a 'fair and reasonable' manner.[42] Comparatively, the WTO Anti-dumping Agreement has a more detailed provision in this regard.[43] The comparison must be made at the same level of trade, normally at the ex-factory level, and in respect of sales made at as nearly as possible the same time. In addition, various factors affecting the price comparability must be duly considered, such factors including the terms and conditions of sale, taxation, level of trade, quantities and physical characteristics. As discussed below, while the *PRC Anti-dumping Regulations* do not contain such detailed guidance, MOC still applies the WTO rules in its anti-dumping investigation practices.

The second principle is to compare a weighted average normal value with a weighted average of prices of all comparable export transactions, or to compare normal value with export prices on a transaction-to-transaction basis. However, if the export prices differ significantly among different purchasers, regions or time periods which make the weighted-average-based comparison difficult, MOC can compare the weighted average normal value with prices of individual export transactions.[44] This is consistent with Article 2.4.2 of the WTO Anti-dumping Agreement.

9.2.4.2 WTO Cases

Some WTO cases further interpret what allowance can be made so as to achieve the comparability between normal value and export price. In *US – Stainless Steel*, the Panel held that:

> [T]he phrase 'conditions and terms of sale' refers to the bundle of rights and obligations created by the sales agreement, and 'difference in conditions and terms of sale' refers to differences in that bundle of contractual rights and obligations. Thus, to the extent that there are, for example, differences in payment terms in the two markets, a difference in the conditions and terms of sale exists. The failure of a customer to pay is not a condition or term of sale in this sense, however. Rather, non-payment involves a situation where the purchaser has violated the 'conditions

[42] *PRC Anti-dumping Regulations*, Art 6(2), see n 8 above.
[43] The WTO Anti-dumping Agreement, Art 2.4, see n 9 above.
[44] *PRC Anti-dumping Regulations*, Art 6(3) and (4), see n 8 above.

> and terms of sale' by breaching its obligation to pay for the merchandise in question.[45]

Thus, the Panel rejected the argument of the US that the bad debts caused by the bankruptcy of importers should be treated as direct selling expenses to be allocated over all sales.

The WTO Anti-dumping Agreement allows the authorities to make allowances for costs (including duties and taxes) and profits incurred or accrued between importation and resale to independent purchasers when the independent resale method is adopted.[46] But the Panel on *US – Stainless Steel* clarifies that this provides 'an authorization to make certain specific allowances', so 'allowances not within the scope of that authorization cannot be made'.[47] Also, the costs 'incurred between importation and resale' usually means the costs incurred between the time of importation and the time of resale, while this general meaning does not absolutely exclude the costs incurred after the time of resale. But the Panel further pointed out:

> While … as a general principle a related importer may be expected to establish price based on costs plus profit, a price certainly cannot be expected to reflect an amount for costs that were entirely unforeseen at the time the price was set. To deduct costs which not only were incurred after the date of resale but which were certainly unforeseen at that time would not result in a 'reliable' export price in the sense of the price that would have been paid by the related exporter had the sale been made on a commercial basis.[48]

A kind of 'foreseeability' test still applies to the determination of such costs to be deducted from or added into the export price.

9.2.4.3 Chinese Anti-dumping Investigations

The comparability between the normal value and the export price and the relevant adjustment of the export price are two weak points in the final rulings of MOC on anti-dumping investigations. A template paragraph in the final rulings to deal with these issues will read as follows:

> [MOC] has compared the normal value of [the products of] all companies under the investigation with their export prices at the ex-factory level. In accordance with Article 6 of the PRC Anti-dumping Regulations, the comparison by MOC has been carried out on the basis of the evidence and materials provided by these companies and in a fair and reasonable manner, and has adjusted appropriately the following factors: transportation costs, insurance costs, packaging costs, port expenses,

45 Panel Report on *US – Stainless Steel*, para 6.75, see n 18 above.
46 The WTO Anti-dumping Agreement, Art 2.4, the fourth sentence, see n 9 above.
47 Panel Report on *US – Stainless Steel*, para 6.94, see n 18 above.
48 Panel Report on *US – Stainless Steel*, para 6.100, see n 18 above.

> credit expenses, kickbacks, commissions and profits etc. For certain expenses not supported by evidence, MOC has adjusted them accordingly on the basis of currently available materials.[49]

This template has been used from the first case until late 2003. The reasoning was extremely insufficient and made the decision process of MOC in this area totally non-transparent. It is not possible to judge what items have been adjusted, whether they are foreseeable or not, whether there exists differences in the rights and obligations of various transactions, and how the adjustment could be deemed reasonable and fair. If MOC did not change this reasoning style, it would be vulnerable before a WTO panel if challenged.

The latest published final ruling on optical fibers imported from the US, Japan and Korea[50] suggests some improvements in this respect. In relation to each company under the investigation, MOC separately discusses the normal value and the export prices, as well as the applications from that company for adjustment and the decision to take or not to take such adjustment by MOC. For example, one US company, Corning Incorporated, exported all products to the PRC within the investigation period through its Hong Kong subsidiary. That subsidiary sold the products partly to independent domestic buyers, and partly to the company's affiliates within the PRC for processing. MOC decided to choose the resale price to independent domestic buyers as the basis of export prices. For the part of products sold to the affiliated companies, MOC used the weighted average of the independent resale prices to replace the actual prices for such connected transactions. However, the final ruling does not specify how MOC reached the weighted average of export prices of Corning Incorporated on the basis of these two parts of export prices – presumably, it adopted a weighted average approach to combine these parts.

For the adjustment items, Corning Incorporated applied to deduct the after-sale service expenses, marketing expenses and travel expenses from the export price. MOC reviewed the relevant documents and acknowledged the genuineness of these expenses, but still refused to adjust on the ground that these expenses were not 'directly relevant to the export sales to the PRC of the product in question'. Instead, MOC recognised the reliability of the information or documents in relation to such costs and expenses as kickbacks, refunds and compensation, inland freight, storage expenses before sale, inland insurance expenses, international freight and insurance expenses, packaging expenses, credit expenses and advertisement expenses, and used the supplied figures to adjust the export price accordingly. The scope of adjustable expenses, costs and profits satisfies the foreseeability test under the WTO cases. Because this company sold products to the PRC market under the CIF term, MOC adopted the invoice amounts for such sales to calculate

[49] See, for example, the Final Ruling of the *Aclylate Case*, para 3(2), see n 35 above.

[50] *Final Ruling of the Anti-dumping Investigation on Optical Fibers from US, Japan and Korea*, issued by MOC on 1 January 2005 ('The *Optical Fibers* Final Ruling').

the weighted average CIF prices.[51] From this latest example, MOC seems to be on the right track for improving the reasoning in its rulings with regard to the comparability and adjustment issues.

9.2.5 Injury

9.2.5.1 PRC Law

The term 'injury' means material injury or threat of material injury to an established domestic industry or material retardation of the establishment of such domestic industry.[52] MOC is now in charge of the investigation and determination of injury. Where the investigation involves agricultural products, MOC should work with the Ministry of Agriculture for the investigation and determination of injury.[53] Before the creation of MOC, this work was assumed by the then SETC.

PRC law provides a non-exhaustive list of factors to be reviewed for the purpose of determination of injury: first, whether the volume of imported products that have been dumped into the Chinese market ('dumped product'), including the volume of dumped products either in absolute terms or relative to the production or consumption of a like domestic product, has been increasingly significantly, or the possibility of a significant increase in dumped product; second, the effects of dumped imports on price, including price undercutting by the dumped product, or the significant suppressing or depressing effects on the price of a like domestic product; third, the consequent impact of the dumped imports on the relevant economic factors and indices of the domestic industry; fourth, the production capacity or export capacity of the exporting country or the country of origin, and inventories of such dumped product; and fifth, other factors that may cause or have caused injury to a domestic industry.[54] There are three qualifications on the discretion of MOC. The threat of material injury must be based on facts and not merely on allegation, conjecture or remote possibility. The determination must be based on positive evidence and the injuries caused by factors other than dumping must not be attributed to dumping.[55] In addition, the effects of dumped imports shall be assessed in relation to the separate identification of the domestic production of the like product, or if not possible, at least by the

51 *Ibid*, para 4(i) (in relation to Corning Incorporated).

52 *PRC Anti-dumping Regulations*, *Zhonghua Renmin Gongheguo Fanqingxiao Tiaoli* (中华人民共和国反倾销条例)), issued by the State Council on 31 October 2001, the State Council Decree No 328, revised by the State Council on 31 March 2004 (effective from 1 June 2004), the State Council Decree No 401 ('PRC Anti-dumping Regulations'), Art 7(1).

53 *Ibid*, Art 7(2).

54 *Ibid*, Art 8(1).

55 *Ibid*, Art 8(2) and (3).

examination of the production of the narrowest group or range of products (including the like domestic product).[56]

Sometimes the dumped imports originate from two or more than two countries. MOC can assess the cumulative impact of such product from different countries on the domestic industry, after satisfying two conditions. First, the margin of dumping established in relation to the dumped imports from each country is no less than two per cent and the volume of such imports from each country is not negligible. Second, a cumulative assessment is appropriate in light of the conditions of competition between the dumped imports and the domestic like product. According to the *de minimis* principle, the volume of dumped imports from one country will normally be regarded as negligible if it accounts for less than three per cent of the total imports of the like product, unless countries which individually account for less than three per cent of the total imports of the like product collectively account for more than seven per cent of its total imports of the like product.[57]

The above rules in the *PRC Anti-dumping Regulations* seem to be straightforward in meaning and application on paper, although MOC has sufficient flexibility to apply these abstract rules into the investigation practices. These rules are basically the Chinese translation of the corresponding provisions under Article 3 of the WTO Anti-dumping Agreement. One notable difference is about the threat of material injury. PRC law lists several factors to be taken into account when MOC determines the injury to the domestic industry, but only has an abstract principle requiring the facts other than allegations or remote possibility for the determination of threat of material injury. Comparatively, the WTO Anti-dumping Agreement requires that the threat of material injury must be 'clearly foreseen and imminent' and lists certain factors (such as the significant rate of increase of dumped product, the sufficiently free disposable or imminently substantial increase in the capacity of the exporter, the prices and the inventories) to be considered. It further qualifies that none of the above factors by itself can give decisive guidance to the existence of 'threat of material injury', but these factors in total must be able to lead to the conclusion that 'future dumped exports are imminent and … unless protective action is taken, material injury would occur'.[58] Since the *PRC Anti-dumping Regulations* lack the guidance on the determination of 'threat of material injury', the relevant WTO rules can serve as a reference. Actually, the absence of guidance (or more precisely, the qualifications) on this issue could give as much discretion as possible to MOC and virtually expands the net of Chinese anti-dumping regulation. After all, not every investigation can lead to a firm conclusion that the domestic industry has already been injured. The greater the discretion of MOC in respect of the determination of 'threat' of injury, the more it is possible that the

56 *Ibid*, Art 10.
57 *Ibid*, Art 9.
58 The WTO Anti-dumping Agreement, Art 3.7, see n 9 above.

investigation can achieve a favourable result for the affected domestic industry.

9.2.5.2 WTO Cases

In *Thailand – H-Beams*, the Appellate Body held that 'Article 3.1 [of the WTO Anti-dumping Agreement] … permits an investigating authority making an injury determination to base its determinations on *all* relevant reasoning and facts before it', rather than only upon evidence disclosed to it by the parties.[59]

The injury must be caused by the 'dumped imports', but it is not clear from the text of the WTO Anti-dumping Agreement whether or not such dumped imports mean those products dumped by the exporters under investigation (that is, those sold at export prices below the normal value). The Panel on *EC – Bed Linen* clarified that once a determination has been made that a product in question from particular producers is being dumped, this conclusion will then apply to all imports of that product from that source (whether or not at a dumped price).[60]

9.2.5.3 Chinese Anti-dumping Investigations

MOC has found no difficulty in considering all relevant reasoning and facts when it determines the injury of dumping to the domestic industry, and usually has gone beyond the information provided by the relevant parties. It also considers the impact caused by all imported product in question, rather than limiting its consideration to the dumped product only. These approaches are consistent with the WTO cases.

MOC has applied a template of analysis to the injury issue in anti-dumping investigations since the first case. A normal format of the section in final rulings on the injury will include the following parts, usually using the data from the previous three years (including the investigation period): the consumption of the product in question in the Chinese market; the quantities of importation of the product in question and the market share in the PRC; the export prices of the product in question; and the impact of the product in question on the relevant domestic industry in the PRC. The last part – the impact on the domestic industry – is generally the focus of the reasoning and covers a number of factors. For example, the final ruling of the *Aclylate* Case took into account the following factors to prove the injury caused by the dumped imports: the suppression on the increase of production capacity for the like product by the domestic industry; the rate of increase of the output of the like product by the domestic industry; the suppression on the increase

[59] Appellate Body Report on *EC–Anti-dumping duties on imports of cotton-type bed linen from India*, WT/DS141/AB/R, 2001 ('*Thailand – H-Beam*'), para 107.

[60] Panel Report on *EC – Bed Linen*, para 6.136, see n 26 above.

of the sales volumes of the like product by the domestic industry; the declining rate of the increase of the sales revenues of the like product by the domestic industry; the declining of the market share of the like product by the domestic industry; the increase of the labour production rate over the period (proving that the decrease of domestic industry is not caused by the reduction in the labour production rate); the fluctuation of domestic prices and before-tax profits of the like product and the trend of declining; the declining of the investment returns on the domestic industry; the increase of net cash outflow of the domestic industry; the increase of the unemployment rate of the domestic industry and the decrease of the average salary of employees of the domestic industry; and the increase of the inventories of the like product by the domestic industry.[61] From the above list of factors (which can also be found in almost all anti-dumping final rulings to date), MOC seems to take into account all possible factors and assess their impact on the domestic industry, so that the injury to the domestic industry can be justified. This detailed approach is consistent with the WTO rules.

Moreover, MOC usually goes one step further by analysing other factors that might cause injury to the domestic industry, with a purpose to prove that the injury is indeed not caused by such 'negative factors'. These factors include the domestic need, the change of the domestic consumption model, the management of the domestic industry, the imports of the product in question from other countries (which are not subject to the investigation), the competition status between domestic like product and imported product, the relevant domestic policy, and the force majeure.[62] This step is to ensure that the injury to the domestic industry is not caused by some other reason than the dumped imports. For example, natural decrease of the domestic need or change of the consumption model could also contribute to reduced needs for the like product of the domestic industry and thus cause the domestic industry to decline in terms of production capacity, output volume or sale prices. By this approach, MOC presents a stronger case to conclude the existence of injury to the domestic industry.

Notably, two anti-dumping investigations – the *Polystyrene* case (2001) and the *L-Lysine Monohydrochloride* case (2002) were terminated after the preliminary ruling because the investigating authority concluded that the domestic industry was not injured by the dumped imports. In the *Polystyrene* case, it was found that the volume of imported product had been decreasing during the past three years, as well as the PRC market shares of the exporters under the investigation. In addition, the price of the imported product had a trend of increase in prices. For the domestic industry, the annual output volume had been increasing, resulting in the increase of prices, sale revenues, before-tax profits, investment returns as well as the employment rate and salary level. As a result, the investigation authority concluded that:

[61] Final Ruling of the *Aclylate Case*, para 4, see n 35 above.
[62] Final Ruling of the *Aclylate Case*, para 4(7), see n 35 above.

> Although the product in question originated from Korea, Japan and Thailand has a relatively large volume of export to the PRC market during the investigation period, occupying about one third of the domestic market share, and has caused certain negative impact on the domestic industry, the quantity of imported product has been declining in recent years, with an increase of [import] prices. In addition, various business ratios of the applicants have returned to the normal status. Consequently, there is no reasonable data showing that the domestic industry has suffered a material injury. [63]

A similar analysis was adopted in the preliminary ruling of the *L-Lysine Monohydrochloride* case. In that case, the investigating authority found the trend of the increase of various business ratios of the applicants in terms of output volume, sales, sale prices, sale revenues, before-tax profits and utilisation rate, in spite of the increase of imported volume. This proves that the domestic industry was not suppressed by the dumped imports. Therefore, the conclusion was that the product in question imported from the US, Korea and Indonesia did not cause material injury or a threat of material injury to the domestic industry – a step further than in the *Polystyrene* case for only opining on the non-existence of the threat of material injury.[64]

9.2.6 Causation

9.2.6.1 PRC Law

The requirement of causation is straightforward: the injury to the domestic industry must be caused by the dumped imports. If the domestic industry has been injured but injury has been caused by other reasons than the dumped imports, the dumping itself cannot be blamed. The *PRC Anti-dumping Regulations* simply require the preliminary and final rulings of MOC to determine 'the dumping, the injury and the causation between these two facts'.[65]

The WTO Anti-dumping Agreement has a more comprehensive provision on this requirement. It provides that the demonstration of a causal relationship between the dumped imports and the injury to the domestic industry must be based on an examination of all relevant evidence, and the authorities must examine any known factors other than the dumped imports which are injuring the domestic industry and exclude such factors from the determination. These non-attributable factors usually include the volume and prices of

[63] *Final Ruling of the Anti-dumping Investigation on Polystyrene Originated from Korea, Japan and Thailand*, jointly issued by MOFTEC and SETC on 6 December 2001 ('*the Polystyrene Case*'), para 4.

[64] *Final Ruling of the Anti-dumping Investigation on L-Lysine Monohydrochloride Originated from US, Korea and Indonesia*, jointly issued by MOFTEC and SETC on 29 September 2002 ('*the L-Lysine Monohydrochloride case*'), para 4(5).

[65] *PRC Anti-dumping Regulations*, Arts 24 and 25, see n 52 above.

imports not sold at dumping prices, contraction in demand or changes in the patterns of consumption, trade-restrictive practices of and competition between the foreign and domestic producers, developments in technology and the export performance and productivity of the domestic industry.[66] Although the *PRC Anti-dumping Regulations* do not contain similarly detailed provisions, as shown from the discussion of the Chinese anti-dumping investigations, MOC does elaborate in its final rulings how those non-attributable factors affect the domestic industry. Therefore, the Chinese practice is broadly consistent with the WTO rules.

9.2.6.2 Chinese Anti-dumping Investigations

MOC distinguishes all factors affecting the domestic injury into two groups: the direct reasons caused by the dumped imports and the indirect reasons not caused by the dumped imports. While it does not specify the standards for balancing these two groups of reason, it may take a probability test in practice to decide which group wins. If the direct reasons outweigh the indirect reasons (which is the case in most investigations), MOC will conclude a causal link between the dumped imports and the injury to the domestic industry.

The reasoning in the *Polystyrene* case is reflective of the absence of the causal link between the dumped imports and the injury to the domestic industry. The investigating authority noticed that the sale volumes of the applicants during the investigation period had increased on a rate slower than the increase of domestic needs and that the domestic market shares of such applicants had dropped, with an increase of inventories. However, there was no evidence to show that these were caused by the dumped imports. There were three reasons to support this observation. First, the import of the product in question was not mainly from Korea, Japan and Thailand (in aggregate dropping from 52 per cent in 1998 to 42 per cent in 2000). The significant increase of the import of the product in question was from other countries. Second, quite a few new factories with advanced technology were put into operation during the investigation period, which products were like the imported product and were sold totally within the PRC. This broke the existing market division and competition status and suppressed the production and operation of existing factories owned by the applicants. Third, the market needs and purchasing power for polystyrene dropped since 2000 due to the world economic recession, which must have a negative impact on the domestic industry. Based on these reasons, the investigating authority concluded that the dumped imports had not caused a material injury to the domestic industry.[67]

[66] The WTO Anti-dumping Agreement, Art 3.5, see n 9 above.
[67] Final Ruling of the *Polystyrene Case*, para 5, see n 63 above.

9.2.7 Domestic Industry

Under the *PRC Anti-dumping Regulations*, the term 'domestic industry' means the domestic producers as a whole of the like products within the PRC or those of them whose collective output constitutes a major proportion of the total production of those products. But those domestic producers that have an affiliation with the exporters or importers or act as importers of the dumped product must be excluded from the scope of domestic industry. In exceptional cases, the producers within a regional domestic market may be regarded as a separate industry in the event that the producers within such market sell all or almost all of the like products in that market, and the demand in that market is not to any substantial degree supplied by other domestic producers outside that market.[68] These rules are basically the Chinese translation of Article 3.7 of the WTO Anti-dumping Agreement.

There are two significances for determining the scope of 'domestic industry'. First, an anti-dumping investigation application can only be brought by one or more than one applicant jointly when they can represent the domestic industry in question. This is to prevent the abuse of the anti-dumping regime, for example, by one small domestic producer with a small volume of output. Usually, the representativeness is based on the aggregate of the output volumes of the applicants compared to the total output volumes of the whole industry. Thus, the bigger the domestic industry, the more difficult it is for the applicants to satisfy the threshold for application. Second, as a rule of thumb, it is always easier for the investigating authority to prove that the dumping has caused an injury to a relatively small domestic industry. If the domestic industry is big enough, the impact of the dumped product may be absorbed by the market or even escape the notice of the market. Due to these concerns, the applicants tend to prove a narrow scope of domestic industry that they are representing for the anti-dumping investigation.

In the anti-dumping investigations, MOC takes a practical approach – instead of proving the like products and the domestic industry, it tends to replace the concept of domestic industry with that of like products. While the final rulings still mention the term of 'domestic industry', MOC focuses on the assessment, whether or not the products manufactured or sold by the applicants are the like product of the dumped imports. If they are the like products, MOC will further determine whether the applicants have an aggregate output of such like products that satisfies the threshold for application: if yes, it will admit that the applicants represent the domestic industry. The impact on the domestic industry by the dumped imports will then practically turn to the question of how the dumped imports affect the production and operation of the business of these applicants. So long as the applicants can meet the threshold in terms of output volumes, this simplified approach does

[68] *PRC Anti-dumping Regulations*, Art 11, see n 52 above.

not differ much from the WTO rules even though it does not use the term 'domestic industry' in a consistent way.[69]

9.3 ANTI-DUMPING: INVESTIGATING PROCEDURES

9.3.1 Overview

One deficiency of China's pre-WTO anti-dumping practice was that it lacked a transparent, fair and foreseeable procedure, due to the limited provisions on procedural issues in the old regulations and the greater discretionary powers in the hands of the government. The injustice involved in the process of reaching substantive decisions may also cause poor substantive outcomes.

This part outlines how Chinese anti-dumping law implements the relevant WTO rules in relation to investigation procedures. The then MOFTEC issued a package of such administrative rules on 13 March 2002, effective from 15 April 2002. Together with existing rules, they constitute a comprehensive, detailed anti-dumping procedure. Table 9-1 illustrates this coverage.

9.3.2 Initiation of the Anti-dumping Investigations

Under the *PRC Anti-dumping Regulations*, the domestic industry or the natural person(s), legal person(s) or the relevant organisation(s) (collectively as the 'applicants') that can represent the domestic industry have the right to submit a written application to MOC for the anti-dumping investigation.[70] The domestic industry is an abstract concept and may be viewed as an aggregation of all domestic producers and traders of the same industry. Therefore, the domestic industry usually acts through one organisation – generally the industry association (whether sponsored by the government or self-organised) – or several big domestic players to present its interests and requirements. Considering the concept of 'domestic industry' (see above), all producers, or at least the producers of which output volume occupies the significant part of the total output volume of the like product by all such producers, can claim to represent the domestic industry. From this perspective, so far as the producers that one industry association represents can satisfy this quantity threshold, that association can be representative of the domestic industry and has the right to apply for an anti-dumping investigation by MOC.

[69] See, for example, the Final Ruling of the *Polystyrene Case*, para 2, see n 63 above. Actually, every final ruling has a separate paragraph (usually paragraph 2 or 3) discussing the domestic industry and the like products of the applicants.

[70] *PRC Anti-dumping Regulations*, Art 13, see n 52 above.

Table 9-1 Key Components of the Anti-dumping Procedure: Chinese Implementing Measures

Stage	Name of Chinese Rules	WTO Anti-dumping Agreement
Initiation	Interim Measures on Initiation Standards of Anti-dumping Investigation	Article 5
Evidence	Interim Measures on On-site Verification	Article 6.7 and Annex 1
	Interim Measures on Questionnaire Investigation	Article 6.1
	Interim Measures on Sampling	Article 6.10
Investigation	Interim Measures on Information Disclosure	Article 6.8 and Annex 2
	Interim Measures on Access to Non-confidential Information	Article 6.5
	Interim Measures on Hearing Meetings of Anti-dumping Investigation	Article 5
	Measures on Hearing Meetings for Determination of Injury to Industry	Article 5
	Rules on Investigation of Industrial Damages in Anti-Dumping Cases	Article 3
Price Undertakings	Interim Measures on Price Undertakings	Article 8
Enforcement	Interim Measures on Tax Refund	Article 9.3
	Interim Measures on Review of New Exporters	Article 9.5
	Interim Measures on Procedures of Adjusting the Scope of Anti-dumping Products	Article 10

The key issue is how to set up the quantity threshold as a pre-condition for the initiation of anti-dumping investigations. If the threshold is too high, it creates an obstacle to the domestic industry or indeed the producers making up the domestic industry to rely on the anti-dumping remedy. If the threshold is too low, this remedy could be abused by one or a few domestic producers which only occupy a small or even negligible percentage of the total output volume of that domestic industry. Because the initiation of the investigation process may impose tremendous pressures on the operation of foreign competitors during their export to the Chinese market, the abuse of this remedy means a kind of trade protectionist measure that is inconsistent with the spirit

of the WTO Agreement and the FTL (2004) – the encouragement and facilitation of free trade. MOC has to find a balancing point on this issue.

Currently, PRC law sets up a threshold of 50 per cent of the total output volume of the represented domestic industry. If the aggregate of the output volumes of the applicants (either as an association or as the domestic producers) occupies 50 per cent or more than 50 per cent of the total output volume of the like products on a nation-wide basis, the applicants are eligible to bring the application for the anti-dumping investigation against the (suspicious) dumped imports.[71] However, this 50 per cent threshold may still be too high to most applicants. PRC law relaxes this threshold to a certain degree. For the part of the domestic industry expresses either support for or opposition to the application ('expressed domestic industry'), the applicants will be deemed eligible if the application is supported by those domestic producers whose aggregate output volumes exceed 50 per cent of the total output volumes of the expressed domestic industry.[72] Nevertheless, where the aggregate of the output volumes by those domestic producers who express support for the application is below 25 per cent of the total output volumes of the like products in the PRC, the investigation procedure cannot be initiated – in other words, an absolute minimum threshold still exists.[73] These rules are consistent with Article 5.4 of the WTO Anti-dumping Agreement.

As a practical matter, it is now likely that several big domestic producers can apply to MOC for the initiation of the anti-dumping investigation against one imported product, as long as their output volumes occupy at least 25 per cent of the total output of the like product in the PRC. If these companies express the support for the application, which is self-evident as they can even bring up the application by themselves, they will be eligible applicants in accordance with PRC law. Of course, it is rare in practice that one single domestic producer can satisfy this minimum threshold, so the application is often submitted by a group of domestic producers together with the relevant industry association.

The written submission should contain the following minimum contents: the names, addresses and relevant information of the applicants; the complete description of the imported product under investigation, including the name of the product, the exporting or originating country or countries involved; the exporters or producers known to the applicants; the price information of the product in question in the exporting or originating country or countries; the export prices etc; the output volumes and value of the

[71] *Interim Measures on Initiation Standards of Anti-dumping Investigation*, MOFTEC Order No 8 (2002), effective from 13 March 2002, Art 5.

[72] *PRC Anti-dumping Regulations*, Art 17, see n 52 above; *Interim Measures on Initiation Standards of Anti-dumping Investigation*, Art 6, see n 71 above.

[73] *PRC Anti-dumping Regulations*, *Zhonghua Renmin Gongheguo Fanqingxiao Tiaoli* (中华人民共和国反倾销条例)), issued by the State Council on 31 October 2001, the State Council Decree No 328, revised by the State Council on 31 March 2004 (effective from 1 June 2004), the State Council Decree No 401 ('PRC Anti-dumping Regulations'), Art 17.

like product produced in the PRC; and the quantity of imported product and the effects on the domestic industry.[74] The submission must attach the relevant evidence to prove that the product in question has been dumped into the Chinese market and there is a causal link between the dumping and the injury to the domestic industry.[75] The *Interim Measures on Initiation Standards of Anti-dumping Investigation* contain some more detailed guidance on the information or evidence that the applicants must submit to justify the application.

MOC must review the application within 60 days of receipt and decide whether or not to initiate the anti-dumping investigation.[76] If it decides to investigate, it shall notify the initiation of such investigation to the governments of the export country or countries, as a notification obligation under the WTO Anti-dumping Agreement. Under certain circumstances, MOC may initiate the investigation by itself without an application from the domestic industry, provided that it has sufficient evidence to prove the existence of the dumping and the injury to the domestic industry, as well as the causal link between them.[77] This 'patronising' clause empowers MOC to initiate the anti-dumping investigation, but it is more likely that it will not exercise this power in normal cases. After all, it is the domestic industry (or the relevant domestic producers) that can judge whether there is a dumping in the market and how it affects them and what would be the best way to deal with this situation. Government officials, no matter how enthusiastic they are, may not replace the collective function of the domestic producers.

The issue is whether MOC really acts as a filter to stop those unfounded applications (which are more like a nuisance to the normal importation of the like product) or whether it only reviews the application in a formal way and then starts the investigation in any way. In the latter case, this trade remedy measure seems to be used as a tactic by domestic producers to prevent the further penetration by the imported product in question. In practice it is difficult to assess the behaviours of MOC in this respect due to several reasons. First, most anti-dumping applications to date have been brought either by large domestic producers as state-owned enterprises or by the relevant industry association which itself tends to have a strong link with the government.[78] The applicants are likely to formally or informally have some communications or enquiries with MOC (or those officials in charge of the anti-dumping investigations) before they submit the application. This kind of communica-

[74] *Ibid*, Art 14.
[75] *Ibid*, Art 15.
[76] *Ibid*, Art 16.
[77] *Ibid*, Art 18.
[78] Indeed, most national industry associations are even transformed from the former ministries with the line management jurisdiction over the relevant industries. For example, the Association of Textile Industry and the Association of China Coal Industry are successors to the former Ministry of Textile Industry and Ministry of Coal Industry in respect of the function of industrial self-regulation.

tion channel (even being an under-table form) ensures that MOC actually gets involved in an earlier stage than the law requires, and also reduces (if not eliminates) the possibility of the application being rejected by MOC. Second, the anti-dumping investigation is one key trade remedy available to the Chinese government, which will naturally tend not to impose too rigid requirements on the applicants at the first stage. Third, as a practical matter, to bring an anti-dumping investigation means a big investment of time and expense by the applicants who have no incentives to submit a hopeless application. Without a justifiably strong case, any sensible domestic producer will not invest in any futile efforts. Consequently, while there is no evidence to prove that MOC allows the abuse of the anti-dumping applications, it may adopt somehow a favourable attitude toward these applications.

9.3.3 Information Disclosure

Two aspects of information disclosure exist in the anti-dumping investigation: the information disclosed by interested parties and the access by the other side, and the information disclosed by the regulator relating to the investigation and decision-making processes.

The *Interim Measures on Access to Non-Confidential Information*[79] cover the first aspect. It defines 'non-confidential information' as information that is not labeled by one party or determined by the regulator as confidential.[80] Interested parties may review or photocopy such non-confidential information at a place and time designated by the regulator.[81]

One weak point in regulating information disclosure by interested parties is the question of how to decide on the confidentiality of information. The *PRC Anti-dumping Regulations* only stipulate in principle that the interested parties may apply for confidentiality if they 'believe[] that [disclosure] will cause serious harm' and the regulator may approve given it 'deem[s] such request to be well grounded'.[82] The general practice is for the party supplying the information to identify and label which parts are confidential to the regulator only and which parts are non-confidential and therefore available to other parties. The regulator has the final discretion on the degree of disclosure. The crucial point is: besides this general principle, are there any other reliable standards to assess the impartial and fair exercise of regulatory discretion? The current measures are silent on this point and may well undermine impartiality in information disclosure. For example, it is likely that the regu-

[79] *Interim Measures on Access to Non-Confidential Information*, MOFTEC Order No 19, effective from 15 April 2002.

[80] *Ibid*, Art 5. For example, such information includes the application for investigation, the questionnaire answered by foreign exporters and the summaries of the regulator's on-site investigation.

[81] *Ibid*, Arts 7–10.

[82] *PRC Anti-dumping Regulations* (2004), Art 22, see n 73 above.

lator would adopt a stricter attitude toward foreign exporters and producers, with the effect that domestic applicants may disclose less information in otherwise similar scenarios. The unequal level of available information would disadvantage foreign exporters and producers, especially for the preparation of replies or comments. In order to reduce the possibilities of this potentially impartial treatment, it is suggested here that the regulator should develop a more tangible set of rules or guidelines to direct the judgment of confidential information. The basic rule may be to the detriment of the party who supplies the relevant information if such information is obtained by other parties with adverse commercial interests.[83]

The second aspect is covered by the *Interim Measures on Information Disclosure* purporting to ensure the 'equality, fairness and transparency' of anti-dumping investigation.[84] 'Disclosure' is defined as the procedure by which the regulator provides the interested parties with 'basic data, information, evidence and reasons' used to determine the existence and extent of dumping.[85] Accordingly, the regulator is obliged to disclose all information (including reasons) relevant to its determinations in three chains of investigation: within 20 days after the publication of the preliminary determination,[86] a 'reasonable period' after the completion of on-site verification,[87] and 'not less than ten days' before the final determination.[88] The contents to be disclosed include: key data or evidence[89] relied on in determining the existence of dumping and the margin of dumping, the reasons for adopting – or not adopting – some data or evidence, the utilisation of the currently most available information, and the authenticity, completeness and accuracy of data and information.[90]

In summary, the increase of transparency in these aspects is not only a compliance with the WTO rules but more importantly, acts as a sample to other regulatory processes in trade-related areas or in general. Chinese regulators may be more inclined to observe better the timelines and standards of regulatory process if the relevant law sets up specific and unambiguous requirements or guidance. The anti-dumping investigation procedure suggests two directions to improve the regulatory process: first, specific deadlines must be prescribed for a particular action of the regulator, while discretion needs to be restricted and limited as possible; second, the law must list specific standards or factors to be taken into account for decisions, as guidance to both the interested parties and the regulator itself.

[83] See, for example, Report of panel on *Argentina – measures affecting the export of bovine hides and the import of finished leather*, WT/DS155/R, 2000, para 11.92 *et seq*.
[84] *Interim Measure on Information Disclosure*, MOFTEC Order No 18, effective from 15 April 2002, Art 1.
[85] *Ibid*, Art 3.
[86] *Ibid*, Art 7.
[87] *Ibid*, Art 9.
[88] *Ibid*, Art 10.
[89] For example, the data or evidence relates to normal value, export price and costs. *Ibid*, Art 5.
[90] *Interim Measure on Information Disclosure*, Art 9, see n 84 above.

9.3.4 Investigation

9.3.4.1 Public Notice

After MOC decides to initiate the investigation, it has the obligation to issue a public notice, usually published in the MOC Gazette. MOC shall also notify the applicants, exporters or producers and importers already known, the governments of the exporting countries and all other organisations or individuals with an interest in the investigation (together as the 'interested parties').[91] The notice usually provides a period for the exporters or producers (known or unknown) to register with MOC for the attendance of the anti-dumping investigation. While one exporter or producer can refuse to respond to or cooperate with the investigation, it has to bear all adverse consequences that may result from this choice. Usually, the response to the investigation provides a chance for the exporters or producers under investigation to prove that they have not dumped the product in question into the PRC market or the margin of dumping is less than what the domestic applicants claim it to be. No response means the application of the highest margin of dumping (if any) to their product upon the conclusion of MOC based on existing materials (usually from the respondents). MOC also needs to send a copy of the submission by the applicants to the known exporters and the governments of the exporting countries.[92]

While the law requires MOC to notify other 'interested parties', this is not a firm obligation on MOC to satisfy. There is no clear scope of these interested parties. One usual example will be the national industry association representing the relevant domestic industry in cases where several eligible domestic producers submit the application. The public notice in the MOC Gazette is sufficient enough to constitute a valid notice to interested parties.

9.3.4.2 Investigation Period and Stages

As a general rule, the anti-dumping investigation should be completed within 12 months of the public notice. Under some special circumstances, for example, the complexity of the case or the large number of parties involved, MOC may extend a further six months.[93]

MOC will investigate and issue a preliminary ruling on the dumping, the injury to the domestic industry and the causal link between them, usually within six months of the public notice. If the conclusions on all these three

91 *PRC Anti-dumping Regulation*s, *Zhonghua Renmin Gongheguo Fanqingxiao Tiaoli* (中华人民共和国反倾销条例), issued by the State Council on 31 October 2001, the State Council Decree No 328, revised by the State Council on 31 March 2004 (effective from 1 June 2004), the State Council Decree No 401 ('PRC Anti-dumping Regulations'), Art 19(1).

92 *Ibid*, Art 19(2).

93 *Ibid*, Art 26.

issues are affirmative, MOC will carry on the investigation towards the issue of a final ruling.[94] Before the issue of the final ruling, MOC shall notify all known interested parties of the basic facts to support such ruling.[95]

As discussed below, once an affirmative preliminary ruling is given, MOC has the power to impose certain interim anti-dumping measures on the dumped imports.

MOC can adopt the following investigation methods to collect information from the interested parties: questionnaire, sampling, hearing and on-site verification.

9.3.4.3 Questionnaire

MOC may issue written questionnaires for the anti-dumping investigation to the exporters or producers who respond to the investigation ('respondents').[96] A respondent must report to MOC for the response to the investigation within 20 days after the public notice of such investigation.[97]

A respondent must provide some basic information to MOC when it responses to the start of the investigation: the intention to attend the investigation; the name, address, legal representative and contact methods; the total volume and value of the product in question that was exported to the PRC within the investigation period.[98]

The questionnaire shall be sent to the respondents within 10 working days after the expiration of the period for registering the attendance of the anti-dumping investigation. The respondents should answer the questions correctly and completely and submit all relevant information and materials as required.[99] The *Interim Measures on Questionnaire Investigation* also lists some detailed format requirements on the answers to the questionnaire.

The answers have to be submitted to MCO within 37 days after the release of the questionnaire. If one respondent cannot complete the answers within this period, it can apply to MOC for an extension by a written notice seven days before the expiry of the above 37 day period. MOC may consider the extension (usually no more than 14 days) if there is a legitimate reason for such delay.[100] An interesting point is that the respondent must undertake that the electronic carriers (such as floppy discs or CD-ROMs) containing the information or materials have no virus. The existence of a virus would be

[94] *Ibid*, Arts 24 and 25(1).
[95] *Ibid*, Art 25(2).
[96] *Interim Measures on Questionnaire Investigation*, issued by MOFTEC and taking effect from 15 April 2002, MOFTEC Decree [2002] No 14, Art 4. The rules discussed below also apply to the questionnaire to Chinese importers.
[97] *Ibid*, Art 6.
[98] *Ibid*, Art 7.
[99] *Ibid*, Art 10.
[100] *Ibid*, Arts 17–18.

treated as impeding the investigation, under which MOC can ignore the information contained in such electronic carriers.[101]

The questionnaire must be handled and submitted to MOC by a PRC licenced lawyer on behalf of the respondent. Accordingly, the answer files should contain a valid authorisation letter by the respondent to that lawyer, plus the copy of that lawyer's valid practicing certificate.[102]

MOC can further send supplementary questionnaires to the respondents asking for additional or supplementary information and materials.[103]

If the respondent fails to submit the answers within the prescribed period or in a manner as required in terms of completeness and accuracy, or refuses MOC to verify the supplied information, or otherwise impedes the investigation by MOC, MOC has the right to base its rulings on the available facts and the 'currently best materials'.[104] This implies that MOC can ignore the particular facts of that respondent and decide the application on the decisions of other respondents to that respondent. Although this does not necessarily mean the worst results for other respondents, the practice usually witnesses the application of such worst results to that non-cooperative respondent (whether voluntarily or due to other reasons).

9.3.4.4 Sampling

MOC should decide the individual dumping margin of each respondent on the basis of full investigation. However, in case there are too many exporters, producers, product types or involved transactions that make the individual investigation overburdened and impedes the timely completion of the investigation process, MOC may apply the methodology of sampling to investigate the dumping.[105] MOC selects the samples by adopting effective statistical methods or on the basis of export volume, but the samples must be representative of the respondents or the product in question.[106] The regulations do not specify the threshold for the application of sampling, as the terms 'too many', 'overburdened' or 'impedes the timely completion' are too ambiguous and lack a degree of certainty. In practice, even if there are less than 10 respondents, the task of individual investigation still seems feasible.

MOC can select the representative exporter or producer from all respondents, including those samples under investigation and those back-up samples. It must notify such choice to all interested parties as soon as possible and the selected parties can provide comments within seven days of receipt of the notice. Although MOC should try to select those respondents who agree

[101] *Ibid*, Art 25.
[102] *Ibid*, Art 27.
[103] *Ibid*, Art 29.
[104] *Ibid*, Art 31.
[105] *Interim Measures on Sampling*, MOFTEC [2002] Decree No 15, effective from 15 April 2002, Art 3.
[106] *Ibid*, Arts 4 and 5.

to be selected as samples, their agreement is not a pre-condition for MOC's choice. After selecting these samples, MOC will only issue the questionnaire to them. Nevertheless, other respondents who are not selected as samples can voluntarily provide information to MOC. In case one sample does not cooperate with the investigation, MOC can replace it with one back-up sample.[107]

The significance of sampling is that MOC will only decide the individual dumping margin of those selected samples.[108] The dumping margin of other unselected respondents will be based on the weighted average of dumping margins of those samples. The weighted average of dumping margins excludes the zero margin (which means no dumping exists), *de minimis* dumping (which means a margin below two per cent) and the margins that are decided by MOC on the basis of most available materials.[109] If one unselected respondent provides the information to MOC and requires an individual investigation, MOC should individually assess that respondent unless such investigation could impede the timely completion of the investigation.[110] For those exporters or producers who have not responded to the investigation, their dumping margins will be based on the most available materials or information to MOC. In practice, this usually means an application of the weighted average dumping margins of those samples. From this perspective, whether or not to respond and cooperate with the anti-dumping investigation by MOC makes little difference, especially where the exporter or producer is a small or medium company with a relatively small volume of export of the product in question to the PRC and does not want to bear the expenses of cooperation with the investigation. For them, a better choice may be to wait for the decisions on the respondents.

The sampling methodology also applies to the selection of product types for the investigation. If MOC finds out from the answers to the questionnaire by the selected samples that the product in question has too many types, it can select some types of that product to determine the dumping and the margin.[111] After a preliminary selection of the types of product to be investigated, MOC should notify all interested parties – again, these parties can comment on the selection within seven days of receipt of the notice.[112] Similar to the sampling of respondents, the dumping margin of the product in question is based on the weighted average of dumping margins of those types of such product as selected.[113]

Similarly, MOC can also select sample transactions (either as domestic sales or as the export of the product in question) to determine the normal

[107] *Ibid*, Arts 6–13.
[108] *Ibid*, Art 11.
[109] *Ibid*, Arts 13 and 14.
[110] *Ibid*, Art 15.
[111] *Ibid*, Art 17.
[112] *Ibid*, Art 18.
[113] *Ibid*, Art 20.

value or export price of that product.[114] But the selection of such sample transactions must obtain the consent of the relevant respondents.[115] The normal value or export price of the product in question is based on the weighted average of the normal values or export prices of those samples.

9.3.4.5 On-site Verification

In relation to those respondents who have fully cooperated with MOC for the anti-dumping investigation, MOC may send its officials to the office or factory of such respondents so as to verify the completeness, accuracy and genuineness of the information provided and collect further information for the investigation.[116] The on-site verification usually happens after the preliminary ruling, but sometimes MOC may also carry out this action before the preliminary ruling if there are justifiable reasons. An advance notice must be given by MOC to the relevant respondent and its home government, and the express prior consent by such respondent must be obtained.[117] Nevertheless, if the home government of the respondent refuses the on-site verification by MOC, MOC will not implement this investigation plan.[118]

MOC shall provide the verification results to the respondent within a reasonable period after this exercise. It can also provide a summary (except for confidential information) to other interested parties. The information or materials verified by MOC or such further collected information or materials are the basis for MOC to determine the dumping and the margin.[119]

In addition, upon the request of a respondent and without objection of its home government, MOC can send its officials to that respondent for an explanation of the questionnaire.[120] This kind of explanation may actually be a guide to answer the questionnaire.

Generally speaking, the respondents should try to invite MOC for the on-site verification. Since the anti-dumping investigation is basically triggered by the information provided by the domestic applicants and MOC may only be exposed to limited or selected information, the on-site verification is a valuable opportunity for the respondent to provide full information in a favourable way. The visit can also help the officials better understand the product and the production process. It is also a good chance for better communications between the respondent and the officials – otherwise, the name of the respondent or the product in question are just some letters on paper and have little practical or first-hand meaning to the officials. The anti-dump-

[114] *Ibid*, Art 21.
[115] *Ibid*, Art 23.
[116] *Interim Measures on On-site Verification*, MOFTEC [2002] Decree No 13, effective from 15 April 2002, Art 3.
[117] *Ibid*, Arts 8 and 9.
[118] *Ibid*, Art 10.
[119] *Ibid*, Arts 19 and 20.
[120] *Ibid*, Art 23.

ing investigation and the determination of the dumping or margin are not rocket science but a kind of process based on the estimation of most available information and the experience (or even impression) of the officials in charge. The decisions are made by persons – from this perspective, there is no harm to somewhat influence the decision process by close communications with those decision makers.

9.3.5 Investigation Period and Termination of Investigation

As mentioned above, the anti-dumping investigation by MOC must be completed within 12 months of the announcement of investigation, or be extended for a further six-month period under special circumstances.[121] The regulations do not prescribe what constitutes 'special circumstances', but in practice MOC tends to extend the investigation period where there are quite a few exporters under investigation or the documents involved are complex or need a longer time for review or verification on technical issues.

The investigation may be terminated due to several reasons as follows: the application by the applicant(s) to revoke the application for anti-dumping investigation; no sufficient evidence for the existence of dumping, damages or the causal relationship between dumping and damages; *de minimis* dumping (that is, the margin of dumping is below two per cent); the actual or potential volume of import or such damage caused being negligible; other reasons that MOC believes have caused the continuation of investigation inappropriate.[122] Among these grounds, the last one is a typical 'catch-all' legislative technique in China which actually grants an open-ended power to MOC for the decision of termination or continuation of an anti-dumping investigation. But the first ground – the application by the applicants to revoke the investigation – should be subject to a public interest review: although the regulations do not express this point, it is submitted that once the anti-dumping investigation procedure is triggered MOC should have the power to continue the investigation so long as it views this as what the public interest requires. In other words, MOC must be able to continue the investigation if necessary despite the application by the applicants to revoke such investigation.

9.3.6 Regulatory Process: Several Breakthroughs

9.3.6.1 The Comment Rule

In terms of regulatory process, several breakthroughs can be summarised from the above discussion of the anti-dumping investigation. One break-

[121] *PRC Anti-dumping Regulations*, Art 26, see n 91 above.
[122] *Ibid*, Art 27, see n 91 above.

through of the anti-dumping procedure is the formal establishment of the systematic 'comment rule' in the regulatory process, which may be the first example of its kind in China. The comment rule in anti-dumping investigation mainly involves the comments by interested parties on evidence produced by the other side or on determinations made by the regulator. In other words, it ensures a minimum degree of participation by the parties in the regulatory process and allows their opinions to be heard by the regulator before a decision is taken.

Basically, the anti-dumping investigation is not of an adversarial nature, but for the regulator to find out facts and information to support the reach of determinations. It is not a 'cross-examination' of evidence from the other side. Instead, the interested parties are entitled to receive non-confidential information and provide written comments within specified periods. Therefore, the comments would be practically the most important chance to rebut the evidence from the opposite parties, present their own evidence, and argue for the case. In this sense, an adversarial style in the presentation is more or less inevitable.

The *PRC Anti-dumping Regulations* simply provide in Article 20 that the regulator 'shall provide opportunities for the interested parties to state their opinions and arguments'. The procedural rules amplify this principle by incorporating the opportunities for comment into each chain of investigation. There are two categories of detailed comment rules: first, relating to the evidence from the other side; second, relating to the determinations by the regulator.

For the evidence from the other side, the rules are silent in most circumstances except for the price undertaking by foreign exporters and producers.[123] The *WTO Anti-dumping Agreement* requires the opportunities 'for all interested parties to meet those parties with adverse interests, so that opposing views may be presented and rebuttal arguments offered'.[124] The current Chinese rules obviously fall short of this standard because they do not provide any opportunity for meeting with the other side (except in the hearing) and for presenting arguments. Therefore, it is advisable to expand the scope of comment opportunities to interested parties on the evidence or materials submitted, especially by allowing foreign exporters and producers to present the written comments on the application of the anti-dumping investigation with an aim to giving them a chance of full defence.

Comparatively, there are more comment opportunities on the regulator's determinations. The interested parties may present the comments on the following chains of investigation and decision processes: within seven days after the selection of sample foreign exporters and producers and of the types

[123] *Interim Measure on Price Undertaking*, MOFTEC Order No 20, effective from 15 April 2002, Art 9.
[124] *The WTO Anti-dumping Agreement*, Art 6.2, see n 9 above.

of sample products for investigating the dumping margins,[125] within 10 days after the preliminary determination,[126] within 10 days before the final determination,[127] within the designated period after the rejection of proposed price undertaking and after the decision of revocation of price undertaking,[128] and within 14 days after the notification of review of new exporters.[129] Nevertheless, the parties only have the chance to make comments, and the regulators do not necessarily accept their arguments. The existence of the comments opportunity is itself a promotion of impartiality in the regulatory process, but the real challenge is how best to ensure that sensible comments may be reasonably taken into account by the regulator. Without such control mechanisms, the existence of comment opportunities is a sham.

This study suggests that the most efficient control mechanism is the requirement for full reasoning (as discussed below), which means the regulators should be obliged to give full and justifiable reasons for making the determinations. The full deliberation will give clues on how the regulator treats each submission and argument from interested parties. The ignorance of some comments or the simple rejection without justification may prima facie prove the deficiency in the decision-making process.

9.3.6.2 Hearings

One unsatisfactory aspect of Chinese anti-dumping investigation is the hearing procedure. The *Anti-dumping Regulation* (2002) only authorise a regulatory body to hold hearing sessions at its own discretion[130] but gives the interested parties no right to request a hearing of any sort. The want of a right to a hearing is at odds with the requirement for regulatory due process and deprives the interested parties of one basic procedural right.[131] Again, this would put foreign exporters and producers in a less advantageous position, because they cannot present their case and arguments to the regulator in an interactive manner and influence the outcome of the decision process. Although the practices suggest that most anti-dumping investigations involves at least one hearing, this procedure must be formally incorporated into the procedural rules so to give more legal certainty to foreign parties.

When the regulator decides to open a hearing session, the interested parties are only allowed to present their own arguments. There is no adversarial

125 *Interim Measure on Sampling*, MOFTEC Order No 15, effective from 15 April 2002, Arts 7(2) and 18(2).

126 *Interim Measure on Information Disclosure* (2002), Art 8, see n 84 above.

127 *Ibid*, Art 10, see n 84 above.

128 *Interim Measure on Price Undertaking* (2002), Arts 13(1) and 23, see n 123 above.

129 *Interim Measure on Review of New Exporters*, MOFTEC Order No 21, effective from 2002, Art 11.

130 *PRC Anti-dumping Regulations*, Art 20, see n 91 above.

131 PM Norton and KW Almstedt, ‘China’s New Anti-dumping Rules: Battleground for a New Protectionism?’ (2002) *China Law & Practice* 79 at 81.

procedure and these parties cannot argue against each other.[132] However, the line between advocacy and the presentation of rebuttal arguments is not always clear, and this study supports a strict prohibition on advocacy in the hearing procedure is not necessary. The hearing needs not be of a formal adversarial nature, but an adversarial flavour may be promoted to encourage the parties to present rebuttal arguments against the opposing parties' evidence or opinions. This will help the regulator to achieve a better understanding of the facts and reasons in the anti-dumping investigation.

9.3.6.3 Reasoning

The non-transparency of the decision process and reasoning in China's general administration is always subject to complaints.[133] In practice, the administrative authorities are inclined to give a negative decision without any reasons or only a general statement attached which makes the interested parties feel that they have received unfair or unequal treatment. The refusal decision may be correct, but lack of reasoning is a sign of undue regulatory process.

From this perspective, it is a limited breakthrough that the anti-dumping procedural rules expressly require the regulator to give full reasons in certain determinations. For example, the regulator must specify the reasons for rejection of proposed price undertaking by foreign exporters and producers,[134] as well as the reasons for not opening the case for review of new exporters.[135] However, this is not fully in line with the *WTO Anti-dumping Agreement* that requires any final determinations, 'set forth … in sufficient detail the findings and conclusions reached on all issues of fact and law'.[136] Such WTO requirements on a transparent result are conspicuously absent in the *Anti-dumping Regulations* (2004) of which Articles 24 and 25 simply authorise the regulators to render preliminary and final determinations 'based on their investigations' rather than to provide any of the details as prescribed in the WTO agreement. This deficiency has not been remedied by subsequent procedural rules. In some anti-dumping cases, it is observed that the Chinese regulator has failed to provide sufficient information on the data and methodologies followed, especially for determination of the dumping.[137]

132 *Interim Measure on Anti-dumping Investigation Hearings*, issued by MOFTEC on 2 June 2000, Art 9.

133 Ying Songnian (ed), *Xingzheng Chengxu Fa Lifa Yanjiu* (*Research on Legislation of Administrative Procedure Law*) (Beijing, China Legal System Publishing House, 2001) 46–8.

134 *Interim Measure on Price Undertaking* (2002), Art 13, see n 123 above.

135 *Interim Measure on Review of New Exporters* (2002), Art 11, see n 129 above.

136 *The WTO Anti-dumping Agreement*, Art 12.2, see n 9 above. The reasons must include the methodology in the dumping margin calculation and the factors to be considered in the injury and causation determination.

137 Presentation by Olivier Proset of Gide Loyrette Nouel in a conference at Brussels dated 7 October 2002, titled 'The New Face of Anti-dumping Issues in EU-China Relations', in the author's file.

Some scholars have even predicted that the insufficient nature of their rulings would become subject to challenges by other Members before a WTO panel.[138]

Thus, it is submitted that MOC must contain full reasons and supporting information as required by the WTO agreement in all kinds of determinations. In particular, full reasons shall be given in the determinations prescribed under Article 4 (normal value of imported products), Article 6 (dumping margins) and Article 8 (injury to domestic industry) of the *PRC Anti-dumping Regulations* (2004). Apart from this legislative supplement, it is more important for the regulator to abide by the reasoning requirement in issuing each determination in practice. A failure to do so may well result in challenges by interested parties either in China through administrative or judicial reviews, or through their home state governments before the WTO panel.

9.4 ANTI-DUMPING MEASURES

9.4.1 Interim Measures

If MOC decides in the preliminary ruling that the dumping has existed and caused damages to domestic industry, there are two interim measures available to Chinese trade regulators: the interim anti-dumping duty and security in the form of deposit, bond or other acceptable instruments.[139]

While MOC has the right to propose the imposition of the interim anti-dumping duty at a level not higher than the margin of dumping as decided in the preliminary ruling, the final decisive power is vested in the Tariff Commission of the State Council.[140] As a general rule, however, the Tariff Commission of the State Council has no reason to reject the proposal by MOC unless there is a very significant unusual circumstance. Since this Commission has no direct investigation power and function in respect of the anti-dumping cases but only has a power to approve or reject the proposal by MOC of the interim anti-dumping duty, it will follow the MOC proposal in practice. For the imposition of the security (such as a deposit or a bond from a reliable bank), MOC has the power to decide directly. After the approval by the Tariff Commission of the State Council (for interim anti-dumping duty) or by MOC (for the security requirement), MOC must publish a circular for

138 Norton and Almstedt, above n 131 at 82.

139 *PRC Anti-dumping Regulations*, *Zhonghua Renmin Gongheguo Fanqingxiao Tiaoli* (中华人民共和国反倾销条例), issued by the State Council on 31 October 2001, the State Council Decree No 328, revised by the State Council on 31 March 2004 (effective from 1 June 2004), the State Council Decree No 401 ('PRC Anti-dumping Regulations') Art 28.

140 *Ibid*, Art 29.

such decision ('Interim Measures Circular') and Customs must carry out such decision from the date of the Interim Measures Circular.[141]

The period of interim anti-dumping measures shall not be more than four months from the date of the Interim Measures Circular, or nine months from such date under special circumstances.[142] Again, the regulations do not prescribe what constitutes these 'special circumstances' but give MOC a wide discretion to extend the period in the name of a special circumstance. However, there is one restriction on the imposition of interim anti-dumping measures: no such interim measures can be imposed within 60 days of the date of starting the investigation.[143] This means that the respondents should have at least a 60 day period to respond to the investigation, which is also a minimum period for MOC to investigate and decide the preliminary ruling.

9.4.2 Price Undertaking

A 'price undertaking' means an undertaking voluntarily taken by the exporter(s) or producer(s) to MOC for the change of the export price or the termination of exporting the product in question at a dumping price, which is accepted by MOC who thereafter suspend or terminate the anti-dumping investigation.[144] The nature of price undertaking is voluntary – the exporter(s) or producer(s) can propose it to MOC and MOC can also propose it to them.[145] But MOC cannot force the exporter(s) or producer(s) to accept the proposed price undertaking. PRC law clearly states that the refusal by an exporter or producer to accept the price undertaking shall not cause any adverse effect to the determination of the dumping or dumping margin of its product in question.[146]

The price undertaking can be proposed before the expiration of 45 days after the date of publication of the preliminary ruling.[147] Correspondingly, MOC cannot propose or accept the price undertaking before the affirmative preliminary ruling on dumping and damages. After receipt of the price undertaking from an exporter or producer, MOC shall notify other interested parties and provide the non-confidential version (without revealing confidential information in the eyes of that exporter or producer) for their comments.[148]

[141] *Ibid*.
[142] *Ibid*, Art 30(1).
[143] *Ibid*, Art 30(2).
[144] *Ibid*, Art 31(1); *Interim Rules on Anti-dumping Price Undertakings* (反倾销价格承诺暂行规则), MOFTEC Decree [2002] No 20, effective from 15 April 2002, Art 3.
[145] *Interim Rules on Anti-dumping Price Undertakings* (反倾销价格承诺暂行规则), MOFTEC Decree [2002] No 20, effective from 15 April 2002, Art 4. In addition, MOC can also enter into a price undertaking with the government of the exporting country (Art 29).
[146] *Ibid*, Art 5.
[147] *Ibid*, Art 6.
[148] *Ibid*, Arts 8 and 9.

The price undertaking must include minimum information as follows: the scope of product; the reference prices (including the determination of prices, the method to increase the export prices, the margin of increase, the stage-by-stage adjustment); the reporting obligations; the express agreement to the on-site inspection; and the undertaking for not circumventing the price undertaking.[149] The margin of the increase of export prices must be equal to the margin of dumping under the preliminary ruling; if the margin of price increase is below such margin of dumping but is still sufficient to eliminate the damages to domestic industry, the margin of price increase can also be lower than that of dumping.[150]

As a general rule, MOC will only accept the price undertaking proposed by an exporter or producer that has fully cooperated with MOC during the investigation period. There are a number of factors that MOC should take into account when deciding whether or not to accept this proposal, including: whether the price undertaking can eliminate the damages caused by the dumping; whether there are efficient ways to supervise the implementation of this undertaking; whether the acceptance conforms to the public interests of the PRC; and whether there is a possibility of circumvention.[151] These factors are generally discretionary and give an uncontrollable power to MOC in this respect. For example, there is neither definition nor criteria on what amounts to 'public interests of the PRC'. As a practical matter, two key points to secure a successful price undertaking are first, the track record of full co-operation with MOC during the investigation and second, a detailed proposal outlining the factors to be taken into account and showing the effect to eliminate the damages caused by the dumping (such as through the sufficient increase of export prices) that can justify the validity and enforceability of the proposal.

Upon the review, MOC may accept the price undertaking and decide to suspend or terminate the anti-dumping investigation in relation to the relevant exporter(s) or producer(s). The decision of suspension or termination of the anti-dumping investigation must be published by MOC. The price undertaking will take effect from the date of such publication, for a period of five years.[152] However, if MOC only accepts the price undertakings from part of the exporters or producers, the five-year period should start from the date of the completion of investigation on other exporters or producers who have not proposed the price undertakings or whose price undertakings have been refused by MOC. Comparatively, if MOC refuses to accept the proposed price undertaking, it shall give a full reasoning to the relevant exporter or producer and allow such exporter or producer to provide sufficient com-

[149] *Ibid*, Art 14.
[150] *Ibid*, Art 15.
[151] *Ibid*, Arts 10 and 11.
[152] *Ibid*, Arts 12 and 16. MOC shall notify the price undertaking to the WTO within seven days after such undertaking takes effect (Art 30).

ments on such refusal. In addition, the decision and reasons for refusing the price undertaking must be stated in the final ruling.[153] The above rules also apply to the situation where MOC proposes a price undertaking to the exporter(s) or producer(s).

MOC has a power to supervise the implementation of the price undertaking. It may take one of the following ways to supervise. First, it can require the relevant exporter or producer to provide a status report, including the actual volume of export, the export prices and the names of Chinese importers. Second, it can periodically verify the data on export to the PRC by such exporter or producer from Customs. Third, it can carry out an on-site inspection of such exporter or producer. Fourth, it can seek or verify information of such exporter or producer from the Chinese importers. Furthermore, even if MOC accepts the price undertaking, it may still continue the anti-dumping investigation on the relevant exporter or producer subject to the price undertaking, upon the application request of such exporter or producer or upon MOC's own initiative. This kind of continuing investigation does no more harm to the export or producer that is already bound by the price undertaking: if the final ruling affirms the dumping and the damages, the price undertaking will continue to be complied with; if the final ruling shows no dumping or damages, the price undertaking will automatically cease to be effective.[154]

The price undertaking can be revoked either by MOC on the ground that the implementation of this undertaking does not conform to the public interest of the PRC, or by the relevant exporter or producer within the five-year period (but subject to a 30 day prior notice period).[155] Upon revocation, MOC will notify Customs to resume the application of the interim anti-dumping measures applicable to all exporters and producers under the investigation to such exporter or producer who is no longer bound by the price undertaking. It will also immediately resume the anti-dumping investigation. Nevertheless, if the original investigation is completed and set up a margin of dumping on exporters and producers, the anti-dumping duty as determined will be collected from the date of revoking the price undertaking.[156]

The exporter or producer will be deemed as breaching the price undertaking if one of the following events exists: the export of the product in question at a price below the undertaken export price; the failure to provide the implementation status report or data; the refusal of the verification of its information or data by MOC; the material inaccuracy of its information or

[153] *Ibid*, Art 13.

[154] *Ibid*, Arts 18–20. In addition, if MOC finds that there is no sufficient evidence for the existence of dumping, damages or the causal relationship between the dumping and the damages, the price undertaking will also automatically cease the effect.

[155] *Ibid*, Arts 22–24.

[156] *Ibid*, Art 25.

data as provided; and the existence of a clear circumvention behaviour.[157] Once the exporter or producer breaches the price undertaking, MOC shall immediately resume the anti-dumping investigation and immediately adopt the interim anti-dumping measures based on the best information available. If the final ruling affirms the dumping and the damages, the anti-dumping duty can be imposed retrospectively on the product in question that was imported into the PRC during the 90-day period before the imposition of interim anti-dumping measures (except for those products imported before the breach of the price undertaking).[158] The same retrospective imposition rule also applies to the situation where the exporter or producer breaches the price undertaking at a time that the original anti-dumping investigation has already been completed and the margin of dumping has already been decided.[159]

9.4.3 Anti-dumping Duty

If the final ruling finds that the dumping has existed and caused damages to the domestic industry, MOC may propose the imposition of an anti-dumping duty on the imported product in question for the decision of the Tariff Commission of the State Council.[160] Interestingly, PRC law requires that the imposition of the anti-dumping duty should conform to the public interests.[161] Since the law is silent on what constitutes the public interests and under what circumstances such public interests should prevail over the anti-dumping, MOC has a wide discretion on this issue. For example, if the product in question is of strategic importance to Chinese consumers and the imposition of an anti-dumping duty may increase the import price to such a level that may cause seriously adverse effects on consumers, there is a possibility to argue that the imposition of an anti-dumping duty is not consistent with the public interests of the Chinese society as a whole.

The anti-dumping duty applies to the product in question that will be imported after the publication of the final ruling. The taxpayers are the Chinese importers of such product, and Customs will be responsible for collecting the duty. As a general rule, MOC will determine the individual duty payable by each exporter or producer under the investigation, rather than taking a 'one-size-fits-all' approach. In any case, the anti-dumping duty

157 *Ibid*, Art 26.
158 *Ibid*, Art 27.
159 *Ibid*, Art 28.
160 *PRC Anti-dumping Regulations*, *Zhonghua Renmin Gongheguo Fanqingxiao Tiaoli* (中华人民共和国反倾销条例), issued by the State Council on 31 October 2001, the State Council Decree No 328, revised by the State Council on 31 March 2004 (effective from 1 June 2004), the State Council Decree No 401 ('PRC Anti-dumping Regulations'), Arts 37 and 38.
161 *Ibid*, Art 37.

should not exceed the margin of dumping in respect of each exporter or producer as determined under the final ruling.[162]

It is likely that MOC has required the imposition of interim anti-dumping measures before the final ruling. It is easy to understand that the collected interim anti-dumping duty must be refunded to the payers where the final ruling decides not to impose an anti-dumping duty.[163] In case the final ruling determines the existence of a material damage, the anti-dumping duty can be applied on a retrospective basis to the product that was imported during the period of interim anti-dumping measures. However, in case the final ruling only determines the existence of a *threat* of material damage but MOC has already ordered the interim measures, the anti-dumping duty can still be applied retrospectively. This means that the retrospective application of such duty cannot be available if there was no interim measure applicable before the final ruling on the threat of material damage. Another issue is the rate of the anti-dumping duty as compared to the rate of the interim anti-dumping duty. If the (final) anti-dumping duty is set at a rate higher than that of the interim anti-dumping duty, the balance will not be collected in respect of the period from the imposition of the interim duty up to the final ruling. In contrast, if the anti-dumping duty is set at a rate lower than that of the interim duty, the part of the interim duty as additionally paid should be either refunded to the payers or counted toward the duty payable.[164]

Moreover, there is one aggravating reason for the retrospective application of the anti-dumping duty: if the product in question has a history of dumping into the Chinese market, or the Chinese importers know or should have known that the exporters or producers are dumping the product in a way that will cause damage to the domestic industry. If the product has been imported in a substantial volume within a short period and could seriously damage the remedial effect of the coming anti-dumping duty, the anti-dumping duty can even be applied retrospectively to the product that was imported within 90 days before the imposition of the interim anti-dumping measures (except for those imported before the start of the investigation).[165] Notably, MOC has the absolute power to determine whether or not the above two situations exist and the exporters or producers have no chance to defend themselves – once determined, MOC can register the import of the product in question during the investigation period, so as to facilitate the possible retrospective imposition of the anti-dumping duty in future.[166]

[162] *Ibid*, Arts 39–42.
[163] *Ibid*, Art 45.
[164] *Ibid*, Art 43(3).
[165] *Ibid*, Arts 43 and 44.
[166] *Ibid*, Art 44.

9.4.4 Refund of Duty

It is possible that the margin of dumping as determined in the final ruling of MOC in respect of the product exported from one exporter or producer may exceed the actual margin of dumping. This may be caused by a number of reasons. For example, that exporter or producer may not provide sufficient data to help MOC accurately determine the margin of dumping, or the methodology adopted by MOC may not accurately reflect the price elements of the product in question.

In order to redress the possible distortion between the determined margin of dumping and the actual margin of dumping, MOC allows the Chinese importers to bring a written application for refund of duty provided that they have evidence to prove that the anti-dumping duty actually paid exceeds the actual margin of dumping.[167] But there is a deadline for such application: it must be brought within three months of the actual payment of the anti-dumping duty.[168] Since one importer may pay the anti-dumping duty on an on-going basis so long as it imports the product in question, it should consider the application once it is aware of the above difference – ideally after the first payment. But the above three-month period does not apply to the payment of the interim anti-dumping duty on the product imported during the period before the final ruling, because the gap between the payment and the issuance of the final ruling by MOC may well be beyond three months – but in any event, such application still has to be brought within three months after the final ruling.[169]

The application for refund of duty must be in writing, duly signed by the legal representative of the importer or its authorised person. The importer is allowed to submit the confidential version and the non-confidential version of the application, with one original copy and six duplicate copies.[170] If the importer imports the product in question from more than one exporter or producer, it must apply for the refund separately. The application must be accompanied by certain information or data: the name, address and relevant information of the importer and the relevant exporter or producer; the average sale price, transaction volume, total values of the product in question sold in the domestic market of the exporting country, and the average export price, transaction volume, total values of the export to the Chinese market in the previous six months; the data for the normal value and export prices of the product in question in the previous six months; the preliminary calculation results for various adjustments for the calculation of the margin of dumping as well as such margin of dumping; the copy of the import con-

[167] *Interim Rules on Refund of Duty in Anti-dumping Cases* (反倾销退税暂行规则), MOFTEC Decree [2002] No 22, issued by MOFTEC and effective from 15 April 2002, Arts 2–4.
[168] *Ibid*, Art 4(1).
[169] *Ibid*, Art 4(2).
[170] *Ibid*, Art 10.

tracts, invoices, bills of lading and payment certificates for the product in question; and the payment certificates for the anti-dumping duty by the importer.[171] From the above list, it is fair to conclude that there is a heavy burden of proof on the importer and can only be satisfied with the full support of the exporter or producer. In case there is no affiliation between the importer and the exporter or producer, MOC requires that the exporter or producer should provide the above information or data directly to MOC within 30 days of the application for refund by the importer, plus a statement that the margin of dumping has already been reduced or eliminated.[172] If the exporter or producer fails to provide the statement and the information or data within the prescribed 30-day period, the application of the importer will be rejected. From this perspective, the main incentive of the exporter or producer in supporting the application relies on how it views the importance of the Chinese market: since the anti-dumping duty will be paid by the Chinese importers and finally transferred to end-users by way of increasing the sale price in the Chinese market, its product will be more competitive if this additional level of charge can be removed or reduced as early as possible.

MOC must complete the review of the refund application within 12 months after the date of receipt of such application. If it decides that the actual margin of dumping has not been reduced as compared against the final ruling, it will reject the application. If it decides that the refund is justifiable, it must make a refund proposal to the Tariff Commission of the State Council before 15 days prior to the expiration of the review period. Upon the approval by the Tariff Commission of the State Council, the amount of refund will be based on the balance between the newly decided margin of dumping and the original margin of dumping as decided under the final ruling.[173]

9.4.5 Adjustment of the Scope of Product

PRC law provides some rules for the adjustment of the scope of import product under investigation or subject to anti-dumping measures.[174] MOC has the power to confirm the adjustment and Customs have the duty to implement the adjustment orders.

The procedure is usually triggered by the interested parties, including the applicant(s), exporter(s) or producer(s), Chinese importer(s) and other parties or individuals that have interests in the anti-dumping investigation or

[171] *Ibid*, Art 6.
[172] *Ibid*, Art 9.
[173] *Ibid*, Arts 15–18.
[174] The main administrative rule is the *Interim Rules on Procedures of Adjustment of the Scope of Product in the Anti-dumping* (关于反倾销产品范围调整程序的暂行规则), issued by MOFTEC and effective from 12 January 2003.

measures.[175] After MOC publishes the circulars for the commencement of the anti-dumping investigation or for the imposition of the anti-dumping measures, it will identify in such circulars the scope of the product under investigation or subject to the anti-dumping measures. It is likely that an interested party does not agree with the scope of the product, for example, whether one type of product should or should not be covered by the investigation or the anti-dumping measures. The procedure for the adjustment of the scope of product provides an opportunity for such party to express its concerns and argue the case before MOC.

The application for the adjustment must be submitted in writing.[176] The application report shall include: the name and information of the applicant; the product that it applies for an adjustment; the reasons and detailed explanation and evidence for the adjustment; the detailed description and explanation of the product to be adjusted (such as the tariff code, the physical and chemical characteristics[177]); the detailed description and explanation of the differences between the product in question and the domestic 'like product'; and information of the exporter or producer and the Chinese importer and end-users.[178]

MOC has the right to review the application report and accept the application provided that the report satisfies the above requirements. It will verify or investigate the accuracy of the report by way of questionnaire, on-site inspection or hearing. In particular, it should investigate the reasonableness of the report and the benefits to all interested parties to the anti-dumping process (including the applicant). This implies a reasonableness requirement and a cost-benefit analysis by MOC for the purpose of endorsing or refusing the adjustment. If MOC endorses the application, it shall publish the adjustment of the scope of product in question not later than the publication of the final ruling – in other words, the final ruling should accordingly adjust the scope of product that will be imposed on the anti-dumping measures.[179]

Alternatively, MOC may initiate the adjustment of the scope of product under investigation or subject to the anti-dumping measures upon its review of all materials submitted by the interested parties, even without an application of one party.[180]

[175] *Ibid*, Art 5(3).
[176] *Ibid*, Art 5(4).
[177] The description should be detailed enough to show the uniqueness and exclusivity of the product or if not possible, be sufficient enough for the function or usage of the product. *Ibid*, Art 6(3).
[178] *Ibid*, Art 6. The application report shall be signed or sealed by the legal representative of the applicant or the duly authorised person.
[179] *Ibid*, Art 7(1)–(4).
[180] *Ibid*, Art 7(5).

9.4.6 New Exporters

The anti-dumping investigation and the anti-dumping measures normally target specific exporters or producers from specific countries or regions. After the imposition of the anti-dumping duty on such exporters or producers, it is likely that other exporters or producers who are not subject to the investigation would also export the product in question to China. Under this circumstance, it is necessary for MOC to decide the rate of the anti-dumping duty applicable to those new exporters or producers (for simplicity, referred as the 'new exporter'). But it is a pre-condition for the separate decision that a new exporter cannot affiliate with the exporters or producers that were already subject to the anti-dumping investigation (for simplicity, referred as the 'old exporter'). If the new exporter is only a trading company, its supplier cannot affiliate with the old exporters either.[181]

An eligible new exporter is such new exporter that has exported the product in question to China after the original anti-dumping investigation procedure and such product has been imposed on the interim or final anti-dumping duty. It can only bring the application to MOC after the coming into effect of the final ruling, but the application cannot be later than three months after the date of export.[182] The application for the review by MOC must be in writing and contain the following evidence and materials: name, address and information of the applicant; the corporate structure and the names of affiliated persons; the average price, number of transactions and total value of the domestic sale of the product in question, of the export of the product in question to China and of the export of the product in question to a third country during the six-month period before the application; the copy of the contracts, invoices, bills of lading, payment evidence for the product and for the anti-dumping duty by Chinese importers for the export to China; and other information that the applicant intends to explain to MOC.[183] The application report can have the confidential version and the non-confidential version, each with one original copy and six duplicate copies.

MOC shall notify the applicant(s) for the original anti-dumping investigation of the application by a new exporter within seven working days of the receipt of such application, and the applicant(s) shall provide any opinion on whether or not the application by such new exporter should be accepted as a case for consideration within 14 working days of the receipt of the above notification. MOC will consider the opinions of the applicant(s) and review the application report by the new exporter and decide whether or not to accept the case for consideration within 30 days of the receipt of the applica-

181 *Interim Rules on Review of the New Exporters in the Anti-dumping* (反倾销新出口商复审暂行规则), MOFTEC Decree [2002] No 21, effective from 15 April 2002, Art 4.

182 *Ibid*, Arts 5–7. The date of export shall be decided by the date of the relevant invoice.

183 *Ibid*, Arts 8 and 9.

tion.[184] Provided that MOC decides that it will accept the application as a case for consideration, it will publish a circular describing the relevant information and indicating a comment period for all interested parties. MOC must also notify Customs before the publication of such circular that from the date of publication Customs need to suspend the collection of the anti-dumping duty on the product in question that is exported by the new exporter. However, this does not mean that the new exporter can freely export the product in question to the Chinese market: although the relevant Chinese importer need not pay the anti-dumping duty, the importer is still obliged to pay a deposit as a kind of performance bond at the rate of the anti-dumping duty as applicable to 'other companies' under the final ruling.[185]

MOC has a six-month period for investigating the application of the new exporter. The purpose is to decide whether the new exporter exports the product in question to China by way of dumping and if so, what will be the dumping margin. The procedures applicable to a normal anti-dumping investigation are also applicable here. Notably, the export price will be deduced from the resale price for the sale of the product in question to an independent purchaser, which aims to exclude the distortion caused by the affiliation between the new exporter and the relevant Chinese importer(s). Also, if the new exporter can sufficiently prove that the anti-dumping duty has been appropriately reflected in the export price and the resale price in the following transactions, MOC shall not deduct the amount of the anti-dumping duty that has already been paid by the Chinese importer(s).[186]

One difference between the review of the new exporter's application and the normal anti-dumping investigation is that the former has no stage of issuance of a preliminary ruling by MOC. But MOC is still obliged to disclose the preliminary conclusions and the facts and reasons relied upon to all interested parties (including the new exporter) and provide these parties a period not less than 10 days for comments. For the new exporter, it can propose a price undertaking within 15 days of the disclosure of the preliminary conclusions.[187] The normal rules for the price undertaking are also applicable here.

The review of the new exporter's application cannot exceed nine months starting from the date of acceptance by MOC as a case for consideration. After the disclosure of the preliminary conclusions and the consideration of the comments from all interested parties, MOC must suggest to the Tariff Commission of the State Council the anti-dumping duty applicable to the

[184] *Ibid*, Arts 11 and 12.

[185] *Ibid*, Art 15. This implies that the final ruling should provide such rate of the anti-dumping duty that is applicable to new exporters in the name of 'other companies'.

[186] *Ibid*, Arts 17–20. Since the new exporter may have known the imposition of the anti-dumping duty on the product in question at the time of the export, it is very likely that the new exporter will increase the export price to incorporate this element. That is why MOC shall not deduct the paid anti-dumping duty under this circumstance, provided that the new exporter can provide sufficient evidence.

[187] *Ibid*, Arts 22 and 23.

new exporter – if the new exporter has indeed dumped the product in question to China. The Tariff Commission of the State Council will decide the applicable anti-dumping rate on the basis of MOC's proposal, and MOC in turn will publish a circular for the decision of the Tariff Commission of the State Council for this matter before the expiration of the nine-month review period.[188] If the imposition of anti-dumping duty is approved by the Tariff Commission, the normal rules of anti-dumping duty are applicable here.

9.4.7 Interim Review

The periods for the imposition of the anti-dumping duty and the price undertaking are within five years. But this five-year period can be extended if the interim review confirms that the termination of the anti-dumping duty will be likely to continue the dumping and the damages or to cause the reoccurrence of the dumping and the damages.[189] This means that it is possible for the exporters or producers to bring an application for an interim review by MOC of the imposition of the anti-dumping duty, for the purpose of termination of such imposition.

There are two routes to trigger the interim review. The first route is by the initiation of MOC. Under PRC law, MOC has the right (but not a duty) to 'decide to review the necessity for the continuing imposition of anti-dumping duty under the circumstances with proper reasons'.[190] However, it is doubtful if MOC has the real incentive to maintain an on-going review of the imposition of the anti-dumping duty on a specific product. Thus, the second route – an application by an interested party (most likely as the exporter or producer or the Chinese importers endorsed by the exporter or producer) after 'a reasonable period' of the imposition of the anti-dumping duty. Upon such application, MOC will review the relevant evidence produced by the applicant and decide if it is necessary to continue the anti-dumping duty or to amend or terminate such duty.[191] Similar rules apply to the interim review of price undertakings as well.[192] As a general rule, the interim review will not exceed one year from the date of acceptance of the application as a case for decision.[193] During the interim review period, the anti-dumping duty decided by the final ruling of MOC must continue to apply.[194]

[188] *Ibid*, Arts 24 and 25.
[189] *PRC Anti-dumping Regulations*, *Zhonghua Renmin Gongheguo Fanqingxiao Tiaoli* (中华人民共和国反倾销条例), issued by the State Council on 31 October 2001, the State Council Decree No 328, revised by the State Council on 31 March 2004 (effective from 1 June 2004), the State Council Decree No 401 ('PRC Anti-dumping Regulations'), Art 48.
[190] *Ibid*, Art 49.
[191] *Ibid*, Art 49(1).
[192] *Ibid*, Art 49(2).
[193] *Ibid*, Art 51(2).
[194] *Ibid*, Art 52.

For the anti-dumping duty, MOC shall propose to the Tariff Commission of the State Council for a decision of maintenance, amendment or termination of such anti-dumping duty and then publish such decision in the form of a circular; for the price undertakings, MOC can decide by itself whether to maintain, amend or terminate such undertakings.[195]

9.5 TWO RELATED ISSUES

9.5.1 Anti-avoidance Measures

The FTL (2004) has a provision on anti-avoidance, simply indicating that '[t]he State may adopt counter-evasion measures against acts of evasion of the foreign trade remedial measures stipulated [in the FTL]'.[196] The *PRC Anti-dumping Regulations* also provide that 'MOC may adopt appropriate measures to prevent acts of avoiding anti-dumping measures' (Article 55). To date, MOC has not issued a separate administrative rule on the operation of anti-avoidance measures. Obviously, the simple provision under the FTL (2004) or the *PRC Anti-dumping Regulations* cannot ensure MOC takes 'appropriate' measures rather than some disguised protectionist measures aiming to case a wider net on foreign competitive products. The practices of other WTO Members and the relevant WTO rules may play an important role in this respect – but as a practical matter, it is not likely that MOC will start an anti-avoidance investigation before it issues more tangible rules or guidance on this matter.

9.5.2 CEPA

Article 7 of the CEPA between the Mainland China and Hong Kong provides that each party undertakes not to take an anti-dumping measure against the products 'originated from' the other party. The CEPA between the Mainland China and Macau has a similar provision (Article 7). Notably, this special arrangement only applies to the products 'originated from' either party. It is still possible that one party takes the anti-dumping measures against the products exported by the exporters or producers of the other party, provided that such products cannot be classified as being originated from the other party under the applicable rules of origin. For example, a Hong Kong or Macau company acts as the exporter of the product in question originated from a

[195] *Ibid*, Art 50.
[196] FTL (2004), Art 50, see n 7 above.

third country or region, or only processes such product in a simple way without satisfying the value-added criterion.

Similarly, the CEPAs between the Mainland China and Hong Kong and Macau respectively provide that each party undertakes not to take an anti-subsidies measure or a safeguard measure against the product 'originated from' the other party.[197]

9.6 ANTI-SUBSIDIES

9.6.1 Substantive Issues

Most principles and rules in relation to anti-dumping as analysed above can apply to anti-subsidies in the PRC. Therefore, this section only briefs the main characters of the Chinese anti-subsidies regime. Up to January 2005, no anti-subsidies case has been brought in the PRC. One possible reason is that the anti-dumping case could be relatively easier to be brought by the domestic applicants, because it is easy for them to collect the information on the export price (which indeed can be deducted from the import prices of the product in question) and the domestic price of the dumped product. Comparatively, the evidence of the subsidies provided by the home government to one exporter or producer (more like a purely domestic issue in the relevant country or region) may not be so straightforward or available to the public. Having said that, the anti-subsidies regime is still a key part of trade remedies. Even if it will not be applied so frequently as anti-dumping, there still exists an option for the Chinese domestic producers to trigger the anti-subsidies process when they become more sophisticated and capable of collecting and analysing information of foreign competitors or when the market competition becomes so fierce that they have to apply for more kinds of trade remedy than the traditional anti-dumping route.

Since the articles in relation to anti-subsidies in the old regulations were too general and simple, the *PRC Anti-subsidies Regulations* are more based on the structure and wording of the *WTO Anti-subsidies Agreement*, with certain adjustments. From the perspective of implementation, *PRC Anti-subsidies Regulations* may be an ideal example to show the drafting technique of incorporating the wording of WTO Agreements into Chinese domestic law. Table 9-2 shows this textual consistency.

On the other hand, the new regulation differs from the *WTO Anti-subsidies Agreement* in some respects, reflecting the 'cherry-picking' approach in

[197] *Closer Economic Partnership Arrangement* between the Mainland China and the Hong Kong Special Administrative Region, signed on 29 June 2003 ('CEPA'), Arts 8 and 9; *Closer Economic Partnership Arrangement* between the Mainland China and the Macau Special Administrative Region, signed on 17 October 2003 ('CEPA') , Arts 8 and 9.

designing the implementing legislation. Two most notable examples of this approach are that, first, it does not distinguish among prohibited, actionable and non-actionable subsidies, and second, it has no provision on non-actionable subsidies (that is, the exceptions to the anti-subsidies regime). The first example might be only a matter of format, because the new regulation covers the types of prohibited subsidies by the definition of 'specificity' that in turn brings all subsidies with the specificity into the scope of investigation. However, the reason for being silent on the exceptions of non-actionable subsidies is more difficult to ascertain. More strangely, the old 1997 regulation had a short article referring to these exceptions, but the new regulation does not include any such article. In my view, the underlying rationale may be that the government aims to de facto expand the scope of anti-subsidies investigation. Where there are no express exceptions to investigation, domestic industry or the MOC can initiate the investigation on imported products that would otherwise be exempted from the outset. This virtually casts a 'wider net' and provides certain regulatory discretion to the trade regulators, who now have the final say to initiate or to stop the investigation. After the procedure is triggered, it is likely to impose some pressures on the exporting country in consideration of adjusting these non-actionable subsidies. In other words, the policy consideration of protecting domestic industry from foreign competitors might be inferred from this particular example.

Even for the provisions with a high textual relativity to the *WTO Anti-subsidies Agreement*, a few of them are not simply mirroring the latter's wording. For example, the *WTO Anti-subsidies Agreement* stipulates that the amount of subsidies for governmental provision of equity capital shall be that amount of capital, save that the investment decision is inconsistent with 'the usual investment practice of private investors'.[198] In the corresponding Chinese article, however, the extent of the subsidies turns out to be the 'amount of equity capital actually received by the enterprise'.[199] The deletion of the 'usual investment practice' condition is more tangible than the text: any kind of governmental equity investment is potentially caught by the *PRC Anti-subsidies Regulations*, regardless of its consistency with the market practice in that Member. This illustrates how the implementing measure can be drafted with a slightly different wording from the WTO rule, but with a significant impact on foreign exporters.

9.6.2 Procedures

Similar to the procedural rules applicable to the anti-dumping investigation, MOC issued a package of anti-subsidies investigation procedures (see Table

[198] *The WTO Anti-subsidies Agreement*, Art 14(a).
[199] *PRC Anti-subsidies Regulations*, Art 6(4).

Table 9-2 Anti-subsidies: The WTO Agreement and Chinese Implementing Measures

Issues	WTO Anti-subsidies Agreement	1997 PRC Regulation	2004 PRC Regulation
Subsidy	A benefit is conferred by a government or any public body's financial contribution where: (1) direct transfers or potential direct transfers of funds or liabilities; (2) foregone or not-collected government revenue that is otherwise due; (3) governmental provision of goods or services other than general infrastructure, or purchase of goods; (4) governmental payments to a funding mechanism, or entrusts or directs a private body to carry out (1) to (3). (Article 1.1)	Financial contribution or benefits directly or indirectly provided by foreign governments or public bodies to the industry or enterprises. (Article 36)	(the same to the WTO provision, Article 3)
Specificity	A subsidy is specific to an enterprise or industry or group of enterprises or industries, provided that: (1) where the granting authority explicitly limits access to a subsidy to certain enterprises; (2) where the granting authority establishes criteria or conditions in law, regulation or other official document, governing eligibility and amount of a subsidy, but the eligibility is not automatic or such criteria and conditions are not strictly adhered to; (3) where the granting authority limits a subsidy to certain enterprises located within a designated geographical region. (Article 2)	(no corresponding provision)	A subsidy subject to this Regulation must have specificity in the following circumstances: (1) (the same to the WTO provision) (2) where the law or regulation of the exporting country expressly limits access to a subsidy to certain enterprise or industry; (3) (the same to the WTO provision) (4) subsidies contingent upon export performance; (5) subsidies contingent upon the use of domestic over imported goods. (Article 4)
Prohibited subsidies	(1) subsidies contingent upon export performance; (2) subsidies contingent upon the use of domestic over imported goods. (Article 3.1)	(no corresponding provision)	(no clear provision, but contains the same two types of prohibited subsidies in Article 4 for 'specificity', see above)

Actionable subsidies	The use of any subsidy referred in Article 1 (see the column of 'subsidy') which causes adverse effects to the interests of other Member. (Article 5)	(no corresponding provision)	(no corresponding provision)
Non-actionable subsidies	(1) subsidies which are not specific (see the column of 'specificity'); (2) subsidies for assistance for research activities, save that the assistance covers not more than 75 per cent of the costs of industrial research or 50 per cent of the costs of pre-competitive development activity and that such assistance is limited exclusively to costs of research activities; (3) subsidies for assistance to disadvantaged region for general regional development; (4) subsidies for assistance to promote adaptation of existing facilities to new environmental requirements in law or regulation.	Subsidies only used for industrial research and development, assistance to disadvantaged region, and environmental protection. (Article 37)	(no provision)
Calculation of subsidies	(1) For governmental provision of equity capital: the amount of capital, if the investment decision is inconsistent with the usual private investor's practice; (2) For governmental loan: the difference between the interests payable on the government loan and on a comparable commercial loan; (3) For a governmental loan guarantee: the difference between the interests payable on the government-guaranteed loan and a comparable commercial loan absent the government guarantee; (4) For governmental provision of goods or services or purchases of goods: the difference between the prices where the provision is made for less than adequate remuneration or the purchase for more than adequate remuneration, and the prices in prevailing market conditions. (Article 14)	The net subsidies received by the subsidised product, calculated on a reasonable and fair basis. (Article 38)	(1) For governmental provision of equity capital: the amount of the capital actually received; (2) (the same to the WTO provision) (3) (the same to the WTO provision) (4) (the same as the WTO provision) (5) For gratuitous allocation of funds: the amount of funds actually received; (6) For foregone or no collection of revenues: the amount of difference between the revenues payable under the law and the revenues actually paid. (Article 6)

Note: Other issues such as the definition of 'injury', 'domestic industry' and the criteria and scope of assessment are similar to those in the anti-dumping legislation.

Table 9-3 Key Components of the Anti-subsidies Procedure: Chinese Implementing Measures

Stage	Name of Chinese Rules	WTO Anti-subsidies Agreement
Initiation	Interim Measures on Initiation Standards of Anti-subsidies Investigation	Article 11
Evidence	Interim Measures on On-site Verification	Article 12.6 and Annex VI
	Interim Measures on Questionnaire Investigation	Article 12.1
Investigation	Interim Measures on Hearing Meetings of Anti-subsidies Investigation	Article 11
	Measures on Hearing Meetings for Determination of Injury to Industry	Article 11
	Rules on Investigation of Industrial Damages in Anti-Subsidies Cases	Article 15

9-3). Their texts are highly similar to those of the relevant anti-dumping procedures, sometimes even only having the word ‘anti-dumping’ changed to ‘anti-subsidies’. The analysis on the anti-dumping investigation as above can serve as a good reference for the same process for the anti-subsidies investigation.

10

Safeguard Measures

10.1 OVERVIEW

Besides anti-dumping and anti-subsidies measures, safeguard measures are the third pillar of China's foreign trade remedy system. The FTL (2004) provides that:

> Where a large increase in the quantity of imported products results in serious injury or threat of serious injury to a related domestic industry that produces similar or directly competitive products, the State may adopt necessary safeguard measures to eliminate or mitigate such injury or threat of injury, and may also provide necessary support to such domestic industry.[1]

The specific regulations – *PRC Regulations on Safeguard Measures* contain the same clause to define the scope of its application.[2] These clauses are basically the Chinese translation of Article 2(1) of the *WTO Agreement on Safeguards*.

In addition to the above basic regulations, MOC has issued four administrative rules governing the commencement of, and investigation under, safeguard measures: *Interim Rules on the Filing of Investigations for Safeguard Measures*,[3] *Interim Rules on the Hearings of Investigations for Safeguard Measures*,[4] *Interim Rules on the Procedures of Adjustment of the Scope of Products Subject to Safeguard Measures*,[5] and *Rules on the Investigation for*

1 *The PRC Foreign Trade Law*, *Zhonghua Renmin Gonghe Guo Duiwai Maoyi Fa* (中华人民共和国对外贸易法), promulgated on 12 May 1994 by the Seventh Meeting of the Standing Committee of National People's Congress of the PRC and taking effect from 1 July 1994, as amended on 6 April 2004 and taking effect from 1 July 2004 ('FTL (2004)'), Art 44.

2 *PRC Regulations on Safeguard Measures* (中华人民共和国保障措施条例), issued by the State Council with effect from 1 January 2002, and amended by the State Council on 31 March 2004 (the State Council Decree No 403) with effect from 1 June 2004, Art 2.

3 *Interim Rules on the Filing of Investigations for Safeguard Measures* (保障措施调查立案暂行规则), MOFTEC Decree [2002] No 9, effective from 13 March 2002.

4 *Interim Rules on the Hearings of Investigations for Safeguard Measures* (保障措施调查听证会暂行规则), MOFTEC Decree [2002] No 11, effective from 13 March 2002.

5 *Interim Rules on the Procedures of Adjustment of the Scope of Products Subject to Safeguard Measures* (关于保障措施产品范围调整程序的暂行规则), issued by MOFTEC with effect from 13 January 2003.

Injury of Industry under Safeguard Measures.[6] Obviously, the procedural rules applicable to safeguard measures are not as comprehensive as those of anti-dumping or anti-subsidies. Upon a close review, the above four rules are found to be very similar to the corresponding rules applicable to anti-dumping investigations. As a practical matter, it would be reasonable for MOC to refer to the rules applicable to anti-dumping investigations in case there is no corresponding provision in relation to the safeguard measure investigation, or at least adopt the rationale of such rules when dealing with the issues arising from the safeguard measure investigation. In the following sections, unless the rules for safeguard measures have different provisions from the anti-dumping rules, they will not be separately discussed.

There is only one case to date: the safeguard measures on certain imported steel products in 2002. On 19 April 2004, the China Steel Industry Association and five Chinese steel companies submitted to the then MOFTEC the application for a safeguard investigation on certain imported steel products (referred to as '*Steel Product* case'). MOFTEC accepted the application on 20 May 2002 and started the investigation. It immediately issued a preliminary ruling imposing the interim safeguard measures on the import of such products from 24 May 2002 for a period of 180 days. On 19 November 2002, MOFTEC issued the final ruling imposing the formal safeguard measures on the import of selected steel products under investigation for a period of three years (from 24 May 2002 to 23 May 2005). However, these safeguard measures were finally terminated on 26 December 2003, only after about 19 months of imposition. The analysis of regulations on safeguard measures in the following sections will also combine the facts and findings of this case – the only case to show how the Chinese trade regulator dealt with the safeguard measures in practice.

10.2 COMMENCEMENT OF INVESTIGATION

10.2.1 Applicants

Eligible applicants for commencing a safeguard investigation include natural persons, legal persons and other organisations or institutions 'in relation to' the affected domestic industry.[7] They can submit a written application report to MOC, which will decide whether or not to commence an investigation. The scope of eligible applicants is wide and the threshold for application is quite low: the term 'in relation to' the affected domestic industry is a qualita-

6 *Rules on the Investigation for Injury of Industry under Safeguard Measures* (保障措施产业损害调查规定) , MOC Decree [2003] No 5, effective from 17 November 2003.

7 *PRC Regulations on Safeguard Measures*, Art 3, see n 2 above.

tive rather than quantitative requirement and does not require the applicant to prove its annual output of the product in question or its market share. It is even possible for one domestic entity to start the investigation as long as the application report puts forward sufficient evidence to MOC.

Alternatively, MOC may commence the investigation on its own initiative if it has sufficient evidence that a domestic industry is being affected by the significant increase of the import of the product in question.[8]

10.2.2 Application Report

The application report must be in writing and express the intention to request MOC to commence the safeguard investigation, duly signed or sealed by the applicant(s). It shall contain the following contents: information of the applicant(s); description of the imported product in question and domestic like product or directly competitive product; information of export countries or regions, exporters, producers and Chinese importers of the product in question; description of the relevant domestic industry which is known to the applicant(s); description of the increase of the import of the product in question, the injuries caused and the causal link; and the request for MOC's action.[9] The applicable rule further requires that the report must provide certain information of each of the above points. For example, in respect of the domestic industry, the report must contain such information as all domestic producers and industrial associations that are known to the applicant(s), the aggregate output of the domestic like product(s) or directly competitive product(s) and the market share of such domestic-made product(s) in the previous five years.[10] The application report is the key document for the applicant(s) to convince MOC that commencement of the safeguard investigation is justifiable. The burden of proof rests on the applicant(s) because MOC may not have necessary expertise and capacity to investigate the domestic industry and the imported product(s) in question in great detail in practice. In order to be convincing, it is necessary for the applicant(s) to provide as much objective and quantitative information as possible. To prove that the increase of the import of the product in question has already caused injury to the domestic industry, the applicant(s) must provide objective and quantitative factors or criteria that have affected the status of the domestic industry, as well as evidence of the impact of the price of such imported product on that of domestic like product.[11] Comparatively, the applicant(s) must provide evidence of export capacity, inventory and the likely increase of

[8] *PRC Regulations on Safeguard Measures*, Art 4, see n 2 above; *Interim Rules on the Filing of Investigations for Safeguard Measures*, Art 3, see n 3 above.

[9] *Interim Rules on the Filing of Investigations for Safeguard Measures* (保障措施调查立案暂行规则), MOFTEC Decree [2002] No 9, effective from 13 March 2002, Art 6.

[10] *Ibid*, Art 10.

[11] *Ibid*, Art 12.

import in future, plus evidence that is required under the circumstance of existing injuries.[12]

One challenge for the applicant(s) is to prove that there exists a causal link between the increase of the import of the product in question and the injuries caused to the relevant domestic industry. The determination of causation involves to a certain degree the qualitative analysis. MOC requires the applicant(s) to illustrate all factors other than the increase of import that have been known to cause the injuries. These factors include (but without limitation) the reduction of need, the change of consumption mode, restrictive trade business of foreign and Chinese producers, technical developments, export results, and production rate of the domestic industry. While these factors are also attributable to the injuries to the domestic industry, the applicant(s) must prove that they are not the main factors that cause such injury, or compared to the increase of the import their effects are only marginal.[13]

The application report can have a confidential version and a public version. The applicant(s) must submit one original copy and six duplicate copies for each version. An electronic version is also required by MOC.[14]

10.2.3 Acceptance of the Application

MOC will investigate the increase of the import of the product in question and the injuries to domestic industry. If the product in question is an agricultural product, MOC needs to work together with the Ministry of Agriculture for the investigation.[15]

As a general rule, MOC must decide whether or not to accept the application within 60 days of receipt of the application report. If it decides to refuse the application, it has the duty to notify the reasons to the applicant(s). If it decides to accept the application, it is obliged to publish a circular indicating all information relevant to the investigation, including the name and description of the product in question, the export countries or regions subject to investigation, a summary of the reasons for starting the investigation, the investigation period, deadlines for interested parties to provide opinions and contact details of MOC.[16] The date of the circular will be the starting date for the safeguard investigation.

MOC has the duty under the WTO Agreement to notify the WTO about the investigation within seven days after the decision.[17] It is not clear whether

12 *Ibid*, Art 13.
13 *Ibid*, Art 15.
14 *Ibid*, Arts 21 and 22.
15 *PRC Regulations on Safeguard Measures*, Art 6, see n 2 above.
16 *Interim Rules on the Filing of Investigations for Safeguard Measures* (保障措施调查立案暂行规则), MOFTEC Decree [2002] No 9, effective from 13 March 2002, Art 30.
17 *Ibid*, Art 31.

the term 'decision' refers to the decision as published in the circular or the internal decision before the publication, but as long as MOC satisfies the former timeline this should not be a controversial point.

10.3 INVESTIGATION

10.3.1 Methods

MOC can adopt a number of investigation methods in a safeguard investigation, including questionnaire and hearing.[18] The procedures are similar to those in an anti-dumping investigation. In addition, some related issues such as confidentiality, comments rule and publicity are also similar to those in an anti-dumping investigation.[19]

10.3.2 Significant Increase of the Import

The first issue for the safeguard investigation is to determine if there is a significant increase of the import of the product in question. The increase may be absolute in a quantitative way, or may be relative only compared to the domestic production.[20] Therefore, it is possible that the quantity of import in the current year is less than the quantity of import in the previous year (that is, an absolute decrease of the quantity of import), but may still be recognised as a kind of 'significant increase' because of more reduction in the domestic production in the current year.

In the *Steel Product* case, the then MOFTEC issued about 350 questionnaires on 23 and 24 June 2002 to various interested parties that had registered to participate in the investigation. These questionnaires fell into three categories, respectively applicable to exporters, domestic producers and importers. MOFTEC received valid responses totalling 214 questionnaires, 60.62 per cent of the total number of questionnaires issued. MOFTEC further held hearings on 25 and 26 September 2002 for interested parties to give presentations and exchange opinions during the meetings. In addition, some exporters or domestic producers provided written submissions to MOFTEC to express their concerns or opinions, and MOFTEC also reviewed oral or written opinions from the governments of several countries or regions (such as Japan, Korea, EU, Mexico and Argentina). All these

[18] *PRC Regulations on Safeguard Measures* (中华人民共和国保障措施条例), issued by the State Council with effect from 1 January 2002, and amended by the State Council on 31 March 2004 (the State Council Decree No 403) with effect from 1 June 2004, Art 12(2).

[19] *Ibid*, Arts 12(1), 13 and 14.

[20] *Ibid*, Art 7.

methods focused on the investigation of the import increase.[21] Based on the above investigation, MOFTEC concluded that the import of the product in question had been significantly increased during the years from 1997 to 2001 either in an absolute way or in a relative way.[22]

Although it is insufficient to conclude the MOC approach in respect of the issue of the import increase only from the single *Steel Product* case, as a practical matter, this issue should not be controversial in a general sense. The applicant(s) must have done a thorough investigation before starting the application procedure. Since the increase of import can totally be based on quantitative analysis on publicly available figures, it would be difficult for exporters to argue against the positive findings on this issue.

10.3.3 Injuries

The regulations require MOC to review the following factors when deciding the injuries caused by the import increase to the relevant domestic industry: the rate and quantity of increase (absolute or relative) of the import of the product in question; the share of the increased quantity of the product in question in the relevant domestic market; impact of the import on the relevant domestic industry (including on such areas as work in process, sales, market share, production rate, equipment utilisation rate, profits and losses and employment of or in the relevant domestic industry); and other factors that may cause injuries to the relevant domestic industry.[23] As a general rule, other factors than the import increase that have caused injuries to the relevant domestic industry must be excluded.[24]

Two related concepts are the relevant 'domestic industry' and 'causation'. Domestic industry is defined as 'the producers as a whole of the like or directly competitive products operating within the territory, or those whose collective output constitutes a major proportion of the total domestic production of those products'.[25] Thus, whether or not an injury is caused to the relevant domestic industry must be assessed in a broad way that covers at least the majority of domestic producers of the like product. From the perspective of the applicant(s), if their aggregate output of the like product has already occupied a 'major proportion' of the total output, they can claim to represent the relevant 'domestic industry'. Since there is no statutory definition of 'major proportion', MOC has a wide discretion on this issue. For example,

[21] *MOFTEC Final Ruling on the Steel Product Case*, dated 19 November 2002, para 1(2).

[22] *Ibid*, para 2(1), ss 1.2.3(49), 2.2.3(90), 3.2.3(131), 4.2.3(170), and 5.2.3(213).

[23] *PRC Regulations on Safeguard Measures* (中华人民共和国保障措施条例), issued by the State Council with effect from 1 January 2002, and amended by the State Council on 31 March 2004 (the State Council Decree No 403) with effect from 1 June 2004, Art 8(1).

[24] *Ibid*, Art 8(3).

[25] *Ibid*, Art 10. This definition conforms to the same definition under the *WTO Agreement on Safeguards* (Art 4.1(c)).

the applicant(s) occupying more than 50 per cent of the total output in China can easily satisfy this requirement. At the same time, the applicant(s) occupying less than 50 per cent (but still a relatively large portion, say 30 per cent) of the total output may also satisfy this requirement in an arguable way, provided that other producers are all small to medium players and no single one can challenge their position.

Even if there exists injuries to the domestic industry, there must be a causal link between such injuries and the import increase. In other words, it is likely that such injuries are caused by other factors than the import increase, or the import increase only plays a trivial or non-deciding factor to such injuries. In order to establish the causal link, MOC has to identify all other factors that may cause injuries to the domestic industry besides the increase of import, and analyse whether or not the injuries are mainly caused by such other factors and cannot blame the increase of import. This is the key issue to be argued by the applicant(s) and foreign exporters, because it involves not only quantitative analysis (which can hardly be rebutted as long as the data is objective and accurate) but also qualitative analysis (which more or less involves a degree of discretion by MOC).

In the *Steel Product* case, SETC[26] had no difficulty in concluding that the relevant domestic industry – those producers of steel products like the imported ones in question had suffered injuries. The applicants represented the major proportion of the domestic industry.[27] The following evidence, supported by figures and data, proved such injuries to the domestic industry: the slow-down of the increase of productivity and output; the decrease of utilisation rate; the slow-down of the increase of sales and market shares; the significant decrease of sale prices and the trend of the decrease of sale revenues and pre-tax profits in recent periods; and the continuing decrease of employees and the corresponding increase of average wages and production rate. Based on the above evidence, SETC concluded that the domestic industry had suffered serious injury between 1997 and 2001, with a clearer trend in recent periods.[28]

The challenging issue is to prove the causal link between the increase of import and the injuries to the relevant domestic industry in the *Steel Product* case. Notably, MOFTEC adopted a 'material reason' test in this case. It concluded that the increase of import was the material reason that had caused serious injuries to the domestic industry. In order to justify this conclusion, it also identified some other reasons that could have caused injuries to the

[26] Before the merger of SETC and MOFTEC into MOC, SETC was responsible for the investigation of injuries to the relevant domestic industry.

[27] See, for example, *MOFTEC Final Ruling on the Steel Product Case*, dated 19 November 2002, para 1.3. But MOFTEC did not specify what percentage of the aggregate output of the applicants occupied the total output of the product in question in China. This point seems to imply that the applicants might not occupy more than 50% of the total output. MOFTEC should have dealt with this issue in a more transparent way.

[28] See, for example, *Ibid*, para 1.4.

domestic industry, including: the increase of the domestic production capacity that resulted in the increase of the supply of domestic like product and of the competition to a certain degree; the change of consumption volume, the change of the domestic industry's operation status; and the development of technology. However, it held that the first reason had a kind of link with the injuries that the domestic industry had suffered but could not be recognised as a major reason, whilst other reasons had no link to the injuries at all.[29] Therefore, the conclusion was that:

> Based on the above evidence and analysis, the Investigation Authority holds that other factors had caused injuries to the domestic industry, but these factors played a very insignificant role compared to the injuries caused by the increase of import. The increase of import of the product in question should be the material reason for causing serious injuries to the domestic industry, and should have a material causal link with such serious injuries.[30]

It is reasonable to predict that MOC may continue to apply the 'material reason' test in analysing the causal link between the increase of import and the injuries caused to the domestic industry in following safeguard investigations. This test itself does not conflict with the *WTO Agreement on Safeguards*, but its application in practice may be easily abused. For example, MOC has a wide discretion on concluding whether or not one factor has a link with the injuries to the domestic industry or whether such factor only has played an insignificant role among a number of reasons. Whether or not this test can stand the challenges by exporters or their governments even before a WTO panel can only be decided by the facts of a particular case.

10.4 SAFEGUARD MEASURES

10.4.1 Preliminary Ruling and Interim Safeguard Measures

Preliminary ruling is not a mandatory stage of the safeguard investigation by MOC. But if there is express evidence to show the increase of the import of the product in question and the emergency of non-reparable damages to be caused to the domestic industry if without interim safeguard measures, MOC may issue a preliminary ruling and adopt such interim measures.[31]

Interim safeguard measures take the form of tariff increase.[32] MOC should

[29] *Ibid*, para 1.5.

[30] *Ibid*, para 1.5.4(71).

[31] *PRC Regulations on Safeguard Measures* (中华人民共和国保障措施条例), issued by the State Council with effect from 1 January 2002, and amended by the State Council on 31 March 2004 (the State Council Decree No 403) with effect from 1 June 2004, Art 16(1).

[32] *Ibid*, Art 16(2).

propose these measures to the Tariff Commission of the State Council for a decision, and publish the decision for Customs to implement from the date of publication.[33] Before adopting the interim measures, MOC will notify this action to the WTO.[34] The period of interim measures must not exceed 200 days from the date of adoption (ie the date of publishing the relevant circular).[35] In the *Steel Product* case, MOFTEC proposed the interim measures by way of increase – a special tariff on the product in question from 28 June 2002.

10.4.2 Final Ruling and Safeguard Measures

MOC can issue a final ruling either after the preliminary ruling or directly based on the evidence and investigation.[36] If MOC concludes that the increase of the import of the product in question has caused injuries to the relevant domestic industry, it can impose safeguard measures in the form of tariff increase or quantitative restriction.[37] The measures are applicable to the product in question generally, rather than targeting at certain exporting countries or regions. They must also be confined to the degree that is necessary to prevent injuries, remedy serious injuries already caused, and facilitate the adjustment of the domestic industry.[38]

For the tariff increase, MOC should propose to the Tariff Commission of the State Council for a final decision; for the quantitative restriction, MOC can decide it directly. Comparatively, the tariff increase may have a less serious impact on the trade flow than the quantitative restriction.[39] Due to the serious effect of quantitative restriction, there are more stringent rules applicable to this safeguard measure. For example, the volume of import after the imposition of the quantitative restriction cannot be below the average volume of import during the most recent three representative years. The volume of allowed import must be allocated between all exporting countries or regions.[40]

In the *Steel Product* case, MOFTEC adopted the combination of tariff increase and quantitative restriction on the volume of the import of certain steel products that had been recognised as causing injuries to the domestic industry. It was similar to the tariff quota system, that is, the import of these products within the quota was still subject to the normal tariffs as applicable on a 'first-come, first-serve' basis, but the import exceeding the quota was

33 *Ibid*, Art 17(1).
34 *Ibid*, Art 17(2).
35 *Ibid*, Art 18.
36 *Ibid*, Art 15.
37 *Ibid*, Art 19.
38 *Ibid*, Arts 22 and 23.
39 *Ibid*, Art 20.
40 *Ibid*, Art 21.

subject to a higher tariff rate. This method aimed to balance the interests of existing exporters and future exporters, and actually allowed the performance of those executed contracts by paying the normal tariff rate.

10.4.3 Application of Safeguard Measures and Review

The application of safeguard measures cannot exceed four years.[41] But the period may be extended appropriately if satisfying the following conditions: first, it is still necessary to be in place to prevent or remedy serious injuries; second, there is evidence to show that the relevant domestic industry is under the process of adjustment; third, MOC has already performed the notification or consultation obligations to the WTO and the governments of other Members; and last but not least, the measures in the extended period shall not be stricter than those in the previous four years.[42] But the total period (that is, original four years plus the extended period) cannot exceed 10 years.[43]

If the safeguard measures apply for more than one year, they must be reduced gradually during the application period.[44] If exceeding three years, MOC must apply an intermediary review during the application period. The review should cover impacts on and adjustment of the domestic industry.[45] MOC needs to decide whether to maintain, cancel or relax the applicable safeguard measures after the review.[46]

In the *Steel Product* case, MOFTEC proposed a three-year period for the safeguard measures. However, the measures were terminated on 26 December 2003, after about 19 months of application (starting from the imposition of interim measures). While the official explanation was that the injuries caused by the increase of import had been reduced or even eliminated, it is submitted that the true reason was the conflict of interests between domestic steel plants and domestic end-users of the restricted steel products. From the perspective of the end-users, the imposition of safeguard measures means the reduction of the import of those steel products in question or the increase of the price for such products in the domestic market. While this helped the domestic steel plants, it hurt the end-users (such as the manufacturing or building industry that used a large volume of steel products). Thus, the end-users also aligned to argue that the safeguard measures should be terminated ahead of the schedule. At the same time, China's economy has maintained the high-speed increase in the years of 2002 and 2003 so there

41 *Ibid*, Art 26(1).
42 *Ibid*, Art 26(2).
43 *Ibid*, Art 26(3).
44 *Ibid*, Art 27.
45 *Ibid*, Art 28.
46 *Ibid*, Art 29.

was a strong need for steel products – even beyond the capacity of domestic steel plants. Under this circumstance, it is not appropriate to maintain the safeguard measures to protect domestic steel plants any longer; instead, the public interests require more import of steel products from other sources to satisfy domestic needs. After balancing the interests of all parties, MOC finally decided to terminate the safeguard measures on the import of certain steel products.

The *PRC Regulations on Safeguard Measures* also copies the same provisions in the *WTO Agreement on Safeguards* in respect of the restrictions on imposing the safeguard measures on one product. It provides that,

> no safeguard measures shall be applied again to the import of a product which has been subject to such a measure, for a period of time equal to that during which such measure had been previously applied, provided that the period of non-application is at least two years.[47]

But a safeguard measure with a duration of 180 days or less may be applied again to the import of the product in question if at least one year has elapsed sine the date of introduction of such safeguard measure, or such measure has not been applied on the same product more than twice in the five-year period immediately before the date of introduction of such measure.[48]

10.5 TWO RELATED ISSUES

10.5.1 Services

The FTL (2004) has a new provision for the safeguard measures on trade in services. Article 45 provides that:

> Where an increase in the services provided to China by service providers of another country or region results in injury or threat of injury to a related domestic industry that provides similar or directly competitive services, the State may adopt necessary remedial measures to eliminate or mitigate such injury or threat of injury.[49]

This provision is based on Article X (*Emergency Safeguard Measures*) of GATS that authorises a three-year period for the Members to conduct 'the multilateral negotiations on the question of emergency safeguard measures

47 *Ibid*, Art 30(1). This provision is the Chinese translation of Art 7(5) of the *WTO Agreement on Safeguards*.

48 *Ibid*, Art 30(2). This provision is the Chinese translation of Art 7(6) of the *WTO Agreement on Safeguards*.

49 FTL (2004), Art 45, see n 1 above.

based on the principle of non-discrimination'. However, since such negotiation had not reached any result until the time of China's revision of the FTL (1994), the drafters added the above provision into the FTL (2004).

The basic rationale and wording of the safeguard measures on supply of services mirror those on tangible goods. But the services have their own feature: services are intangible and cannot easily be measured either for characteristics or for normal values. Fundamentally, the export of a product by the exporters or producers involves the Chinese importers who are the actual payer of the increased tariff. In respect of provision of services, it is extremely difficult to measure the value of the service provided and require the service receiver (who are the end-user in most cases) to pay an additional amount of 'additional service fee' to the State. It is simply impractical to design, collect and supervise such service fee due to the intangible nature of the service. In addition, the current rules for the safeguard investigation and measures are limited to the tangible goods and thus cannot be extended to cover the services as the target. From these perspectives, it is submitted that the provision of safeguard measures on services is not likely to be applied to a practical case in the near future. Therefore, the FTL (2004) has incorporated this provision as a kind of 'pre-emptive' strike, rather than for any immediate use.

10.5.2 Trade Diversion

The FTL (2004) has a new provision on trade diversion. It provides that:

> Where a large increase in the import of certain products into the market of China due to restriction on import of a third country results in injury or threat of injury to a related domestic industry that has already been established, or substantially impede the establishment of a related domestic industry, the State may adopt necessary remedial measures to restrict the import of such product.[50]

This provision is largely similar to one clause in China's WTO Accession Protocol. Paragraph 16(8) of the Accession Protocol allows a Member to restrict or prohibit the import from China if the special safeguarding measures taken by other Members are to 'cause significant diversions of trade into its market'. Comparatively, the FTL (2004) imposes stricter conditions on the application of the trade diversion rule by MOC. First, there must exist a 'large increase' of the import of the product in question. This quantitative requirement at least implies a materiality test and excludes a small or moderate increase of such import. Second, the large increase of the import of the product in question must cause or threaten to cause damages to the related domestic industry or 'substantially impede' the establishment of such industry. This requirement is a restriction on the imposition of trade remedial

[50] FTL (2004), Art 46, see n 1 above.

measures under the circumstance of trade diversion, because the applicant has to prove the damages of the trade diversion and cannot rely on the fact of the import increase only. In contrast, the trade diversion clause in the Accession Protocol does not require the test of damages.

The FTL (2004) uses the generic term 'remedial measures to restrict the import of such product'. This means that MOC may choose a measure from increasing the tariff rate applicable to the product in question to the prohibition of the import altogether, depending on the degree of seriousness. However, the anti-dumping measures are probably not applicable here because MOC does not investigate whether or not the product in question is dumped into the Chinese market.

Although the FTL (2004) contains the rule on trade diversion, there lacks detailed operational rules or guidance on the implementation of this rule by MOC. As a result, it is likely that MOC will not easily use this ground to restrict or prohibit the import. In addition, it is unclear whether or not a private party can apply to MOC for a trade restriction or prohibition on this ground. Without the involvement of private parties, MOC may not have sufficient incentives to start the trade diversion investigation procedure on its own initiative.

Part IV

Related Issues

11

Trade Promotion

11.1 GENERAL FRAMEWORK

The Chinese government has put foreign trade (particularly export) as one priority of economic development since the late 1970s. With the trade liberalisation and the decrease of governmental intervention in trade activities, the government has turned to indirect ways to promote foreign trade by Chinese exporters. The FTL (2004) has a separate chapter on trade promotion.[1] Trade promotion measures include the establishment of a public trade information system and foreign trade development funds and risk funds, the provision of export credit, insurance and tax refund, the establishment of trade associations,[2] and the encouragement of small-and-medium enterprises for engaging in foreign trade.

This chapter focuses on three types of export promotion measures that give a direct incentive to Chinese exporters: export credit, export credit insurance and export tax refund.

11.2 EXPORT CREDIT

11.2.1 The Export-Import Bank of China (China EXIM Bank)

11.2.1.1 Overview

China EXIM Bank, established in 1994, is the sole export credit agency in the PRC that provides direct funding to the export of Chinese goods and services.[3] It takes the form of a 'policy bank' (that is, a bank whose mission is to

1 *The PRC Foreign Trade Law*, *Zhonghua Renmin Gonghe Guo Duiwai Maoyi Fa* (中华人民共和国对外贸易法), promulgated on 12 May 1994 by the Seventh Meeting of the Standing Committee of National People's Congress of the PRC and taking effect from 1 July 1994, as amended on 6 April 2004 and taking effect from 1 July 2004 ('FTL (2004)'), Ch 9 'Foreign Trade Promotion', Arts 51–9.

2 The most important foreign trade association is the China Council for the Promotion of International Trade or CCPIT (http:// www.ccpit.org). CCPIT also acts as the China Chamber of International Commerce.

3 The website of China EXIM Bank is http:// www.eximbank.gov.cn.

carry out policy objectives of the PRC government) and is wholly owned by the PRC government. Since it has the same credit rating as the PRC, the credit risk of China EXIM Bank is relatively easy to assess by the business counterparts.[4]

The main business scope of China EXIM Bank comprises export seller's credit, export buyer's credit, Chinese government concession loans, onlending of loans from foreign government or international financial institutions, guarantees and performance bonds. Among these businesses, the export seller's credit is the most important one.

11.2.1.2 Business Process for the Export Seller's Credit

China EXIM Bank ('Bank') has a set business process for the application for, and provision of, export credits. An eligible Chinese exporter must satisfy certain conditions to apply for the export seller's credit.[5] First, the export shall comply with PRC law and the laws of the importing country and shall not prejudice the national interests of China. Second, the export goods shall be the products (and related services) manufactured within China and provided by Chinese service suppliers. The local rate shall be not lower than 70 per cent for complete sets of equipment or mechanical and electrical products or 50 per cent for vessels, aircrafts and automobiles. Third, the amount of export shall not be less than USD1 million. Fourth, the contract shall provide for a percentage of down payment or prepayment by the importer, not lower than 15 per cent of the contract amount for complete sets of equipment or mechanical and electrical products or 20 per cent for vessels before delivery. Fifth, the repayment period of the Insured Project shall be between one year and 10 years and shall not exceed 12 years (for big projects only). Sixth, the political risk of the importing country is acceptable to China EXIM Bank and if necessary, the exporter should purchase the insurance policy from commercial insurance companies or China's sole export credit insurance company—Sinosure (see below). Seventh, the importer and the guarantor should have an acceptable credit standing, and the project should have a sound technological level and good prospects for returns and also conform to the importing country's environmental requirements. Usually, the export contract should not have been signed at the time of application for the export seller's credit loan.

The typical process is as follows. The first step is the enquiry – the Chinese exporter must discuss with the Bank about the export credit at an early stage by filling in the Form of Enquiry on Export Credit. If satisfying the Bank's preliminary assessment, the bank will issue a Letter of Interest containing the indicative terms and conditions. The second step is the risk assessment. The bank will assess all risks relevant to the project and participate in the negotia-

[4] For details of credit rating, see http://english.eximbank.gov.cn/profile/rating.jsp.

[5] These criteria are to a large extent applicable to the export buyer's credit.

tion of the export contract and security documents. Finally, a formal export seller's credit loan agreement will be signed by the Chinese exporter and the Bank.

Where the contract amount exceeds USD100 million in relation to the export of large-scale and complete sets of equipment or overseas contracting or construction projects, a complex set of rules for governmental approvals and filings will apply. In summary, MOC must approve the grant of export credit facility first, and then the project must obtain the final approval by the State Council. For a project with a value lower than USD100 million, the MOC approval may be sufficient. If the exporter signs the contract before the approval by the State Council, the contract must be stated as 'subject to the approval by the PRC government' and will only be valid after obtaining all necessary approvals.

11.2.2 WTO Legality

Under the *WTO Agreement on Subsidies and Countervailing Measures*, export credits at rates below the normal market rates would constitute a prohibitive export subsidy, 'so far as they are used to secure a material advantage in the field of export credit terms'.[6] However, if a Member is a party to the international undertaking on official export credits, or if in practice a Member applies the interest rate provisions of the relevant undertaking, such export credit practice will not be viewed as being prohibited by the WTO Agreements.[7]

For the first point of exemption, it is possible for China to argue that the export funding provided by the Bank is not used to secure a 'material advantage' in the field of export credit terms. As the Appellate Body indicates in *Brazil – Aircraft (Article 21.5 – Canada)*:

> [I]f Brazil had demonstrated that the payments made under the revised PROEX were not 'used to secure a material advantage in the field of export credit terms', and that such payments were 'payments' by Brazil of 'all or part of the costs incurred by exporters or financial institutions in obtaining credits', then we would have been prepared to find that the payments made under the revised PROEX are justified under [the *WTO Agreement on Subsidies and Countervailing Measures*].[8]

6 *WTO Agreement on Subsidies and Countervailing Measures*, one document of Annex 1A to the *Marrakesh Agreement Establishing the World Trade Organization*, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994 ('The WTO Agreement on Subsidies and Countervailing Measures'), App 1(k), para 1.

7 *Ibid*, para 2.

8 *Brazil – Export financing programme for aircraft – Recourse by Canada to Article 21.5 of the DSU*, Panel Report, WT/DS46/RW, adopted 4 August 2000, as modified by the Appellate Body Report, WT/DS46/AB/RW, para 80.

The burden of proof lies on the Chinese government. The determination of whether a payment is 'used to secure a material advantage' implies a comparison between the export credit terms available under the programmes of the Bank and some other 'market benchmark'. The Appellate Body also indicates that one appropriate benchmark would be the Commercial Interest Reference Rate (CIRR) defined in the Arrangement on Guidelines for Officially Supported Export Credits ('OECD Arrangement').[9] Thus, if China can prove that the interest rate charged by the Bank for its export credit programmes is at or above the CIRR, or another appropriately alternative market benchmark, these programmes should not be prohibited by the WTO Agreement.

While China is not a party to the OECD Arrangement, the Bank claims to follow the practices of the OECD Arrangement when it carries out the export credit business. However, this claim cannot be verified by laws or policies issued by the PRC government. Moreover, it is difficult to assess whether or not the export credit programmes of the Bank are consistent with the OECD Arrangement, because some sensitive information (such as the interest rate or the terms) in individual projects are usually not disclosed to the public. In any way, the burden of proof lies on China to prove compliance with the OECD Arrangement in the practice of the Bank, as long as it aims to rely on the second point of exemption under the *WTO Agreement on Subsidies and Countervailing Measures*. For other Members, if they want to bring a WTO complaint against China's export credit programmes, the collection of relevant information in specific projects will be the key to the success of the complaint.

11.3 EXPORT CREDIT INSURANCE

11.3.1 China Export & Credit Insurance Corporation (Sinosure)

11.3.1.1 Organisational Overview

Sinosure is the sole official export credit insurance agency in the PRC.[10] It was established in October 2001 by a merger of the export credit insurance departments of the People's Insurance Company of China (PICC) and of The Export-Import Bank of China. As of January 2005, it has set up 12 regional offices and seven representative offices within the PRC. Sinosure has a General Manager's Office as its highest organ comprising one General Manager (who acts as the legal representative of Sinosure) and two Vice-General

[9] *Ibid*, paras 67–9.
[10] The website of Sinosure is http://www.sinosure.com.cn.

Managers and two Assistant General Managers, supervised by the Supervisory Committee. Under the General Manager's Office, there are the Asset Management Committee, the Risk Management Committee, the Business Innovation Committee, various business departments and regional branches and representative offices.

The business scope of Sinosure covers export credit insurance in foreign currencies and RMB, guarantees and re-insurance business relating to export credit insurance, information and consultation service businesses relating to export credit insurance, management of funds as permitted by laws and regulations, and other businesses as approved by the State Council. So the core business of Sinosure is export credit insurance.

The Ministry of Finance is the competent authority for Sinosure. Important business and management decisions of Sinosure must be approved by this Ministry in advance.

11.3.1.2 Legal Status, Capital Structure and Credit Risk

The *PRC Insurance Law* (enacted in 1995 and revised in 2002) regulates 'commercial insurance activities' (Article 2). Strictly speaking, this law does not clearly govern Sinosure's export insurance even though export insurance would probably fall within the broad concept of commercial insurance activities. However, Sinosure is still regulated by the China Insurance Regulatory Commission (CIRC) to some extent. The *PRC Insurance Law* and other insurance regulations and rules, unless expressly excluded, may nevertheless be important references to the operation of Sinosure. Notably, the consultation paper on the *Judicial Opinions on the Adjudication of Insurance Cases* ('Judicial Opinions') was published by the People's Supreme Court on 9 December 2003. The draft *Judicial Opinions* provide that the adjudication of export credit insurance cases shall apply Section 1 (General Rules) of Chapter 1 (Insurance Contracts) of the *PRC Insurance Law* and the relevant interpretations, 'subject to the clauses of the export credit insurance contract'. This not only clarifies the applicability of the *PRC Insurance Law* to Sinosure's insurance policy but also recognises the supremacy of express clauses in the policy (unless violating some PRC mandatory rules).

Unlike export credit agencies of some other countries, Sinosure takes the legal form of a 'wholly state-owned company'. A 'wholly state-owned company' ('WSOC') is a limited liability company under *PRC Company Law*, with the State being its (direct or indirect) sole shareholder. The State usually holds the equity interests of WSOC through its authorised investment departments or institutions. Therefore, a WSOC is a commercial entity, rather than a state organ. This implies that a Chinese WSOC shall have no sovereign immunity and be subject to legal proceedings, judgments and enforcement of judgments. From this perspective, Sinosure cannot claim itself as having the sovereign credit status.

Sinosure has a registered capital of RMB4 billion (approximately USD500 million), drawn from the Export Credit Insurance Risk Fund ('Fund'). The State Council holds the whole equity interest of Sinosure, and the Ministry of Finance is the competent authority in charge of Sinosure's business. While there is no publicly available law in respect of the credit status of, and government support to, Sinosure, the cap of Sinosure's insured obligation is limited to 20 times the Fund in accordance with the State Council's policy. More interestingly, the State will support the Fund through its financial budget if necessary. It implies that the State will allocate a budget to supplement the Fund in the event that the existing amount of the Fund cannot honour Sinosure's policies. As a result, Sinosure has indirect support from the Central Government of the PRC through the form of budgetary allocation, which will in turn enhance Sinosure's credit status. However, it is unclear how this budgetary allocation will work and under what conditions, nor whether there is any limit or a legal procedure to trigger this mechanism. Most importantly, this budgetary allocation is not set out in a publicly available law – its legal effect is doubtful in the eyes of outsiders.

As a limited liability company, Sinosure can legally declare or be declared insolvent. Therefore, Sinosure is not immune from insolvency and such risk (even if remote) must be properly – and practically – assessed by business partners. Nevertheless, whether or not the Central Government will allow the insolvency of Sinosure will be driven by policy considerations. As the sole official export credit insurance agency in the PRC, it would seem likely that the Government would be keen to intervene (or, at least, would very seriously consider intervention) in the light of its pending insolvency. Therefore, from a practical perspective, although the insolvency risk of Sinosure cannot be eliminated under PRC law, it could have a minimal impact on its business operation.

11.3.2 WTO Legality

Under the *WTO Agreement on Subsidies and Countervailing Measures*, the provision by governments (or special institutions controlled by governments) of export credit guarantees or insurance programmes or of insurance or guarantee programmes against increases in the cost of exported product or of exchange risk programmes, 'at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes', will constitute a prohibitive export subsidy.[11] Sinosure is a company 'controlled' by the PRC

[11] *WTO Agreement on Subsidies and Countervailing Measures*, one document of Annex 1A to the *Marrakesh Agreement Establishing the World Trade Organization*, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994 ('The WTO Agreement on Subsidies and Countervailing Measures'), Annex 1(j).

government and provides export insurance or guarantee programmes. Therefore, whether or not Sinosure's existence and operation comply with the WTO Agreement depends on if the premium rates charged by Sinosure for its insurance products will be adequate enough to cover its long-term operating costs and losses.

It is difficult to assess Sinosure's overall operating costs and losses of its insurance business because of the non-transparency of its financial information. From the information available on its website (as of 1 January 2005), the insured amount in 2003 was USD5.71 billion, representing 107.6 per cent increase from 2002, while the aggregate premium in 2003 was RMB 996,000,000 (approximately USD120,000,000), representing 23 per cent increase from 2002. However, there is no public information on the amount of insurance payment by Sinosure either in aggregate since its establishment in 2001 or in each single financial year. Moreover, since the WTO legality relies on the 'long-term' prospects, the deficit in one year or even in a period of years is not sufficient proof. As a result, the assessment of WTO legality of Sinosure's business operation requires the disclosure of more financial information and long-term business plans by Sinosure or by its sole shareholder – the Chinese government.

11.3.3 Medium-long Term Buyer's Credit Insurance Policy

11.3.3.1 Overview

Sinosure offers a wide range of insurance products, mainly comprising buyer's credit insurance policy (short-term and medium-long term[12]), seller's credit insurance policy (short-term and medium-long term), overseas investment policy and performance bonds. This section analyses Sinosure's Standard Medium-Long Term Buyer's Credit Insurance Policy ('Policy'), which can serve as a reference to other types of insurance policies issued by Sinosure. In practice, this Policy has attracted significant interest of foreign banks.

The Policy insures the lenders (domestic or foreign financial institutions, as the 'Insured') under buyer's credit loan agreements that provide funds to foreign purchasers of Chinese goods ('Debtor'). Usually the Chinese exporter acts as the applicant for the Policy and may even pay all insurance premiums and related expenses as an incentive to the Debtor's purchase of Chinese goods, because now the credit risk of the Debtor is transferred to Sinosure under the Policy and the Insured can claim against Sinosure for repayment of the principal of and accrued interest on the buyer's credit loan in the event that the Debtor fails to repay such loan.

[12] If the term of the policy is below one year, it is a short-term policy; otherwise, it is a medium-long term policy.

The Policy is governed by PRC law and submits any disputes to arbitration by the China International Economic and Trade Arbitration Commission (CIETAC) held in Beijing. The Policy will only be issued in a Chinese version. This is consistent with the practices of other Export Credit Agencies ('ECAs').

The Policy has been approved by the Ministry of Finance in late 2004. As a general rule, Sinosure refuses to negotiate to change the provisions of the Policy in individual cases. However, depending on the projects and the bargaining powers of the applicant and the Insured, Sinosure might consider negotiating for some specific wording in the Policy so far as those amendments are not material. Any material change of the Policy still requires the approval by the Ministry of Finance. Sinosure may use this as an excuse to refuse the negotiation if it takes a wider view on what constitutes a 'material' change.

11.3.3.2 Covered Risks

In general, the Policy covers 'losses of principal and interest to which the Insured is entitled under the Loan Agreement resulting from and only from' the following risks: Debtor's defaults under or breach of the Loan Agreement; Debtor's bankruptcy, insolvency, winding-down, dissolution or liquidation; prohibition of Debtor's repayment due to laws, regulations, rules, decrees or administrative actions of the government of the Debtor's country or territory; moratorium order(s) of the government of the Debtor's country or territory or of a third country or territory in which the payments have to pass; and war (except for any war between two or more than two permanent members of the United Nation Security Council), revolution, turmoil or other political event that Sinosure deems to be applicable in its sole discretion. Broadly speaking, the Policy covers both commercial risks of the Debtor and political risks of the Debtor's home jurisdiction.

One significant point is that the Policy does not expressly cover the risk of nationalisation and expropriation by the home government of the Debtor. While the Policy covers the exchange risks (that is, the government's prohibition of Debtor's repayment of the loan), these risks are not equal to the nationalisation risk. Of course, the nationalisation risk in relation to the loan agreement may only take the form of extinguishments of the repayment obligation by the Debtor under the loan agreement by the home government, which somehow falls within the literal meaning of 'prohibition of repayment'. From the lenders' point of view, they must carefully assess the possibility (however remote) of nationalisation by the home government of the Debtor – if this risk is significant, additional risk coverage has to be considered.

The Policy differs from a normal demand style guarantee in several important aspects. First, under a demand guarantee, once the debtor fails to repay the debt or perform a contractual obligation and upon the demand by the

guaranteed party, the guarantor is obliged to pay the debt to the guaranteed or (less usually) perform that obligation. The guaranteed party need not prove its loss or damages, or the causal link with the debtor's default. However, under the Policy, the Insured must prove its loss or damages and the causal link with the occurrence of an Insured Event. Second, Sinosure can refuse the insurance payment on various grounds (such as the risk not caused by an Insured Event, misrepresentation and breach of covenants by the Insured etc) under the Policy. These are not generally available to a guarantor under a demand guarantee. Third, the Insured assumes various obligations in respect of claims for an insurance payment under the Policy, for example, the obligations to mitigate the loss, to collect the overdue debts and to share collected amounts with Sinosure. In comparison, the guaranteed party under a demand guarantee may not assume such obligations. Last but not least, the Insured has an obligation to take any necessary action to collect the debt (including actions against the borrower), while under a demand guarantee the guaranteed party need not claim against the debtor before it demands the guarantor to repay the debt, nor is it obliged to take any subsequent action against the debtor.

11.3.3.3 Misrepresentation Risk

Under the Policy, the Insured represents and covenants to Sinosure that all information provided or disclosed by it to the Insurer 'in connection with or relating to' this Policy shall be true and accurate, without any 'material' omissions, errors or reservations. Any breach of this representation will entitle the Insurer to terminate the Policy 'without Insurance Payment for any losses and without refund of any insurance premium'. As most information for the application of the Policy is actually supplied by the Debtor or the applicant (the Chinese exporter), the Insured now assumes the misrepresentation risk of these parties even if it only acts as the mailbox or even has no involvement in the application procedure.

The relevant clause in the Policy is stricter than the relevant provisions of the *PRC Insurance Law*. Under that law, the insured is obliged to fully disclose any information relating to itself or the subject matter of insurance, as enquired by the Insurer. The Insurer is entitled to terminate the insurance contract due to (i) the deliberate non-disclosure of the Insured or (ii) the failure to disclose due to the Insured's fault which is sufficient to influence the decision of the Insurer as to whether or not to insure or to increase the premium. For deliberate non-disclosure, the Insurer is not liable to pay the insurance amount in relation to any insured event that has occurred before the termination of the insurance contract (whether the non-disclosure has a causal link with the insured event or not) and to refund the premium. However, for the failure to disclose due to the Insured's fault, such non-disclosure must have 'material effects' on the occurrence of the insured event. Upon

satisfaction of this materiality test plus the causal link test between the non-disclosure and the occurrence of the insured event, the Insurer is not liable to pay the insurance amount in relation to any insured event which has occurred before the termination of the insurance contract, but may choose to refund the premium. The Chinese court practice suggests that under the materiality test the non-disclosed matters must be the major or decisive reason attributable to the occurrence of the insured event. In other words, if the insured event is not caused by such non-disclosed material matters, the Insurer cannot terminate the insurance contract.

From the above analysis, it seems that the Policy deviates from the *PRC Insurance Law* in two main aspects. First, the Policy allows Sinosure to terminate the Policy upon any materially negligent non-disclosure or misrepresentation, regardless of the test of 'material effects' on the occurrence of the insured event. Second, the Policy allows Sinosure to refuse the refund of premium in any circumstance.

In my view, the first deviation in the Policy may not be effective under PRC law, because the 'material effects' test contained in the *PRC Insurance Law* should be mandatory in nature so as to balance the interests of the Insured and the protection to the Insurer; and any article in the Policy to a contrary effect for this issue cannot be valid and enforceable by the Chinese courts.[13] However, since the *PRC Insurance Law* only provides that the Insurer *may* refund the premium under the circumstance of negligent non-disclosure or misrepresentation, the Policy can instead entitle Sinosure to forfeit the premium in any circumstance. Therefore, the second deviation in the Policy may be enforceable under the PRC law.

11.3.3.4 Claim Procedures

Figure 11-1 shows the basic claim procedures under the Policy.

Sinosure has the right to decide whether to pay the Insured on an acceleration basis or on the basis of the original repayment schedule under the loan agreement, but it usually prefers the repayment schedule. This means that even if the Insured declares the acceleration of all undue interest and principal under the loan agreement, it has to apply to Sinosure each time the Debtor fails to pay the interest and principal in accordance with the original repayment schedule. This will significantly increase the administrative burdens of the Insured. Notably, the 90-day waiting period does not apply to the subsequent claims for insured losses caused by the same and continuous insured risk. As a result, the Insured need not wait for 90 days before it can obtain the insurance payment under the Policy for the claims based on the repayment schedule (except for the first claim).

[13] Before the Judicial Opinion is formally issued by the Supreme People's Court and confirms that the *PRC Insurance Law* applies to the export credit insurance policy, Sinosure may still argue that this law does not apply to the Policy.

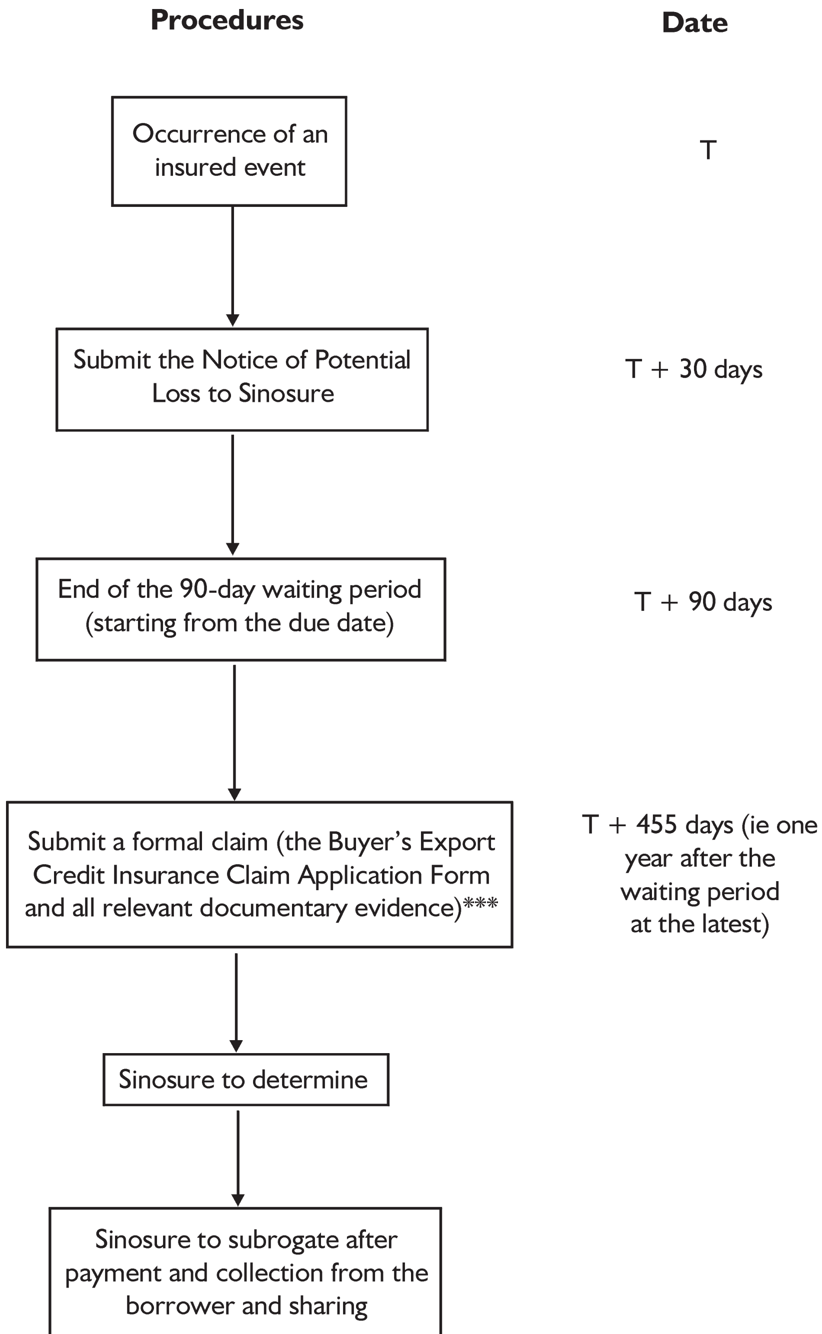

Figure 11-1 Claim procedure under the policy.

11.3.3.5 Termination of the Policy

The Policy may be terminated by Sinosure due to any of the following reasons: first, the Insured fails to pay the full amount of the insurance premium as provided under the Policy; second, the Insured does not disburse the loan proceeds to the borrower 'in strict compliance with' the loan agreement; third, the Insured revises, amends, alters or otherwise changes any provision of the loan agreement or of any guarantee agreement in relation thereto, without the prior written consent of Sinosure; fourth, the Insured assigns, mortgages, pledges or otherwise disposes of any of its rights or benefits under the Policy, the loan agreement or any other agreement in relation thereto, without the prior written consent of Sinosure; fifth, the Insured provides or discloses materially untrue or inaccurate information in relation to the Policy to Sinosure, 'including but not limited to information in the Insurance Application'.

The requirement for prior written consent appears to expose lenders to a significant risk of termination. In particular, this could provide Sinosure with a technical basis for termination even in respect of minor amendments. Also, it is not clear whether changes in lenders (on asset sales) are caught and require Sinosure's prior consent. These points should be clarified with Sinosure before issuance of the Policy.

The Policy is also silent on the issue as to whether the termination relates to the entire financing or only part of it. Therefore, it is reasonable to conclude that the termination of the Policy relates to the entire financing. The Policy does not provide for any grace period or cure rights for the Insured. It is suggested that these issues should be clarified in the Policy – express terms on these points for clarification will be valid and enforceable under PRC law.

11.4 EXPORT TAX REFUND

11.4.1 China's Tax Refunding System

If the export is the engine for China's development in the past 25 years, the export tax refunding is the engine for China's export. With the fierce competition of foreign trade (either in international markets or between competitive domestic exporters), the profit rate of export has dropped to an average of four or five per cent of the export price. Actually, most Chinese exporters cannot get any profit from the trade if there is no tax refunding provided by the State as an incentive to the export business.

China has a value added tax (VAT) system, with the normal VAT rate of 17 per cent and the reduced rate of 13 per cent for limited types of product. The difference between the output price and the input price is payable for

VAT and the amount of VAT so calculated must be paid to the government. A further reduced rate of six per cent applies to those so-called 'small VAT payers' who cannot claim for the deduction of input VAT so are obliged to pay the six per cent flat rate on the output price. In addition, there is a consumption tax with a top-up nature, imposed on certain luxury products or scarce resources (such as cosmetics, cigarettes and cars). VAT and consumption tax will be payable at the time of the sale of taxable goods within the PRC or of the import of such goods into the PRC.

The essence of export tax refunding is to refund the collected VAT and consumption tax (if applicable) on the exported goods to the exporter. On the one hand, this means that the exporter can reduce the export price after taking into account the 17 per cent or 13 per cent refund of VAT (plus any applicable consumption tax), which in turn will increase the competitiveness of Chinese goods in international markets. On the other hand, the tax refund requires the government to pay out such amount of VAT and consumption tax that have already been collected and paid into the Treasury prior to the export to the exporter – this imposes a cash flow pressure on the government's fiscal budget and also implies a re-allocation of fiscal benefits between the government and the exporters. As a chain reaction, any delay in tax refund by the government would cause tremendous pressures on the exporters who may even go into bankruptcy without the cash returned from the government, and the bankruptcy of exporters may cause a problem to all upstream suppliers which in turn will affect the government's tax revenues in an overall sense. Thus, it is easy to understand how strictly the government applies the export tax refund system, as well as why tax refund rules and policies are so frequently changed in order to accommodate fiscal situations in either individual regions or in the whole country.

There are three categories of Chinese goods under the export tax refunding system. The first category covers the goods that are exempt from VAT and consumption tax, including the goods exported under the processing trade (by using imported materials, spare parts and components), anti-pregnancy medicines and tools, ancient and old books, cigarettes and military products.[14] No tax refund shall be applied to such products exempted from VAT and consumption tax, because they have not paid these taxes at all.

The second category relates to certain types of exported goods that cannot enjoy the tax refund privilege. These goods include crude oil, goods exported for assistance, goods prohibited from export and sugar.[15] Since the export of

14 *Administrative Measures on the Tax Refund (Exemption) for Exported Goods* (出口货物退(免)税管理办法) , issued by the State Administration of Taxation, effective from 1 January 1994, para 3.

15 *Ibid*, para 4. One exception is the goods exported under the form of imported materials for the processing trade which has been approved by the government, as the import of the materials are subject to VAT and consumption tax (if any) at the chain of import. The refunding makes the price neutral of tax effects because the processing trade is to use the cheap labour in the PRC for the processing of materials for the purpose of exporting the end-products.

these goods are not encouraged by the government, the refusal of VAT and consumption tax refunding will act as a kind of deterrent to the export by reducing the profit margin of exporters.

The third category relates to all other goods that are subject to VAT and consumption tax. The refundable VAT is calculated on the basis of the input price. If the exporter has a separate account for the exported goods and can distinguish the goods purchased for export and the goods purchased for domestic on-sale, the refundable VAT will be calculated by the following formula:[16]

$$\text{Refundable VAT} = Q \times \text{weighted average of IP} \times \text{VAT rate}$$

Q: the aggregate quantity of the exported goods
IP: the input prices of the exported goods

However, if the exporter cannot set up a separate account for the exported goods or cannot distinguish the exported goods from the goods for domestic on-sale, the refundable VAT shall be the lesser of (i) the product of the output prices for domestic on-sale multiplied by the VAT rate and (ii) the balance of the input VAT that cannot be deducted from the output VAT.[17] The rationale is that the amount of input VAT was paid for both the exported goods and the goods for domestic on-sale, so it must be used to deduct the amount of output VAT that has been calculated from the domestic on-sale. The balance is supposed to be the amount of input VAT that should be allocated to the exported goods. Nevertheless, if the output VAT for domestic on-sold goods is below the balance of input VAT, this means that the exported goods should exceed the domestic on-sold goods – however, since there is no separate account for the exported goods, the government will not simply refund all of the balance to the exporter. Instead, the refundable VAT shall be the amount of the output VAT for domestic on-sold goods, but the balance between such output VAT and the non-deducted input VAT can be carried forward into the next period for tax refunding.

The exporters can claim for tax refunds on a monthly basis. After the export, it must submit the VAT Invoice issued for the exported goods, together with the sales account, Customs' clearance form (for tax refunding) and the collection of export prices in foreign currencies, to the tax authorities for the application of refunding.[18] The tax authorities shall review the documents and decide to approve or refuse the tax refunds. Although the rules require the completion of tax refunding within one month of receipt of all

[16] *Ibid*, para 7(1).
[17] *Ibid*, para 7(2).
[18] *Ibid*, para 14.

documents,[19] there is usually a delay in practice – sometimes the delay may be as long as six months or even one year.

For the goods imported under the processing trade (that is, to be processed within the PRC and the end-products to be exported), the processing entity can apply to the tax authorities for the exemption of VAT and consumption tax that should have been payable had the goods not been imported under this trade form.[20] After the export, the processing entity must cancel the record of imported goods that have been exempted from paying VAT and consumption tax at the relevant tax authorities.

11.4.2 WTO Legality

11.4.2.1 General Rule

There are two grounds for the legality of the export refund system under the *WTO Agreement on Subsidies and Countervailing Measures*. First, the exemption or remission of indirect taxes (including VAT and consumption tax in the PRC) in respect of the production and distribution of exported products are allowed as long as such exemption or remission will not be 'in excess of those levied in respect of the production and distribution of like products when sold for domestic consumption'.[21] Second, the prior-stage cumulative indirect taxes levied on inputs that are consumed in the production of the exported products can be exempted, remitted or deferred even if no similar level of exemption, remittance or deferment is granted to those domestic sold like products.[22]

China's export tax refunding system is not based on the first ground, that is, the exemption or remittance of VAT and consumption tax on the like products sold in the domestic markets, because the domestic sold products are payable for VAT and consumption tax. Thus, the WTO legality of this system depends on the second ground – the exemption and remittance of the prior-stage cumulative VAT and consumption tax that are levied on inputs consumed in the production of the exported products. Under the current system, China's VAT and consumption tax are collected on the cumulative basis. Each purchaser shall pay the VAT on the balance of the purchase price (that is, the output price from the perspective of the seller) and the input price of

[19] *Ibid*, para 25.

[20] *Ibid*, para 20. The exemption of VAT also extends to the fees charged for the processing activities that would otherwise be subject to VAT.

[21] *WTO Agreement on Subsidies and Countervailing Measures*, one document of Annex 1A to the *Marrakesh Agreement Establishing the World Trade Organization*, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994 ('The WTO Agreement on Subsidies and Countervailing Measures'), Annex 1, para (g).

[22] *Ibid*, Annex 1, para (h).

the seller (that is, the purchase price of the seller from the previous seller) in a cumulative way. While it only pays the balance of its input VAT and output VAT to the government, the VAT payable is not credited in the subsequent sales. Therefore, China's VAT refunding system is generally in line with the WTO Agreements.

11.4.2.2 The First WTO Complaint against China

The first WTO case brought by a Member against China – the Semiconductor Tax Dispute between the US and China in 2004 – relates to the VAT refunding system on semiconductor producers.[23] This dispute is about an industrial development policy issued by the State Council on 24 June 2000 under which the semiconductor factories within the PRC were granted a VAT preferential treatment – up to 2010, any portion of VAT collected from these factories beyond the actual VAT payment of six per cent (the normal VAT rate being 17 per cent) shall be immediately refunded to the factories for the research and development as well as the increase of production capacity.[24] The six per cent threshold was further reduced to three per cent in 2002.[25] This policy was apparently neutral, because it applied to all qualified semiconductor factories within the PRC, either as domestic enterprises or as FIEs.

From the perspective of export tax refunding, the above VAT preferential policy on exported semiconductors does not apply on the basis of trade (ie export or domestic sale) but on the basis of the nature of the manufacturer. Any manufacturer that engages in the research and development of semiconductors is qualified to enjoy this policy. As a result, it seems not to directly contradict the WTO Agreement on Subsidies and Countervailing Measures, because both domestic sold semiconductors and exported semiconductors are virtually levied at the same VAT rate (three per cent).

However, a further analysis of the VAT refund policy may reveal its disguised protectionist nature in favour of the China-based producers. First, the VAT refund can effectively reduce the costs of semiconductors produced in the PRC and thus the export price of such semiconductors, so to increase their competitiveness in the international market. Second, the application of this policy can discriminate against the semiconductors manufactured by foreign producers outside the PRC, because these foreign semiconductors

[23] For detailed facts, see the special topic titled 'Semiconductor Tax Dispute' in the USTR website, available at http://www.ustr.gov/World_Regions/North_Asia/China/Section_Index.html (17 September 2004).

[24] *State Council's Several Policies on the Encouragement of the Development of Software and Semiconductor Industries* (Guowuyuan guanyu guli ruanjian chanye he jicheng dianlu chanye fazhan de ruogan zhengce), Guo Fa [2000] No 18, issued on 24 June 2000, Art 41.

[25] *Circular on Tax Policies on a Further Encouragement of the Development of Software and Semiconductor Industries* (Guanyu jinyibu guli ruanjian chanye he jicheng dianlu chanye fazhan shuishou zhengce de tongzhi), issued by MOF and SAT on 10 October 2002, Cai Shui [2002] No 70, para 1.

will be charged at the normal 17 per cent VAT rate at the time of import. The different treatment (that is, applicable VAT rates) to China-made semiconductors and foreign-made semiconductors under PRC law can effectively place the latter in a less favourable competitive status in the Chinese market. In fact, the US government held the view that under this tax policy, US exporters of semiconductors to China must pay up to five times as much tax as local Chinese manufacturers, which disadvantaged US producers.[26] Therefore, it is submitted that this favourable VAT policy that has been adopted by the Chinese government would be a breach of the national treatment principle in general and China's accession commitments (in relation to the equal treatment to domestic and foreign goods) in particular. In other words, while the VAT preferential policy on semiconductors can survive under the WTO anti-subsidies rules, it is still caught by other rules such as the national treatment principle for the domestic-manufactured products and the imported like foreign products.

The Chinese government seemed to have realised this point and reached an agreement with US that the favourable VAT policy would no longer be offered and the VAT refunds to existing beneficiaries would be withdrawn from 1 April 2005. This case may be a good reference to assess the WTO legality of any similar incentive measures that have been adopted or will be adopted by the Chinese government for the export promotion measures – either in an explicit way or in a disguised way.

[26] See 'US and China Resolve WTO Dispute Regarding China's Tax on Semiconductors', dated 7 August 2004, available at the USTR website, see n 23 above.

12

Trade and Competition

12.1 FOREIGN TRADE ORDER

12.1.1 Definition

The term 'foreign trade order' has been used widely in China's trade regulation. There is no statutory definition of this term, and its meaning and scope of application depend on the context to a great extent. When foreign trade was a State-planned activity in China, foreign trade order meant the 'planned' order created by the State in the foreign trade business (in the form of monopoly of trading rights and pricing) and any activity falling outside this planned order was labelled as violating the 'foreign trade order'. With the liberalisation of trading rights in the past two decades, State intervention in the foreign trade business has been reduced to a minimum degree. As a result, this term needs to be re-defined in the current context.

One representative academic view is that 'foreign trade order' means the orderly status of foreign trade as a result of fair and reasonable competition between the trade businesses of foreign trade operators (FTOs).[1] While this definition is easily understood by Chinese scholars and trade officials, it seems strange in the eyes of non-PRC readers. What exactly does the 'orderly status' of foreign trade mean? How can it be 'orderly'? How does this relate to 'fair and reasonable competition' between FTOs?

A brief history study of China's foreign trade reform will help provide a better understanding of this Chinese-style term. The PRC government traditionally granted trading rights to FTOs on the basis of their ownership, a feature of the planning economy and the state monopoly of foreign trade.[2] The business of foreign trade was a privilege of 'foreign trade companies' ('FTC') owned by central or local governments and some large manufacturing enterprises. This imposed an impassable barrier on other enterprises

1 Huang Dongli and Wang Zhengmin (ed), *Zhonghua Renmin Gonghe Guo Duiwai Maoyi Fa: Tiaowen Jinjie ji Guoji Guize* (Understanding PRC Foreign Trade Law and Related International Rules) (Beijing, The Law Press, 2004) 237.

2 For an excellent study, see M Williams and Zhong Jianhua, 'The Capacity of Chinese Enterprises to Engage in Foreign Trade: Does Restriction Help or Hinder China's Trade Relations?', (1999) 8 *Journal of Transnational Law & Policy* 197 at 204 *et seq*.

potential to enter into the market, because they lacked the appropriate route of being licenced if they were not owned or supervised by the local governments or ministries eligible to apply for establishing a FTC.

The enactment of the *PRC Foreign Trade Law* in 1994 marked the first significant reform in the trading rights regime. The definition of FTOs had a universal applicability to all enterprises within China, and did not distinguish between state and non-state ownership. Although in practice the pace of liberalising trading rights to state-owned enterprises was much faster than that to other enterprises, the law itself provided a level playing field at least in theory, and could serve as the platform to accommodate further reforms. The Chinese government launched an evolutionary, gradual campaign to deregulate the trade regime and liberalise trading rights since 1994.[3]

The direct result of foreign trade reform was the increase of the number of FTOs. The original State monopolised business now turned to a profitable business in the hands of local governments, large SOEs or even some individuals or private companies. One consequence was the sharp decrease of the Central Government's ability to control the pricing of goods to be exported. In order to expand the export (which could bring more foreign currency revenues), FTOs were in fierce competition with each other in respect of the purchase of goods and of the export pricing strategy. In the former aspect, FTOs had to increase the purchase price so that they could secure the source of supply. Usually, the local governments of the source of such goods had to take measures to restrict or even prohibit FTOs incorporated outside their respective jurisdiction from purchasing the goods, so as to protect the supply for their local FTOs. In the latter aspect, FTOs had to reduce the export price in order to grasp more international market shares–-sometimes even in a way of dumping. This behaviour reduced the profit margins that FTOs should have enjoyed on the one hand, and gave other countries a chance to bring anti-dumping cases against Chinese goods on the other hand. In the regulator's eyes, this kind of competition was not desirable and indeed caused harm to the 'foreign trade order' in China.

Under this historical background, it would be easier to understand what the regulator desires for an 'orderly status' of foreign trade. From a macro-perspective, the ideal status of foreign trade in China (especially for the export) should be a complete and healthy competition between FTOs, based on the marketing strengths, distribution channels and quality of goods, and result in a pricing strategy with reasonable or internationally comparable profit margins. FTOs must not compete between themselves in a simple way of increasing purchase price or reducing export price. In other words, the core of foreign trade order is fair competition in the market. Any activity that causes harm to fair competition in the foreign trade business will be deemed

[3] Generally, see Xin Zhang, 'Distribution Rights in China: Regulatory Barriers and Reform in the WTO Context', (2001) 35 *Journal of World Trade* 1247 at 1253–61.

as an activity that violates the foreign trade order, and then should fall within the regulation by MOC.

12.1.2 FTL (2004)

The FTL (2004) has a separate chapter on foreign trade order (Chapter 6 'Foreign Trade Order'), comprising five articles (Article 32 to Article 36). The core of the regulation is the anti-monopoly and anti-unfair competition in foreign trade (as discussed below).

In addition, the FTL (2004) lists several activities that are viewed as destructive to the 'foreign trade order' and prohibited in the business of foreign trade. These prohibited activities are: the forgery of origin marks or origin certificates of the exported or imported goods, or of the export or import licences, quota certificates or other documents; frauds for receiving export tax refund; smuggling; the avoidance of legally required authentication, inspection or quarantine measures; and any other behaviour that violates laws or administrative regulations.[4] While these activities are listed under the title of 'foreign trade order', they are with a more serious nature than aggressively commercial activities and are subject to administrative or criminal penalties. But these activities do not touch the core of 'foreign trade order' – the status of fair competition.

12.2 TRADE AND MONOPOLY

12.2.1 Anti-monopoly Law

The FTL (2004) provides that FTOs shall not implement 'an act of monopoly' in the foreign trade business that violates the laws and administrative regulations on anti-monopoly. If such act of monopoly exists and causes harm to the 'fair competition of the market', it must be handled and penalised in accordance with the relevant laws or administrative regulations on anti-monopoly. In case such act also causes harm to the foreign trade order, MOC may adopt 'necessary measures to eliminate the harm'.[5]

The provision itself is clear and straightforward. However, one fundamental flaw is that there is no specific laws or administrative regulations on anti-monopoly in China to date. Actually, the drafting of the *PRC Anti-*

[4] *The PRC Foreign Trade Law*, *Zhonghua Renmin Gonghe Guo Duiwai Maoyi Fa* (中华人民共和国对外贸易法), promulgated on 12 May 1994 by the Seventh Meeting of the Standing Committee of National People's Congress of the PRC and taking effect from 1 July 1994, as amended on 6 April 2004 and taking effect from 1 July 2004 ('FTL (2004)'), Art 34.

[5] *Ibid*, Art 32.

Monopoly Law is still in an early stage, which can only be published as early as late 2006. It seems that the FTL (2004) takes a pre-emptive strike in this respect, by putting on paper the anti-monopoly provision in respect of foreign trade in advance. This provision can be triggered and put into operation whenever the *PRC Anti-Monopoly Law* comes into existence.

Although there is no anti-monopoly law in general or in respect of foreign trade business in particular, some laws have certain provisions that deal with or relate to the monopoly. For example, the *PRC Anti-Unfair Competition Law* lists the restrictive business practices by public utility entities or other natural monopoly entities (such as the compulsory sale to consumers) and the abuse of administrative powers by the government or governmental organs as two types of anti-competitive or monopoly activities.[6] These rules are relating more to public utility entities or governmental organs than to private producers or traders, with few connections with the foreign trade business.

Another example is the *PRC Pricing Law*, which prohibits the business operators from conspiring to manipulate the market prices.[7] This is in essence a prohibition on the price cartel, and may have some relevance to the foreign trade business where the FTOs agree with each other the export price of one product. However, a careful reading of the *PRC Pricing Law* casts some doubts on whether or not this law applies to foreign trade. On the one hand, this law applies to the pricing activities that occur within the PRC.[8] If the Chinese exporters conspire to agree with a minimum export price, the pricing activities occur within the PRC and should fall within the ambit of this law. On the other hand, the legislative purpose of the *PRC Pricing Law* is to regulate the pricing activities within the PRC, rather than on the export pricing strategy. Even if there exists any pricing conspiracy between Chinese exporters, it is the foreign customers that should complain to their home governments, which in turn could investigate in accordance with their national laws. In practice, the PRC government seems to have no incentive to take any measures to control the pricing co-ordination between Chinese exporters (if any).

12.2.2 Regulatory Powers of MOC

MOC will only intervene when an act of monopoly causes harm to the foreign trade order, that is, to adversely affect fair competition in the foreign trade business. It is not surprising that MOC has no detailed rules or guidelines on how to exercise these regulatory powers, because there is no anti-monopoly law at this stage to help them assess what constitutes the monopoly

6 *PRC Anti-Unfair Competition Law* (中华人民共和国反不正当竞争法), effective from 1 December 1993, Arts 6 and 7.

7 *PRC Pricing Law* (中华人民共和国价格法), effective from 1 May 1998, Art 14(1).

8 *Ibid*, Art 2(1).

status of FTOs and where and when the anti-monopoly procedures under the FTL (2004) should bite.

Under the FTL (2004), MOC has the right to carry out the foreign trade investigation into any act of monopoly.[9] Once affirmed, MOC can take 'necessary measures' to eliminate the harm. The FTL (2004) does not provide details of the options available to MOC. In my view, this is only a blank authorisation to MOC, because whether and how to deal with a monopoly can only be set out in the future *PRC Anti-Monopoly Law*. Ideally, this law should take into account the anti-monopoly powers designated to MOC and give guidance on how MOC can exercise such powers. In theory, MOC should have the power to order the termination of any explicit or disguised pricing arrangement in respect of import or downstream sale of imported goods, to prohibit the trade activities of a FTO with the monopoly status until it eliminates this status through corporate or industry restructuring, and even to trigger the process to dissolve a FTO with the monopoly status. Of course, these powers and procedures of exercise can only be clarified after the promulgation of the *PRC Anti-Monopoly Law*. In addition, MOC has the power to issue a public announcement to disclose and censure a FTO violating the anti-monopoly laws. This aims to place public pressure on that FTO and forces it to change its activities.

12.3 TRADE AND UNFAIR COMPETITION

12.3.1 Anti-unfair Competition Law

Unlike anti-monopoly, there is a specific law applicable to unfair competition behaviours – the *PRC Anti-Unfair Competition Law*. The FTL (2004) specifically refers to certain types of unfair competition behaviours in the foreign trade business. In theory, all unfair competition behaviours listed in the *PRC Anti-Unfair Competition Law* are also incorporated into the FTL (2004) by way of reference to unfair competition. But some behaviours are not applicable to foreign trade in practice, such as the restrictive business practices by public utility entities as mentioned above. Thus, the FTL (2004) lists four types of unfair competition behaviours: dumping of the products, coercive bidding, publication of false advertisements, and commercial bribery.[10] Notably, this is not an exhaustive list so MOC may from time to time expand

[9] *The PRC Foreign Trade Law, Zhonghua Renmin Gonghe Guo Duiwai Maoyi Fa* (中华人民共和国对外贸易法), promulgated on 12 May 1994 by the Seventh Meeting of the Standing Committee of National People's Congress of the PRC and taking effect from 1 July 1994, as amended on 6 April 2004 and taking effect from 1 July 2004 ('FTL (2004)'), Art 37(6). For details of foreign trade investigation, see Ch 8 'Trade Remedies: General Rules'.

[10] *Ibid*, Art 33(1).

it to cover any new unfair competition behaviours applicable to foreign trade business.

Dumping of products means the sale of products (in the context of foreign trade, the export of products) at a price lower than the cost of such products. This behaviour is also caught by the anti-dumping laws of the importing countries. Chapter 9 'Anti-dumping and Anti-Subsidies' gives detailed discussion on the anti-dumping practices in the PRC. While it is directed at the imports from foreign countries or regions, the general theories are also applicable here. The prohibition of dumping reflects the government's efforts to control the root of foreign anti-dumping cases against Chinese products.

Coercive bidding, in the context of foreign trade, applies to illegal coercion during the bidding process for export or import quotas and licences by the Chinese exporters or importers. The purpose is to squeeze out other competitors by artificially controlling the bidding prices or creating a false result of bidding.

False advertisement includes those advertisements containing false, inaccurate or misleading information, with a purpose to deceive the target audience. Notably, the FTL (2004) does not define the scope of advertisement. As a result, advertisements addressed to foreign customers will also be caught in the same way as addressed to domestic customers.

Commercial bribery is also a kind of prohibited unfair competition behaviour. This covers not only the bribery given to domestic suppliers or purchasers but also the bribery given to foreign purchaser or sellers. Nevertheless, PRC law does not prohibit the discount given to the purchaser, or the commission paid to the agent, but the discount must be an express discount shown in the contract whilst the commission must be correctly reflected in the accounts.[11] This rule is also applicable to the foreign trade business.

12.3.2 Regulatory Powers of MOC

Apart from the foreign trade investigation and the right to issue a public announcement or censure on any FTO that violates the anti-unfair competition laws in the foreign trade business, the FTL (2004) also empowers MOC to prohibit the foreign trade activities taken by such FTO so as to eliminate any harm caused by it.[12] The condition is that the unfair competition activities are serious enough to cause harm to the foreign trade order.[13] The implication is where these activities do not cause harm to the foreign trade

11 *PRC Anti-Unfair Competition Law*, Art 8, see n 6 above.

12 *The PRC Foreign Trade Law*, *Zhonghua Renmin Gonghe Guo Duiwai Maoyi Fa* (中华人民共和国对外贸易法), promulgated on 12 May 1994 by the Seventh Meeting of the Standing Committee of National People's Congress of the PRC and taking effect from 1 July 1994, as amended on 6 April 2004 and taking effect from 1 July 2004 ('FTL (2004)'), Art 33(3).

13 *Ibid*.

order, they are subject to the administrative penalties available to other governmental organs authorised under the *PRC Anti-Unfair Competition Law* (such as the Price Bureau in relation to the dumping). If it does cause harm to the foreign trade order, MOC has the power to take trade measures under the FTL (2004), including the prohibition of relevant trade activities, on top of the penalties under the *PRC Anti-Unfair Competition Law*.

13

Trade and Intellectual Property Rights

13.1 OVERVIEW

Compared to the FTL (1994), the FTL (2004) adds a new chapter (comprising three articles) on the protection of trade-related intellectual property rights ('IP rights').[1] This development is brought by China's accession to the WTO. The legal basis is the *WTO Agreement on Trade-Related Aspects of Intellectual Property Rights* ('TRIPs'). But the FTL (2004) approaches this issue from the perspective of foreign trade. On the one hand, it protects IP rights during the foreign trade business; on the other hand, it prevents the abuse of IP rights by the owners in a way that could bring an adverse effect to China's foreign trade. This distinguishes the protection of IP rights by Chinese IP laws from the protection by the FTL (2004). The former is directed at all issues that arise from the IP rights, rather than on foreign trade only.

The application of the FTL (2004) to the protection of IP rights depends on the recognition of such rights under the IP laws from a substantive perspective. Chinese IP laws comprise three basic laws – the *PRC Patent Law* (2000), the *PRC Trade Mark Law* (2001), the *PRC Copyright Law* (2001) and their implementing measures, the *PRC Rules on Protection of Computer Software* (2001), the *PRC Rules on Protection of Circuit Design* (2001), and the *PRC Rules on Protection of New Botanic Varieties* (1997). China committed that for accession to the WTO Agreement and compliance with TRIPs, it should take further amendments to the IP laws after the accession.[2] The Working Party Report further lists such IP laws and rules that must be amended for this purpose.[3] The above laws and rules were amended immediately before or after the WTO accession and are now consistent with the

1 *The PRC Foreign Trade Law*, *Zhonghua Renmin Gonghe Guo Duiwai Maoyi Fa* (中华人民共和国对外贸易法), promulgated on 12 May 1994 by the Seventh Meeting of the Standing Committee of National People's Congress of the PRC and taking effect from 1 July 1994, as amended on 6 April 2004 and taking effect from 1 July 2004, ('FTL (2004)'), Ch 5 'Protection of Trade-Related Intellectual Properties', Arts 29–31.

2 *Report of the Working Party on the Accession of China*, issued by the Working Party on the Accession of China, WT/ACC/CHN/49, adopted 1 October 2001 (01–4679) ('The Working Party Report'), para 252.

3 *Ibid*, para 252, Table B 'Revision of China's IRP Laws in Conformity with the TRIPS Agreement'.

TRIPs. This chapter does not provide an analysis on Chinese IP laws, but focuses on the analysis of the FTL (2004) in this regard from the perspective of trade regulation.

The FTL (2004) deals with three trade-related IP issues: first, the infringement of IP rights by imported goods; second, the prevention of the abuse of IP rights by the owners; and third, the principle of retaliation.

13.2 PROTECTION OF IP RIGHTS AND IMPORTATION

13.2.1 MOC

Two ministries are involved in the protection of IP rights in importation: one as the MOC and the other as Customs. The regulatory power of MOC comes from the FTL (2004), while the power of Customs comes from the *PRC Law on Customs*. Apart from the apparent difference of legal source, the regulation of MOC focuses more on the IP rights relating to the importation of foreign products, but the regulation of Customs focuses more on border control. The regulation of Customs will be discussed in the next section.

As a general principle, China protects the trade-related IP rights in accordance with IP laws and administrative rules.[4] More specifically, the FTL (2004) expressly provides that '[w]here imported goods infringe upon IP rights and harm the foreign trade order, the [MOC] may adopt measures such as prohibition of the import of goods produced or sold by the infringer within a certain time period'.[5] This is a new provision under the FTL (2004) compared to the old FTL (1994). While it grants an unambiguous power to MOC with regard to the protection of IP rights against the infringement by imported goods, the application in practice is uncertain and far from clear.

Since there is no definition of the term 'IP rights', there are two ways of interpretation. From a narrower perspective, IP rights only refer to the IP rights that are recognised and protected under PRC law. In other words, if an IP right is protected in the US but not protected in the PRC (for example, without registration in the PRC or such registration having been rejected by the relevant Chinese IP registry), the import of goods infringing such US-protected IP rights does not technically violate the FTL (2004). From a wider perspective, the IP rights referred to in this provision cover not only such rights that are recognised and protected under PRC law, but also such rights

4 *The PRC Foreign Trade Law*, *Zhonghua Renmin Gonghe Guo Duiwai Maoyi Fa* (中华人民共和国对外贸易法), promulgated on 12 May 1994 by the Seventh Meeting of the Standing Committee of National People's Congress of the PRC and taking effect from 1 July 1994, as amended on 6 April 2004 and taking effect from 1 July 2004, ('FTL (2004)'), Art 29(1).

5 *Ibid*, Art 29(2).

that are protected under the laws of other countries or regions. Thus, the goods infringing US-protected IP rights in the above example should also be prohibited from entering into the PRC. In my view, the narrow interpretation is more desirable. The FTL (2004) is a Chinese domestic law which application is only confined to the territory of the PRC. Whether or not an IP right is recognised and protected under PRC law (even if protected under laws of other jurisdictions) is an issue to be decided by the substantive provisions of Chinese IP laws. From the trade perspective, the FTL (2004) does not intervene into the recognition and protection of IP rights, but is only concerned about the protection of such recognised and protected rights from being infringed by imported goods. Due to the territorial restriction of national laws, there is no legal basis for the extension of the protection under the FTL (2004) to such IP rights that are protected in other countries than in the PRC. Nevertheless, there is one important qualification on this view: if a foreign IP right is protected under an international treaty to which the PRC is a party, such foreign right must be treated as being protected under Chinese IP laws as well. Thus, MOC still needs to protect this kind of internationally protected IP right.

The literal meaning of this provision restricts the regulatory power of MOC to 'imported goods'. This seems to suggest that MOC is only concerned about the infringement of IP rights by such goods that are or are to be imported into the territory of the PRC. The issue is whether MOC has the regulatory power to prohibit the export of Chinese goods that infringe either a Chinese-protected IP right or an internationally protected IP right. From the literal meaning of the FTL (2004), MOC does not regulate this area partly because Custom's protection of IP rights (see below) covers both import and export of goods. However, it seems illogical that MOC, as the primary trade regulator, only has the right to regulate the imported goods but not the exported goods that could equally infringe IP rights. This point needs to be clarified by MOC or covered by another law or administrative rule that empowers MOC to protect export-related IP rights.

There are two conditions for MOC to exercise the regulatory powers to protect the IP rights infringed by imported goods: first, the imported goods infringe such IP rights; second, the importation also causes harm to the 'foreign trade order'. The first condition is a question of fact and should be proved by the applicants for protection. The second condition, however, is ambiguous and confusing. The implication is if the imported goods – though infringing the IP rights – do not cause harm to the 'foreign trade order' MOC will not intervene. This does not comply with the rule of law. Since the infringement of IP rights is an illegal activity and MOC has the power (and duty) to prevent such illegal activity, there is no legal basis for adding a sort of materiality test as a pre-condition of the protection by MOC. More importantly, there are no criteria or guidelines on what 'foreign trade order' exactly means and what constitutes 'harm' to the foreign trade order. As mentioned

in chapter twelve, the term 'foreign trade order' is a widely used jargon by MOC but has never been clearly defined. MOC may enjoy too much discretion in deciding whether or not the second condition is met. Also, these uncertainties would cast doubt on the effectiveness of the FTL (2004) in the area of IP rights protection.

Before MOC takes any measure against the imported goods, it must carry out the necessary foreign trade investigation.[6] Chapter eight discussed the procedures of such investigation and the potential problems, which are also applicable here. The FTL (2004) empowers MOC to prohibit the import of goods manufactured or sold by the infringer, but does not set out the procedures for exercising such power. Significantly, it is not clear how a private party can trigger the investigation and regulation by MOC, or even whether a channel in this respect exists. After all, the private parties (especially the IP right owners) are the persons that will most probably possess the information of any infringement on their IP rights.

In conclusion, it is a good progress for the FTL (2004) to provide the protection of IP rights, but the application of this procedure is still ambiguous and requires supporting administrative rules to put it into effect in practice. Some issues highlighted above may have been resolved under the Custom's protection of trade-related IP rights.

13.2.2 Customs

13.2.2.1 Customs Protection of IP Rights

Customs play a more important role than MOC in respect of the protection of IP rights in foreign trade. China promulgated a new *PRC Rules on the Customs Protection of IP Rights* taking effect from 1 March 2004.[7] Customs issued implementing measures taking effect from 1 July 2004.[8] These constitute the legal basis for Customs protection of IP rights in the PRC.

The term 'Customs protection of IP rights' is clearly defined as the protection by Customs of trademarks, copyrights and patents that are related to the exported or imported goods and are also protected by PRC law.[9] This definition clarifies two issues that are ambiguous under the FTL (2004) as discussed above. First, Customs protection applies to both export and import, removing the worries that China does not control the export of Chinese goods that infringe IP rights. Second, the IP rights that relate to foreign trade must be

6 *Ibid*, Art 37(6).

7 (中华人民共和国知识产权海关保护条例), State Council Decree No 395, issued on 2 December 2003 and effective from 1 March 2004.

8 *Implementing Measures by the Customs of the PRC Rules on the Customs Protection of IP Rights* (中华人民共和国海关关于<中华人民共和国知识产权海关保护条例>的实施办法), Customs Decree No 114, issued on 25 May 2004 and effective from 1 July 2004.

9 *PRC Rules on the Customs Protection of IP Rights*, Art 2, see n 7 above.

those IP rights protected under PRC law. This is also consistent with my view on the narrow interpretation of the term 'IP rights' under the FTL (2004). As a result, if a foreign IP right owner has a serious concern that Chinese companies may manufacture and export products that infringe his IP right, the owner must register such IP right in China in the first instance – that is, to obtain the recognition and protection of such foreign IP rights under PRC law by transforming it to a PRC IP right through the proper registration or application procedures. After this transformation, foreign IP right owners are entitled to the benefit of Customs protection in the PRC.

13.2.2.2 Standards and Procedures

The general rule is that the consignee or its agent of the imported goods, or the shipper or its agent of the exported goods is obliged to investigate the status of IP rights relating to the exported or imported goods 'within a reasonable scope', declare such status to Customs and submit the relevant proofs.[10] The reasonableness test here is not very helpful, because it is too wide to follow in practice. As a practical matter, it would be naive to expect that an infringer will voluntarily reveal the information of infringement to Customs. Thus, PRC law prescribes a set of procedures for the application of Customs protection by the IP right owners.

The first step is the filing of IP rights with Customs, requiring Customs protection. This is not a condition for the owner to get Customs protection, but would facilitate the application in specific cases. The owner should submit an application report to Customs, including the following contents: the name and the place of incorporation (for a company) or nationality (for an individual); the title, contents and relevant information of the IP right; the status of licencing of the IP right; the name, place of production, and the branches of Customs for export or import; the exporter or importer of the goods; major characteristics and prices of the goods which can use the IP rights in a legal way; and the manufacturers, exporters, importers, the branches of Customs for export or import, major characteristics and prices of such goods that are already known to the applicant with an infringement of the IP right.[11] Within 30 working days of receipt of the application and all supporting documents, Customs will decide whether or not to allow the filing.[12] The filing will be effective for 10 years and can be extended for another 10 years by the submission of an application to Customs not later than six months before the expiration of the first 10-year period.[13] The

10 *PRC Rules on the Customs Protection of IP Rights*, Art 5, see n 7 above; *Implementing Measures by the Customs of the PRC Rules on the Customs Protection of IP Rights*, Art 3, see n 8 above.

11 *PRC Rules on the Customs Protection of IP Rights*, Art 7, see n 7 above.

12 *Ibid*, Art 8.

13 *Ibid*, Art 10.

advantage of filing is that the applicant need not prove the IP rights at the time of applying for Customs protection in specific cases; otherwise, it has to prove the ownership and the validity of such IP rights in each case as a precondition for applying for Customs protection.

When the IP right owner finds that any goods with a suspicion of infringing its IP rights would be imported into, or exported from, the PRC, it has the right to apply to the relevant branch of Customs at the place of importation or exportation for a detainment of such goods.[14] The application for detainment must include certain minimum contents: the name of the consignee or the shipper of the suspicious goods; the name and specification of such goods; the import or export port, time and transportation vehicle; Customs filing number for the IP rights that are infringed by such goods.[15] If the applicant has not filed the IP rights with Customs, it should also provide the information relevant to such rights in order to prove its ownership and validity. The evidence supplied by the applicant must be sufficient to prove first, the goods are about to be exported or imported and second, the goods have used the IP rights (such as trademark, copyright or patent) owned by the applicant but which have not been licenced to be used in such goods.[16]

However, the owner cannot simply apply for Customs' detainment of the goods – otherwise, this right can easily be abused. The owner must provide a security to Customs with a value equivalent to the value of the goods to be detained.[17] The security will be used to compensate any loss caused to the consignee or the shipper in case the application is not justified,[18] as well as to pay the storage and disposal costs incurred by Customs after the detainment. After the submission of the application as well as the provision of security, the applicant can further request Customs to allow it to inspect the goods to be detained. This is a cautious step for the applicant, because it may find out upon physical inspection that such goods do not infringe its IP rights or its evidence is not strong enough to justify the detainment. Under this circumstance, the applicant can modify or even revoke the application for detainment from Customs.[19]

When the applicant duly submits the application and provides the bank guarantee or bond, Customs will detain the suspicious goods. Alternatively, if Customs find out some goods are suspicious of infringing the filed IP rights for Customs protection, it may also initiate by itself the protection procedure

[14] *Ibid*, Art 12.

[15] *Ibid*, Art 13.

[16] *Implementing Measures by the Customs of the PRC Rules on the Customs Protection of IP Rights*, Art 14, see n 8 above.

[17] *PRC Rules on the Customs Protection of IP Rights*, Art 14, see n 7 above. The applicant can provide a cash deposit or a guarantee or bond issued by banks or financial institutions. The latter is more popular in practice.

[18] For example, Customs cannot determine whether or not the goods infringe the IP rights after due investigation, or the owner loses the court cases against the suspects.

[19] *Implementing Measures by the Customs of the PRC Rules on the Customs Protection of IP Rights*, Art 16, see n 8 above.

by giving a notice of such facts to the IP right owner, who must then apply for the detainment within three working days of receipt of such notice.[20] Without the owner's application (together with the guarantee or bond), Customs cannot detain these goods by itself – even if it has reasonable doubt. Having said that, it is more possible in practice for the IP right owner to initiate the procedure because it is more familiar with the trading of suspicious goods. The expectation that Customs will initiate the protection procedure on its own initiative cannot be too high.

After the detainment of the suspicious goods, Customs must allow the applicant and the consignee or the shipper to inspect the goods. The consignee or the shipper has the right to rebut the application by the IP right owner by proving that the goods have not infringed such IP rights. Further, the consignee or the shipper can provide the guarantee or bond with a value equivalent to the detained goods to Customs and request that Customs release the goods in advance.[21]

In practice, Customs will investigate whether the suspicious goods infringe the protected IP rights after detaining these goods. At the same time, the IP rights owner usually brings a suit against the infringer in Chinese courts. If the owner applies for the detainment, Customs will release the detained goods after 20 working days of detainment if it has not received from the courts the attachment order.[22] This means that the owner must bring the suit and obtain the court order for attaching the suspicious goods within this period. Comparatively, if Customs find out that the suspicious goods are infringing IP rights and notify the owner for an action, Customs will release the detained goods after 50 working days if it has not received from the courts the attachment order.[23] In either case, a prompt court action by the owner is desirable.

The legal consequence of the infringement of IP rights by the exported or imported goods, once proved, is for Customs to confiscate such goods.[24] If these goods can be used for public interests, Customs will transfer them to the relevant public authorities for this purpose; alternatively, if the IP right owner intends to purchase these goods, Customs may also sell them to the owner.[25] If these goods cannot be used for public purposes nor does the owner plan to purchase them, Customs can remove any sign showing the infringement of IP rights from the goods and then auction the 'cleaned' goods. However, if the signs cannot be removed, Customs may only destroy these goods.

[20] *Ibid*.
[21] *Ibid*, Arts 18 and 19.
[22] *PRC Rules on the Customs Protection of IP Rights*, Art 24(1), see n 7 above.
[23] *Ibid*, Art 24(2). Another condition is that Customs investigate whether the suspicious goods infringe the IP rights and cannot make a decision within such 50-working day period.
[24] *Ibid*, Art 27.
[25] The proceeds of sale or auction belong to the State.

13.2.3 WTO Legality

MOC's regulation of trade-related IP rights and Customs protection reflect China's commitment to implement the TRIPs. Article 51 of TRIPs provides that:

> Members shall … adopt procedures, to enable a right holder, who has valid grounds for suspecting that the importation of counterfeit trademark or pirated copyright goods may take place, to lodge an application … for the suspension by the customs authorities of the release into free circulation of such goods. … Members may also provide for corresponding procedures concerning the suspension by the customs authorities of the release of infringing goods for exportation from their territories.

Accordingly, Members are obliged to protect the IP rights from importation of counterfeit trademark or pirated copyright goods, but have the right (rather than the obligation) to control similar issues with regard to exportation. The FTL (2004) implements the first part of the obligation in respect of importation of goods, whilst Customs protection covers both importation and exportation. Besides trademarks and copyrights, PRC law also expressly protects patents.

The relevant provisions of the FTL (2004) and the *PRC Rules on the Customs Protection of IP Rights* are in line with Section 4 'Special Requirements Related to Border Measures' of TRIPs, in respect of the criteria on application,[26] the provision of security,[27] indemnification of the consignee or the shipper,[28] and the right of inspection and information.[29]

There are only two points that are not completely consistent with TRIPs. The first point is the period of suspension of the release of goods. TRIPs requires the Members to give a period not exceeding 10 working days for the applicant to take judicial or other administrative actions to prolong the suspension, and only extend a further 10 working days 'in appropriate cases'. The Chinese law takes a simplified approach by stipulating a uniform 20 working days period for all cases. This minor difference actually increases the degree of protection to the IP right owners, but reflects a titling in favour of the owners rather than in favour of the consignee or the shipper under this circumstance. The second point is that TRIPs exempts *de minimis* imports (that is, small quantities of goods with a non-commercial nature contained in

[26] *Agreement on Trade-Related Aspects of Intellectual Property Rights*, Annex 1C to the *Marrakesh Agreement Establishing the World Trade Organization*, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994 ('TRIPs'), Art 52.

[27] *Ibid*, Art 53.

[28] *Ibid*, Art 56.

[29] *Ibid*, Art 57.

traveller's personal luggage or sent in small consignments[30]) from Customs control, but this point is not expressed under PRC law. Again, this difference is in favour of the IP right owners.

13.3 ABUSE OF IP RIGHTS

13.3.1 Overview

Before the FTL (2004), the regulation of the abuse of IP rights by the owners was only found in the regulations applicable to the technology import contracts. The regulation of trade in technology still prohibits seven types of restrictive business practice.[31] The FTL (2004) now has a new provision on the abuse of IP rights, empowering MOC to take necessary measures to eliminate any harm caused by such abuse. Under Article 30, it provides that:

> Where an owner of intellectual property rights commits any one of the acts including preventing licensees from inquiring about the validity of intellectual property rights specified in the licensing contract, giving compulsory package licence, stipulating terms of exclusive grant back rights in licensing contracts, thereby harming the order of fair competition in foreign trade, [MOC] may adopt necessary measures to eliminate such harm.

This provision is based on Section 8 'Control of Anti-competitive Practices in Contractual Licences' of TRIPs.[32] There are two conditions for MOC to intervene: first, there are certain anti-competitive practices or abuse of IP rights by the owners; second, such practices or abuse cause harm to the order of fair competition in foreign trade. Chapter twelve discussed what constitutes such harm to 'fair competition' in foreign trade, which is also applicable here.

There are two ambiguous issues in the application of this provision. First, it is not clear whether it only applies to three restrictive business practices in the licencing of IP rights as illustrated, or whether it also applies to all other types of restrictive business practices that can be identified in the licencing, or even to the transfer of IP rights. If taking the first view, the scope of protection by the FTL (2004) is indeed narrow. From a literal interpretation, this provision only applies to the licencing contracts and does not regulate the contracts for transfer of IP rights. A proper control of the restrictive business

30 *Ibid*, Art 60.
31 See ch 7 'Trade in Technology', sec 7.2.3.
32 TRIPs, Art 40, see n 26 above. Art 40(1) provides that '[M]embers agree that some licensing practices or conditions pertaining to intellectual property rights which restrain competition may have adverse effects on trade and may impede the transfer and dissemination of technology' – the rationale of regulation.

practices in the transfer contracts may be the task of the regulation on technology import or export contracts.[33] More importantly, because the FTL (2004) uses unambiguous words 'any one of the acts including …' and then follows with three such acts, this is a strong suggestion that the statute is concerned about these three acts – in other words, this is an exclusive list of prohibitive actions rather than an open list into which MOC can freely add any acts. The effect of the above interpretation is that MOC will intervene under the FTL (2004) in respect of three restrictive business practices in the licencing contracts, by taking certain measures to eliminate the harm caused by such practices. In accordance with the regulation on technology export or import contracts, other types of restrictive business practices (either in the licencing contracts or in the transfer contracts) shall be void from a contractual perspective – whose effectiveness cannot be reckoned and protected under PRC law. But MOC is not empowered to take trade measures against these practices (such as the prohibition of trade). Having said that, since the technology contracts only cover the patent or know-how contracts or any other contracts that involve the technology, some types of contract not involving the technology (such as trademarks or copyrights) are thus not covered by such regulation. As a result, there is a loophole that the transfer contracts for trademarks or copyrights might be able to contain some anti-competitive provisions that escape the control either by the FTL (2004) or by the regulation on technology contracts.

The second issue is whether MOC has the power to regulate the listed restrictive business practices taken by Chinese IP right owners (that is, the licensors) in the licencing contracts with foreign licensees. It is clear that the legislator's intention is to prevent foreign licensors from abusing their IP rights in the licencing contracts with Chinese licensees (for example, Chinese importers of the foreign IP rights by way of licencing), because the importation of advanced foreign technology has been an encouraged objective. But the wording of Article 30 of the FTL (2004) does not restrict the regulatory powers of MOC to the import of foreign IP rights. Instead, the term 'an owner of intellectual property rights' is generic and should cover both Chinese owners and foreign owners of IP rights. Therefore, there is a legal basis for MOC to regulate the anti-competitive activities by Chinese IP licensors – of course, whether or not MOC has the incentive to regulate is a practical matter.

[33] *Agreement on Trade-Related Aspects of Intellectual Property Rights*, Annex 1C to the *Marrakesh Agreement Establishing the World Trade Organization*, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994 ('TRIPS'), Art 40.

13.3.2 Restrictive Business Practices

The first type of restrictive business practice prohibited in the licencing is the prevention of licensees from challenging the validity of the licenced IP rights. The wording is the same as the relevant provision under the TRIPs.[34] The licencing contract usually contains this clause, which puts the licensee in a prejudiced position. If this clause were effective, the licensee would not be able to sue the breach of the licencing contract by the licensor even where the licenced IP rights are invalid or infringing a third party's legal rights. The high risks allocated to the licensee may prevent it from entering into the licencing contract, because it is difficult to investigate and ensure the validity of the IP rights – in a simple word, this risk must be assumed by the licensor who has the most accurate knowledge of its own rights.

The second type is the compulsory package licencing.[35] Under the package licencing, the licensee is obliged to accept goods or IP rights that are not required, or unreasonable terms in the licencing contract, as a condition for entering into the licencing contract. From a pure contractual perspective, different bargaining powers between the licensor and the licensee usually put the licensee in a vulnerable position. For example, a licensee may have to agree with any terms in order to obtain the licence to use a key technology in its products, which would otherwise be non-sellable. The State intervention in this respect can redress this imbalance of bargaining powers.

The third type is the exclusive grantback conditions.[36] Under an exclusive grantback clause, the licensee can only licence any IP rights that are or are to be developed by the licensee on the basis of the licenced IP right from the licensor to the licensor. This constitutes a restriction on the freedom of the licensee to use its own-developed IP rights – even though they are based on the IP rights provided by the licensor in the first place.

13.3.3 MOC Measures

The FTL (2004) empowers MOC to 'adopt necessary measures to eliminate such harm' caused by the abuse of IP rights during the licencing in the form of the above three restrictive business practices.

Except for this principle, the FTL (2004) is silent on what these measures would be and how they would be applied. MOC can initiate a foreign trade investigation into these restrictive business practices.[37] But the FTL (2004)

34 *Ibid*, Art 40(2).

35 *Ibid*.

36 *Ibid*.

37 *The PRC Foreign Trade Law, Zhonghua Renmin Gonghe Guo Duiwai Maoyi Fa* (中华人民共和国对外贸易法), promulgated on 12 May 1994 by the Seventh Meeting of the Standing Committee of National People's Congress of the PRC and taking effect from 1 July 1994, as amended on 6 April 2004 and taking effect from 1 July 2004, ('FTL (2004)'), Art 37(6).

does not provide an action that can be taken by MOC after the confirmation of such practices by the investigation. The FTL (2004) allows MOC to take trade remedies 'on the basis of the foreign trade investigation results',[38] but the trade remedies only comprise anti-dumping, anti-subsidies, safeguards measures, and the suspension or termination of international obligations in respect of the breach of international treaties by other countries or regions.[39] None of these remedial measures are applicable to the licensors as private parties. Furthermore, since the licencing itself does not involve the trade, MOC can hardly prohibit the trade between the licensor and the licensee. Of course, when the licensee applies to MOC for import licences for those goods or IP rights that are sold under the compulsory package, MOC may have the right to refuse the issuance of such licences.

In theory, whether or not a clause falls within the prohibited restrictive business practices and is invalid under PRC law can only be decided by the Chinese courts. It would be inappropriate for MOC to declare the invalidity of such clause. Even if MOC has this power, the purpose of regulation is to prohibit the restrictive business practices rather than to declare the invalidity of the whole licencing contract.[40]

As a result, the IP rights anti-abuse clause under the FTL (2004) may be toothless and difficult to be relied upon in practice. The legislators simply transplant the relevant provisions under the TRIPs into the FTL (2004), but may not be clear on what they want to achieve and how this legitimate purpose can be implemented by MOC. It is the task of MOC to promulgate more workable administrative rules in this regard. Otherwise, this provision can only have a window-dressing effect.

13.4 RETALIATION

Where any country or region fails to grant national treatment to the Chinese entities or individuals, or fails to provide sufficient and effective IP protection to goods, technology or services originated from the PRC, MOC has the right to 'adopt necessary measures on trade with such country or region' in accor-

38 *Ibid*, Art 40.

39 *Ibid*, Arts 41–47.

40 It is likely that the licensor may terminate the licencing contract if it views the restrictive business practice clauses in the contract as vital to protect its interests. Under this circumstance, the licensee may sue for the breach of the licencing contract (ie a wrongful termination) by the licensor. A complexity is that the licencing contract may choose a law other than PRC law as the governing law and a court other than Chinese courts as the jurisdiction for disputes. Whether or not the mandatory rules under PRC law in this respect will be recognised by another court under the governing law is a complicated issue. But in practice, even if that court gives a favourable judgment to the licensor, the licensor cannot enforce it against the licensee within the PRC (for example, for damages caused by the licensee) because the enforcement of this judgment may violate the public interest in China – to give effect to a practice that is expressly prohibited by PRC law.

dance with applicable PRC laws and the international treaties concluded by the PRC.[41] This grants the retaliatory powers to MOC against any country or region that fails to provide 'sufficient and effective' protection to Chinese IP rights. Chapter eight 'Trade Remedies: General Rules' discussed the principles of trade retaliation by the PRC, which are also applicable to the retaliation based on the protection of IP rights.

41 FTL (2004), Art 31, see n 37 above.

14

Trade Disputes

14.1 GENERAL FRAMEWORK

14.1.1 Methods of Dispute Resolution

This chapter discusses the methods available to a private party (domestic or foreign) who has a trade-related dispute with Chinese trade regulators and seeks the resolution of this dispute. It will briefly discuss the procedures for each method of dispute resolution, and focuses on assessing whether these methods comply with the WTO Agreement. The trade regulatory behaviours include not only 'specific administrative acts'[1] of Chinese trade regulators (mainly MOC)[2] that are aimed at specific persons in respect of specific matters, but also 'abstract administrative acts' in the form of legislative activities (for laws, administrative regulations, rules and normative documents) that are aimed at the general public.

There are three methods available to a private party to seek remedies against trade regulatory behaviours in China: first, to initiate an 'administrative review' procedure within the administrative system; second, to initiate a 'judicial review' procedure in a Chinese court (in Chinese legal terminology, the 'administrative litigation'); third (which is only applicable to a foreign party), to persuade the Member government of its home state to bring the case before a WTO panel and (if winning the case) enforce the ruling in China. The first and the second methods belong to the domestic or internal remedies provided by the Chinese legal system, whilst the third is an external remedy by the WTO. From this perspective, private parties have direct access to the internal remedies, but only indirect access to the external remedy.

The following sections outline the WTO requirements on national dispute resolution as well as China's commitments in the first place, and then explore these methods for resolving trade-related disputes. The general conclusion is that China still lacks an independent administrative or judicial review pro-

1 In this chapter, the words 'administrative' and 'administration' refer to the executive branch in the PRC state structure, or used more usually, the government.

2 In this chapter, the term 'PRC government' refers to the legislative and executive branches in the PRC state structure, whilst 'the government' only refers to the executive branch.

cedure in terms of objectivity and impartiality due to the restraints of current political and legal constraints. This chapter finally suggests some reforms for improving the independence and efficiency of these dispute resolution methods.

14.2 WTO AND DISPUTE RESOLUTION

14.2.1 The WTO Requirements

There are no specific WTO provisions regarding the national enforcement of its rules, and wide differences exist between the regimes created by the various WTO agreements. Besides the usual term 'judicial review',[3] other terms are used to refer the judicial or quasi-judicial procedures for enforcement, such as 'right of appeal',[4] 'review procedure',[5] 'appeals procedures'[6] or 'conformity assessment procedures'.[7]

Several basic requirements may be deducted from the relevant provisions of GATT, GATS and TRIPs. As a general principle, GATT and GATS require each Member to maintain independent 'judicial, arbitral or administrative tribunals or procedures' for prompt review and correction of trade-related administrative acts.[8] If these procedures are not fully or formally independ-

[3] *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994*, one document of Annex 1A to the *Marrakesh Agreement Establishing the World Trade Organization*, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994 ('The WTO Anti-dumping Agreement'), Art 13.

[4] *Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994*, one document of Annex 1A to the *Marrakesh Agreement Establishing the World Trade Organization*, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994 ('The Agreement on Customs Valuation'), Art 11.

[5] *Agreement on Rules of Origin,* one document of Annex 1A to the *Marrakesh Agreement Establishing the World Trade Organization*, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994 ('The Agreement on Rules of Origin'), Art 2(j).

[6] *Agreement on Preshipment Inspection*, one document of Annex 1A to the *Marrakesh Agreement Establishing the World Trade Organization*, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994 ('The Agreement on Preshipment Inspection'), Art 21.

[7] *Agreement on Technical Barriers to Trade,* one document of Annex 1A to the *Marrakesh Agreement Establishing the World Trade Organization*, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994 ('The Agreement on Technical Barriers to Trade'), Art 5.

[8] *General Agreement on Tariffs and Trade 1994,* one document of Annex 1A to the *Marrakesh Agreement Establishing the World Trade Organization*, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12- 15 April 1994 'GATT'), Article X (3)(b); *General Agreement on Trade in Services,* Annex 1B to the *Marrakesh Agreement Establishing the World Trade Organization*, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994 ('GATS'), Art VI (2)(a).

ent of the agencies performing the relevant administrative acts, they must be able to provide an 'objective and impartial review' of such acts.[9] In contrast, Part III (Enforcement of Intellectual Property Rights) of TRIPs remarkably defines in great detail the national civil and criminal procedures by means of which IP rights are to be enforced, and entitles private parties to judicial review of final administrative decisions.[10] This approach may come to serve as a precedent that suggests overall harmonisation of all WTO agreements in respect of private parties' remedial rights.[11]

Consequently, the core requirement is the independence of the decision-making bodies and the promptness of the national dispute resolution mechanisms. While formal independence cannot be guaranteed, substantive independence – objectivity and impartiality of the reviewing organisations and procedures – must be satisfied.

14.2.2 China's Accession Commitments

During the accession negotiations, some Members expressed concern about the possibility of 'prompt review of all administrative acts relating to the implementation of laws, regulations, judicial decisions and administrative rulings of general application' in China with respect to various WTO agreements.[12] In particular, private parties affected by an administrative act may not have the opportunity for appeal in some areas, for example, certain decisions for IP issues.[13]

Accordingly, the Accession Protocol contains two specific commitments. First, China must designate and maintain tribunals, contact points and procedures for prompt review of all administrative acts relating to the implementation of laws, regulations, judicial decisions and administrative rulings of general application referred to in Article X:1 of GATT, Article VI of GATS and the relevant provisions of the TRIPS Agreement (the 'trade-related disputes'). Such tribunals shall be 'impartial and independent' and have no substantial interest in the outcome of the matter.[14] Second, review procedures shall include the opportunity for appeal to a judicial body, without

[9] GATT, Art X (3)(c); GATS, Art VI (2)(a).

[10] *Agreement on Trade-Related Aspects of Intellectual Property Rights*, Annex 1C to the *Marrakesh Agreement Establishing the World Trade Organization*, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco, 12–15 April 1994 ('TRIPs'), Art 41(4).

[11] E McGovern, *International Trade Regulation* (Exeter, Globalfield Press, 1996), para 1.135.

[12] *Report of the Working Party on the Accession of China*, issued by the Working Party on the Accession of China, WT/ACC/CHN/49, adopted 1 October 2001 (01–4679) ('The Working Group Report'), para 76.

[13] The *PRC Patent Law* and *PRC Trademark Law* originally gave the Patent Examination Commission or the Trademark Examination Commission immunity from judicial review with regard to certain decisions. These laws were amended during 2000 to 2001 to keep in line with the TRIPs.

[14] The Protocol on the Accession of the People's Republic of China ('The Accession Procotol'), dated 10 November 2001, para 2(D)(1).

penalty, by private parties affected by any administrative act subject to review (the 'affected private parties'). The appeal procedure must be transparent with respect of the notice and reasons of a written decision.[15]

There are two salient features of these commitments from a textual perspective. The first feature is the terminology chosen to describe the review procedures. Although this sub-paragraph is entitled 'Judicial Review', the text deliberately uses two pertinent terms 'tribunals' and 'review procedures'. In China, this means that the commitment covers not only the courts, but also administrative review organs that are internal parts of the administrative system. It further refers to 'contact points' but leaves them undefined, which seems to impose little obligation on China to establish a new system to handle the complaints against administrative acts.[16] Similarly, the review procedures comprise procedures of both internal administrative review and judicial review. This approach is in line with the prevailing academic view in China that administrative review is of a quasi-judicial nature for resolving disputes between private parties and the administration.[17]

Another feature is the wide scope of administrative acts to be covered. For example, Article X:1 of GATT covers all aspects of trade in goods, and Article VI of GATS covers all measures of general application affecting trade in services. In order to avoid non-exhaustion, the scope is specified to include administrative acts relating to 'the implementation of national treatment, conformity assessment, the regulation, control, supply or promotion of a service, including the grant or denial of a licence to provide a service and other matter'.[18] For the purpose of implementation, the PRC government is now obliged to grant and inform affected private parties in *all* trade-related aspects the unconditional right to appeal to a judicial body. These commitments are beyond the requirement of existing WTO rules.[19] Even where the specific legislation is silent in the right of judicial review, the general rights contained in the *PRC Administrative Review Law* (1999) and the *PRC Administrative Litigation Law* (1989) must be granted to an affected private party.

14.2.3 Issues

There are two scenarios under which the dispute resolution mechanisms described in this chapter would be triggered. First, certain Chinese laws,

15 *Ibid*, para 2(D)(2).
16 In practice, existing administrative review organs or courts are acting as contact points for any complaint against governmental conduct.
17 Wang Hong and Fu Siming, *WTO yu Zhongguo Xingzheng Fazhi Jianshe* (WTO and Construction of Rule of Law in Chinese Administration) (Beijing, The Central Party School Publishing House, 2002) 144.
18 The Working Group Report, para 79, see n 12 above.
19 Julia Ya Qin, '"WTO-Plus" Obligations and Their Implications for the World Trade Organization Legal System: An Appraisal of the China Accession Protocol' (2003) 37 *Journal of World Trade* 483 at 496.

administrative regulations or rules, or other normative documents or policies of general application with regard to international trade regulation are inconsistent with the WTO Agreements. Second, the government takes a trade-related specific administrative act directing it at one private party who considers this act as being in breach of the WTO Agreements or the respective PRC implementing measures. Under the second scenario, one possibility is that the legal source of a disputed administrative act does not comply with the WTO Agreements, a situation that then falls within the scope of the first scenario.

As for the internal remedies, three common issues are to be addressed. First, what is the scope of 'reviewable administrative acts' in the context of trade regulation and how would it be evolved after the WTO accession? Second, does existing law provide sufficient institutional support to the independence and impartiality of the reviewing organ – an administrative review organ for the administrative review procedure and a court for the judicial review procedure – in practice? Third, do existing mechanisms 'promptly' review administrative acts as required by the WTO Agreements? As for the external remedy, the key is how to prevent the Chinese government from unlawfully delaying or escaping the implementation of WTO rulings.

14.3 ADMINISTRATIVE REVIEW

14.3.1 Reviewable Administrative Acts

14.3.1.1 Specific Administrative Acts

The *PRC Administrative Review Law* ('ARL'), effective from 1 October 1999, purports to prevent and redress 'illegal or inappropriate specific administrative acts' of an administrative authority[20] so as to protect 'legitimate interests of citizens, legal persons and other organisations'.[21] The official statement of the functions of 'administrative review' (*xingzheng fuyi*) is that it is 'an important supervisory institution for the administration to self-rectify mistakes'.[22]

As a general principle, if a private party considers a 'specific administrative act' infringes its legitimate interests, it is entitled to apply for an administrative review. Whether or not there is a 'specific administrative act' decides

[20] In the context of ARL, the term 'administrative authority' refers to various levels of the government as the executive branch of the state structure.

[21] *PRC Administrative Review Law* (中华人民共和国行政复议法), effective from 1 October 1999 (the 'ARL'), Art 1.

[22] *Circular on the Implementation of the PRC Administrative Review Law*, issued by the State Council on 6 May 1999, para 1.

whether or not that party has the right to bring an administrative review application. The key concept of 'specific administrative act' (*juti xingzheng xingwei*) means that this kind of act is directed at a specific person in relation to a specific matter, rather than at the general public.[23] An administrative authority designated by the ARL to perform the duty of review is named 'administrative reviewing organ' or 'reviewing organ', and its internal department in charge of legal affairs (usually the Bureau of Legal Affairs [*Fazhi Ju*] or Office of Legal Affairs [*Fazhi Bangongshi* or *Fazhi Chu*]) will handle the reviewing process.[24]

PRC law does not provide an exhaustive list of what types of specific administrative acts may infringe a private party's interests under the implementing measures, but much depends on the rights of that party under a specific measure or in a specific sector. However, several types of specific administrative acts are most likely to be challenged in practice, for example, penalties (for example, fines or suspension of business), seizing or freezing of property, and refusal, revocation or variation of licences or permits in relation to trade or investment activities.[25] In particular, the type of administrative act relating to the application for licences or for governmental approvals may be the most relevant to foreign investors, who have to obtain the authorities' permission for accessing almost every service sector. The provisions of ARL are applicable to these cases. When a foreign investor considers that it is qualified to get the approval or licence but the authority refuses its application without a justifiable reason or fails to respond to its application within the prescribed period, it is entitled to challenge such administrative misconduct.

14.3.1.2 Abstract Administrative Acts

Chinese scholars tend to divide administrative acts into two groups: 'specific administrative acts' and, in contrast, 'abstract administrative acts'. There is no uniform definition for 'abstract administrative acts' (*chouxiang xingzheng xingwei*), but the popular view holds it as an administrative act directed at unspecific persons for unspecific matters, with a general applicability to the public.[26] The abstract administrative acts usually take the form of issuing administrative regulations, rules and other normative documents. Therefore, the question of reviewability of an abstract administrative act is equal to the

[23] See, for example, *The Supreme Court's Opinion on Several Issues Relating to the Implementation of PRC Administrative Litigation Law (Pilot)*, Art 1. This Opinion was abolished on 10 March 2000, but this definition has been an authority and widely accepted by Chinese academics and courts.

[24] *Ibid*, Art 3.

[25] The categorisation follows Art 6 of ARL, but only includes those most relevant to trade or investment activities.

[26] Luo Haocai, *Xingzheng Fa Lun* (Administrative Law) (Shanghai, Guangming Daily Press, 1988) 151.

question whether administrative regulations, rules and other normative documents are subject to the administrative review.[27]

It is common sense that an administrative regulation, issued by the State Council as the highest organ of administration, may only be revoked or amended by the NPC or the State Council. The ARL further excludes the administrative rules issued either by the ministries of the State Council or by local governments from the scope of review.[28]

Notably, Article 7 of the ARL stipulates that:

> Where a citizen, a legal person or an organisation considers that the following measures [*guiding*] as the basis of specific administrative acts by administrative authorities are not legal, it may apply to the reviewing organ, in conjunction with the application for reviewing such specific administrative acts, to review these measures:
>
> (i) issued by ministries of the State Council;
>
> (ii) issued by various local governments beyond the county level and their departments; and
>
> (iii) issued by the governments at the level of township.

The 'measures' in Article 7 refer to normative documents, for example, those in the form of orders, decisions or circulars issued by the government or one department of the government with a general applicability. Therefore, the ARL at least subjects one type of abstract administrative act – the normative documents – to administrative review, which has been praised by Chinese scholars as a 'new breakthrough'.[29]

Despite the institutional breakthrough to subject normative documents to review, there are several reasons for the inefficiency of this breakthrough in practice that are also at odds with the WTO requirements.

The first reason is the over-stringent conditions on the eligibility to seek a review of normative documents. In accordance with Article 7 of ARL, three conditions must be satisfied: the existence of a specific administrative act based on the normative document under challenge; the initiation of the administrative review procedures against that specific administrative act; and the party challenging the normative document as the subject of that specific administrative act. Under this Article, a separate procedure against the normative document itself cannot be initiated, nor will a person who is not

[27] Obviously, laws – enacted and amended by the legislature – are out of the scope of administrative review carried out by an administration.

[28] ARL, Art 7(2), see n 21 above.

[29] See, for example, Zhang Shufang, 'Guifanxing wenjian xingzheng fuxi zhidu' (Administrative reviews on normative dDocuments) (2002) 4 *Faxue Yanjiu* (CASS Journal of Law) 18–19; Ma Huaide, 'Xingzheng fuyi fa pingjie: xingzheng jiandu yu jiuji zhidu de xin tupo' (Assessing the ARL: new breakthroughs in administrative supervisory and remedial systems) (1999) 4 *Zhengfa Luntan* (Forum on Law and Politics), also available at http://www.law-lib.com/lw (1 July 2003).

addressed by a specific act but whose legitimate interests are still adversely affected, be entitled to bring the review. Furthermore, some normative documents with a prohibitive nature need no specific administrative act to enforce it.[30] The result of such stringent conditions is to deter the initiation of review on normative documents, which would contravene with not only the purpose of legislation but also the spirit of WTO agreements. For example, GATS uses the term 'an affected service supplier' in the context of dispute review, the scope of which is obviously larger than a person addressed by the specific administrative act. In this sense, Article 7 of the ARL must be revised to expand the scope of eligible persons entitled to initiate the review process on normative documents. It is suggested that all 'citizens, legal persons and other organisations affected by the [measures]' may bring the review, provided that it can prove that its legitimate interest is affected by the targeted normative document.

Second, the reviewing organs for normative documents are ambiguous. Article 26 of ARL provides that:

> If the administrative reviewing organ has the power to deal with [the normative document subject to challenge], it must deal with this document in a legal way within 30 days; if without such power, it must within 5 days … transfer the case to an administrative authority that has the power to deal with this document which then shall deal with it within 60 days in accordance with the law.

At a first glance, this provision seems to clearly define the procedures to handle the review of normative documents. However, a further analysis suggests the complexity of at least three possible reviewing organs: the organ reviewing the case, the organ that issues the disputed normative document, and the organ to which the case is transferred. This causes difficulties in ascertaining the appropriate organ and co-ordinating the reviewing procedure. Due to the lack of detailed criteria or guidelines, there is no control on the discretion of the organ originally reviewing the case to decide whether and to whom the case will be transferred.

Third, the ARL does not provide a procedure to review the normative documents. For example, what steps must the reviewing procedure contain? Is it possible for the private party who initiates the review to express its opinions or take part in the reviewing procedure to some degree? Can the party appeal to a higher level of administration or even recourse to the courts if it does not accept the decision by the reviewing organ? How will the reviewing organ redress the illegal normative documents and what will be the consequence of withdrawing such document on other private parties? Regrettably, the ARL is silent on most of these issues and therefore cannot provide a robust procedural assurance to this reviewing mechanism.

[30] See, for example, Liu Songshan, '"Hongtou wenjian" chongtu falu de zeren guishu' (Attribution of responsibilities for the conflict between 'Red-head' documents [normative documents] and laws) (2002) 3 *Faxue* (Legal Science) 1 at 3–4.

14.3.2 Impartiality of the Reviewing Organs

The general WTO rule is that the reviewing organ must be impartial even if it cannot be independent due to the Member's constitutional structure.[31] Since the reviewing organ is a part of the administrative system, the key issue is not on whether it is independent or not, but on assessing whether it can satisfy the impartiality test.

It is submitted that the ARL fails to satisfy the impartiality test in four aspects. Some scholars have concluded that the administrative review has not been an effective means of controlling administrative discretion partly due to the lack of an independent reviewing body and impartial procedures.[32] In the context of WTO implementation, it is more likely that the administrative acts, especially in the form of measures, would be taken at the ministerial level or the provincial-government level. Under the ARL, a ministry or a provincial government will be the reviewing organ for its own act.[33] As a result, there is neither an explicit guarantee of its impartial behaviour nor the incentives to correcting its own mistakes.

Second, there is no challenge system in the current administrative reviewing procedure. As a general rule, if any personnel in charge of the review has some interest in the outcome of the review or some connections with the agency subject to review or the specific official who has taken the disputed act, a challenge system must be designed to enable the affected private parties to apply for his withdrawal from reviewing the case. However, the ARL is silent in this respect, which means the lack of a basic design to ensure the impartiality of reviewing organs.

Third, the ARL provides insufficient rights of hearing to affected private parties. The review is in principle in the form of a documents review, and only when the affected party applies or the reviewing organ considers it necessary may the organ investigate the facts and seek opinions from all the parties.[34] This provision does not grant the affected private parties the right to request a hearing, nor to initiate the investigation or hearing procedure, but instead leaves these issues to the discretion of the reviewing organs. The absence of a secure right to request a hearing procedure has impaired the impartiality of the reviewing process, as this is more favourable to the agencies subject to review – which need not account publicly for their conduct.

31 GATT, Art X(3)(c); GATS, Art VI(2)(a), see n 8 above. Interestingly, the relevant text in China's Accession Protocol (paragraph 2(D)(1)) uses the phrase 'impartial and independent' in a parallel sense. It is unclear whether this is just a drafting style or an effort to increase the obligations on China.

32 See R Peerenboom, 'Globalization, Path Dependency and the Limits of Law: Administrative Law Reform and Rule of Law in the People's Republic of China' (2001) 19 *Berkeley Journal of International Law* 161 at 232–3.

33 *PRC Administrative Review Law* (中华人民共和国行政复议法), effective from 1 October 1999 (the 'ARL'), Art 14.

34 *Ibid*, Art 22.

Last but not least, the ARL contains no evidential rules. It is surprising that a procedural act does not specify basic rules on burden of proof, categories of evidence, and collection and examination of evidence. The absence of evidential rules is ostensibly applicable to all parties under the reviewing process, but in practice may have a more adverse impact on the applicants. As a result, the agencies subject to review have no legal obligation for the onus of proof on the legality of their own acts.

14.3.3 Promptness

The ARL sets up a straight timetable for the administrative review. An affected private party can bring an application for the review within 60 days of knowing the specific administrative act, which it considers to infringe its interests.[35] The reviewing organ must decide within five days of receipt of the application if the disputed act is within its jurisdiction.[36] Upon accepting the application, that organ shall make the decision within 60 days in general and not later than 90 days for complex cases.[37] Once the decision is serviced to relevant parties, it takes into effect.[38] Therefore, an ideal timing for resolving a dispute under the administrative review procedure would take about 70 to 100 days depending on the complexity of cases.

However, it is not unusual for the procedure to take a longer time in practice, especially as reviewing organs may not care too much about the deadlines set up by the ARL. Moreover, there is no fixed, maximum period for the agencies subject to review to enforce an unfavourable decision.[39] This would increase uncertainties in the efficiency of the administrative review and, again, discount the affected private parties' confidence on this mechanism.

14.3.4 MOC Administrative Review Measures

On 20 May 2004, MOC finally issued the *MOC Implementing Measures on Administrative Review* ('MOC Review Measures') for trade-related administrative review:

[35] *Ibid*, Art 9. When the law allows a period longer than 60 days, the longer period applies.
[36] *Ibid*, Art 17. If not within its jurisdiction, the organ shall inform the applicant of the appropriate reviewing organ to which they should apply.
[37] *Ibid*, Art 31(1). If the law requires the decision within a shorter period, the shorter period applies.
[38] *Ibid*, Art 31(3).
[39] *Ibid*, Art 32. This article only stipulates that the agency 'shall implement the decision' and if it fails to or delays the implementation, its superior administrative agency or the reviewing organ may require it to implement within a period.

> to prevent and redress illegal or inappropriate specific administrative acts, protect the legitimate benefits of citizens, legal persons and other organisations, and safeguard and supervise the exercise of powers in accordance with the law by [trade regulators].[40]

This is a milestone in respect of resolution of trade disputes with MOC, the primary Chinese trade regulator.

The scope of the MOC Review Measures covers all regulatory behaviours of MOC, including, for example, the licencing of foreign trading rights, the import and export licencing and other quantitative control measures, the determinations in the investigation of anti-dumping, anti-subsidies and safeguarding cases, the licencing and regulation of FDI, and so on. The Department of Treaty and Law of MOC takes charge of the reviewing work. Notably, the MOC Review Measures do not designate the power of administrative review to the local branches of MOC; instead, the Department of Treaty and Law will review both MOC's specific administrative acts and such acts of MOC's local branches.[41] This may be interpreted as an effort to increase the uniformity of the application of trade laws and regulations in the nation and to prevent local government from distorting this uniform application. However, the private party may also choose to request the provincial government to review the regulatory behaviours taken by MOC's branches at the provincial-level.[42] For example, if the party has no intention to go to MOC (based in Beijing) to start the review process due to concerns for costs and inconvenience, it can start this process at the capitol city of the province where it is situated.

The private party as the applicant must submit a written application for the administrative review. The application should contain the basic information of the applicant, the specific request and the detailed facts and reasons for such request (including the date when the applicant knows the specific administrative act that was taken against it), and the date of the application.[43] The Department of Treaty and Law must decide whether to accept the application within five working days of receipt of the application.[44] If accepting the application, the Department of Treaty and Law must forward the application to the respondent within seven working days, and the respondent must reply to the application in writing within 10 days.[45] This timeline is tight and should be able to secure the swift process of the review. However, the MOC Review Measures do not provide detailed procedures on the reviewing pro-

40 *MOC Implementing Measures on Administrative Review* (商务部行政复议实施办法), effective from 1 July 2004 ('MOC Review Measures'), Art 1.

41 *Ibid*, Art 3. Alternatively, the applicant may opt to the provincial government for the review of the specific administrative acts of MOC's local branches at the provincial level (Art 3(4)).

42 *Ibid*, Art 3(4).

43 *Ibid*, Art 4.

44 *Ibid*, Art 7.

45 *Ibid*, Art 9.

cess but simply apply those provisions of the ARL. From this perspective, the disadvantages of the ARL procedure will also apply to the administrative review by MOC.

14.4 ADMINISTRATIVE LITIGATION

14.4.1 Overview

As discussed above, an affected private party can bring a trade-related dispute to the administration review and then appeal to the courts if it does not agree with the reviewing organ's decision. Alternatively, the party may directly seek the courts' protection, unless the laws or regulations require the administrative review procedure as a mandatory pre-session procedure. Strictly speaking, only administrative litigation (*xingzheng susong*) falls within the ambit of 'judicial review' as usually understood under the Chinese law.

In relation to trade-related disputes with the government, two levels of law apply: first, the *PRC Administrative Litigation Law*[46] ('ALL') which provides for the general legal framework; second, three recent judicial interpretations by the PRC Supreme Court dealing with trade-related administrative litigations, namely, 'Measures on Several Issues Relating to the Adjudication of International Trade Administrative Litigations'[47] ('the International Trade Opinion'), 'Measures on Several Issues Relating to the Application of Law in Adjudicating Anti-dumping Administrative Litigations'[48] ('the Anti-dumping Opinion'), and 'Measures on Several Issues Relating to the Application of Law in Adjudicating Anti-subsidies Administrative Litigations'[49] ('the Anti-subsidies Opinion').

The private party has to comply with the strict limitation period in the ALL. If the administrative review procedure is a mandatory requirement on the party before it can bring the dispute to the court, the party must bring the administration litigation application within 15 days of the receipt of the review decision.[50] If the administrative review procedure is not a mandatory requirement, the party must bring the dispute to the court within three months of the date when it knows of the taking of the specific administrative

46 *PRC Administrative Litigation Law* (中华人民共和国行政诉讼法), enacted by the Second Meeting of the Standing Committee of the 7th NPC on 4 April 1989 and taking effect from 1 October 1990 ('ALL').

47 *Fashi* (Judicial Interpretation) [2002] No 27, effective from 1 October 2002.

48 *Fashi* (Judicial Interpretation) [2002] No 35, effective from 1 January 2003.

49 *Fashi* (Judicial Interpretation) [2002] No 36, effective from 1 January 2003.

50 *PRC Administrative Litigation Law*, Art 38(2), see n 46 above. The administrative reviewing organ has the obligation to issue the review decision within two months of the acceptance of the application. If it fails to issue the decision within this two-month period, the applicant must bring an administrative litigation to the court within 15 days from the day that the decision should have been issued.

act in question.[51] In terms of trade-related administrative litigation, the court of first instance will usually be the Intermediary People's Court at the place where the trade regulator taking the specific administrative act in question is situated.[52]

14.4.2 Reviewable Administrative Acts

14.4.2.1 Specific Administrative Acts

Similar to the administrative review, whether or not there is a specific administrative act taken against the private party decides whether or not that party has the right to initiate the administrative litigation procedure. The general rule of ALL determines the scope of specific administrative acts subject to litigation. Under Article 2 of ALL, if an affected private party considers that its legitimate rights and interests have been infringed upon by a 'specific administrative act' of an administrative organ or its personnel, it shall have the right to bring an administrative litigation. Article 11 gives a non-exhaustive list of types of such acts, similar to those contained in the ARL.

The recent International Trade Opinion mirrors the relevant provisions in the ALL and then excludes the possibility of expanding reviewable trade-related administrative acts in judicial practice. Article 3 of the Opinion provides that:

> If a citizen, a legal person or any other organisation that his or its lawful rights and interests have been infringed upon by a *trade-related specific administrative act* of a PRC administrative organ or its personnel, he or it may bring an administrative litigation before a people's court in accordance with the PRC Administrative Litigation Law, other laws and regulations. [emphasis added]

The scope of trade-related specific administrative acts is further clarified to cover those acts in respect of international trade in goods, international trade in services and IP issues relating to international trade.[53] The Administrative Litigation Tribunal at the level of the Intermediary Court or the High Court in the city where the trade regulator is situated will be the tribunal to hear these cases.[54] Similarly, the Anti-dumping Opinion and the Anti-subsidies Opinion also restrict their application to certain determinations made by

51 *Ibid*, Art 39. If one law has a different provision on this limitation period, that law will apply.

52 *Ibid*, Arts 13–16. But if the administrative reviewing organ changes the original decision and the party brings an administrative litigation against the decision of that reviewing organ, the court at the place of that reviewing organ may also have the jurisdiction (Art 17).

53 Measures on Several Issues Relating to the Adjudication of International Trade Administrative Litigations ('The International Trade Opinion') *Fashi* (Judicial Interpretation) [2002] No 27, effective from 1 October 2002, Art 1.

54 *Ibid*, Art 2.

the trade regulator in relation to the investigation of specific dumping or subsidies cases.[55]

In short, the scope of specific administrative acts subject to judicial review under existing Chinese law is wide enough to satisfy the WTO requirements. The key point is, therefore, on the reviewability (or non-reviewability) of abstract administrative acts.

14.4.2.2 Abstract Administrative Acts

The ALL provides that 'administrative regulations and rules, regulations, or decisions or orders with general binding force formulated and announced by administrative organs' cannot be brought under suit by a private party.[56] It is a heatedly debated issue as to how to reform the ALL in the WTO context. There are two correlated issues with regard to the reviewability of abstract administrative acts: first, whether the WTO Agreements and China's accession commitments require the Chinese courts to review abstract administrative acts; second, what types of abstract administrative acts need to be reviewed in light of legal and regulatory reforms in China, even not as mandated by the WTO accession.

For the first issue, some scholars suggested that the laws, administrative regulations, rules and normative documents should be subject to judicial review in the WTO context and thus the ALL must be revised accordingly to cover abstract administrative acts.[57] However, this thesis argues that neither the WTO Agreements nor China's accession commitments impose an obligation on the PRC to expand the scope of judicial review.[58] First, the WTO Agreements state that a Member is not required to institute a judicial review procedure which would be inconsistent with that Member's constitutional structure or the nature of its legal system.[59] Therefore, it is an incorrect interpretation of the WTO text to the extent that the WTO accession mandates China to change the current constitutional structure of the legislation review. Second, it would be inappropriate to expand the meaning of phrases used in

[55] For example, Art 1 of the Anti-dumping Opinion subjects the following determinations by the trade regulators to judicial review: final determinations on dumping, dumping margin, damage and damage degree; determinations on whether to charge anti-dumping duties, to collect retrospectively or to refund, and on the new exporters; determinations on review of maintaining, amending or withdrawing anti-dumping duties and the price undertakings; and other suitable anti-dumping administrative acts in accordance with laws and regulations. Similar provisions can be found in Art 1 of the Anti-subsidies Opinion.

[56] ALL, Art 12(2), see n 50 above.

[57] See, for example, Cao Jianming (ed), *WTO yu Zhongguo de Sifa Shenpan* (WTO and the Adjudication in China) (Beijing, China Law Press, 2001) 285.

[58] The same argument below also applies to the administrative review procedure, so the WTO Agreements and the Accession Protocol do not require the review of abstract administrative acts under this procedure.

[59] GATT, Art X(3)(c), see n 8 above; GATS, Art VI(1)(b), see n 8 above.

the relevant WTO provisions such as 'administrative action relating to customs matters' or 'administrative decisions affecting trade in services' to include not only specific decisions or actions but also the issuance of laws, regulations and rules in this regard. This broad interpretation simply conflicts with the normal usage of such words or phrases, and adds requirements that the negotiators of the WTO Agreements do not expressly intend to use.[60] Third, the Accession Protocol only requires a prompt review of 'all administrative actions relating to the *implementation* of laws, regulations, judicial decisions and administrative rulings of general application'[61] [emphasis added] which are already in effect at the time of the implementation actions, rather than a review of 'all administrative actions relating to the *promulgating* and *implementation*' [emphasis added] of these measures. Consequently, the PRC government has no obligation under the WTO Agreements to expand the scope of judicial review to cover abstract administrative acts.

Taking into account the above argument, the second issue is whether and how judicial review in China may be expanded to promote legal and regulatory reforms after the WTO accession. This is one area in which the WTO accession will help these legal and regulatory reforms. It is widely accepted that laws enacted by the NPC or its Standing Committee are beyond judicial review, because the current constitutional structure grants the reviewing power to the NPC (including its Standing Committee) under the *PRC Law on Legislation* (2000).[62] However, there are different views relating to whether abstract administrative acts may be reviewed by the judiciary. The most conservative view concludes that the present administrative litigation system is in line with the WTO Agreements and needs no substantial adjustments,[63] whilst the prevailing view is that the scope of reviewable administrative acts does need to be expanded to increase the judicial supervision and to promote the administration in accordance with law. But even within the latter group, different views exist on which abstract administrative acts are reviewable by the courts. Some scholars argue that only normative documents fall within the scope,[64] whilst other scholars take the view that all of the administrative regulations, rules and normative documents shall be reviewed.[65]

[60] Cao Jianming, above n 57 at 285.
[61] The Accession Protocol, para 2(D)(1), see n 14 above.
[62] *PRC Law on Legislation*, promulgated by the Third Meeting of the Nineth Session of the National People's Congress of the PRC on 15 March 2000 and effective from 1 July 2000, Art 85(1), Art 88(1) and (2).
[63] Cao Jianming, above n 57 at 287.
[64] See, for example, Jiang Bixin, *WTO yu Xingzheng Fazhi: Xingzhengfa de Shijie Yanguang* (WTO and Rule of Law in Administration: the Global Perspectives of Administrative Law) (Beijing, China Public Security University Press, 2002) 77.
[65] See, for example, Wei Qunlin, 'WTO huanjing xia woguo xingzheng susong shouan fanwei de yanjiu' (Research on the scope of Chinese administrative litigation in the WTO context), available at: http://www.law-lib.com/lw (9 May 2004).

I take a pragmatic view, that is, the expansion of judicial review must take account of existing constitutional structure and political consideration on the one hand and the capacity of courts on the other hand. It is suggested that the scope of judicial review must be expanded to cover at least normative documents, for two reasons. First, the ARL already subjects normative documents to administrative review, and the lack of a corresponding mechanism in the ALL means a mismatch between two remedial mechanisms. Those affected private parties who choose the channel of administrative review may have a higher legal right than those who choose administrative litigation. This artificial discrimination between two mechanisms with common aims is not logical. Second, the *PRC Law on Legislation* (2000) already establishes the reviewing procedures for administrative regulations and rules, but does not include normative documents in the ambit of 'administrative legislation' (*xingzheng lifa*) nor provide some controlling mechanism on normative documents. In order to increase the transparency of administration and prevent the administrative organs from undermining the application of legislation by normative documents, it is suggested that the ALL be revised in the near future to allow the courts to review normative documents issued by the administrative organs.

14.4.3 Independence and Impartiality

Article 126 of *PRC Constitution* (1982) provides that the people's courts exercise judicial power independent from any interference by political parties, administrative agencies and individuals. The judicial system is separate from the administrative system, which formally conforms to the WTO requirement of an independent judiciary. However, the reality is that the judicial independence cannot be simply achieved in China only because of some pressures from international conventions.[66]

The key question is whether substantive judicial independence – and thus the impartiality of the judicial process – exists in the judicial practice for resolution of trade-related disputes. A comprehensive discussion of judicial independence in China is beyond the scope of this book. Instead, this part will briefly highlight several institutional deficiencies that frustrate judicial independence in China, and then comment on recent efforts to increase – albeit to a very limited degree – judicial independence. This chapter (below) will present some tentative proposals for increasing judicial independence in resolving trade-related disputes in light of WTO accession, in which experi-

[66] For example, The UN International Covenant on Civil and Political Rights expresses the trial by an independent and impartial tribunal as a basic human right (Art 14). China signed this international treaty on 5 October 1998 but has completed little implementation (including Art 14) in the domestic law. This shows the government's reluctance to implement sensitive political and human rights commitments vis-à-vis the active attitude toward the WTO commitments in the economic area.

ences of the pilot test could also influence reforms in other judicial areas at a later stage.

14.4.3.1 Judicial Independence: Institutional Deficiencies

It has been widely acknowledged that the Chinese courts are not genuinely independent in their exercise of the judicial power.[67] As one Chinese scholar pointed out:

> Justice and efficiency are two main themes of Chinese judicial work in near future, both with a close connection with judicial independence. Overall, the low quality of judges and the illegal intervention from outside sources are unquestionable facts leading to wrongly-decided cases, apart from other reasons such as corruption or relationship. As for local protectionism and departmental protectionism, they have obvious institutional connections with the non-independence of judiciary.[68]

Another scholar has observed an 'interesting dilemma' that the current criticisms of judicial injustice or corruption in Chinese society have reached an unprecedented peak whilst this stage also witnesses the new era of legal reform.[69] There exist several fundamental institutional deficiencies for the non-independence of the judiciary in China.

The first reason is the status of 'Party-State' as determined by the contemporary political system. The superior position of Chinese Communist Party ('CCP') as a political reality means not only the judiciary but also the legislative and the executive branches of the state structure are controlled by a single political party and thus ultimately subordinated to the CCP's policies, decisions and wishes. Although the *PRC Constitution* (1982) officially recognises judicial independence, the Party still has the de facto rights to interfere with the judicial affairs even up to today.[70] A typical example is for the Party to review the undecided case files and issue instructions to handle a case.[71] Furthermore, the CCP has a powerful internal branch titled 'Political-Legal Commission' (*Zhengfa Weiyuanhui*), one of whose main function is to imple-

[67] According to the standards adopted by the International Bar Association, judicial independence comprises personal independence (judges are not subject to executive control, with adequate salaries and pensions, and job security), substantive independence (a judge is subject to nothing but the law and commands of his conscience), internal independence (a judge is independent vis-à-vis his judicial colleagues and superiors in the decision-making process), and collective independence (the judiciary as a whole enjoys autonomy vis-à-vis the executive). See Yuwen Li, 'Judicial Independence: Applying International Minimum Standards to Chinese Law and Practice' (2001) 15:1 *China Information* 68–70. The following text will show the disparity between those standards and the reality in China.

[68] Li Buyun and Liu Zhiwei, 'Sifa duli de jige wenti' (Several theoretical issues of judicial independence) (2002) 24:3 *Faxue Yanjiu* (CASS Journal of Law) 7.

[69] Liu Huisheng, 'Renmin fayuan guanli tizhi gaige de jidian sikao' (Reflections on the reform of the court management system) (2002) 24:3 *Faxue Yanjiu* (CASS Journal of Law) 12.

[70] See, for example, Zou Keyuan, 'Judicial Reform in China: Recent Developments and Future Prospects' (2002) 36 *International Lawyer* 1039 at 1048–50.

[71] See, for example, Jiang Junfeng, 'Lun sifa duli' (Reflections on judicial independence), available at: http://www.law-lib.com/lw (11 April 2004).

ment the Party's leadership and control over judicial affairs and particularly to co-ordinate and instruct the trial of sensitive or important cases.[72]

Second, the current judiciary system is to a great extent 'localised' because of local governmental control on the local courts' budget and the accountability of the local courts under the People's Congress system. Under the current fiscal structure, a local court is funded by the local government in its region. Where there is no fiscal independence of local courts, it seems inevitable that the courts as a whole cannot be isolated from the intervention of local governments. Furthermore, local courts are accountable to the local People's Congress from which it must get approval of its annual report and secure approval of the judges nominated by the courts.[73] There are already several examples in recent years in which the local People's Congress has vetoed the local court's reports.[74] While applauding the increasing degree of legislative supervision on the judiciary, there is a worrying possibility that the local courts may choose to sacrifice the independence in the confrontation of local legislatures who generally represent the interests of local enterprises or people.[75] For instance, it is observed that some local courts tend to be biased in favour of local enterprises in the cases involving their interests so as to avoid being criticised by representatives of the local People's Congress on the ground that the court decision is an 'injustice',[76] or sometimes even report an undecided case to the People's Congress to seek 'clear instructions'. Similarly, budgetary and accountability controls also exist for the Supreme Court at the level of Central Government. For these reasons, we cannot expect a court system independent from the influence of other branches of the PRC government.

A further institutional arrangement undermining judicial independence is that the judges in charge of specific cases are not independent in the decision-making process. The *PRC Law on the Organisation of the People's Courts* (1979) provides that each court may establish an Adjudicative Committee (*Shenpan Weiyuanhui*), usually comprising the heads of the court

72 The usual form of co-ordination is to call up a 'co-ordinating meeting' with the attendance of the relevant heads of the executive, the courts and the procuratorate. I have interviewed judges and prosecutors at various levels of the PRC judicial system on a no-names basis during the writing of this thesis, and all of them confirmed the above understanding.

73 *The PRC Constitution* (1982), Art 128; *The PRC Law on the Organisation of the People's Courts* (Zhonghua Renmin Gongheguo Renmin Fayuan Zuzhi Fa), enacted on 1 July 1979 and revised on 2 September 1983, Art 17.

74 For example, the 4th Meeting of the 12th Session of the People's Congress of Shenyang City, Liaoning Province vetoed the Working Report of Shenyang Intermediary People's Court on 14 February 2002. See Zhang Zhetao, 'Fayuan xiang renda huibao gongzuo yu sifaquan de xingzhenghua' (The reporting to the People's Congress by courts and the administration-style of judicial power) (2002) 6 *Faxue Pinglun* (Law Review) 23.

75 *Ibid*. Compare Jiang Junfeng, 'Baozhang sifa duli: renda jiandu de yingyou zhiyi' (Securing the judicial independence: the true meaning of supervision of the People's Congress), at http://www.law-lib.com/lw (14 July 2003) (arguing that the supervision by the People's Congress would not undermine the judicial independence.)

76 Ironically, sometimes such a representative is also the owner or the manager of the enterprise involved in the case.

and of each tribunal, to discuss complex cases.[77] However, in practice, the Committee turns out to be the final decision-making organ for every important case, and the judges in charge are only empowered to investigate and hear the case rather than decide its outcome. This institutional arrangement effectively deprives the 'individualist' independence of judges in charge. Another common practice is for a court to seek instructions or opinions from higher courts (ideally the Supreme People's Court) on an undecided case – instructions or opinions on which they can base the judgments.[78] The main purpose in this system is to avoid the judgment being dismissed in the appeal procedure, with the judgment viewed as a 'mistake' affecting the reputation of the courts and undermining the promotion prospects for the judges hearing the case. However, this practice makes the appeal procedure meaningless, because the higher court already expresses its formal opinions and is unlikely to change their mind at a later stage.

Thus, the Chinese judicial system has no substantive independence either as a whole or at the level of individual judges in charge of cases, due to the institutional deficiencies highlighted above. This situation is obviously not in line with WTO requirements. How to gain the confidence of the affected foreign parties in the PRC courts to solve disputes with the PRC government is a challenging task for the judicial system. Section 14.6 of this chapter will argue for some pragmatic steps to improve judicial independence under China's current political environment.

14.4.3.2 The Supreme Court's Opinions on Trade-related Disputes

Having realised the importance of trade-related administrative litigation after WTO accession, the Supreme People's Court has issued the International Trade Opinion and two opinions relating to anti-dumping and anti-subsidies.[79] These Opinions show some willingness to implement the WTO Agreements through proper adjudicative actions. However, since they cannot change any institutional settings affecting the judicial independence within which they operate, the positive effects on independent or impartial judicial review for affected private parties will be limited.[80]

77 *The PRC Law on the Organisation of the People's Courts* (中华人民共和国人民法院组织法), promulgated by the Second Meeting of the Fifth Session of the National People's Congress on 1 July 1979 and revised by the Second Meeting of the Standing Committee of the Sixth Session of the National People's Congress on 2 September 1983, Art 11.

78 This author has talked to many Chinese judges who acknowledged their willingness to use the reporting channel to seek the opinions from the higher courts – so to make their judgments 'safer'.

79 The speech of Vice-Chief Justice, Li Guoguang after the issuance of the Anti-dumping Opinion and the Anti-subsidies Opinion. See 'China Issues Rules on Anti-dumping, Anti-subsidy Cases' *International Finance Newspaper* (4 December 2002) 2.

80 See, for example, U Killion, 'Quest for Legal Safeguards for Foreign Exporters under China's Anti-dumping Regime' (2004) 29 *North Carolina Journal of International Law and Commercial Regulation* 417 at 454–5.

The only tangible effort in the Supreme People's Court's opinions to address the issue of judicial independence is the rule of jurisdiction. The International Trade Opinion requires the Intermediary Courts or the High Courts to be the courts of first instance for trade-related administrative litigation. Three reasons may be attributed to this arrangement: first, the lower courts may lack necessary expertise and experience; second, it is easier to ensure the uniform application of trade laws in the trial thanks to the limited number of courts involved; third, the Intermediary Courts or the High Courts are expected to have a more independent status with which to resist local government's intervention. In the Anti-dumping Opinion and the Anti-subsidies Opinion, the defendant would be the ministry or commission of the State Council (for example, MOC and the State Council Custom Tariffs Commission), therefore two Opinions assign the jurisdiction of the first-instance cases to the High Court of Beijing or the Intermediary Court of Beijing as designated by that High Court.[81] However, a simple upgrading of jurisdiction does not add any real independence to the courts or the judges in charge, so its practical effects should not be exaggerated.

More disappointingly, none of the three Opinions include any institutional arrangement to promote the impartiality of adjudicating a trade-related administrative litigation. Instead, the provisions of such Opinions basically mirror the language of the ALL, with minor changes to accommodate the nature of trade-related disputes. From the perspective of implementation, it is impossible that these Opinions can provide a better assurance – procedurally and substantively – to the interests of private affected parties.

14.4.4 Promptness

The ALL stipulates a clear timetable for administrative litigation. A court must examine the case brought by the affected party and decide whether to accept it or not within seven days of receipt of the filing.[82] If the court does not reply or reject the filing within seven days, the claimant may bring the case to the court at a higher level.[83] This provision is useful to ensure the promptness of accepting the case by the court, by preventing the court from unduly delaying the processing. For a first-instance case, the court must issue the judgment within three months after accepting the case.[84] The affected party may appeal to a higher court within 15 days of service of the judgment,

[81] The Anti-dumping Opinion (2002), Art 5, see n 48 above; the Anti-subsidies Opinion (2002), Art 5, see n 49 above.

[82] 'Interpretations on the Implementation of the PRC Administrative Litigation Law' (最高人民法院关于执行《中华人民共和国行政诉讼法》若干问题的解释), issued by the Supreme People's Court on 10 March 2000, Fa Shi [2000] No 8, Art 32(1).

[83] *Ibid*, Art 32(3).

[84] *PRC Administrative Litigation Law* (中华人民共和国行政诉讼法), enacted by the Second Meeting of the Standing Committee of the 7th NPC on 4 April 1989 and taking effect from 1 October 1990 ('ALL'), Art 57.

and the appeal procedure must be completed within two months after receiving the appeal petition.[85] The extension of these deadlines can only be approved by the court at a higher level.[86] In short, an ideal timetable for resolving an administrative litigation could be within six months from the date of filing the case.

However, the practice is much different from the law on the books. Potter observed that 'the Chinese court system continues to reveal significant problems of process and effectiveness' before the accession.[87] This observation may be valid for a period even after the accession. Delays in each chain of the procedure are a common phenomenon, and it is not unusual for a case to take several years to reach its conclusion. The reasons may be varied: the case may be complex or sensitive; the judges are awaiting instructions from higher courts; the defendant imposes undue influence on the court and so on. Therefore, without the institutional security of judicial independence, there is no real chance to secure promptness in the administrative litigation procedure.

14.4.5 Summary

Administrative litigation should protect private parties affected by the PRC governmental actions with regard to implementing the WTO Agreements. The core value of this dispute resolution channel is judicial independence, the absence of which threatens its impartiality and promptness and thus falls foul of the WTO requirements. Nevertheless, the problem of judicial independence of Chinese courts remains after the WTO accession. In fact, the main direction of the Supreme Court's efforts, as evidenced by three trade-related Opinions, is not addressed to this problem. Because current political and institutional constraints cannot be changed in the short-term, the second best option is to design a framework under which impartiality (or strictly speaking, relative impartiality) in trade-related administrative litigation could be achieved. Section 14.5 below will argue for setting up an International Trade Courts system in the PRC to address this issue.

14.5 ENFORCEMENT OF THE WTO DISPUTE SETTLEMENT RULINGS

14.5.1 Overview

Before China's accession to the WTO, a popular concern was that a sudden

[85] *Ibid*, Art 60.
[86] *Ibid*, Arts 57 and 60.
[87] See PB Potter, 'China and the WTO: Tensions between Globalized Liberalism and Local Culture' (1999) 32 *Canadian Business Law Journal* 440 at 449.

influx of complaints against China in front of the Dispute Settlement Body ('DSB') panels would not only cause harm to China but also overload the DSB.[88] This prediction has not come true immediately – no case was brought against China by other Members before March 2004.[89] This section approaches the issue of implementing WTO dispute settlement rulings in China from two perspectives: first, what the PRC government may tactically use of the DSB rules to delay, in a WTO-consistent way, the implementation process for a panel or appellate report finally adopted by the DSB (' the WTO ruling' or 'the ruling'); second, what would happen if the PRC government refuses not to implement the ruling even after the allowable implementation period. By highlighting these interrelated factors in relation with the decision-making of the PRC government, it might be possible to predict the general reactions.

It has been expected that the use of WTO rulings to promote China's compliance would generally help to 'ease the pressure on China's entry into WTO' by providing a structured, cooperative process for devising an implementation strategy.[90] However, the Understanding on Rules and Procedures Governing the Settlement of Disputes ('DSU') contain some loopholes in respect of the enforcement and compliance procedure, which have been fully utilised by some Members either to delay the timing of implementation or to employ an incomplete implementation.[91] The Chinese government may potentially exploit these tactics to protect against the impact of implementing an unfavourable WTO ruling.

14.5.2 The Implementation Process: General Rules

14.5.2.1 Dispute Resolution

The DSU establishes fixed time periods for every stage of the dispute resolu-

[88] See, for example, C Duncan, 'Out of Conformity: China's Capacity to Implement World Trade Organization Dispute Settlement Body Decisions after Accession' (2002) 18 *American University International Law Review* 399 at 473–4.

[89] There would be a number of reasons for this phenomenon, for example, the evolving nature of the Chinese legal and regulatory system, the unfamiliarity by foreign private parties and other Member governments of Chinese laws which could affect their interests, the 'wait-and-see' approach existing among major WTO members, and so on. On 18 March 2004, the US brought the first WTO case against China in respect of China's value-added tax policy on integrated circuits.

[90] See, for example, D Blumental, '"Reform" or "Opening"? Reform of China's State-Owned Enterprises and WTO Accession: The Dilemma of Applying GATT to Marketizing Economies' (1998) 16 *UCLA Pacific Basin Law Journal* 198 at 243.

[91] Two typical examples are the EU's implementation of the decision of *Bananas* case and the US's implementation of the decision of *Tax Treatment of 'Foreign Sales Corporations'* case. See N van den Broek, 'Power Paradoxes in Enforcement and Implementation of World Trade Organization Dispute Settlement Reports: Interdisciplinary Approaches and New Proposals' (2003) 37 *Journal of World Trade* 127 at 145–8.

tion stage. The primary goal of the DSU is the 'prompt settlement' of dispute so as to secure positive solutions between the complaining Member ('the complaining party') and the offending Member ('the respondent').[92] The DSU requires all Members to submit disputes to its jurisdiction, thus strengthening the enforcement of WTO rules. No Member may unilaterally judge the violation of the WTO Agreements by another Member and adopt retaliatory measures without recourse to the DSU procedure.[93] In return, the winning party can expect implementation and availability of sanctions from the system.

Upon the adoption by the DSB of a WTO ruling, the next task is to ensure that the losing party will implement the recommendations of that ruling, which usually requires it to bring inconsistent measures in line with the WTO Agreements. Articles 21 and 22 of the DSU govern the implementation of the WTO rulings against the losing party, which recognises that 'prompt compliance with recommendations or rulings of the DSB is essential in order to ensure effective resolution of disputes to the benefit of all Members'.[94] The DSU establishes three implementation procedures: the acceptance of the implementation plan, the monitoring, and the compensation and retaliation.[95]

14.5.2.2 Acceptance of the Implementation Plan

If one ruling finds that a Member has acted inconsistently with its WTO obligations, or nullifies or impairs benefits accrued to other Members, Article 21.3 requires the Member to notify the DSB of its plan for implementing the ruling at a DSB meeting held within 30 days after the ruling has been adopted. If it is 'impractical to comply immediately with the recommendations and rulings', the Member may have a 'reasonable period of time' to do so.[96] There are three alternative methods to determine a 'reasonable period of time'. The period may be either approved by the DSB[97] or agreed by the winning party

[92] *Understanding on Rules and Procedures Governing the Settlement of Disputes*, Annex 2 to the *Marrakesh Agreement Establishing the World Trade Organization*, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994 ('DSU'), Art 3.3.

[93] *Ibid*, Art 23.2.

[94] *Ibid*, Art 21.1.

[95] WTO is now reviewing the dispute settlement process and Members have submitted a number of proposals for improving this process, including the compliance process. China also submitted its proposal on 5 March 2003 (Specific Amendments to the Dispute Settlement Understanding – Drafting Inputs from China, TN/DS/W/51 and the revised version, TN/DS/W/51/Rev 1 on 13 March 2003). For a general discussion, see, for example, Xinjie Luan, 'Dispute Settlement Mechanism Reforms and China's Proposal: Taking "Right" as a Keystone' (2003) 37 *Journal of World Trade* 1097.

[96] *Understanding on Rules and Procedures Governing the Settlement of Disputes*, Annex 2 to the *Marrakesh Agreement Establishing the World Trade Organization*, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994 ('DSU'), Art 21.3.

[97] *Ibid*, Art 21.3(a).

within 45 days after the date of adopting the WTO ruling.[98] The last resort, under Article 21.3(c), is to determine this period under 'binding arbitration within 90 days'. If so decided, the reasonable period should not exceed 15 months from the date of adoption of a ruling except for 'particular circumstances', which may extend or shorten such a period. Unless the losing party is volunteering to implement the WTO rulings in an immediate way, it may wait for the binding arbitration to decide an implementation period and argue for a 'reasonable period' as long as possible or at least not shorter than 15 months. This delaying tactic can also potentially be used by the Chinese government.

In the early arbitrations, the arbitrators acted as though there were a presumption in favour of the 15-month period.[99] However, the *EC – Hormones* case has introduced a new 'immediate compliance' model, under which the concept of 'reasonable period of time' should be 'the shortest period possible within the legal system of the Member to implement the recommendations and rulings of the DSB'.[100] Arbitrators draw a line between legislative and administrative actions taken by the losing party to implement the rulings, and usually presume the administrative process would take less time than legislative responses.[101] Nowadays, a losing party generally has eight months for administrative implementing action or 12 months for legislative action.[102] The choice and timing of the detailed operating steps in taking appropriate actions are properly left to the party itself.

14.5.2.3 The 'Reasonable Period' of China

In the context of China, the 'immediate compliance' model means that the Chinese law governing the enactment, revision or abolition of a law (by the NPC or its Standing Committee) or the withdrawal or change of an administrative action (including the abstract acts such as issuance of administrative regulations and rules and the specific acts being challenged) may be the primary source to determine how long the reasonable period of implementation would be in China.[103]

For revising a law, the procedures set out in the *PRC Law on Legislation* (2000) apply, roughly divided into the following stages: researching and preparing the bill; proposing the draft bill to the NPC or its Standing Committee; scrutinising and revising the draft by the NPC members or the

[98] *Ibid*, Art 21.3(b).
[99] McGovern, above n 11 at para 2.24.
[100] Report of arbitration on *EC measures concerning meat and meat products* (Hormones), WT/DS26/15, WT/DS48/13, 1998, para 26.
[101] Report of arbitration on *Canada – patent protection of pharmaceutical products*, WT/DS114/13, 2000, para 49.
[102] P Monnier, 'The Time to Comply with an Adverse WTO Ruling: Promptness within Reason' (2001) 35 *Journal of World Trade* 825 at 831.
[103] The procedures described below also apply to the actions at the local governmental level.

Standing Committee members; voting for the bill; and if passed, signing by the Chinese President and publishing in the official gazette before coming into force.[104] Nevertheless, there are neither comprehensive provisions nor a clear timetable on the legislative process. The only clue is in Article 39, which provides a two-year deadline for dropping a legislative bill from the agenda of the Standing Committee due to failure of approval, which implies that the longest period for deliberating a bill must be within two years. In light of China's practice of legislation, the above stages can normally be completed within one year, given the frequency of the NPC meeting (once in a year) or the Standing Committee meetings (once in every two months). Therefore, it is submitted that the maximum reasonable period of time for China to take legislative action to comply with the WTO rulings is 12 months.

As for taking an administrative action, the speed will be faster and the procedure more flexible. In the case of enacting or withdrawing an administrative regulation or rule, the usual procedure involves the following stages: the annual legislation plan of the State Council, the allocation of drafting task to the relevant ministry or to the Legislative Affairs Office of the State Council, the preparation of drafts, the scrutinising of the draft by the Legislative Affairs Office, the review and approval by the Standing Meeting of the State Council, and finally, the publication of the regulation or rule before coming into force.[105] This process may be generally completed within eight months. As a result, the normal 'reasonable period of time' for China to take legislative or administrative actions to implement the rulings could be in line with the general WTO practices.

The next issue is how the Chinese government may argue for a longer implementation period on the grounds that there are 'particular circumstances'. The WTO practice suggests that the arbitrators tend to take into account the complexity of the domestic legislative or administrative process, as well as the constraints on speed and flexibility of the implementation systems, but not other facts. Therefore, it is likely that the arbitrators would accept China's arguments for delays caused by the complexity of its rule-making process relating to a particular measure,[106] by the procedures that officials must normally follow even if they are not legally binding (for example, administrative guidelines),[107] or by developing country status,[108] but

104 *PRC Law on Legislation* (中华人民共和国立法法), Ch 2 'The Law', Arts 12–41.

105 *Procedural Rules on Enactment of Administrative Regulations* (行政法规制定程序条例), issued by the State Council, State Council Decree No 321, effective from 1 January 2002, Arts 10–30. Similar procedures apply to the local rules or normative documents, which may be even faster than changing a regulation. For example, the ministry responsible for issuance of a rule or normative document has the power to revise or abolish it.

106 For example, Report of arbitration on *EC – Bananas*, WT/DS27/15, 1998, para 19; Report of arbitration on *EC – Hormones*, WT/DS26/15, WT/DS48/13, 1998, para 47.

107 Report of arbitration on *Canada – patent protection of pharmaceutical products*, WT/DS114/13, 2000, para 41.

108 Report of arbitration on *Indonesia – certain measures affecting the automobile industry*, WT/DS54/15, WT/DS55/14, WT/DS59/13, WT/DS64/12, 1998, para 24.

would reject the arguments for the controversial nature of the measure,[109] the political balancing during the legislation process,[110] or the need for structural adjustment.[111] The final outcome depends on the facts of particular cases.

14.5.3 Monitoring the Implementation

The second phase is monitoring during the implementation period. The winning party has two principal ways to compel China's compliance with the WTO rulings.

14.5.3.1 The Article 21.5 Compliance Review

The first way is the recourse to Article 21.5 of the DSU, which provides the winning party a right to request a 90-day review by a WTO panel for the 'existence or consistency' of the Chinese implementing measure taken during the implementation period with the WTO ruling. In other words, if the winning party takes the view that Chinese implementing measures do not comply with the ruling, it can request this Article 21.5 review even before the expiry of the reasonable period. Further, the purpose of Article 21.5 is to review the steps taken in the direction of compliance by the losing party, including its actions and omissions, so the phrase 'measures taken' needs to be read as 'measures taken or should be taken'.[112] Without this purposive interpretation, a failure to take remedial steps might escape the review because it is unlikely to bring implementing measures into 'existence' to be reviewed.

However, it is possible for the Chinese government to take use of a critical ambiguity in relation to the 'compliance review' arbitration. Suppose the PRC refuses to take any action to implement a WTO ruling during the prescribed period. In this circumstance, could the winning party directly request arbitration before the expiry of this period, or does it have to wait until the expiry of the period?[113] According to the wording of Article 21.5, the winning party does have to wait until the expiry of the reasonable period,

[109] Report of arbitration on *United States – Section 110(5) of the US Copyright Act*, WT/DS160/12, 2001, para 41.

[110] Report of arbitration on *Canada – term of patent protection*, WT/DS170/10, 2001, para 60.

[111] Report of arbitration on *Canada – patent protection of pharmaceutical products*, WT/DS114/13, 2000, para 61.

[112] Report of Appellate Body on *Canada – measures affecting the export of civilian aircraft* – recourse by Brazil to DSU Art 21.5, WT/DS70/AB/RW, 2000, para 36.

[113] This situation occurred in the *EC – Bananas* case, under which the US proposed to have an immediate Art 21.5 review of the EC's new banana regime whereas the EC rejected this request for several months, insisting that such a review could not be undertaken until the EC's reasonable period of implementation had fully expired. See CB Gleason and PD Walther, 'The WTO Dispute Settlement Implementation Procedures: A System in Need of Reform' (2000) 31 *Law and Policy in International Business* 709 at 720–4.

because theoretically it is possible for the PRC government to comply with the WTO rulings on the last day. By this argument, China may earn several months of additional time to delay the implementation, and this additional time could be essential to adjusting domestic industry for competition after the withdrawal of protectionist measures inconsistent with the WTO Agreements.

14.5.3.2 The DSB Surveillance

The second way of implementation is the DSB's on-going surveillance. Article 21.6 provides that 'the DSB shall keep under surveillance the implementation of adopted recommendations and rulings', by keeping the implementation issue listed on the DSB agenda and requiring China to submit a 'status report' in writing on its implementation process. Nevertheless, the current surveillance mechanism does not include detailed requirements on the manner and contents of the status report, and the Chinese government may simply report that 'significant progress' has been made. As a result, the most significant effect of the DSB surveillance would be the reputation concern by the Chinese government to avoid being put under the spotlight for its non-compliance with the WTO rulings, but cannot add any real pressure to push its implementation process.

14.5.4 Compensation and Retaliation

14.5.4.1 The WTO Rules and Practices

In accordance with Article 22.2 of the DSU, if China does not implement the WTO rulings before the expiry of the reasonable period of time, the winning party may seek compensation by entering into consultations with the Chinese government 'with a view to developing mutually acceptable compensation'. If no acceptable compensation has been agreed within 20 days, the winning party may 'request authorization from the DSB to suspend the application to the Member concerned of concessions or other obligations under the covered agreements'[114] which may be granted by the DSB within 30 days of the end of the reasonable period.[115] There is a sequence for choosing the sectors or agreements under which the concession or other obligations will be suspended for the purpose of retaliation by the winning party on China's failure to implement the rulings: the same-sector retaliation, the cross-sector retal-

[114] *Understanding on Rules and Procedures Governing the Settlement of Disputes*, Annex 2 to the *Marrakesh Agreement Establishing the World Trade Organization*, adopted in the final session of the Trade Negotiations Committee at Ministerial level held at Marrakesh, Morocco from 12–15 April 1994 ('DSU'), Art 22.2.

[115] *Ibid*, Art 22.6.

iation and finally, the cross-agreement retaliation.[116] However, the retaliation must be temporary in nature, that is, only be applied until such time as China's inconsistent measure has been withdrawn or a satisfactory solution has been achieved.[117]

The Chinese government may slightly delay the process of retaliation by initiating an Article 22.6 arbitration to 'object to the level of suspension proposed, or claim that the principles and procedures [of suspension under Article 22.3] have not been followed'.[118] The arbitration must be completed within 60 days of the date of expiry of the reasonable period of time. After issuance of the arbitrator's decision, the DSB, upon request, must authorise the retaliation consistent with that final decision.[119]

14.5.4.2 The 'Sequencing Conflict'

Practice shows a literal conflict between Articles 21.5 and 22, which might also be exploited by the Chinese government in order to delay the implementation process. Article 21.5 is a 'compliance review' of the implementing measures, while Article 22 provides the retaliation upon expiry of the implementation period. The question is: should the Article 22 authorisation be conditional on the findings of the Article 21.5 compliance review (namely, only after the Article 21.5 review concludes that the implementing measures are not consistent with the WTO rulings can the winning party request the DSB authorisation), or can the retaliation be initiated automatically once the implementation period expires (namely, regardless of whether there exists the Article 21.5 review, or if such a review is still pending)? There is no clear sequence of these two procedures in the DSU.[120] As a result, the Chinese government may be able to argue from a literal perspective that a finding of non-compliance under the Article 21.5 review must be found before the authorisation of retaliation, otherwise the retaliation would be a kind of unilateral decision by the winning party on China's implementation status without recourse to the DSU.[121]

However, this so-called 'sequencing conflict' cannot be solved unless Members amend the DSU in the Doha round of negotiation. One approach by the parties to dispute is to enter into a bilateral agreement to clarify the sequencing of proceedings under Articles 21.5 and 22, most of which require waiting for the result of the Article 21.5 compliance review before the request

[116] *Ibid*, Art 22.3.
[117] *Ibid*, Art 22.8.
[118] *Ibid*, Art 22.6.
[119] *Ibid*. In practice, however, the period of the Art 22.6 arbitration often exceeds the 60-day period.
[120] For example, in the *EC – Bananas* case, the EC argued for this point, although it finally required an Art 22 arbitration on the level of the US's proposed suspension of concessions.
[121] Art 23 of the DSU expressly prohibits this kind of unilateral decision.

for retaliation.[122] The view taken in the present study is that the winning party should pursue this bilateral approach with the Chinese government for implementing a WTO ruling in China before the DSU provisions are amended in future.

14.5.5 Summary

It is reasonable to presume that China will vigorously defend its trade-related policy or practices in front of the WTO panels.[123] When it is obliged to implement a WTO ruling to withdraw inconsistent measures, there is no reason to conclude why it should give up the above legally delaying tactics, as widely taken by other Members, to gain more time for adjustment and mitigate the immediate impact on domestic industries. Upon full arguments, it is likely that the Chinese government may gain about 12 to 15 months of 'breathing time' to implement a WTO ruling, or even a longer period where the case involves some particular circumstances. In the event of China's failure to implement the WTO rulings upon the expiry of the reasonable period of time, the usual recourse available to the winning party is the offer of compensation by the Chinese government or the authorisation of retaliation from the DSB.

14.6 PROSPECTS

An overall assessment on dispute resolution mechanisms in China casts some doubts on the capacity and effects of enforcing the WTO Agreements in China and indicates that further reforms are needed, either at the level of WTO supervision or at the national level, to enhance China's implementation status. The creation of a more efficient and equitable system to redress any WTO-inconsistent governmental action will in particular contribute to the judicial reform in China and finally, to the progress toward rule of law.[124] Moreover, these efforts may increase the confidence of international society on China's compliance with the accession commitments. This section briefs some suggested solutions in respect of each dispute resolution channel.

[122] For details, see SA Rhodes, 'The Article 21.5/22 Problem: Clarification Through Bilateral Agreements' (2000) 3 *Journal of International Economic Law* 553 at 553–8.

[123] See, for example, Yu Minyou, 'Lun woguo dui shijie maoyi zuzhi zhengyi jiejue jizhi de duice' (China's countermeasures to the WTO dispute settlement mechanism) (1996) 5 *Zhongguo Faxue* (Chinese Legal Science), 1.

[124] For example, Orts concluded that the goal of the rule of law in China required 'the development of a judicial system that is relatively autonomous of the executive and legislative powers of government'. See EW Orts, 'The Rule of Law in China' (2001) 34 *Vanderbilt Journal of Transnational Law* 43 at 99.

14.6.1 Administrative Review

It is disappointing to find out that the MOC Review Measures fail to enhance the impartiality of the administrative review procedures in respect of MOC's specific administrative acts. First, these Measures are silent on a challenge system that allows the affected private parties to apply for withdrawing officials hearing the case who might not act in an unbiased manner. Second, they lack a full set of evidential rules without taking into consideration the characters of foreign trade regulation. Third and most importantly, they provide the review of written submissions as the basic model of review, without granting a general hearing right to the applicant. Without a hearing procedure, the reviewing process cannot convince the applicant as being transparent and impartial, other than as a 'black box' exercise.[125] From the point of future improvement, the MOC Review Measures must be made consistent with the ALL or the relevant Supreme Court's opinions to avoid any inconsistency between the administrative review procedure and the administrative litigation procedure in trade-related areas.

Moreover, the MOC Review Measures do not prescribe a fixed timeline for implementing the reviewing organ's decisions. It is submitted that MOC needs to enact another ministerial rule to require a period to rectify a specific act or to carry out a new act from the receipt of the reviewing organ's decision. This can ensure the promptness and effectiveness of the administrative review procedure.

In the long run, the reviewing organs could be turned into a more independent body, with a status similar to the ombudsman system in some countries, to increase the impartiality, independence and authority of review. The members of the reviewing body may be chosen either from experienced officials or from external experts, who will be entitled to make their own decisions without the intervention from other officials of MOC.[126]

14.6.2 Administrative Litigation

China's current administrative litigation mechanism may be incapable of convincing affected private parties of its independence, impartiality and promptness in solving trade-related disputes with the government. It is

[125] It is reported that some local governments have already adopted an administrative review procedure with a more adversarial nature and more procedural similarities to the litigation procedure. See Yao Fan, 'Putian: Xingzheng fuyi buzai zhishang tanbin' (Administrative reviews with real teeth in the Putian City), Legal Daily (26 May 2004) 8 'Government and Law'.

[126] Accountability to the legislature would be the most independent of these reviewing organs, but would not be a realistic option due to the existing structure. Generally, if the organ has a high enough level and is not subject to a particular official or a local level of authorities, the degree of independence may be generally acceptable in practice.

estimated that there may emerge a flood of administrative litigations in the context of regulatory reform and WTO implementation, especially after the *PRC Administrative Licencing Law* (2003) came into effect.[127] Thus, the long-term solution is undoubtedly a significant increase in judicial independence even though this would probably be a difficult task. China's existing constitutional and political structures restrain any radical change of judicial system, and a short-term solution to immediately address the concerns after the WTO accession, by adapting existing institutions and resources, would be a more desirable policy choice. The question is: how might the Chinese judiciary through institutional reform enhance impartiality in the adjudication of trade-related administrative litigation and increase the confidence of international society in this respect.

It is suggested that the way forward is to set up an International Trade Courts system as part of the Chinese judiciary. These courts need not be set up at each level of people's court; indeed, to set them up at a relatively high level could enhance their authority. Initially, an International Trade Court of Appeal in the Supreme Court and several International Trade Courts of First Instance as circuit courts at the level of the provincial High Court[128] might be set up. The judges and court staff can be selected from the existing Administrative Litigation Tribunals of the Supreme Court and the relevant provincial High Courts. By taking use of existing resources, the institutional arrangement may be put in place as quickly as possible. But an important condition is that the funding of these courts must not rely on the local government and their budget must be allocated separately by the Central Government on an annual basis. Considering the limited number of such courts, this fiscal independence would not be an unbearable burden on the budget plan. In the long run, it is ideal that the budget will be decided by the NPC, and the Central Government only has the obligation to allocate the funding.

The jurisdiction of International Trade Courts will be wide enough to cover all disputes between private parties (including domestic and foreign parties) and Chinese trade regulators at every governmental level in relation to trade regulation. Potential trade regulators whose specific administrative acts are subject to review may include MOC (in relation to general trade regulation as the primary regulator), the General Office of Customs (in relation to custom matters), AQSIQ (in relation to health and safety inspection), NDRC (in relation to quota for certain goods) and so on. The scope of specific administrative acts is dependent on the provisions of applicable laws.

More importantly, the proposed International Trade Courts could act as a

[127] Qin Ping, 'Fayuan wei xingzheng susong xin gaofeng zhuohao zhunbei le ma?' (Have Chinese courts prepared well for the new flood of administrative litigations?), Legal Daily (22 July 2004) 8 'Voices and Perspectives'.

[128] For example, at least for five regions: Southern China (including Guangdong), South-East China (including Shanghai), Northern China (except for Beijing), Beijing (where the State Council situates), Western China (including the South-western and the North-western regions). The number of judges and staff may differ to reflect the degree of busyness.

platform for implementing China's accession commitments on judicial review, and provide a framework to reform other existing deficiencies.[129] This kind of reform, which is, in essence, a breakthrough of existing laws, may take the form of procedural rules, guidance notes or judicial interpretations issued by these courts within their own jurisdictions. The first area of reform is the scope of reviewable administrative acts. As discussed above, I take the view that this scope should be expanded to cover normative documents of the administration. In relation to trade regulation, it is therefore submitted that the proposed International Trade Courts must be able to review the normative documents issued by various trade regulators, and declare such documents to be illegal or unreasonable. The second area is the increase of independence of individual judges in charge of the case, by avoiding the practices of the final decision by the Adjudicative Committee and reporting to higher courts before judgment. The increase of professional expertise and ethics of judges hearing international trade dispute cases will also be fundamental to improve the quality of judgment and then the public confidence on this new institution. Moreover, a fixed and strictly followed timetable for adjudicating the disputes and enforcing the final judgments is key to guarantee the promptness and effectiveness of the trade-related administrative litigation.

In summary, the establishment of International Trade Courts in China will be a pragmatic proposal. If accepted by the Chinese authorities, it would be a good sign of China's resolution to implement the WTO Agreements. The experiences from this pilot test could serve as a stepping-stone for a general reform of the administrative litigation mechanism and, ultimately, increase the rule of law in China.

14.6.3 Implementation of the WTO Rulings

14.6.3.1 Measures Available to the DSB and the Winning Party

There exist different predictions on China's prospects for implementing the WTO rulings. One popular view is that 'as a developing country, China is more likely to choose to comply with the dispute settlement rulings because not doing so will inflict damage to its economic interests through compensation or retaliation'.[130] For example, one scholar holds the optimistic view for 'the prospect of China's compliance with its commitments and its willingness

[129] This approach also corresponds to China's prevailing route of reform, that is, an evolutionary approach in the form of a pilot test before the implementation in a national-wide range.

[130] See, for example, Julia Cheng, 'China's Copyright System: Rising to the Spirit of TRIPs Requires an Internal Focus and WTO Membership' (1998) 21 *Fordham International Law Journal* 97 at 2012.

and ability to modify its rules if it loses a WTO dispute settlement proceeding.'[131] Another popular view doubts the capacity of the PRC government to implement the rulings, due to the difficulty in identifying an accountable governmental body, the possible lack of political will, time limitation, and local intransigence.[132]

I take an optimistic view with caution. The speed of implementing the WTO Agreements immediately before or after the accession and the general willingness shown by the PRC government to comply with the WTO rules illustrate the positive aspects. The quick resolution of two cases – the *US-China Semiconductor Tax Dispute* and the abortive *EU-China Smoke Coking Coal Dispute* – after the WTO accession serves as a good example. However, it is argued that the retaliation by the winning party would not be an optimal weapon in the context of China. The usual retaliation by the winning party takes the form of withdrawal of concessions to certain products exported from the losing party. One rationale is that the specific industries so affected may impose political pressures on the government and lobby for the full implementation of WTO rulings.[133] But this 'conduit function' could only be effective in a 'liberal' state (that is, generally, states with some form of representative democracy, protection of civil and political rights and a certain degree of openness),[134] and may not operate in China's case due to the absence of institutions to officially channel the pressure from domestic interest groups to the policy formulation of government. On the other hand, the retaliation from other Members might cause more domestic pressure and encourage the PRC government to deviate from other WTO rules as a 'trade-off', or even mislead the general public's perception on the fairness of the WTO system.[135]

There are two measures available to the DSB and the winning party to increase the implementation prospects in China. The first measure is to require the DSB to take a more flexible, proactive approach to dealing with the China's case so as to

> develop a common strategy that both anticipates the international consequences of China's admission while also giving China's reformers the ability to continue domestic reforms and gradually ensure compliance with WTO norms.[136]

For example, the DSB should give clearer and more detailed descriptions of

[131] DC Clarke, 'China's Legal System and the WTO: Prospects for Compliance' (2003) *Washington University Global Studies Law Review* 105–7.
[132] See, for example, C Duncan, above n 88 at 475–87.
[133] N van den Broek, above n 91 at 156.
[134] N van den Broek, above n 91 at 136.
[135] For example, Chinese officials have warned that if large WTO members (such as US and EU) do not act in line with the WTO rulings, the Chinese government will be unable to generate enough domestic support to comply either. See Gleason and Walther, above n 113 at 729.
[136] D Blumental, above n 90 at 204.

the results that the WTO rulings require the PRC government to achieve. For example, instead of using the usual, general recommendation that China should 'bring the measure challenged into compliance with [Chinese] obligations under [the specific WTO agreement]', the rulings may be specific to require the immediate withdrawal of restrictions imposed by that measure. This approach will not only highlight the actions to be taken by the PRC Government but also enable the easy supervision of implementation.

The second measure is the increasing degree of DSB surveillance. The concern for international reputation may play a bigger role in pushing the PRC government to comply with the WTO rulings. A more detailed requirement on the contents of the progress report, the continuing pressure from the DSB in general and the winning party in particular in the DSB meetings, and the demand for transparency in the implementation process can attribute to the prospects for full compliance with the rulings by China within the implementation period.

In summary, the retaliation by the winning party must be used with great caution and as a last resort. More specific DSB recommendations, combined with a higher degree of surveillance and public censure in international society, may be more helpful to achieve the target.

14.6.3.2 Direct Effect of the WTO Rulings?

Is it possible to argue for a direct effect of WTO rulings in the Chinese legal system, that is, such rulings will become enforceable and binding as part of Chinese law if not properly implemented within the reasonable period?

The WTO Agreements do not require the Members to give a direct effect of rulings, nor do the panels support an argument in favour of direct effect.[137] Instead, the issue of direct effect is left to each Member to decide under its domestic legal system. So far as practice shows, all major Members reject to admit this effect of WTO rulings for reasons similar to those for denying direct effect of the WTO Agreements, the core reason being that the rulings are not binding in nature and a losing party may choose compensation instead of compliance with the recommendations of the rulings.[138] Although there are some academic arguments supporting the direct effect of WTO rulings on Members,[139] there are no prospects for a change of tide in the near future.

The present study suggests a theory of 'limited direct effect' of WTO rul-

[137] See, for example, Report of the Appellate Body on *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, reports by the Appellate Body of 4 October 1996.

[138] See, for example, G A Zonnekeyn, 'The Status of Adopted Panel and Appellate Body Reports in the European Court of Justice and the European Court of First Instance: The Banana Experience' (2000) 34 *Journal of World Trade* 93 at 94–102; N McNelis, 'What Obligations Are Created by World Trade Organization Dispute Settlement Reports?' (2003) 37:3 *Journal of World Trade* 647 at 652–8.

[139] See, for example, JH Jackson, 'The WTO Dispute Settlement Understanding – Misunderstandings on the Nature of Legal Obligation', in Cameron & Campbell (ed), *Dispute Resolution in the WTO* (London, Cameron & May, 1998) 73.

ings in China. The denial of granting a full direct effect to the WTO rulings is based on two reasons. First, as discussed above, the nature of WTO rulings is still unclear as the current text of the DSU negates its binding effect to some extent. Second, a full recognition of direct effect would be at odds with existing Chinese constitutional and legal structures. The PRC Constitution does not grant the power of reviewing a law, regulation or rule to the judicial system, and the function of judicial review is only limited to specific administrative acts. Under these structures, the recognition of direct effect of WTO rulings means a fundamental shift of constitutional powers to the courts, which may be put in an awkward position. On the one hand, a court has to apply a law unless it is changed by the legislature; on the other hand, it has to enforce a WTO ruling conflicting with existing Chinese law when a private party invokes that ruling in a case against the government. As a result, the courts are given a 'mission impossible' unless the Constitution has been amended accordingly.

However, from the perspective of implementation, it is desirable to recognise the direct effect of WTO rulings in relation to specific administrative acts. Only a limited scope of rulings deal with specific administrative acts, the majority of which are relevant to anti-dumping, anti-subsidies and safeguarding measures. In these cases, the WTO rulings may recommend the withdrawal of the determination by Chinese trade regulators in specific cases. Given the failure of the regulators to withdraw this determination, the affected parties may launch a judicial review in a Chinese court to enforce these rulings. Under this circumstance, the courts must recognise the direct effect of the relevant WTO rulings and declare the determinations challenged as illegal and unenforceable. This approach conforms to the general rule in China's administrative litigation rules for specific administrative acts.

Based on the above analysis, it is submitted that the general rule for the effect of WTO rulings in China is to deny their direct effect, except for those rulings dealing with specific administrative acts by the Chinese government.

14.6.4 Potential Disputes

It is likely that China will have more trade disputes with other WTO Members in the near future. The bigger the international market share that Chinese exports has, the greater the chance of engaging in trade disputes. Currently, the area where potential trade disputes are most likely to occur is in the export of textile products by Chinese companies.

During 2005, China entered into negotiations with the EU and the US in relation to the export of textile products. Both the EU and the US have initiated special safeguard mechanisms against the rapid growth of the export of textile products from China and have imposed high tariffs on such products. At the same time, the MOC has faced tremendous pressure from Chinese

textile exporters to resolve these potential trade disputes with the EU and the US – or has been obliged to take them to the WTO dispute panels.

In this context, China has reached two important bilateral agreements respectively with the EU and the US, which set out a way of dealing with existing Chinese textile imports which fail to clear EU customs and with the growth of Chinese textile imports in the next few years: the *Memorandum of Understanding Between the European Commission and the Ministry of Commerce of the People's Republic of China on the Export of Certain Chinese Textile and Clothing Products to the European Union* (signed on 11 June 2005, referred to as 'China-EU MOU') and *the Memorandum of Understanding Between the Governments of the United States of America and the People's Republic of China Concerning Trade in Textile and Apparel Products* (signed on 8 November 2005, referred to as 'China-US MOU').

Under the China-EU MOU, China commits to control the growth rates of the export of 10 categories of textile and clothing products between 8 per cent and 12.5 per cent per annum, up to the end of 2007. Further, a 'double checking' system was introduced, according to which EU authorities would issue import licences upon presentation of a corresponding export authorisation issued by the MOC (and upon verification of the existence of the necessary quantities). This system was put into operation on 20 July 2005. The EU undertakes to terminate the special safeguard measures against such 10 categories of textile and clothing products. The China-US MOU (for a term from 1 January 2006 to 31 December 2008) is similar to the China-EU MOU, but expands the scope to 34 categories of textile and clothing products. The annual quota growth rates are 10–15 per cent for 2006, 12.5–16 per cent for 2007 and 15–17 per cent for 2008. In addition, the China-US MOU includes a flexibility mechanism that will enable the Chinese government to increase a quota limit during a particular quota year by 'carrying over' the previous year's unused quota (no more than 2 per cent of the base level of the previous year) or 'carrying forward' the next year's quota (no more than 3 per cent of the base level of the succeeding year). These MOUs could effectively avoid trade disputes between China and the EU or the US in respect of the export of Chinese textile products to these markets (in particular, the relevant special safeguard measures brought in by the EU or US), and create a sound trade environment to Chinese textile exporters.

In order to implement the China-EU MOU, the MOC issued the *Interim Administrative Measures on the Export of Textile Products (Trial)* on 19 June 2005 (with effect from 20 July 2005). This rule was replaced by the *Interim Administrative Measures on the Export of Textile Products* issued by MOC on 22 September 2005 (with effect from the same day).[140] These Measures set out an interim export licencing requirement in respect of those categories of

[140] *Interim Administrative Measures on the Export of Textile Products* (纺织品出口临时管理办法), issued by MOC with effect from 22 September 2005, MOC Decree [2005] No. 20.

textile products which are covered by the China-EU MOU, China-US MOU and other similar bilateral agreements, and prevail over normal rules applicable to the export quota of textile products (see Section 4.6.2 of Chapter 4). The MOC will be the competent authority to maintain a catalogue for the restricted categories of textile products and issue export licences for such products.[141] A proportion of the licences will be allocated to bidders, and the balance will be allocated to those companies with an export performance record in the previous year.[142] Notably, the export licences can be transferred to an entity with foreign trading rights.[143] The valid term of an export licence will be six months, subject to an extension up to three months.[144] These Measures also require the MOC to issue the export licences within three working days from receipt of all valid application documents.[145] By way of imposing the export licencing requirement, it is expected that the growth rate of the export of Chinese textile products (either falling within other WTO Members' restrictions or vulnerable to special safeguard measures brought by other WTO Members) can be effectively controlled, leading to the reduction of the risk of potential trade disputes between China and other WTO Members in this area.

[141] *Ibid*, Art 2.
[142] *Ibid*, Arts 9 and 10 (which sets out the details of weightings of different types of company for the purpose of calculating the export performance record).
[143] *Ibid*, Art 14.
[144] *Ibid*, Art 15.
[145] *Ibid*, Art 20.

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