Abstract

The China miracle? The China threat? China is at the core of every economic conversation and more than ever before perceived as THE strategically important market. Well aware of the increasing competitiveness of the Chinese market, European firms are very sensitive to the complexity and opacity of China’s regulatory landscape. Ten years after Beijing’s accession to the World Trade Organisation (WTO), this raises a number of crucial issues about EU companies market access capacities and, in the long run, the attractiveness of a Chinese market that is perceived as both strategic and difficult to penetrate.

This study provides an independent and concise overview of the major risks and opportunities in EU-China trade and investment relations. It draws upon a number of economic and legal assessments largely related to China’s WTO commitments and its performance in implementation.
This study was requested by the European Parliament's Committee on International Trade.

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1. EXECUTIVE SUMMARY

The China miracle? The China threat? China is at the core of every economic conversation and more than ever before perceived as THE strategically important market. 78% of businesses surveyed in a very recent EU Chamber of Commerce study report an increase in revenue over last year, whilst 71% report an increase in net profit. But concerns over an unfair level playing field in trade with China have recently intensified amongst western businesses and EU companies in particular. Well aware of the increasing competitiveness of the Chinese market, European firms are very sensitive to the complexity and opacity of China’s regulatory landscape. Ten years after Beijing’s accession to the World Trade Organisation (WTO), this raises a number of crucial issues about EU companies market access capacities and, in the long run, the attractiveness of a Chinese market that is perceived as both strategic and difficult to penetrate.

EU policy makers are well aware of this complex situation and the need to better balance the EU-China trade and economic relations for a sustainable economic growth and strategic partnership. But beyond official discourses and apparent activism, EU policies still suffer from a lack of coordination and clarity due to insufficient political unity and will. More than thirty five years after the establishment of diplomatic relations between the People’s Republic of China (PRC) and Europe, it is time for the EU to rethink its strategy to better face the economic challenges and opportunities offered by the unprecedented shift in relative economic power that China’s rise represents.

This study provides an independent and concise overview of the major risks and opportunities in EU-China trade and investment relations. It draws upon a number of economic and legal assessments largely related to China’s WTO commitments and its performance in implementation.

1.1 35 Years of Trade and Economic Relations

From the low point of 1989, Sino-European relations have improved significantly. They have blossomed since 1995, when most of the sanctions imposed by the EU after the Tiananmen Massacres of 1989 were lifted, and the political and economic relations became broader and deeper. At that time, there was quite a positive view from both sides of the relationship, with a belief that the few points of significant tension in EU – Chinese relations were vastly outnumbered by the positive aspects of cooperation. As the relationship progressed however, concern has grown in Europe about the economic consequences of China’s rise and China’s internal political situation. In 2006, the Commission published a Communication on China, as well as a related policy paper on trade and investment, which made explicit a number of these concerns. This sharpened the European political message towards China, and reflected a sobriety that has replaced the earlier exuberance about China in Brussels. Nonetheless, the efforts to promote greater economic cooperation continued, leading to the establishment of the EU-China High Level Economic and Trade Dialogue.

The financial crisis, and the subsequent European sovereign debt crisis, has resulted in the accentuation of a number of existing tensions. On the one hand, an increasingly assertive China has been less eager to accept compromise in international trade negotiations, while on the other, calls for more protectionism have arisen in EU sectors and regions facing low cost Chinese imports. The Chinese restrictions on market access and poor intellectual property protection are considered by European enterprises as important barriers to further expansion in China. Furthermore, there have been concerns about and opposition to Chinese investment in certain European enterprises, the Chinese takeover of Volvo being a case in point that raised fears about job losses in plants in Sweden and Belgium.
Politically, perhaps the most important post-crisis event may have been the Chinese role in the European sovereign debt crisis. In order to provide financial support for the ailing Greek economy in 2010, China invested hundreds of millions in port facilities and other infrastructure programmes. It also stated that it would support the governments of Portugal and Spain and not reduce its holdings of European bonds. These Chinese efforts were met by grudging acceptance rather than a warm welcome, largely due to the EU’s views on China’s crackdown on democracy activists.

These tensions have resulted in the European Commission taking an increasingly strong stance on China’s economic policy, even though political relations between the EU and China remain cordial and communication channels open. The negotiations on a deeper Partnership and Cooperation Agreement are continuing, and there seems to be a commitment from both sides in maintain and strengthen bonds, judging by the results of the annual EU-China summits, as well as the statements of Council President Van Rompuy on his visits to China in 2011. The Sino-European relationship could be considered as having entered a new stage, in which rosy rhetoric and vague promises must give way to efforts to achieve concrete commitments, mechanisms and outcomes.

1.2 The Trade Deficit or Trees Hiding the Wood

Three decades ago, when the Chinese leadership launched the “reform and opening up policy”, the EU and China had almost no trading relations. After a slow start at the beginning of the 1990’s, trade relations increased at a very rapid pace from 2002-2003 on. During the last decade trade in goods between the EU and China increased 400%, from €101 billion (bn) in 2000 to €395 bn in 2010. EU exports to China reached €113 bn in 2010 compared with €26 bn ten years earlier. Imports from China were close to €282 bn in 2010, up from €75 bn in 2000. Since 2007, China has become the EU second biggest trading partner (13,9% of total extra EU 27 trade in 2010) and its biggest source of imports (18,9% of total extra EU 27 imports in 2010). In 2006, the EU became China’s biggest trade partner, with 17% of China’s total trade, well ahead of Japan (10%) and US (13%).

Despite this “great leap forward” in bilateral trade, the EU has been running a structural deficit with China in trade in goods since 1997. The trade deficit in goods is 26 times bigger than the trade surplus in services. This trade deficit is concentrated in manufactured goods with a total of €193 bn in favour of China. In 2010, manufactured goods represented 94,6% of the EU total imports from China and 31,5% of the EU total imports (see table 2).

Amongst the EU 27 member States, Germany is by far the biggest contributor to bilateral trade between the EU and China. Germany alone accounted for 43% of EU exports to China in 2008 (with €34 bn) and 21% of total imports from China (€51 bn). If one adds France, Italy and United Kingdom, the combined exports of these four countries represent 70% of EU exports to China in 2008. No EU member state registers a trade surplus with China, but this is in part due to the re-exportation to the EU of goods produced by EU firms or their subsidiaries in China.

The investment situation shows a completely different picture. Indeed, the EU is well ahead of China. EU member state companies began significant investment in China in the early 1990s. The flow of investment has accelerated since the late 1990s (see graph 2), though the share of the EU in total foreign investment (FDI) in China has decreased over the last decade. In 2009, EU FDI (including reinvested earnings of firms controlled by European companies) in China amounted to € 5.9 bn and the total stock of EU FDI to €58.3 bn.
1.3 China’s WTO Commitments Implementation: Contrasted Records

China’s accession to the World Trade Organization (WTO) highlighted the ability of the People’s Republic of China (PRC) to internationalize by incorporating the norms and practices of multilateral trade. Such institutional importation is not new: Chinese law opened up to foreign influences in the late 19th century, turning first to the Roman-Germanic model, then to the socialist paradigm and finally to the modern West, incorporating various international norms and practices in successive waves. China’s involvement in the global harmonization of legal norms accelerated over the twenty years to December 11, 2001, when after fifteen years of particularly difficult negotiations, China became the WTO’s 143rd member.

The complexity and exceptional character of China’s accession and participation in the WTO deserve particular attention. China’s Protocol of Accession is unique in incorporating a number of WTO-plus commitments as well as WTO-minus rights. Like all other new Members to the WTO, China has undertaken a series of traditional WTO obligations on market access and rules. These go beyond other accessions in the extent of market access commitments, but China also has some special WTO-minus rights that are now very much criticized by China’s official or trade experts. China’s Accession Protocol allows importing WTO Members to take protective measures against Chinese exports that go beyond WTO general disciplines and China is not allowed to seek Special and Differential Treatment (SDT) as other developing country members have.

The dissatisfaction concerning China’s application of the Protocol of Accession must therefore be seen in conjunction with the unique character of China’s commitments and the specificity of its current economic and political regime. Moreover, the incoherence of some of the obligations contained in China’s Protocol, not to mention the absence of any justification for the imposition of rules that derogate from the general principle of non-discrimination, is itself questionable. It is likely that a more assertive China will defend itself against measures it perceives as unfair through a more pro-active use of WTO dispute settlement.

This study’s section on trade barriers provides a detailed account of the numerous problems encountered in the application of China’s Protocol, but a number of problematic areas justify highlighting, such as:

- the general regulatory arbitrariness and opacity
- intellectual property right protection
- industrial policy
- trading rights and distribution services and
- agriculture

1.4 Impaired Market Access

The section on trade barriers provides an overview of the most important barriers to market access for EU exporters in the Chinese market, despite the significant progress Beijing has made in reforming China’s trade policies since it joined the WTO in 2001. It draws upon the most recent reviews of China’s trade policies conducted by the WTO, both under China’s Transitional Review Mechanism (TRM) and the Trade Policy Review Mechanism (TPRM), as well as those undertaken by the United States (through the Congressional Executive Commission on China). Although the EU, unlike the US, has not created a specific task force to monitor China’s compliance with WTO commitments, it makes active use of the WTO review mechanisms as well as bilateral channels. The EU Chamber of Commerce in China also
monitors trade barriers. These sources as well as interviews with stakeholders have been used to identify the main areas of concern for the EU with regard to China’s trade policy.

The Chapter divides the relevant trade barriers into distinct categories and describes the most prevalent Chinese measures under each. It will then give a preliminary indication of possible WTO inconsistencies in the measures discussed.

1.5 Technology Transfers and Industrial Policy: a Major Concern

The Chinese regulatory reform has resulted in foreign firms (foremost among them European firms with strong technology skills) scrambling to take a controlling stake in joint ventures (JVs), or develop wholly owned operations. In the automotive industry and telecommunications sector - despite China’s accession to the WTO -, Chinese partner(s) in JVs must control at least 51%. Interviews with foreign investors suggest that in the event of liberalization of this regulatory environment, all major European firms involved in these sectors would take a majority share and thus control of the JV.

Another constraint on European company involvement in FDI and JVs is the poor protection of intellectual property rights, which limits both the transfer of technology and the willingness to upscale technology in the JV. This could explain why EU FDI in China has not maintained its earlier momentum of the early 2000s. Given the importance of high technology firms in the EU FDI, a significant positive move by China on the issue of joint ventures and intellectual property right protection would certainly have positive effects for EU FDI in China.

In 2009, during the last transitional review mechanism exercise, the representative of the European Communities expressed a number of concerns relating to China’s investment regime. Among them, the following issues are of particular importance:

- the need for China to abandon its local content requirements, especially at the sub-central government level;
- special concerns regarding China’s industrial policy in steel, a sector where foreign ownership is still limited;
- contractual incoherence and incomplete application of China’s WTO Protocol with regards to the approval of foreign investment by national an local authorities – with such approval conditional on local content or other performance requirements such as technology transfer;
- limitations on the Joint Venture ownerships;

These concerns have been underlined in many EU reports including the recent Business Confidence Survey of the European Chamber of Commerce in China and reports made by EU firms to Business Europe, with heavy industry, such as steel especially concerned and textiles and automobiles to a lesser extent.

1.6 Unity, Transparency and the Rule of Law: the Need for Long Awaited Political Reforms

Investors continue to complain about a lack of transparency and uniformity in the drafting and application of the investment regime. They also denounce weak IPR protection, high levels of corruption and an unreliable legal system that fails to enforce contractual obligations. All these rule of law related barriers originate in the Chinese legal and political system itself. While China’s membership of the WTO has played a very impressive role in the reform of the Chinese system, it is illusory to expect rapid change given the profound transformation required. Investors are likely to face these types of
barriers for years to come unless the EU finds new entry points in negotiations and maintains a firm and united stand.

1.7 Grasping the China Opportunity: EU States at the Core of a New Strategic Partnership

EU companies are well equipped to overcome the current China challenges, but they need to be better supported by an EU policy geared to the specificities of the Chinese case. This policy should concentrate on the following targets:

– Overcoming Fragmentation

There are currently too many institutions involved in the EU-China relations. This leads to inefficiencies. A better structure for the institutional organisation would help the EU achieve its political and economic aims.

– Visibility

EU policies and measures suffer from a lack of visibility, compared for example to the US measures. This is due to a fragmentation of effort and an apparent absence of political unity in EU – China relations. One concrete reform that would enhance the EU’s visibility would be to pull together the already available information and publish a yearly assessment report on China’s compliance to the WTO based on the USTR model.

– Reaching an operational consensus

The EU needs a more united front. The apparent lack of unity in relations with China impedes the development of a coherent EU economic strategy. The EU Commission, in contrast to the United States Trade Representative for example, does not always represent a single EU voice.

– Re-evaluating the role of the state

Finally, there should be a re-evaluation of the role of the state in trade and investment. China - and India - very much relies on the state in its economic and industrial policies and has as a result made gains in developing country markets. While the perspective of a uniform European industrial policy is unlikely, the EU still needs to reconsider the place it gives to the state in its policies.

2 INTRODUCTORY ISSUES AND GENERAL OVERVIEW

2.1 Introduction

The China miracle? The China threat? China is at the core of every economic conversation and more than ever is perceived as THE strategic market. 78% of businesses surveyed in a very recent EU Chamber of Commerce in China study report an increase in revenue over last year and 71% report an increase in net profit. But concerns over an unfair level playing field have recently intensified amongst western

1 See the excellent informative survey of the European Chamber of Commerce in China, Europe Business in China, Business Confidence Survey 2011, available at: http://www.europeanchamber.com.cn/view/media/publications. This study is based on a panel of EU representative companies surveyed in 2011. Of companies surveyed, 35% operate in the industrial goods and service sectors, 27% in the consumer goods and services sectors and 33% in the professional services sector. 18% of the respondents in the industrial goods and services sector stated that more than 25% of their global revenue stems from China business (41% in the professional services sector!) and 37% of the respondents in the industrial goods and services sector that their profit increased by more than 20% from 2009.
businesses and EU companies in particular\(^2\). Well aware of the increasing competitiveness of Chinese exporters, European firms insist on action against distorted exchange rates and measures to mitigate the complexity and opacity of China’s regulatory landscape. Ten years after Beijing’s accession to the World Trade Organisation (WTO), this raises a number of crucial issues about EU companies market access capacities and, in the long run, the attractiveness of a Chinese market perceived as both strategic and difficult to penetrate.

EU leaders are well aware of this complex situation and the need for a better balance in EU-China trade and economic relations in the cause of sustainable economic growth and the strategic partnership. Indeed, in a very recent speech he made during a visit to the China-Europe International Business School (CEIBS) in Shanghai, Herman Van Rompuy, the President of the European Council, stressed the need to further improve “China’s economic openness\(^3\)” in market access, investment, public procurement, the rule of Law and effective enforcement of intellectual property rights\(^3\).

Beyond official dialogues and apparent activism, EU policies still suffer from a lack of coordination and clarity originating in insufficient political unity and will. More than 35 years after the establishment of diplomatic relations between the People’s Republic of China (PRC) and Europe, it is time for the EU to rethink its strategy to better face the economic challenges and opportunities offered by an unprecedented shift in relative economic power that China’s growth represents.

This study provides an independent overview of the major risks and opportunities in the EU-China trade and investment relations. It draws upon a number of economic and legal findings largely related to China’s implementation of its WTO commitments.

Organised in 5 chapters, the study places particular emphasis on the numerous barriers that are impeding the development of balanced EU-China trade and economic relations. Its conclusions take the form of targeted policy recommendations. There is an executive summary in English and French. Lastly, a number of important contextual and legal documents are made available in the annexes.

### 2.2 Evolution of EU – China Trade and Investment during the Last Decade

#### 2.2.1 Trade

Three decades ago, when the Chinese leadership launched the “reform and opening up policy”, the EU and China had almost no trading relations. After a slow start at the beginning of the 1990’s, trade relations increased very rapidly from 2002-2003 on. During the last decade trade in goods between the EU and China increased 400%, from €101 billion (bn) in 2000 to €395 bn in 2010. EU exports to China reached €113 bn in 2010 compared with €26 bn ten years before. Imports from China were close to €282 bn in 2010, up from €75 bn in 2000. Since 2007, China has become the EU’s second biggest trading partner (13.9% of total extra EU 27 trade in 2010\(^4\)) and its biggest source of imports (18.9% of total extra EU 27 imports in 2010\(^5\)). In 2006, the EU became China’s biggest trade partner, with 17% of China’s total trade, well ahead of Japan (10%) and US (13%).

\(^2\) Cf. Interviews conducted in Brussels with numerous stakeholders and Business Europe in particular. A Business Europe report on China will be released in July 2011.


\(^4\) 14.5% for the US.

\(^5\) China. EU Bilateral Trade and Trade with the World, EU-DG Trade Statistics, 17.03.2011
In the services sector, the EU benefits from a trade surplus with China of €5.3 bn in 2009, with €18.6 bn of exports and €13.2 bn of imports. This EU surplus in services is mainly concentrated in royalties & license fees (€1.6 bn in 2008) and other business services (€3.6 bn in 2008), which include trade-related services, operational leasing services and miscellaneous business, as well as professional and technical services.

Despite this “great leap forward” in bilateral trade, the EU has been running a structural deficit with China in trade in goods since 1997 (see table and graph 1). The trade deficit in goods is 26 times bigger than the trade surplus in services. The deficit is concentrated in manufactured goods with a total of €193 bn in favour of China. In 2010, manufactured goods represented 94.6% of the EU total imports from China but 31.5% of the EU total imports (table n°2). Trade is more or less balanced for other goods: €347 million deficit in 2010 in agricultural products, €4.8 bn of surplus in fuels and mining products, and €28 millions of surplus in chemicals. In manufactured goods the deficit is concentrated in machinery & transport equipment (€ - 75bn in 2010), textile & clothing (€ - 34.5 bn), and other products (- €62.8 bn). In 2010, machinery and transport equipment imported from China (€144 bn) represented 51.3% of the EU total imports from China and 32.8% of the EU total imports (€441 bn). Within this category of products, office & telecom equipment imported from China represent, by far, the biggest factor in the structural deficit. The EU imported €94 bn of office & telecom equipment from China in 2010 (or 33.6% of all imports from China). Imports of other machinery also contribute significantly the EU trade deficit with China, with €37 bn of imports in 2010 (or 13.2% of all imports from China).
Among the EU 27 member States, Germany is by far the biggest contributor to bilateral trade between the EU and China. Germany alone accounted for 43% of EU exports to China in 2008 (with €34 bn) and 21% of total imports from China (€51 bn). If one adds France, Italy and United Kingdom, the combined exports of these four member states accounted for 70% of total EU exports to China in 2008.
Table 2: EU (27) Exports to China

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<th>2006</th>
<th>2008</th>
<th>2010</th>
<th>Share Total EU Imports (%)</th>
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<td>Millions €</td>
<td>%</td>
<td>Millions €</td>
<td>%</td>
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Table 3: EU (27) Imports from China

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<td><strong>Primary Products</strong></td>
<td>7 578,2</td>
<td>3,9</td>
<td>9 546,5</td>
<td>3,9</td>
</tr>
<tr>
<td><strong>Agricultural Products</strong></td>
<td>4 455,7</td>
<td>2,3</td>
<td>5 394,8</td>
<td>2,2</td>
</tr>
<tr>
<td><strong>Fuels &amp; mining products</strong></td>
<td>3 122,5</td>
<td>1,6</td>
<td>4 151,6</td>
<td>1,7</td>
</tr>
<tr>
<td><strong>Manufactures</strong></td>
<td>186 729,0</td>
<td>95,8</td>
<td>236 214,7</td>
<td>95,3</td>
</tr>
<tr>
<td><strong>Iron &amp; Steel</strong></td>
<td>4 003,1</td>
<td>2,1</td>
<td>7 557,0</td>
<td>3</td>
</tr>
<tr>
<td><strong>Chemicals</strong></td>
<td>6 266,8</td>
<td>3,2</td>
<td>9 066,5</td>
<td>3,7</td>
</tr>
<tr>
<td><strong>Other semi-manufactures</strong></td>
<td>15 579,3</td>
<td>8</td>
<td>21 169,9</td>
<td>8,5</td>
</tr>
<tr>
<td><strong>Machinery &amp; Transport Equipment</strong></td>
<td>93 783,3</td>
<td>48,1</td>
<td>114 706,7</td>
<td>46,3</td>
</tr>
<tr>
<td><strong>Office &amp; telecommunication equipment</strong></td>
<td>64 093,1</td>
<td>32,9</td>
<td>74 259,1</td>
<td>30</td>
</tr>
<tr>
<td><strong>Transport equipment</strong></td>
<td>4 132,1</td>
<td>2,1</td>
<td>6 971,5</td>
<td>2,8</td>
</tr>
<tr>
<td><strong>Other Machinery</strong></td>
<td>25 558,1</td>
<td>13,1</td>
<td>33 476,2</td>
<td>13,5</td>
</tr>
<tr>
<td><strong>Textiles</strong></td>
<td>4 882,8</td>
<td>2,5</td>
<td>5 607,7</td>
<td>2,3</td>
</tr>
<tr>
<td><strong>Clothing</strong></td>
<td>20 782,6</td>
<td>10,7</td>
<td>26 634,8</td>
<td>10,7</td>
</tr>
<tr>
<td><strong>Other manufactures</strong></td>
<td>41 131,0</td>
<td>21,3</td>
<td>51 471,9</td>
<td>20,8</td>
</tr>
<tr>
<td><strong>Other Products</strong></td>
<td>408,4</td>
<td>0,2</td>
<td>717,8</td>
<td>0,3</td>
</tr>
</tbody>
</table>

Sources: Eurostat
It is worth noting the particular role of The Netherlands as the EU’s second largest importer behind Germany with 41 billion euro (or 16% of total imports from China). This large share is largely explained by the role of Rotterdam in imports. No EU member state registers a trade surplus with China.

2.2.2 Investment

The investment situation shows a completely different picture. Indeed, the EU investment in China far exceeds Chinese investment in the EU. The realization of significant investment by EU member state companies began in the early 1990s. The flow of investment has accelerated since the late 1990s (see Graph 2), though the share of the EU in total FDI in China has decreased in the last decade. In 2009, EU FDI (including reinvested earnings of firms controlled by European companies) in China amounted to €5.9 bn and the total stock of EU direct investment amounted to €58.3 bn (including reinvested earnings).

Graph 2: Evolution of FDI in China from EU firms and in EU by Chinese Firms

![Graph showing evolution of FDI in China from EU firms and in EU by Chinese Firms](http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-QA-10-029/EN/KS-QA-10-029-EN.PDF)


The share of EU FDI in the total inward FDI in China has declined since the early 2000s as Asian countries and territories (South Korea, Taiwan, Hong Kong) - with the exception of Japan - have strengthened their relative positions. Nevertheless, it should be pointed out that the exact origin of a very large share of inward FDI from Hong Kong (37.1% of total FDI in 2008) and the Virgin Islands (21.1%) remains difficult to determine. Despite these shortcomings in the Chinese statistics, it is clear that FDI from EU

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6 It is useful to note that imports are registered at the port of entry and not at their final destination within the EU.
member states remains limited compared to the booming bilateral trade and the size and importance of the Chinese domestic market.

The United Kingdom (21.4% in 2008), Germany (18.9%), France (11.7%), Netherlands (15.9%), and Italy (9%), are the main investors in China. In terms of sectors EU FDI is concentrated in manufacturing with nearly 50% of the total, real estate (11.9%) and financial services (9.7%). Low labour costs largely explain the preponderance of EU FDI in Chinese manufacturing. The majority of European companies investing in China uses the Chinese territory as a low labor cost production platform for re-export to third markets, especially to Asia, and back to Europe. This then partly explains the EU’s structural trade deficit with China in that many of the products imported into the EU from China are produced by European firms or by the direct subcontractors of these firms. It is estimated that nearly 85% of the export trade focusing on assembly operations is made by foreign enterprises operating in China.

With the accession of China to the WTO and the rapid development of the Chinese domestic market, European firms are seeking to diversify. Parallel to exports, they aim to expand their sales on the domestic Chinese market. But this strategy is not easy to put in place: despite lower tariffs and abolition of national preferences with China’s accession to the WTO, European firms continue, as we shall see in later chapters, to face many non-tariff barriers. The development during the last two decades agglomerations and technological & product clusters in the manufacturing sector in Chinese regions (Pearl River Delta, Yangtze Delta, Beijing - Tianjin, Zhejiang and Jiangsu Provinces) has effected the FDI policies of EU firms. These firms have not only taken advantage of low labour costs, but also increased their productivity and found a significant range of efficient sub-contractors in above-mentioned regions. Such advantages have been important in the foreign investor’s decisions in recent years. There has been a favorable trend in China’s wage competitiveness compared to other developing countries since the economic crisis of 2008. This is somewhat surprisingly given the recent rapid growth of blue collar wages. But a number of studies suggest that it is the high level technological capabilities available in these clusters that has given China a significant and often crucial advantage over other Asian countries such as Viet Nam in attracting FDI.

The profitability of EU capital investment in China averaged around 11% over the period between 2004 and 2008 (see Graph 3). A comparison with other major emerging countries indicates a lower return than in Russia and India but a little higher than that in Brazil. It nevertheless remains above the average rate of return on outward EU FDI (see Graph 3).

Several econometric studies have shown however that R&D intensive FDI from the EU is discouraged by the poor IPR protection in China. A number of studies also show that European firms hold back from investing in JVs even when the Chinese regulatory environment permits this. The Chinese regulatory reform after its accession to the WTO has resulted in drastic changes in the investment strategy of foreign investors (led by technology intensive EU firms). Foreign firms are scrambling to take a majority stake in the JV, or develop wholly owned operations. In the automotive and telecommunications sectors - despite China’s accession to the WTO - foreign investors are obliged to invest in JVs in which the Chinese partner(s) control at least 51%. Interviews with foreign investors suggest that if the regulatory environment were to change, all major European firms in these two sectors would take majority shares in the JVs concerned. Poor protection of IPRs dampens EU firms’ readiness to transfer technology to operations in China and their willingness to upgrade existing technology used in JVs. This could explain why EU FDI in China has not maintained the rate of the early 2000s. Given the importance

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of the relatively high technology firms in the EU FDI, a significant move by China on joint ventures and IPR protection would certainly have positive effects for EU FDI in the country.

**Graph 2: Rate of Return[^8] on EU FDI Outward Stocks in BRIC Countries (in%)**

![Graph 2: Rate of Return on EU FDI Outward Stocks in BRIC Countries](image)


Chinese FDI in the European Union is still embryonic. Chinese companies have in, the last ten years, just started to invest abroad. Although there has been an increase in direct investment by Chinese firms in the European Union, they are still relatively limited compared to the growth recorded in other geographical areas such as Asia, Africa or Latin America. In 2009, the flow of investment from Chinese firms in the EU was just over 100 million euros and the stock of investment at the end of 2009 was ten times lower than that of European firms in China, (or € 5.7 bn).

In 2009, energy and raw materials sectors continued to account for nearly half of outward Chinese FDI, which in part explains its geographical distribution. In 1995, China’s colossal energy needs encouraged the Chinese government to start restructuring the major state-owned firms operating in the sector. Then, starting in the early 2000s, the state encouraged them to invest abroad in order to secure supplies overseas. Activity by Chinese firms in the oil sector has been very intense in Africa, Central Asia and the Middle East to the point of feeding obsessive fears that the Chinese firms will oust US and European operators from the African market. In the oil sector, we can expect to see an even greater presence in the years to come as the external supply of oil from fields controlled by Chinese firms only amount to 15% of its total imports. Since 2005 other sectors, such as telecommunications, information technology, consumer electronics and automobile manufacturing, have grown rapidly: they now represent nearly 35% of the total outward Chinese FDI. Three firms – Huawei, Haier and ZTE – are particularly active in these sectors. In less than a decade, Haier has, for example, set up 13 production units, 8 design centers, 22 trading companies and nearly 4,600 retail stores outside of China. Chinese FDI is also rapidly increasing in the commercial sector. Chinese industrial firms subcontracting for European, US and Japanese multinationals are now trying to work their way up the added-value chain in order to capture a larger share of the profits on consumer sales in developed countries. To achieve this goal, it is crucial

[^8]: Rate of return is measured by FDI income of year t divided by stock of FDI at the end of year t-1.
for Chinese firms to gain control of the companies acting as intermediaries in the distribution field. Galanz, for instance, the world leader in microwave ovens with nearly 40% of the world market, supplies its products to nearly 250 firms, which resell under their own brand name. Today Galanz is seeking to establish its own brand and invest in the distribution and marketing phase, where the larger share of profits is made. The same pattern is found in many industrial sectors, such as the textile and garment industry, shoes, electronics and toys, of which the Chinese have become major producers by subcontracting without managing to reap large profits. Also, despite a significant decline in China’s direct investments in the European Union in 2009 and 2010. The search for new technological skills held by European producers, colossal foreign currency reserves, and growing competition from foreign companies on the Chinese domestic market, all point to an increasing presence of Chinese FDI in the EU in the coming years.

While there can be no doubt about the capacity of Chinese groups to become serious competitors, there are a number of factors that are likely to limit their competitive potential in the short and medium term. Chinese groups suffer from a lack of internationally trained managers, limited knowledge of the European legal and administrative environments, a lack of flexibility when putting together complex financial arrangements for mergers and acquisitions, as well as considerable deficiencies in their system of governance. This last point is perhaps the most worrisome given the size of Chinese FDI in the tax havens of the Virgin and Cayman Islands (52% of the total in 2008).

2.3 China’s Growing Economic Power: Opportunities and Challenges for the European Union

For the European Union and its firms, the economic rise of China represents a major business opportunity. With India, the two Asian giants will very soon have the biggest domestic market in economic history and an enormous middle class eager to consume goods and services. But this economic rise also poses two major challenges that the EU is not yet certain to overcome, at least if the current Chinese regulatory policies are kept in place.

The business opportunities are relatively well known and there is a broad consensus among both EU governments and firms that these opportunities cannot be ignored. China should experience a rapid urbanization in the coming three decades with the arrival of 250 million rural migrants in cities. This urbanization is expected to generate a very strong demand in infrastructure, energy, education and know-how for the organization of a social security system. The reorientation of the growth mode with more importance given to domestic consumption is now clearly accepted by Beijing\(^9\). Even if the new model will take time to materialize, this economic growth reorientation appears inevitable for China’s economic future and the stability of its political regime. The evolution of China’s growth model should contribute to the development of a middle class whose numbers will exceed the current population of the EU by 2025. Projections made on the purchasing power show that nearly 60% of households constituting this middle class will, in 2025, have a consumption pattern of goods and services similar to the current industrialized countries middle class. Finally, this growth must be accompanied by an increased respect for the environment and implies the pursuit of an economic development strategy based on green technologies.

\(^9\) See China’s Twelve Five Years Plan promulgated on March 14, 2011. A translated version of the text is available in the annexes. Amongst the main objective of the new Five Years Plan China puts particular emphasis on: the expansion of domestic consumption as a source of growth, the growth and development of new strategic industries, the development of small and medium enterprises, the reform of welfare and security system together with a better access to basic public services.
European firms are particularly well placed to participate to these three major developments. Indeed, they have expertise in infrastructure, energy, education, and R&D. EU governments also benefit from public policy expertise to help China build and run a vast social security network. In addition, the active participation of European firms in the development of Chinese domestic market is, in some respects, essential for their own future. A number of innovations in green technologies will first be implemented in China for the Chinese market - mainly because of the vast economies of scale. Ignorance of the Chinese domestic market developments will therefore be a major disadvantage for EU firms. Finally, investing in China does not just mean relocation of activity and the destruction of jobs in Europe through re-exports back into the EU. The Chinese domestic market, even if access remains difficult today, can still represent a crucial market for activities that are still located in Europe in the form of research and development and sophisticated products. But EU firms will face two types of challenge in the Chinese market: access and dealing with technology transfers and innovation.

2.3.1 Market Access

The first challenge relates to the question of a free access to the domestic market and the granting of reciprocal rights to both EU and Chinese firms. As discussed in subsequent chapters, the accession of China to the WTO has led to a major and unprecedented transformation, often positive, of its trade and investment regime. Nevertheless, access to the Chinese market remains difficult due to multiple non-tariff barriers introduced by different levels of government to protect China’s domestic producers. The EU Commission, the European Chamber of Commerce in China, EU firms or Business Europe have clearly identified these non-tariff barriers as limiting, sometimes sharply, trade and investment with China. Given that China is now the second largest economy in the world the need for reciprocity in market access becomes more and more urgent. The transitional period for China’s accession to the WTO is now almost over. EU member states should now have a strong interest in joining forces to remind China of the importance of reciprocal market access.

Despite the recent EU antidumping actions against China, the Chinese government is aware of the lack of a strong consensus among EU member states on the need to maintain a firm position on reciprocity. While some member states are in favor of greater protectionism, others remain favorable to free trade and oppose retaliatory measures and others do not seem to have a clear position. The European Commission does not posses the same political and economic powers as those of an authoritarian and relatively centralized State such as China. Without a strong consensus of member states to back the European Commission in its efforts to achieve reciprocal market access, the balance of power will remain overwhelmingly with China. In this context, it would be dangerous for the EU to grant China market economy status (MES) before 2016 without making this conditional on more reciprocity and better implementation of Beijing’s WTO commitments. An unconditional granting of MES would be a mistake.

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10 Please refer to the below sections on antidumping and subsidies.
11 Indeed, in it’s Protocol of accession to the WTO, China is considered as a non-market economy until 2016. Countries are however allowed to grant the Market Economy Status (MES) on an individual basis before 2016. Despite repeated calls from the Chinese government, the EU is considering that China has not yet met the defined criteria to be granted MES. These rather technical criteria include: “absence of barter trade” and “absence of state induce distortions in the operations of enterprises linked to privatization” as well as the degree of government influence, including through tax discrimination, adequate corporate governance (especially regarding accounting standards), transparent regulation and protection of IP rights, effective bankruptcy regime and lastly a financial sector operating independently from the state. Until now, the EU considers that China has only fulfilled one of the criteria: “absence of barter trade and absence of state-included distortions in the operations of enterprises linked to privatization”.
MES would deprive the European Commission of important leverage in its efforts to change certain Chinese business practices.

2.3.2 Technology Transfers and Innovation

The second challenge is broader and even more complex, although partly connected to the first: how to maintain a technological edge over Chinese firms. This is necessary to avoid foreclosure effects not only on the Chinese market, as we have seen recently seen with the production of solar panels, but also on European markets as witnessed in the steel industry with huge increases in exports from Chinese firms. The technological catch-up realized (or to realize in future years) by Chinese firms is to some extent both inevitable and desirable. Ethically, it is difficult to oppose China’s right to development. It is also in Europe’s interests since a technological catch-up will promote labor productivity and so boost consumption, at least if this new wealth is well redistributed through wages increases to the Chinese household.

However, the technological catch-up by Chinese companies has been based on a very active industrial policy, constantly renewed, by the Chinese state since 1978. This industrial policy raises important questions for the European Union. The EU could challenge some Chinese government measures taken to protect and develop its domestic producers as incompatible with WTO norms and rules. On occasions these threaten the economic and social rights that constitute the basis of European societies. The prospects of bringing about changes in Chinese industrial policy are however, not great, even if there were a consensus among member states on a firm policy line.

**Figure 26: GOVERNMENT POLICY AND INVESTMENT STRATEGY, 2010-2011 [%]**

<table>
<thead>
<tr>
<th>Respondents</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>N=451</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8%</td>
<td>5%</td>
<td></td>
</tr>
<tr>
<td>6%</td>
<td>8%</td>
<td></td>
</tr>
<tr>
<td>6%</td>
<td>7%</td>
<td></td>
</tr>
<tr>
<td>37%</td>
<td>42%</td>
<td></td>
</tr>
<tr>
<td>7%</td>
<td>9%</td>
<td></td>
</tr>
<tr>
<td>7%</td>
<td>6%</td>
<td></td>
</tr>
<tr>
<td>29%</td>
<td>23%</td>
<td></td>
</tr>
</tbody>
</table>

**Answers**

- Have led the company to suspend new investments in Mainland China: 20%
- Have led the company to reduce / slow existing investment plans in Mainland China: 20%
- Have led the company to consider reducing / suspending investments in Mainland China: 15%
- Leave the company’s investment strategy in Mainland China unchanged: 15%
- Have led the company to accelerate planned investments in Mainland China: 10%
- Have led the company to plan additional new investments in Mainland China: 10%
- No opinion: 10%


12 These problems are clearly identified by EU companies facing harsh competition and demand for technology transfers. Cf. interviews conducted in Brussels with Business Europe and other private stakeholders.
Much of China's industrial policy does not violate WTO principles and does not negatively affect the economic and social rights of the Chinese population. It is therefore quite legitimate for the Chinese government to pursue these policies. But this raises major questions for the European Union and its Member States on the role of the state in the economy. By adopting a market and competition based policy and not promoting an industrial policy, the European Union deprives itself of valuable tools in dealing with technological development. In the meantime, China is more than ever determined to give the state a leading role in promoting the technical development of Chinese firms.

3 OVERALL OUTLINE OF EU-CHINA RELATIONS AND CHINA IN THE WTO

3.1 EU-China Trade and Economic Relations in the Aftermath of the Global Economic Crisis (Political Aspects)

From the low point of 1989, Sino-European relations have improved significantly. This period of blossoming started in 1995, when most of the sanctions imposed by the EU after the Tiananmen Massacres of 1989 were lifted and the political and economic relations became broader and deeper. At that time, there was quite a positive outlook from both sides on the relationship, with the understanding that the few points of real tension between Europe and China were vastly outweighed by the positive aspects of cooperation. As the relationship progressed however, concerns started to arise in Europe about differences in outlook on the economic consequences of China’s rise and China’s internal political situation.

In 2006, the Commission published a Communication on China, as well as a related policy paper on trade and investment, which made explicit a number of these concerns. This sharpened the European political message and reflected the sobriety that had replaced the earlier exuberance about relations with China in Brussels. Nonetheless, the efforts to strengthen economic cooperation continued leading to the establishment of the EU-China High Level Economic and Trade Dialogue.

The financial crisis and the subsequent European sovereign debt crisis, added to a number of tensions. On the one hand, an increasingly assertive China has been less eager to accept compromise in international trade negotiations, while on the other there are calls from some EU sectors and regions for more protectionism against cheap Chinese imports. Chinese restrictions on market access and weak intellectual property right protection are considered by European enterprises as significant impediments to a further expansion in China. Furthermore, resistance to Chinese investment in the EU may be growing with the Chinese takeover of Volvo raising fears of job losses in plants in Sweden and Belgium.

Politically, perhaps the most important post-crisis event may have been the Chinese role in the European sovereign debt crisis. In order to provide financial support for the ailing Greek economy in 2010, China invested hundreds of millions in port facilities and other infrastructure programmes. It also stated that it would support the governments of Portugal and Spain and not reduce its holdings of European bonds. But these Chinese efforts have been more grudgingly accepted than warmly welcomed in the EU, where there has been more focus on China crackdown on democracy activists.

Bilateral tensions resulted in the European Commission taking an increasingly strong stance on China’s economic policy. In 2010, Trade Commissioner de Gucht first criticized China’s monetary policy and then its export credit incentives. He called for reciprocity in the treatment of European investors in

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13 A detailed chronology of the major events of the EU-China relations is annexed to this report.
China, to match the benefits Chinese investments have by virtue of the EU’s financial openness. But political relations between the EU and China remain cordial and communication channels open. The negotiation of a deeper Partnership and Cooperation Agreement are continuing, and there seems to be a commitment from both sides to maintaining and strengthening links, as evidenced by the results of the annual EU-China summits. In a recent visit to China in 2011 Council President Van Rompuy argued Sino-European relations could be considered as having entered a new stage in which the rosy rhetoric and vague promised must give way to concrete measures.

The EU-China Relations: A Simple Chronology

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975 May</td>
<td>Establishment of diplomatic relations. Christopher Soames, first European Commissioner to visit China</td>
</tr>
<tr>
<td>1978 May 2</td>
<td>EC-China Agreement on Trade – Joint Committee created</td>
</tr>
<tr>
<td>1979</td>
<td>First EU President Commission to visit China and meet with Deng Xiaoping</td>
</tr>
<tr>
<td>1985 May 21-23</td>
<td>EC-China Agreement on Trade and Economic Cooperation. Visit to China by Jacques Delors (President of the EU Commission)</td>
</tr>
<tr>
<td>1986</td>
<td>EC-China GATT (re)accession negotiations begin</td>
</tr>
<tr>
<td>1988 October</td>
<td>Opening of the European Commission delegation in Beijing</td>
</tr>
<tr>
<td>1989 May-June</td>
<td>China-EC relations frozen after the Tiananmen Massacre. Imposition of sanction on China, including arm embargo</td>
</tr>
<tr>
<td>1990 October</td>
<td>Progressive re-establishment of relations</td>
</tr>
<tr>
<td>1992 June</td>
<td>Launch of a new bilateral political dialogue</td>
</tr>
<tr>
<td>1993</td>
<td>Opening of European Commission office in Hong Kong</td>
</tr>
<tr>
<td>1995</td>
<td>European Commission publishes its first policy paper on China:</td>
</tr>
<tr>
<td></td>
<td>“A long term policy for China-EU dialogue”</td>
</tr>
<tr>
<td></td>
<td>Launch of specific dialogues on human rights</td>
</tr>
<tr>
<td></td>
<td>EC Humanitarian Office (ECHO) gives first humanitarian aid to China</td>
</tr>
<tr>
<td>1998 April 2</td>
<td>First EU-China Summit</td>
</tr>
<tr>
<td></td>
<td>EU adopts a policy paper: “Building Comprehensive Partnership with China”</td>
</tr>
<tr>
<td>2000 May 19</td>
<td>EU China reach bilateral agreement on China’s accession to the WTO</td>
</tr>
<tr>
<td>Date</td>
<td>Event</td>
</tr>
<tr>
<td>------------</td>
<td>-----------------------------------------------------------------------</td>
</tr>
<tr>
<td>2001 December 11</td>
<td>China becomes the 143rd member of the WTO</td>
</tr>
<tr>
<td>2003 March 10</td>
<td>EC opens and economic and trade office in China</td>
</tr>
<tr>
<td>2003 October 13</td>
<td>China released its first policy paper on the EU – The EU publishes “A Maturing Partnership: Shared Interests and Challenges in EU-China Relations”. Visit to China of Pascal Lamy, the EU trade Commissioner</td>
</tr>
<tr>
<td>2005</td>
<td>EU and China sign Textile Agreement</td>
</tr>
<tr>
<td></td>
<td>EU China joint Declaration on Climate change</td>
</tr>
<tr>
<td></td>
<td>MoU on China-EU dialogue on energy and transport strategies</td>
</tr>
<tr>
<td>2006</td>
<td>New EU papers: “China: Closer Partners, Growing Responsibilities”</td>
</tr>
<tr>
<td></td>
<td>and “EU-China Trade and Investments: Competition and Partnership”</td>
</tr>
<tr>
<td>2007 June</td>
<td>First EU-China Civil Society Round Table, Beijing</td>
</tr>
<tr>
<td>2010 May 6</td>
<td>Celebration of the 35th anniversary of EU-China diplomatic relations establishment</td>
</tr>
</tbody>
</table>

### 3.1.1 The EU Trade Strategy vis-à-vis China

The EU trade strategy vis-à-vis China is based on a number of priorities: dismantling the trade barriers preventing EU export or investment, building a sustainable environment for the expansion of European enterprises in China and constructive engagement in the multilateral trading framework. The evolution of the EU trade strategy must be seen in the context of the broader evolution of the multilateral trading framework, the internal structuring of the Union, the tension between Union’s interests and those of individual Member States and the different policy objectives influencing the trade sphere.

Since the 1985 Trade and Cooperation Agreement\(^4\), the international trading environment has grown more complex. Institutionally, new bodies and regimes have come into being, such as the WTO and the G20. In terms of substance a good number of concerns have been raised with regard to trade, including intellectual property rights, climate change, investment, monetary policy and law enforcement. In its relationship with China, the Commission has consistently implemented a policy of constructive engagement and not confrontation, aiming at bringing China into a multilateral trading system, rather than dealing with China on a purely bilateral basis. This did not mean, however, that the approach was always soft: the EC side drove a hard bargain with China before it consented to China’s WTO accession.

Nor was China left to its own devices, as supporting China’s development became an important policy objective. Since China’s WTO accession, the EU has taken a number of initiatives aimed at improving the internal conditions for Chinese economic development as well as to enhance the sustainability of economic reforms and China’s “transition into a stable, prosperous and open country\(^5\)”. These

\(^4\) Available in the annexes.

initiatives have taken the form of capacity building, training programmes for officials, broader platforms – such as the IPR2 programme in the field of intellectual property rights, the EU-China Trade Project – aiming to provide knowledge and know-how, as well as the establishment of specialized teaching institutes, such as the China-Europe International Business School in Shanghai and the China-EU School of Law in Beijing. Conversely, initiatives have also been made help enterprises expanding into China, such as the IPR SME helpdesk.

<table>
<thead>
<tr>
<th>Aid for Trade</th>
</tr>
</thead>
<tbody>
<tr>
<td>According to the Chinese Ministry of Commerce (MOFCOM), China received USD 6.7 billion in bilateral and multilateral development assistance between January 1979 and May 2009. This assistance has clearly been beneficial to the Chinese growth.</td>
</tr>
<tr>
<td>As far as trade is concerned, the OECD estimates that commitments made by developed nations for development assistance to China amounted to USD 1.4 billion in 2007. This included USD 335 m in aid for trade and assisting China in implementing its WTO commitments*.</td>
</tr>
<tr>
<td>The EU has committed itself to very large, long term programmes of trade assistance for China. The most important was the Euro 20.6m joint funded EU China Trade Project that ended in December 2009 and consisted of over 300 technical assistance and training activities designed primarily to support China’s application of its WTO commitments. This supported regulatory and legislative efforts and specifically targeted: the customs and import/export regulatory system, agriculture and agro-food, technical barriers to trade and sanitary and phytosanitary measures, trade in services, legislative and legal aspects of domestic implementation, and transparency, co-operation and policy development.</td>
</tr>
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<td>Over the course of the Project, 50 Chinese government officials from both the central and provincial levels attended internships in European Institutions and 250 Chinese officials participated in study visits to Europe, while EU counterparts visited China. More than 1000 officials were trained either in Europe or internationally**. The main achievement of this programme was certainly the adoption of the long awaited China antimonopoly law, which is largely inspired by European norms and practices. The impact on transparency and rule of law is more doubtful.</td>
</tr>
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<td>In terms of further cooperation the EU China Country Strategy Paper (2007-2013) sets out three main areas for cooperation:</td>
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<tr>
<td>Bilateral trade, business, socio-economic development, support for the internal reform process</td>
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<td>Climate change, the environment and energy</td>
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<td>Human resources development</td>
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<td>Euro 128 million have been allocated for the first four years (2007-2010)***.</td>
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<tr>
<td>This, of course, is not to mention a myriad of other smaller EU projects as well as EU member countries or EU regions specific activities. France, for instance, has developed a quite comprehensive programme of legal and judicial training****.</td>
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</table>

The institutional framework of EU-China trade relations, however, is very complex and suffers from serious coordination problems. The latest organization chart available on the Commission website dates from 2005, and it seems there is disagreement as to how many dialogues and working groups are there. The political dialogue consists of:

- Annual Summits, at the level of the Heads of State or Government. These take place alternately in China and Brussels. The EU is represented by the President of the European Council and the President of the European Commission, assisted by the European High Representative for Foreign and Security Policy/Vice President of the Commission;
- Annual meetings between the President of the Commission, accompanied by members of the European Commission and Premier Wen, accompanied by members of the State Council (so-called "executive-to-executive" meetings);
- Regular political dialogue on strategic and foreign policy issues between the EU High Representative for Foreign and Security Policy/Vice President of the Commission and the Chinese State Councillor responsible for foreign affairs;
- Meetings when needed between the EU High Representative for Foreign and Security Policy/Vice President of the Commission and the Foreign Minister of China, in addition to annual meetings in the margins of the United Nations General Assembly;
- Annual meetings of EU and Chinese Political Directors. These alternate between Beijing and the Brussels;
- Annual meetings between the EU Director for Asia Pacific affairs and his or her Chinese counterpart on Asian and Pacific issues. These alternate between Beijing and Brussels;
- Meetings at least once a year between EU and Chinese experts on international security, arms control, non-proliferation and export controls issues;
- Meetings at least once a year between EU and Chinese experts on the control of Small Arms and Light Weapons;
- A meeting every six months between the Minister of Foreign Affairs of China and the Ambassadors from the European Union posted in Beijing;
- A meeting every six months between the EU High Representative for Foreign and Security Policy/Vice President of the Commission and the Ambassador of China to the European Union;

Economic relations are governed by the High-Level Economic and Trade Dialogue, the EC-China Joint Committee established by the TCA, ministerial and senior official meetings, and economic and trade working groups. Under these there are over 25 dialogues and working groups, involving a variety of participants and in various forms from informal exchanges to conferences and formal annual meetings. The problem however, is coordination. Many dialogues and working groups involve more than one DG or Chinese administrative body and work autonomously. Involvement of non-governmental actors seems to be minimal in a number of cases. Member State involvement varies greatly, depending on the issue area. This lack of coordination is not only present horizontally, within the Union, but also vertically, between Union, national and sub-national levels. Member States, or individual regions and municipalities conduct their own China policy outside of the Union’s activity. This lack of coordination should be seen in the context of internal tensions within the EU that influence trade policy towards China. Not all Member States stand to gain from increased trade with China, as jobs are endangered and sectors opened up to strong Chinese competition.
3.1.2 Trade Relations with China in the Context of the EU 2020 Communication

The Europe 2020 Communication aims to reform the EU economy in the aftermath of the economic crisis. Concretely, the Commission proposes five EU targets, to be attained by 2020, in the areas of employment, research and innovation, climate change and energy, education and combating poverty. In order to do so, seven flagship initiatives are listed in the areas of improving conditions for research and innovation, high-speed internet, resource efficiency, improving the business environment for SMEs, modernising the labour markets and combating poverty.

In a number of these areas, China is becoming a strategic competitor. China’s 12th Five-Year Plan\textsuperscript{16} has explicitly made scientific development into a prime objective, and promotes seven strategic industrial sectors: clean energy technology, next-generation IT, biotech, high-end machinery and equipment such as airplanes, high-speed rail and manufacturing technology; new energy, new materials and new energy vehicles. These objectives are strongly export-oriented, as the Plan’s domestic consumption target is relatively low and largely off-set by inflation and increased competitiveness in a number of sectors in which EU currently occupies a strong position could significantly impact the EU. There is also competition for resources required for further growth, such as oil and rare earths. Nonetheless, Europe 2020 and China’s Five-Year plan share a number of similar ideas and priorities. Practical cooperation in green technology, innovation and research could generate significant investment in Europe, creating and preserving jobs. European enterprises would also be well placed to benefit from the Five-Year Plan’s focus on strategic emerging industries, provided China reduces its restrictions on FDI in these sectors.

In order to take advantage of these opportunities, the EU will need to find an operational consensus on how to approach China and counteract the current horizontal and vertical fragmentation of policies. It will also need to stimulate demand for low-carbon products, next-generation technology and the related services. This could be done by raising emission-reduction targets or promoting the use of such technologies, products and services. The EU also needs to strengthen investment in strategic sectors in order to maintain competitiveness. Last, but perhaps most importantly the EU would need to open up the Chinese market, as discussed above.

3.1.3 Impact of Monetary Policies on Trade

China’s monetary policy is perhaps the most significant point of contention in the Sino-US relationship. For a long time, China pegged its currency to the dollar at a rate of 8.27 RMB per dollar from 1997 to 2005. The peg was eased in 2005, leading the RMB to appreciate to 8.11 RMB per dollar, but reinstated at the beginning of the financial crisis, at a value of 6.83 RMB per dollar. Since June 2010, the RMB is subject to a managed floating exchange rate, with the value determined by market supply and demand in relation to a basket of currencies. This has led the Yuan to rise in value to 6.48RMB to the dollar in June 2011\textsuperscript{17}. However, the United States still contends that China is maintaining its currency artificially low and thus providing a hidden subsidy for Chinese exports. While the EU has not taken as strong a stance as the United States, there are similar concerns in Europe. Council President Van Rompuy has stated the expectation that the RMB would in time become a major reserve currency, which would entail full market convertibility. China’s role in the sovereign debt crisis, in which it has taken considerable steps to secure the value of the Euro, renders the debate more complex. Also, the value of the RMB in Euro has seen a different trajectory, where the RMB has decreased in value from 8.26 RMB to

\textsuperscript{16} Cf. Annexes.

\textsuperscript{17} All currency data are retrieved from www.exchangerates.org.uk, on 14 June 2011.
the Euro to 9.3 RMB to the Euro in June 2011, which suggests that this matter needs more careful and nuanced analysis.

Another argument centres on the question of whether the perceived undervaluation of the RMB is as serious as alleged, and what the effect of an appreciation of the Yuan would be on international trade. For example, estimates of what the market value of the RMB would be are based on figures for Chinese exports that include significant volumes of re-exports with relatively little value-added in China itself. Large Chinese foreign currency reserves are also due to inward FDI and ‘hot money’ entering the country as much as the trade surplus. Furthermore, it is argued that the current deficit with China is partly due to a shift in the pattern of trade away from other low cost locations towards China. This would increase the bilateral Sino-EU deficit, but not significantly change the EU’s current account balance.18

In short, the influence of China’s monetary policy on Sino-EU trade should not be overstated. Furthermore, the spectre of inflation and its political consequences precludes significant changes in current Chinese policy. Rather, as mentioned above, attention should focus on China’s macro-economic policies and their influence on the Chinese internal market. An expansion of China’s imports for domestic consumption would do much more to balance Sino-EU trade than currency revaluation.

3.2 China and the WTO: Degree of Implementation of China’s Protocol of Accession to the WTO

3.2.1 Time as an Ally for the Implementation of a Unique Protocol of Accession

China’s accession to the World Trade Organization (WTO) highlighted the ability of the People’s Republic of China (PRC) to internationalize by incorporating the existing norms and practices of the international trading system. Such institutional assimilation is not new: Chinese law opened up to foreign influences in the late 19th century, turning first toward the Roman-Germanic model, then of course to the socialist paradigm, and finally to the modern West, incorporating various international norms and practices in successive waves. This process of harmonization, which is part of the overall trend towards the acceptance of global legal norms, accelerated over a period of twenty years and reached its climax on December 11, 2001, when after fifteen years of particularly difficult negotiations, China became the WTO’s 143rd member.19

The complexity and unique character of China’s accession and participation in the WTO deserve particular attention. It is worth recalling the historical background and main developments in the slow but largely positive process of China’s accession that constituted the engagement of “the future of

18 There are complex questions involving the consequences of an appreciation of the Yuan on trade with the European Union, as EU imports from China contain a significant amount of re-importation. Components or primary materials that are exported from the EU to China also add to the figure of aggregate EU import. It would be imaginable that a rise in the Yuan might entail that the effect of lower-priced goods from China mitigating consumer price inflation would be offset. On the other hand, manufacturing might then shift to other low labour cost economies. Similarly, inflation within China, commodity and energy price changes and the consequences of the sovereign debt crises might also significantly influence EU inflation. At present, these complex relationships are not well understood, and further research is necessary to chart the impact of these matters against the background of shifting economic patterns.

19 This veritable diplomatic marathon ended at the WTO ministerial conference in Doha with the signing of a 900-page accession agreement. See China’s Protocol of accession in the annexes to this report.
China in the world as well as the future of its economy." Chinese development policy was largely based on internationalizing its economy by increasing foreign exchanges and direct investment. China’s participation in the General Agreement on Tariffs and Trade (GATT) was the means of achieving this. This had been preceded by China’s re-entry into the United Nations (UN) on October 25, 1971, and its integration into the International Monetary Fund (IMF) and the World Bank on May 15, 1980. On July 10, 1986, the Chinese government presented the GATT director general with a request to resume its status as contracting party to the Agreement: "(. . .) the Government of the People’s Republic of China, recalling the fact that China was one of the original Contracting Parties … has decided to seek the resumption of its status as a contracting party to GATT." Beijing further specified that "China is currently pursuing the basic national policy of opening to the outside world and revitalizing the domestic economy[,]" and that "[i]t is the firm belief of the Government of the People’s Republic of China that the ongoing process of economic reform will contribute to the expansion of economic and trade relations with the contracting parties, and that the participation of China as a contracting party in the work of the GATT will further the objectives of the General Agreement." The PRC concluded its request for reinstatement in the GATT by insisting on its status as a developing country and its desire to benefit from the trade regime granted such countries. China made this request for five very clear reasons: to "increase the volume of foreign trade, deepen economic reforms, participation in international affairs and the formulation of trade rules, combating protectionism, and acquiring greater information on exchanges." It cannot be overstated how much internal policy goals have determined China’s international strategy. In the space of just thirty years China went from some association with the international legal order to a position of excluding and challenging it and then to actively participating in it.

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20 According to interviews conducted in Geneva on September 21, 2001 with Pierre-Louis Girard, president of the working group on China’s participation in the GATT then the WTO.
22 China launched its policy of rapprochement with the GATT in November 1982 by sending a delegation to participate as observers in the thirty-eighth conference of contracting parties, insisting that it was one of the original parties to the Agreement. In November 1984, China had to obtain authorization to sit in as an observer on the GATT Council and in the conferences of its subsidiary bodies. In April 1985, it became a member of the advisory committee on developing countries.
24 Yang Guohua, deputy director of the treaty division of the Ministry of Foreign Trade and Economic Cooperation (MOFTEC). Cf. Yang Guohua and Cheng Jin, “The Process of China’s Accession to the WTO,” Journal of International Economic Law, vol. 4, n° 2, 2001, pp. 297-328. After reorganizations related to China’s accession to the WTO, the MOFTEC is now the Ministry of Commerce of the People’s Republic of China (MOFCOM). It comprises twenty-five departments, one of which is devoted to “WTO Affairs.” See http://english.mofcom.gov.cn. The MOFCOM site has been greatly improved and includes more and more useful information. Beyond this undeniable formal improvement, however, the site is not very readable due to the frequently incoherent and biased choice of information.
25 See Leïla Choukroune “China’s accession to the WTO: a turning point?” and « L’accession de la Chine à l’OMC: un tournant historique? » Perspectives chinoises and China Perspectives, n°69, January-February 2002. « L’Etat de droit par l’internationalisation, objectif des réformes? » and “A Rule of Law through Internationalization, the...
China’s Protocol of Accession is unique in that it includes a number of special or WTO-plus commitments as well as WTO-minus rights. Like all other new Members to the WTO, China has undertaken a series of traditional WTO commitments on market access and rules. But unlike, other accessions, China not only accepted extensive market access commitments, it also accepted a number of special rules applicable to China only that are now very much criticized by China’s officials and trade experts. The WTO-plus commitments impose stricter disciplines than required by the WTO agreement. At the same time the WTO-minus provisions allow other WTO Members to take protective measures against Chinese exports that deviate from general WTO disciplines. Lastly, China’s Protocol of Accession prevents China seeking Special and Differential Treatment (SDT) as other developing countries Members.

**WTO-plus commitments include:**

- **“Rule of Law” obligations**

  Transparency, judicial review and uniform administration of trade: these are the special commitments developed in China’s Protocol under the article X of the GATT 1994 (Publication and Administration of Trade Regulations). These special provisions have never been used before and remain quite unique in their nature and implications. Of course, it was the nature of the Chinese authoritarian regime that explains the instance of US and EU negotiators on inserting such atypical provisions. For many years the rule of law or governance issues had represented a major hurdle in trade relations with China and remain as complex as problematic today.

- **Obligations to progressively practice a market economy**

  WTO rules assume a market economy, but nothing in the Agreement prescribes the participation of non-market economies (NME). China’s Protocol of Accession, in contrast to what is (not) imposed on other Members, establishes special market economy obligations for China. China is obliged to allow the market to determine prices for a number of domestic goods and prohibited from using price controls except for specifically listed categories of products. Moreover, China has to liberalise foreign trading rights and not influence decisions of the State Owned Enterprises (SOEs). This, of course, is particularly tricky to implement in a “socialist market economy” in which the role of the State still pervasive. So it is easy to understand the complexity and, to some extent, hypocrisy involved in implementing such provisions.

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27 We have recently seen an explosion of “academic” and/or official articles denouncing the unfairness of China’s Protocol. See, for instance, Xiaohui WU, “No Longer Outside, not yet Inside: Rethinking China’s Membership into the WTO”, Chinese Journal of International Law, vol. 10, 2011.


29 See China’s Protocol, section 5.1.
– Obligations to eliminate export tariffs

WTO Members are free to levy tariffs/taxes on their exports. But in a departure from this general rule, China is required to “eliminate(s) all taxes and charges applied to exports except for those specifically provided in the Annex 6 of the Protocol”\(^{30}\).

– Special obligations on foreign investment

Here again, the China Protocol departs from normal WTO disciplines. China, for instance – and this is very controversial today - may not make approval of foreign investment conditional upon the existence of domestic competitors or, more importantly, on any performance requirement including technology transfer or obligations to conduct research and development activities in China\(^{31}\). Furthermore, foreign investors and foreign owned enterprises are entitled to national treatment with respect to all their China activities. As will be shown below in the section on trade barriers, these requirements have yet not been fully accepted nor applied by China.

– Additional Transitional Review Mechanisms

A special transitional review mechanism\(^{32}\) is established by the Protocol to review China’s implementation every year during the first eight years after accession as well as year ten. This special scrutiny regime was unique and was additional to regular trade policy reviews conducted for all WTO Members at regular intervals.

WTO-minus provisions cover the following issues:

– Special anti-subsidy \(^{33}\)

China’s Protocol permits an importing WTO Member to use non-market economy (NME) methodologies to calculate Chinese subsidies and possibly take measures against them. This is not subject to a time limit. There are also special rules for government subsidies to state owned enterprises (SOEs) that again depart from normal WTO rules. These include an additional ownership criterion when defining the specificity of government/public support. Under this criterion, subsidies granted to Chinese SOEs are considered to satisfy the requirement of specificity thus making them actionable under WTO rules on subsidies. Curiously, China is not allowed to make use of a very interesting WTO provision allowing developing countries to provide subsidise to companies that are directly linked to a privatisation programme, even though one could imagine such a rule would promote the existing privatization policy for Chinese SOEs. The lack of coherence in these measures makes application of China’s Protocol of Accession more difficult.

– Special anti-dumping rules

China’s Protocol allows WTO Members to treat China as a non-market economy (NME) for 15 years\(^{34}\) i.e. until 2016. In WTO law, dumping is determined\(^{35}\) when a product is exported at less than its “normal value” and causes or threatens to cause material injury to an industry of the importing country. As long as China is considered as a NME, importing WTO Members can argue that the Chinese domestic prices cannot be used to assess the dumping margin and that generally higher priced equivalents in a third country should be used. Tensions over the NME status of China seem set to continue as there is no clear

\(^{30}\) See China’s Protocol Section 11 (3).

\(^{31}\) See China’s Protocol Section 7 (3).

\(^{32}\) See China’s Protocol of Accession, Section 18.

\(^{33}\) Please see the subsidies section in Chapter 3 for a detailed account of the current situation.

\(^{34}\) See China’s Protocol of Accession, Section 15.

\(^{35}\) See Article VI of the GATT 1994 and the Anti-dumping Agreement.
definition of a non-market economy in WTO law and WTO Members applying anti-dumping measures have the right to determine whether the exporting country is or not a market economy. China is likely to see itself as a victim of unfair anti-dumping methodologies while the EU and US will more often target China for anti-dumping measures. It is equally easy to understand why China is pushing the EU and the US to obtain a market economy status.

Special safeguards

The China Protocol contains a special set of safeguard provisions in addition to the existing WTO safeguard regime that can be invoked until 2013. WTO members can apply safeguards selectively against products of Chinese origin if they can show “market disruption” and causality with increased imports, an easier test than the normal injury test for safeguards under the WTO. Furthermore, an importing country does not even have to prove the “injury” and “causal link” if it argues that there is “trade diversion” as a result of another member’s safeguards against China. One can clearly see the risks of this sort of spillover effects. There was also a special safeguard mechanism applicable to textile and clothing products of Chinese origin up to 2008. This allowed WTO members to impose quotas if they could show that imports of Chinese textile and clothing products caused ...“market disruption, threatening to impede the orderly development of trade in these products.” This safeguard provided the basis for bilateral textile agreements between China and the EU and US in 2005. Of course, these rules were accepted by China during the course of the WTO accession negotiations and one need to bear in mind that they are extremely difficult to implement for both technical and political reasons.

An unusual negotiation in line with a policy of reform and opening to the world

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
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<tbody>
<tr>
<td>1945</td>
<td>Creation of the United Nations; China obtains a permanent seat on the Security Council.</td>
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<td>1947</td>
<td>China participates in the second conference preparing the United Nations Conference on Trade and Employment, organized in Geneva by the UN Economic and Social Council (ECOSOC) and serving as a preparatory framework for the GATT.</td>
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<td>1949</td>
<td>China signs the GATT text and becomes one of its 23 original contracting parties, which enables it to participate in the first two tariff negotiations in 1947 and 1949, mainly granting concessions on its manufactured products.</td>
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<td>1950</td>
<td>The Republic of China (Taiwan) (December 20): A draft protocol on China’s re-entry into the GATT is published.</td>
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<tr>
<td>1950</td>
<td>The People’s Republic of China (November 15): The People’s Republic and the United States sign in Beijing a bilateral agreement on China’s accession to the WTO.</td>
</tr>
<tr>
<td>1995</td>
<td>China obtains WTO observer status.</td>
</tr>
<tr>
<td>1999</td>
<td>Zhu Rongji, Chinese prime minister, goes to the United States to try to obtain US agreement on Chinese membership of the WTO.</td>
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<tr>
<td>2000</td>
<td>China and the European Union sign their bilateral agreement on China’s accession to the WTO.</td>
</tr>
<tr>
<td>2005</td>
<td>Zhu Rongji, Chinese prime minister, goes to the United States to try to obtain US agreement on Chinese membership of the WTO.</td>
</tr>
<tr>
<td>2005</td>
<td>Sino-American negotiations are interrupted.</td>
</tr>
<tr>
<td>2005</td>
<td>Accidental NATO bombing of the PRC’s embassy in Belgrade; Sino-American negotiations are interrupted.</td>
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</tbody>
</table>

36 See China’s Protocol Section 16.
37 It is nevertheless important to note that the application of the textile special safeguard clause was subjected to a complex regime. For the EU, see the Notice on the application of the article 10 a of Council Regulation (EEC) n° 3030/93 concerning a textile specific safeguard clause, available at: [http://trade.ec.europa.eu/doclib/docs/2005/may/tradoc_122153.pdf](http://trade.ec.europa.eu/doclib/docs/2005/may/tradoc_122153.pdf)
decides to withdraw from the GATT. The PRC considers this withdrawal void to the extent it considers that Taiwan cannot represent the Chinese state.

- 1965 (January): Taiwan obtains GATT observer status.
- 1971 (October 25): The UN General Assembly adopts Resolution 2758 enabling the PRC to regain its UN seat.
- 1980 (May 15): the PRC regains its seat at the World Bank and IMF.
- 1983: China becomes a member of the Multi-Fibre Arrangement.
- 1984 (November): China becomes an observer at the GATT Ministerial Conference and its subsidiary bodies.
- 1986 (April 23): Hong Kong becomes a GATT contracting party.
  (July 10): China presents an official request to the GATT director general to regain its status as Contracting Party.
- 1987 (February 13): China provides the GATT with a guide to all aspects of its foreign trade.
- 1992 (January): Taiwan asks to participate in the GATT.

Representatives grants China Permanent Normal Trade Relations (PNTR) status.

- 2001 (November 10): The WTO’s ministerial conference in Doha decides on China’s accession.
  (November 11): The ministerial conference adopts the accession decision of the distinct customs territory of “Taiwan, Penghu, Kinmen et Matsu.”
- 2002 (March 26): First WTO Dispute: China requests (WT/DS252) for consultations to be opened before the WTO Dispute Settlement Body (DSB) with respect to the United States’ safeguard measures on imports of certain steel products.
- 2004 (March 18): The American authorities request the opening of consultations with the PRC government before the DSB with respect to the Chinese value-added tax on integrated circuits.
  (December 31): End of textile quotas.
- 2005: Controversy concerning China, the United States and Europe on the opening of textile trade. An agreement limiting Chinese exports is finally reached with Brussels and Washington.
- 2005 (December 13-18): Sixth WTO ministerial conference in Hong Kong.
- 2010 (May 31-June 2): China Trade Policy Review (TPRM) exercise at the WTO.
  (December 31): Definitive elimination of customs taxes on merchandise. Publication of the last assessment of the mechanism for overseeing implementation of the agreements.
-2011: Last Transitional Review Mechanism (TRM) exercise for China.
-2013 (December): The transitional safeguard mechanism reaches its term.
- 2016 (December): End of anti-dumping review exercise

### 3.2.2 China’s Participation to the WTO

While China’s Protocol of accession was unique and broke with the unity of the WTO agreement, hence contesting the generally accepted thesis that views WTO as a “single undertaking” relying on the principle of non-discrimination, Beijing’s approach to the WTO is relatively benign. China is not
opposing the rules from within and the proposals it has made during the Doha round have
concentrated on improving of the anti-subsidy and anti-dumping disciplines. The view among
observers and practitioners\(^{38}\) is that China has made major improvements in its attitude towards the
WTO. It now complies more fully with its notification obligations than during the early years of its
membership and importantly it has decided to make use of the WTO’s legal instruments by initiating a
larger number of disputes.

**China and WTO Dispute Settlement: When China Uses its New Legal Tools**

10 years ago, a dispute between China and Japan over Japanese safeguard measures against three
agricultural products from China gave an early indication of Beijing’s determination to put its new legal
arsenal to good use. In April 2001, Tokyo announced it would take a provisional safeguard action for
200 days (the very first use of safeguards by Japan since its entry into the GATT in 1955). In retaliation
against what it considered discriminatory treatment, Beijing imposed a special customs tax of 100% on
certain Japanese imports. A negotiated settlement of the dispute was agreed in December 2001. China
was not yet a member of the WTO, but both parties frequently referred to the WTO agreements in their
legal arguments.

In 2002 China grabbed the attention of trade lawyers with its provisional safeguard measures with
respect to certain American steel products. These came less than six months after China adopted
legislation on safeguards, causing some experts to qualify Beijing’s attitude as “aggressive legalism.”
China also joined a group of seven complainants (including the EU) challenges President Bush’s March
5, 2002 decision to impose safeguard measures on steel imports.

It is now very interesting to observe how China is better apprehending a rules based system and not
only acting as a rule taker, but also a rule user.

In March 2004 the United States introduced its first procedure requesting consultations before the DSB
against China with respect to the Chinese value added tax on integrated circuits. The EU and other WTO
members lined up to participate in these consultations, but in July 2004 the USTR Zoellick announced
the dispute had been settled.

The EU has been or is still involved in a number of crucial cases with China. These include:

**EU as Complainant**

- DS 339 – China Measures affecting imports of automobile parts: On 30 March 2006, the European
  Communities and the United States, and on 13 April 2006, Canada, requested consultations with
  China regarding China’s imposition of measures that adversely affect exports of automobile parts
  from the European Communities, the United States and Canada to China. The European
  Communities considered that, under the measures identified, imported automobile parts that are
  used in the manufacture of vehicles for sale in China were subject to charges equal to the tariffs
  for complete vehicles, if they are imported in excess of certain thresholds. These measures were
  in violation of WTO law (GATT 94 and SCM agreement) as well as in contradiction with China’s
  Protocol of accession hence impairing or nullifying the EC benefits. On October 6, 2006, the DSB
  established a single panel. On July 18, 2008, the Panel very detailed reports were circulated to the
  Members. Lastly, on September 15, 2008 China notified its decision to appeal the Panel’s report.

\(^{38}\) Interviews conducted in Brussels with EU Commission China Experts.
On December 15, 2008, the appellate body report was circulated to the Members and adopted in January 2009. Finally, in September 2009, China declared that it had brought its measures into conformity with the DSB recommendations and rulings.

- **DS 372** – China - Measures affecting financial information services and foreign financial information suppliers: a dispute relating to the a set of measures that restricted the operation of foreign financial providers in China, which was settled at the consultations phase.

- **DS 395** – China - Measures related to the exportation of various raw materials: a dispute dealing with export restrictions (mainly quotas) on various raw materials and especially bauxite, coke, fluorspar, magnesium, manganese, silicon carbide, silicon metal, yellow phosphorus and zinc. After complicated negotiations (China blocked the establishment of the panel), a panel was eventually composed by the WTO Director General on March 29, 2010. And on April 1, 2011, the panel circulated its final confidential report to the parties to the dispute.

- **DS 407** – China - Provisional anti-dumping duties on fasteners from the EU. As from December 28, 2009, China has imposed provisional anti-dumping duties on certain iron or steel fasteners from the EU. The EU considers that the imposition of these duties is in violation of WTO law and in particular of the Anti-Dumping Agreement. The EU challenges various Chinese measures and in particular the MOFCOM notice n°115 (2009) and the article 56 of the Regulations of the People’s Republic of China on Anti-Dumping. Consultations between the EU and China took place on June 4, 2010 in Geneva. On June 28, 2010, China imposed definitive anti-dumping duties. The EU Commission is now analyzing the new Chinese measures.

### EU as Respondent

- **DS397** – EC - Definitive anti-dumping measures on certain iron or steel fasteners from China

  On July 31, 2009, China requested consultations with the EC concerning the Article 9(5) of Council Regulation (EC) No. 384/96 (the EC’s Basic Anti-Dumping Regulation) which provides that in case of imports from non-market economy (NME) countries, the duty shall be specified for the supplying country concerned and not for each supplier and that an individual duty will only be specified for exporters that demonstrate that they fulfill a number of criteria listed in that provision. China claims that these provisions are inconsistent with the EC WTO obligations and the Anti-Dumping Agreement in particular. On October 23, 2009, the DSB established a Panel. On December 10, 210, the Panel report was circulated to the Members. The Panel found a number of inconsistencies in EC policy and rejected other Chinese claims. On March 25, 2011, the European Union notified the DSB of its decision to appeal certain issues of law covered in the panel report and certain legal interpretations developed by the Panel, and on March 30, 2011, China notified the DSB of its decision to as well.

- **DS 405** – EU - Anti-Dumping measures against certain footwear from China: On February 4, 2010, China requested consultations with the EU on EU anti-dumping measures on certain leather footwear from China. China is challenging as WTO-inconsistent the Basic EC Anti-Dumping Regulation, which provides that, in case of imports from NME countries, the anti-dumping duty shall be specified for the supplying country concerned and not for each individual supplier. China considers that the measures in question are inconsistent with the EC WTO obligations, the Anti-Dumping Agreement and China’s Protocol of accession. On 18 May 2010, the DSB established a panel. On 5 July 2010, the Director-General composed the Panel. The Panel report is expected in July 2011.
Since its accession to the WTO, China has appeared 21 times as respondent, 8 times as complainant and 78 times as a third party in disputes. China now seems to be much more willing to use the WTO DSB as a complainant (as in the majority of cases introduced in 2008, 2009 and 2010).

See:  http://www.wto.org/english/thewto_e/countries_e/china_e.htm

3.2.3 Contrasted Records

Obviously, there is now a certain level of dissatisfaction amongst international stakeholders as to the application of China’s WTO Protocol of accession. But this incomplete and often frustrating situation needs to be read in conjunction with the unique character of China’s commitments and the specificity of its current economic and political regime. Moreover, the incoherence of some of the obligations contained in China’s Protocol, not to mention the absence of justification for the imposition of rules that derogate from the general principle of non-discrimination, is itself questionable. It is likely that a more assertive China will now defend itself against measures perceived as unfair and derogatory and so will adopt a more pro-active dispute settlement position.

The trade barrier section provides the reader with a very detailed account of the problems encountered in the application of many aspects of China’s Protocol. But a number of problematic areas can already be identified. If China’s application of its Protocol of accession is generally satisfactory as shown by the report published by the United States Trade Representative (USTR) on a yearly basis, some issues remain in the following domains:\footnote{See generally, 2010 Report to Congress on China’s WTO Compliance, USTR, December 2010, as well as Trade Policy Review Body, Trade Policy Review: Report by the Secretariat – China (Revision), WT/TPR/S/230/Rev.1, 5 July 2010, and China’s Transitional Review Mechanism; Communication from the European Communities, G/MA/W/97, 22 September 2009.}

- General Regulatory Arbitrariness and Opacity
- Intellectual Property
- Industrial Policy
- Trading Rights and Distribution Services
- Agriculture
Figure 25: Respondents’ Opinion Towards China’s WTO Implementation, 2009-2011 [%]

Question: Overall, how would you describe China’s efforts towards WTO implementation?

<table>
<thead>
<tr>
<th>Total</th>
<th>N=235</th>
<th>N=377</th>
<th>N=594</th>
</tr>
</thead>
<tbody>
<tr>
<td>Implementing changes in the spirit of the WTO agreement</td>
<td>22%</td>
<td>21%</td>
<td>25%</td>
</tr>
<tr>
<td>Willing, but falling to implement changes</td>
<td>34%</td>
<td>26%</td>
<td>31%</td>
</tr>
<tr>
<td>Actively seeking loopholes in the requirements to avoid</td>
<td>22%</td>
<td>25%</td>
<td>23%</td>
</tr>
<tr>
<td>No opinion</td>
<td>23%</td>
<td>25%</td>
<td>21%</td>
</tr>
</tbody>
</table>

4 BARRIERS TO TRADE IN CHINA

4.1 Introduction

In acceding to the WTO in December 2001 China was bound to all the WTO obligations to promote the elimination or reduction of trade barriers. Beijing has made significant progress in reforming its trade policy to comply with its WTO obligations. Nevertheless, several barriers to trade remain in place, as can be seen by the concerns raised by several WTO Members as well as commercial operators on the Chinese market.

This Chapter provides an overview of the most significant barriers to EU trade. It draws up on the most recent reviews of China’s trade policies conducted by the WTO, both under China’s Transitional Review Mechanism (TRM) as well as in terms of the Trade Policy Review Mechanism (TPRM), and by the United States (through the Congressional Executive Commission on China). Although the EU, unlike the US, did not create a specific task force to monitor China’s compliance with WTO commitments, it makes active use of the above-mentioned review mechanisms of the WTO, i.e., the TPRM and TRM as well as using bilateral and unilateral channels for this purpose. Monitoring of China’s trade barriers is also undertaken by the European Union Chamber of Commerce in China. These sources have been complemented by information obtained through interviews with stakeholders.

The Chapter will divide the relevant trade barriers into distinct categories and describe the most prevalent Chinese measures under each. It will then give a preliminary indication of possible WTO inconsistencies in the measures discussed.

40 China’s WTO obligations are contained in the WTO Agreement, including all its Annexes, as well as the Protocol of Accession of China to the WTO (WT/L/432), and the incorporated paragraphs of its Working Party Report (WT/ACC/CHN/49).

41 Section 18 of the Protocol of Accession of China creates a Transitional Review Mechanism for China. It provides for 8 years of annual reviews, and a final review in year 10, of China’s trade policies by the 16 subsidiary bodies of the WTO with a mandate in an area covering China’s WTO commitments. These bodies report to the relevant WTO specialised council, which in turn reports to the General Council at the end of the year. The latest review is therefore that of 2009. A final review will take place in 2011.

42 The WTO’s Trade Policy Review Mechanism conducts periodic reviews of the trade policies of all Members, in the context of which the WTO Secretariat and the reviewed Member submit reports that are discussed in a meeting of the Trade Policy Review Body. Other Members may submit questions and concerns and the reviewed Member may respond.

43 The United States Trade Representative is obliged under the US-China Relations Act of 2000 to annually report on China’s WTO compliance to Congress. The Congressional Executive Commission on China submits annual reports in this regard.

44 In the EU, the Section 133 Committee, which is responsible for common commercial policy matters, reviews China’s compliance with its WTO obligations and reports on this to the Council of Ministers. See Paolo D. Farah, 2006, Five Years of China’s WTO Membership: EU and US Perspectives on China’s Compliance with Transparency Commitments and the Transitional Review Mechanism, Legal Issues of Economic Integration 33(3), 263-304, 288.

45 Interviews conducted in Brussels in May 2011 with EU Commission’s China Experts, private stakeholders and Business Europe.
4.2 Tariffs

WTO law does not prohibit tariffs between its Members, but only obliges Members to respect the maximum tariff levels they have committed themselves to in their GATT Schedules of Concessions (known as the ‘bound rate’).\(^46\) Members’ applied tariffs are often lower than their bound rates. Not only the tariff themselves, but also the way in which they are applied is subject to WTO rules. These rules encompass customs valuation of products for purposes of applying a tariff, customs classification of products and rules of origin.

4.2.1 Tariff rates

Despite the sharp reduction in China’s average applied most-favoured nation (MFN) tariffs and its low bound tariff rates, tariffs remain one of China’s main forms of border protection.\(^47\)

China’s average MFN applied tariff is now only 9.5% ad valorem, and its applied tariffs are close to its bound tariffs, which enhances predictability for traders. However, China’s tariff structure is sometimes complex (60 different ad valorem rates are contained in the MFN applied tariff, and non-ad-valorem duties apply to 52 tariff lines). China also applies ‘interim’ tariffs in some cases, adding to the complexity. In 2010 China increased its interim tariffs on jet fuel and fuel oil, in an effort to save energy. It also abolished its lower interim tariffs on pork, neem oil and soybean oil.\(^48\)

There are tariff peaks (bound rates vary from 0 to 65% for agricultural products and from 0 to 50% for non-agricultural products). Examples of tariff peaks are prepared food, footwear and headgear.\(^49\) Tariff escalation (higher tariff rates for more processed, value-added products) occurs in the chemical, manufacturing, and textile sectors.\(^50\)

However, there is no indication that the currently applied tariffs exceed China’s bound tariff rate and therefore no WTO inconsistency arises.

4.2.2 Customs valuation

In the customs valuation area, it has been noted that China does not seem to uniformly follow WTO rules. The practices of China’s customs administration seem to vary from port to port, both in terms of customs clearance procedures and valuation determinations and, in some cases, these give rise to WTO concerns.\(^51\)

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\(^{46}\) Article II GATT 1994.


\(^{48}\) China uses a system of standard and interim applied tariff rates. The interim tariff applies to specific products and temporarily replaces a standard applied tariff rate, while not exceeding the standard rate.


\(^{50}\) Trade Policy Review: Report by the Secretariat – China (Revision), WT/TPR/S/230/Rev.1, 5 July 2010, Section III Chart III.3.

4.3 Non-tariff-barriers to trade

As reported by the WTO Secretariat in 2010, China still uses several non-tariff border measures to direct the allocation of resources. These include government procurement practices, import/export prohibitions, import/export licensing requirements, quotas, taxes and state trading. Non-tariff barriers to trade of particular importance for EU industry are discussed below.

4.3.1 Government procurement practices

The WTO principle of non-discrimination between imports and domestic products (national treatment) does not apply to government procurement. While a plurilateral Agreement on Government Procurement (GPA) exists, it is binding only on those WTO Members that have signed it, which China has not. Accession to the GPA requires that China identify the entities (at central, regional and municipal levels) that will be covered by the GPA and determine the threshold levels at which specified goods and services are to be covered. Reform to China’s government procurement system would be needed to conform to the GPA rules. China applied to join the GPA in 2007 and revised its offer in 2010. However, certain parties to the GPA have expressed concerns that China’s indigenous innovation initiative and its new procurement regulations are not GPA-compliant. In addition, China’s initial offer proposed extremely high minimum contract value thresholds, very limited commitments on coverage (with no sub-central or state-owned enterprises include), and very limited coverage of goods and services.

The Government Procurement Law of China requires the government to buy domestically produced goods (or services or projects). This requirement was re-emphasised in the 2009 stimulus package introduced by China to address the effects of the financial crisis. Circular No. 1361 sets out a ‘Buy Chinese’ requirement for all projects under this 4 trillion RMB stimulus package. Only in exceptional circumstances may foreign products/services/projects be purchased by government, namely when the relevant goods/services/projects are not available in China, or not under reasonable commercial terms; or when they are procured for use outside China. However, no local content requirements or rules of origin exist to determine whether a product or service is domestic or foreign. The 1999 Regulations on Government Procurement specify that products with less than 50% value added in China are regarded as foreign goods, and this seems to still be the prevalent approach. This varies between industries and the lack of certainty constitutes an obstacle to the participation of foreign owned enterprises in Chinese public procurement contracts.

An additional problem is that most public procurement in China occurs at local government level. This makes it difficult to ensure a consistent and transparent approach to public procurement, giving rise to

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55 Government Procurement Law, Article 10.
56 European Union Chamber of Commerce in China, European Business in China Position Paper 2010/11, 111. This circular states that priority must be given to domestic products for all government invested projects.
problems such as circumvention of the government procurement system, corruption, preferences for specific suppliers and historical differences in approach across regions.60

4.3.2 Restrictions on raw materials

China applies export restrictions, in the form of quotas or duties, on raw materials. These export restrictions artificially raise world prices of raw materials and concomitantly lower China’s domestic prices, giving Chinese downstream producers a substantial advantage over foreign competitor.61

In January 2004, China sharply restricted its coke exports, justifying this as an environmental measure to limit internal demand and production. Following several discussions between China and the EU, China revoked its restrictions and China committed to reforming its export licensing system in accordance with WTO rules.62

In 2009, China’s export restrictions, in the form of duties, quotas and other measures (including non-automatic licensing), on bauxite, coke, fluorspar, magnesium, manganese, silicon carbide, silicon metal, yellow phosphorus and zinc were challenged by the EC, the US and Mexico under the WTO dispute settlement system.63 A single panel was established to hear the three disputes and the panel report was due in April 2011. It has however not yet been circulated.

A more recent dispute is that of China’s restrictions on the export of rare earths and other strategic resources. Rare earths are a group of 17 related raw materials that are essential to industries, especially those producing high-tech products, around the world. China produces about 97% of the global supply of rare earths. Major Chinese suppliers of rare earths compete for greater market share by lowering their prices. In response the government has imposed quotas limiting the export of rare earths to prevent environmental damage and to ensure higher export prices.64 In the first half of 2011, China cut its export quota of rare earths by 35% compared to the previous year. This has led to considerable dissatisfaction among EU user industries, which are placed at a significant disadvantage compared to China’s domestic industry.65

WTO rules generally prohibit export quotas.66 In respect of export duties, China has made commitments in its WTO Protocol of Accession restricting their use.67 As a result, the export restrictions on rare earths

62 In March 2004, the EC responded to China’s export restriction on coke by threatening to initiate a WTO dispute, which would have been the first dispute against China in the WTO. China’s displeased response was an immediate withdrawal of tax rebates for coke exports on 24 May 2004. On 26 May 2004, the EC issued an ultimatum to China to revoke the coke export restriction by 28 May or to face a WTO dispute. A settlement was reached on 28 May 2004. See Kong Qingjiang, EU’s Monitoring of China’s Compliance with its WTO Obligations, EAI Background Brief No. 417, 4 December 2008, para. 2.11 and note 9.
63 China – Measures Related to the Exportation of Various Raw Materials, Request for consultations by the EC, 23 June 2009, WT/DS395. See also the requests for consultations by Mexico, WT/DS398 and by the United States, WT/DS394.
64 Kong Qingjiang, EU’s Monitoring of China’s Compliance with its WTO Obligations, EAI Background Brief No. 417, 4 December 2008, para. 2.12.
65 See the comments of the EC in the context of the TRM, ‘The EC would like to reiterate its growing concern regarding China’s policy in the field of raw materials. In particular, the EC notes an increased use of measures restricting access of EU industry to materials that serve as inputs for different sectors of EU interest.’ See Committee on Market Access, China’s Transitional Review Mechanism; Communication from the European Communities, G/MA/W/97, 22 September 2009, para. 1.1.
could be challenged in WTO. One should bear in mind, however, that China seeks to justify its policy as falling under the general exception that allows for measures conserving exhaustible natural resources, if they are taken in conjunction with restrictions on domestic production or consumption. China argues that it is facing tremendous pressure in natural resource conservation and protection of the environment and aims to realise long term sustainable development. It claims that its export restrictions are accompanied by restrictive measures on domestic production and consumption, such as production caps. If this is the case and the restrictions are not applied in a manner that constitutes arbitrary or unjustifiable discrimination or a disguised restriction on trade, they may be justifiable under WTO law.

4.3.3 Energy-related measures

Due to increased awareness of climate change, China has expended considerable efforts in areas of energy saving, renewable energy, and new energy vehicle investment, as reported by the EU Chamber of Commerce in China. The government has implemented several support measures for renewable energy at industry level since 2006, resulting in China becoming the world leader in wind and solar energy. In addition, the government has created incentives to boost domestic demand. Currently China is reportedly the world's fastest-growing wind power market. China’s government support to industry in the energy sector takes the form of subsidies, and one instance of such support has been challenged by the US under the WTO rules on subsidies, as discussed below.

4.4 Subsidies

Several studies and investigations by WTO Members have established the existence of subsidies provided by China. In the context of the TRM, the EU has argued that "it is undeniable that the distortive effect of these subsidies has contributed to China's rapid export growth in recent years." It pointed to the example of China's transformation from a steel importing country to by far the largest steel exporter in the world (holding a global market share of 20.7% in 2007, and 37.6% in 2008). The EU argued that this growth in exports 'is not primarily based on a genuine competitive advantage of China in steel making but rather on the variety of subsidy programmes addressed to the steel making industry on a highly selective basis.' The Agreement on Subsidies and Countervailing Measures (SCM...
The SCM Agreement disciplines the use of subsidies by WTO Members, prohibiting certain particularly trade distorting subsidies and rendering other subsidies actionable if they cause adverse effects to the domestic industry of the importing Member. It also allows injured Members to counteract the effects of injurious subsidisation by applying countervailing duties on subsidised products.

In addition to the normal WTO rules on subsidies, as mentioned above, in its accession negotiations China agreed to special rules applicable when other WTO Members seek to enforce the disciplines of the SCM Agreement against Chinese subsidies (either in countervailing duty proceedings in challenges in WTO dispute settlement against actionable or prohibited subsidies). These special rules allow WTO members to identify Chinese subsidies and measure the ‘benefit’ that may be countervailed using methods other than those set out in the SCM Agreement, in order take account of the non-market economy nature of China’s economy. For instance, in certain circumstances, when determining whether the government has provided a ‘benefit’ to a Chinese enterprise by means of a loan from a state-owned commercial bank, WTO members can use as a benchmark the normal situation on a foreign market rather than the Chinese market to ascertain the benefit of that loan and its terms. Special rules also apply to determine the actionability of subsidies provided to State Trading Enterprises.

China’s failure to comply with some of its obligations in respect of subsidies creates problems for EU exporters, whose products are placed at a competitive disadvantage. Some elements of such non-compliance are set out below.

### 4.4.1 Notification requirements for subsidies

Article 25 of the SCM Agreement requires that subsidies be notified not later than 30 June of every second year. The Protocol of Accession of China also specifically addresses this issue, whereby China committed to notify the WTO of any subsidy within the definition given in Article 1 of the SCM Agreement. However, the first subsidy notification submitted by China was in April 2006. This long-overdue notification was very incomplete. It covered only the period 2001 to 2004, the usefulness of which was called into question by the EC. Further, it failed to notify any subsidies provided by provincial and local government authorities or any subsidies provided by state-owned banks (such as preferential loans or debt forgiveness). Further, as noted by the US Trade Representative, while several subsidies that appeared to be prohibited were contained in this notification, no commitment to withdraw them was made, and other subsidies that appear to be prohibited were not included in the notification. China further neglected to submit the required notifications for the periods 2005-2006 and 2007-2008.

In the context of the TRM in 2009, China reported that its subsidies notification for 2005-08 would be submitted in the coming months. However, it stated that this notification would not again contain support provided by sub-central governmental bodies. Other WTO members found this worrying as after nearly eight years of WTO Membership, China had provided no notification of sub-central governmental support despite the concerns expressed by other WTO members in China’s Accessions working party report about such measures, and the issue being raised in several previous TRM.

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76 United States Trade Representative, 2010 Report to Congress On China’s WTO Compliance, 44.
77 Protocol of Accession of China, para.10 ‘subsidies’
78 Committee on Subsidies and Countervailing Measures, Transitional Review Mechanism Pursuant to Paragraph 18 of the Protocol on The Accession of the People’s Republic of China, Questions from the European Communities to China, G/SCM/W/SSO, 15 October 2009, p. 1.
79 United States Trade Representative, 2010 Report to Congress On China’s WTO Compliance, 44.
discussions before the Subsidies Committee. Monitoring of subsidisation in China has revealed that provincial and local governments play an important role in implementing China’s industrial policies, including through subsidization. It is therefore crucial that transparency be provided by China regarding these subsidies in its required notifications to the WTO.

4.4.2 Forms of subsidisation

The definition of a ‘subsidy’ in the SCM Agreement refers to a financial contribution by a government or public body that confers a benefit on the recipient. These can take various forms, such as direct transfers, loans at interest rates lower than those commercially available, provisions of goods/services at lower than market prices, purchase of the products of the industry at higher than market prices, income or price support and tax rebates. To be caught by the disciplines of the SCM Agreement, subsidies must be ‘specific’ to an enterprise, industry or region.

BusinessEurope has identified several forms of subsidy, such as China’s policy of creating ‘national champions’ by providing significant government support to specific companies, including through favourable export financing. It further noted that in advanced high technology sectors such as telecommunication infrastructure, export credits are provided that are contrary to OECD guidelines on export credits. Similarly, the EC Trade defence services have reported significant subsidies in the form of tax rebates, tax exemptions, the provision of land and land rights, subsidized prices of raw materials and industrial inputs and subsidized loans. The United States has flagged the discriminatory application of VAT exemptions in the agricultural sector (discussed below) as possible subsidies. As several of these subsidies are provided to specific industries and sectors, they are challengeable under the SCM Agreement or may be counteracted by the application of countervailing measures by injured Members. In practice, due to the strict requirements set out in the SCM Agreement for the imposition of countervailing duties, including procedural requirements to be followed in countervailing duty investigations, Members do not readily impose countervailing duties. In addition, the EU’s practice until recently has been to use anti-dumping duties rather than countervailing duties as the trade remedy of choice in the case of non-market economies due to the difficulty in establishing market benchmarks for the determination of subsidisation in non-market economies. In fact, the decision on 14 May 2011 by the EU to impose countervailing duties (as well as anti-dumping duties) on imports of coated fine paper from China (discussed in Chapter 4 below) was the first instance of EU use of countervailing measures against China to date.

As noted above, the SCM Agreement distinguishes prohibited from actionable subsidies. Prohibited subsidies are those recognized to be especially trade distorting, namely subsidies conditioned on the

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80 See the comments of the US in the context of the TRM in Council for Trade in Goods, Report of the Council for Trade in Goods on China’s Transitional Review, G/L/910, para. 7.8.
81 According to the USTR, recent academic literature indicates that provincial and local governments are responsible for nearly 20% of China’s investment in industry, much of which is misdirected into sectors with excess capacity, such as steel. See United States Trade Representative, 2010 Report to Congress On China’s WTO Compliance, 44.
84 According to the latest WTO statistics, by June 2010 the EU had initiated countervailing duty investigations a total of 56 times (exceeded only by the US with 104 initiations), and China had been the subject of 40 countervailing duty investigations by WTO Members, 25 of which by the US (making China the second most frequent target of countervailing duty investigations, after India). In 21 cases, countervailing duties were actually imposed against Chinese products. See WTO Secretariat, Statistics on subsidies and countervailing measures, 1 January 1995-30 June 2010, available at: http://www.wto.org/english/tratop_e/scm_e/scm_e.htm.
use of domestic over imported goods – known as import substitution subsidies – and subsidies contingent on exportation – known as export subsidies. While import substitution and export subsidies are prohibited, actionable subsidies are permissible under the SCM Agreement unless they have adverse effects for another WTO member. In its Accession Protocol, China agreed to eliminate all prohibited subsidy programmes (namely export contingent subsidies and import substitution subsidies) falling within the scope of Article 3 of the SCM Agreement upon Accession. This commitment expressly extends throughout China’s customs territory including special economic zones and other special economic areas. However this commitment does not seem to have been complied with.

An example of an allegedly prohibited subsidy under the SCM Agreement is that under China’s Special Fund for Wind Power Manufacturing. The awards under the program appear to be contingent on Chinese wind power equipment manufacturers using parts and components made in China rather than foreign-made parts and components. This form of import substitution subsidy falls under the category of prohibited subsidies. The US has initiated a WTO dispute challenging this subsidy. The EU joined the consultations on this dispute on 12 January 2011. On 7 June 2011, USA Today, citing US Trade Representative Ron Kirk, reported that China has agreed to stop granting subsidies to wind power companies.

Another instance of the alleged granting of export subsidies by China that led to the initiation of WTO dispute settlement proceedings relates to the measures taken to implement central government directives under two umbrella programmes: the China World Top Brand Programme and the Chinese Famous Export Brand Programme, under which grants, loans and other incentives are granted to enterprises in China. These incentives appear to be contingent on export performance, thus qualifying as prohibited subsidies under WTO law. In addition, to the extent they are granted to agricultural products, they allegedly violated the disciplines on export subsidies in the WTO Agreement on Agriculture, which subject agricultural export subsidies to reduction commitments as discussed below. Mexico, the US and Guatemala requested WTO consultations on these measures in December 2008 and January 2009, and these consultations were joined by the EU. Intensive discussions took place and the parties reached a negotiated settlement in December 2009, whereby China withdrew or modified several of the measures at issue.

85 Article 3.1 (a) and (b) of the SCM Agreement.
87 China-Measures Concerning Wind Power Equipment, Request for consultations by the United States, 22 December 2010, WT/DS419.
88 See ‘US: China ends wind power subsidy program,’ USA Today, 7 June 2011
89 Articles 3, 9 and 10 of the Agreement on Agriculture.
91 United States Trade Representative, 2010 Report to Congress On China's WTO Compliance, 45.
4.5 Anti-dumping measures

As will be discussed below, China is most often targeted in respect of anti-dumping measures, which are the response WTO Members may take to counteract the injury caused by dumped products on their markets. However, China has also increased its own use of this trade remedy against imports from other WTO Members, becoming one of the most frequent users of anti-dumping measures. In contrast China had imposed only one countervailing duty by the end of 2009 (on grain-oriented flat-rolled electrical steel from the US).

China’s increasing resort to anti-dumping is likely to hinder exports of products from the EU that are in competition with Chinese goods considered strategic or enjoying special ‘protection’ from the Chinese authorities through the illegitimate use of anti-dumping measures. The EU has expressed concern regarding the arbitrary initiation of antidumping investigations and has called for transparency in the investigation procedures. It has been noted important lapses in transparency including the failure of China’s Ministry of Commerce (MOFCOM) to require the petitioning Chinese company to provide non-confidential summaries of its submission, so as to enable interested parties to adequately defend their interests in any anti-dumping investigation. In addition, more detailed disclosure is needed from MOFCOM in its disclosure of dumping margin calculations and of the essential facts supporting its preliminary determination, together with sufficient time for the preparation of a rebuttal before a final determination is made.

Reform of these transparency-related aspects of China’s anti-dumping procedures is essential to ensure that all parties receive the procedural fairness to which they are entitled under the Anti-Dumping Agreement. In addition, full compliance with the substantive obligations contained in the Anti-Dumping Agreement as interpreted by the WTO jurisprudence is essential. In this regard, the EU initiated a WTO dispute against China on 7 May 2010, regarding China’s provisional anti-dumping duties on certain iron or steel fasteners from the EU, which was apparently imposed in response to the EU’s imposition of anti-dumping duties on the same products from China. According to the EU, Notice 115 (2009) of the Ministry of Commerce of China, imposing the provisional anti-dumping measures in question is inconsistent with several obligations of the Anti-Dumping Agreement and GATT 1994. In addition, the EU challenged a provision of the Chinese Anti-Dumping Regulations themselves, which provides in part, ‘where a country (region) discriminately imposes anti-dumping measures on the exports from the People’s Republic of China, China may, on the basis of actual situations, take corresponding measures against that country (region)’. Such unilateral counteraction would be
contrary to WTO rules and is therefore at issue in this dispute. The view has been expressed that accumulating dissatisfaction on China’s compliance with the rules of the Anti-Dumping Agreement may lead to further trade disputes between China and the EU.  

4.6 Technical barriers to trade

Mandatory technical regulations, voluntary standards and conformity assessment of products with such regulations or standards (including certification requirements) can create significant barriers to trade. For this reason, the WTO Agreement on Technical Barriers to Trade (TBT Agreement) disciplines these types of measures. It appears that China has technical barriers to trade in place that do not conform to the obligations under the TBT Agreement as set out below.

4.6.1 Harmonization of rules and standards

To reduce the trade restrictive effect caused by divergent technical requirements across export markets, the TBT Agreement mandates harmonisation of technical requirements and standards around international standards, unless the latter are ineffective or inappropriate to achieve the chosen legitimate objective.

In the context of the TRM, the EC has welcomed the increase in the adoption of international standards by China and its commitment to continuously align its domestic technical regulations and standards with international standards. Nevertheless, recently China has repeatedly adopted its own unique national mandatory technical requirements in various sectors despite the fact that relevant international standards were readily available. China has failed to provide adequate justification for departing from the international standard. An example of this is the case of China’s maximum residue levels for sulphur dioxide in wines, which was raised by the EC in the TBT Committee on several occasions. Another example is in the ICT sector where China tends to favour ‘home-grown’ standards embodying unique Chinese technologies. BusinessEurope further notes that, in the automotive sector, China adopts its own standards without justification despite the fact that China is a member to Working Party 29 (World Forum for Harmonization of Vehicle Regulations) of the United Nations Economic Commission for Europe (UNECE) and signed up to its 1958 and 1998 agreements.

If it can be shown that the existing international standards are effective and appropriate to achieve China’s legitimate objectives, China could be found to be in breach of its obligations under the harmonisation provisions of the TBT Agreement.

4.6.2 Transparency

Lack of transparency in respect of technical regulations, standards and conformity assessment procedures can be a significant hurdle for exporters. The TBT Agreement therefore contains

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100 Kong Qingjiang, EU’s Monitoring of China’s Compliance with its WTO Obligations, EAI Background Brief No. 417, 4 December 2008, para. 2.9.
101 Articles 2.4 and 5.4 and Annex 3.G TBT Agreement.
102 Committee on Technical Barriers to Trade, China’s Transitional Review Mechanism: Communication from the European Communities, G/TBT/W/326, 29 October 2009, para. 18. A similar concern was raised by the US in the context of the TRM. The US ascribes China’s failure to adopt relevant international standards and instead developing its own unique standards to the objective of protecting domestic companies from competing with foreign technologies and standards. Council for Trade in Goods, Report of the Council for Trade in Goods on China’s Transitional Review, G/L/910, para. 7.11.
103 Committee on Technical Barriers to Trade, China’s Transitional Review Mechanism: Communication from the European Communities, G/TBT/W/326, 29 October 2009, para. 24.
transparency obligations that mandate the prior notification of draft regulations, standards and conformity assessment procedures, providing a reasonable period for comments by affected Members. They also require the prompt publication of these measures once they have been adopted, in order to ensure that all interested parties can familiarise themselves with the new requirements.

While China has made improvements with respect to compliance with its transparency obligations under the TBT Agreement, and now issues public calls for comments on draft legislation in important sectors, the EC has noted that there is still lack of predictability in the use of this procedure. It therefore requested China to consistently call for public consultations on all new draft laws and administrative measures that may have a significant effect on trade. It also asked that China consistently provide a reasonable period for comments on these drafts in order to allow stakeholders to adequately examine the proposals and give considered comments. Further, in accordance with the commitments it undertook in its Accession Protocol, China should establish a single official journal where all laws, regulations and other measures affecting trade in goods are published.

Violation of these transparency obligations can have a significant effect on European exporters, who are thereby denied the opportunity to provide input where draft technical regulations are proposed that affect their exports, and face the additional obstacle of trying to establish which technical requirements they must comply with in order to be granted access to China’s market.

4.6.3 The China Compulsory Certification (CCC) System

The TBT Agreement prohibits discrimination and obliges Members to ensure that technical regulations, standards and conformity assessment procedures are not prepared, adopted or applied so as to create unnecessary obstacles to trade. These measures may not be more trade-restrictive than necessary to fulfil a legitimate objective, taking account of the risks non-fulfilment would create.

An example of a technical barrier to trade that is problematic under these requirements is the China Compulsory Certification (CCC) System, introduced on 1 August 2003, replacing the certification systems that previously existed for domestic and imported products respectively. Certification under this system is a mandatory requirement for market access to China for 22 product categories, including medical equipment, household appliances, automobile parts, information technology equipment and electrical machinery. The EC raised concerns about the CCC system already during the second TRM.

In June 2008, China notified the TBT Committee of a Draft Amendment to the Regulations on Compulsory Product Certification. The EC welcomed this as a first step to a more substantive review of the CCC system. A second revision was announced in 2009 March 2009 and a simplification process was launched to reduce the administrative costs of CCC compliance, reducing the number of key components to be tested and certified separately from the finished product. The EC encouraged China...

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105 Articles 2.9 and 5.6 and Annex 3.L TBT Agreement
106 Articles 2.11 and 5.8 and Annex 3.O TBT Agreement
107 Committee on Technical Barriers to Trade, China’s Transitional Review Mechanism: Communication from the European Communities, G/TBT/W/326, 29 October 2009, para. 1.
108 Article 2.2 and 5.1.2 and Annex 3.E TBT Agreement.
111 See G/TBT/N/CHN/399.
to build on these positive steps, by ensuring that the CCC system becomes more transparent and less burdensome for economic operators, and based on a risk-oriented approach.\footnote{112 Committee on Technical Barriers to Trade, China’s Transitional Review Mechanism: Communication from the European Communities, G/TBT/W/326, 29 October 2009, para. 4.}

The EC has stressed its continued concern due to a growing number of sectors now affected by the CCC provisions.\footnote{113 The initial product coverage was limited to 19 product categories and 132 types. In April 2007 this was extended to 22 categories and 159 types, including ceramic tiles, decoration and furnishing products, WLAN products and toys. In 2010, an addition of 13 types of information safety products was made. See European Union Chamber of Commerce in China, European Business in China Position Paper 2010/11, 141.} This moves the CCC beyond the scope of its initial objective of protecting human health and safety, animal life and health, the environment and public safety with requirements that appear, according to the EC, to be trade restrictive, impose heavy costs on importers and are disproportionate to the objectives stated by the Chinese legislation.\footnote{114 Committee on Technical Barriers to Trade, China’s Transitional Review Mechanism: Communication from the European Communities, G/TBT/W/326, 29 October 2009, para. 7.} For example, the requirement of separate certification of sub-groups of products based on slight differences in design or components adds unnecessarily to the costs faced by producers. The EC has argued that comprehensive third-party testing and factory audits assign the same high level of risk to all products within CCC scope, despite their evidently posing very different levels of health and safety risks.\footnote{115 European Union Chamber of Commerce in China, European Business in China Position Paper 2010/11, 141.} Further, CCC testing often duplicates testing already conducted to comply with international standards.\footnote{116 Committee on Technical Barriers to Trade, China’s Transitional Review Mechanism: Communication from the European Communities, G/TBT/W/326, 29 October 2009, para. 7.} This problem is compounded by the fact that several overlapping testing bodies exist in certain industries, each with their own, almost identical standards and certification requirements, leading to double or triple certification.\footnote{117 Committee on Technical Barriers to Trade, China’s Transitional Review Mechanism: Communication from the European Communities, G/TBT/W/326, 29 October 2009, para. 7.} In addition, testing in foreign laboratories is seldom allowed leading to additional costs and delays in getting a product onto the market.

The EC urged China to reform the CCC system to avoid unnecessary barriers to trade. It proposed that China set conformity assessment requirements on the basis of the actual risks associated with the products and consider simplified procedures, including Supplier Declarations of Conformity for lower risk products whenever possible.\footnote{118 Committee on Market Access, China’s Transitional Review Mechanism; Communication from the European Communities, G/MA/W/97, para. 2.2.} Pending such a review, the EC proposed a short-term simplification of the CCC through: wider exemptions for spare parts and components intended for incorporation into a final product that is itself subject to CCC certification; the limitation of factory inspection in third countries to those aspects not covered by ISO 9001 certificates, for factories that are ISO 9001 certified; more recognition of foreign test results; initial factory inspection by foreign bodies; allowing foreign-owned laboratories and certification bodies legally established in China and authorized by the CNCA to test and certify under the CCC scheme; the reduction of administrative burdens (lower certification fees, shorter procedures, fewer test samples, etc.); and the elimination of redundancies with other approval procedures for radio and telecom equipment.\footnote{119 Committee on Market Access, China’s Transitional Review Mechanism; Communication from the European Communities, G/MA/W/97, para. 2.5.}

In the absence of such reform, it appears that several elements of the CCC system are open to challenge under the abovementioned disciplines of the TBT Agreement. In particular, duplicative certification requirements could be found to be more trade restrictive than necessary to achieve the legitimate objectives strived for.
4.6.4 Voluntary standards that become mandatory regulations without notification

The practice in China whereby standards initially developed as "Voluntary Industrial Standards" are later made mandatory (usually by incorporating them in mandatory conformity assessment procedures) has been strongly criticised by the EC.\(^{120}\) Currently 62 bodies in China have the power to draft standards, and many of these can potentially become mandatory. There are now over 3000 national standards in China that have become mandatory.\(^{121}\) Generally no notification in accordance with the provisions of the TBT Agreement is given of the changed status of the standard from a voluntary to a mandatory requirement (de facto a technical regulation). The EU Chamber of Commerce in China has also raised its concerns regarding the fact that voluntary sectoral standards have the potential to become national mandatory requirements.\(^{122}\) An example here is the standard on a Unified Charger for Mobile Telecommunications Terminal Equipment,\(^{123}\) which was developed and initially adopted in 2006 as a 'Voluntary Industrial Standard' but in 2007 became mandatory for all mobile phones and chargers manufactured in China under the Network Access License procedure.\(^{124}\) No notification was given that the previously voluntary standard had become a mandatory technical regulation. This is in violation of the transparency obligations of the TBT Agreement.

4.6.5 Technical requirements for textiles

There are several technical barriers to trade in textiles in China, about which the EC has also raised its concerns. In particular, when revising existing textile standards or developing new ones, the EC requested China to refrain from introducing technical changes or national deviations in Chinese standards as compared with existing ISO standards.\(^{125}\) Such deviations, if not justified, violate the harmonisation provisions discussed above.

Another problem is the mandatory imposition of quality standards for textile and clothing products (such as levels of colour fastness). The EC argues that this be left to market operators to decide upon without state intervention.\(^{126}\) Under the TBT Agreement, technical regulations may only be imposed where necessary to meet a legitimate objective. While there is no closed list of legitimate objectives, China would have to indicate what legitimate purpose underlies its imposition of such requirements.

There are also systematic inspections of imported textiles, clothing and footwear in China. The EC argues that random inspections are sufficient, and that China should accept suppliers’ declarations of conformity and EU test reports as assurance of conformity with applicable requirements.\(^{127}\) The TBT Agreement states that conformity assessment must be limited to what is necessary and may not be more strict or be applied more strictly than is necessary to give the importing Member adequate

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\(^{120}\) Committee on Technical Barriers to Trade, China’s Transitional Review Mechanism: Communication from the European Communities, G/TBT/W/326, 29 October 2009, para. 20-22.


\(^{123}\) YD/T 1591-2006.

\(^{124}\) Committee on Technical Barriers to Trade, China’s Transitional Review Mechanism: Communication from the European Communities, G/TBT/W/326, 29 October 2009, para. 21. See also Business Europe, ‘WTO Trade Policy Review of China’ Position Paper, 14 May 2011, para. 4(e).

\(^{125}\) Committee on Technical Barriers to Trade, China’s Transitional Review Mechanism: Communication from the European Communities, G/TBT/W/326, 29 October 2009, para. 32.

\(^{126}\) Committee on Technical Barriers to Trade, China’s Transitional Review Mechanism: Communication from the European Communities, G/TBT/W/326, 29 October 2009, para. 33.

\(^{127}\) Committee on Technical Barriers to Trade, China’s Transitional Review Mechanism: Communication from the European Communities, G/TBT/W/326, 29 October 2009, para. 34.
confidence that products conform with the applicable technical regulations or standards, taking account of the risks non-conformity would create.

### 4.6.6 Technical requirements for cosmetics

China’s pre-marketing approval procedures for ‘non-special use’ imported cosmetics was criticised by the EC in the context of the TRM. The EC noted that these procedures delayed the marketing of these cosmetics by 4 to 6 months as compared to domestic ‘non-special use’ cosmetics and that this amounts to a violation of the national treatment obligation in the TBT Agreement.\(^\text{128}\)

A further concern regarding the regulation of cosmetics is the fact that two separate standards are currently being enforced by the Ministry of Health (the Hygiene Standard for Cosmetics 2007) and General Administration for Quality Supervision, Inspection and Quarantine (AQSIQ) (the already outdated Standard for Cosmetics (GB 7916-1987) issued in 1987). The EC therefore requested China to develop a single hygiene standard for cosmetics.\(^\text{129}\)

### 4.7 Sanitary and Phytosanitary Measures

Sanitary and phytosanitary measures are concerned with the protection of human, animal and plant health and fall under the separate WTO Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement). This aims to balance the need to liberalise agri-food trade with the right of WTO Members to address risks from food or feed and from pests and diseases of plants and animals.

In response to recent food safety scares, including the melamine in infant formula case, China has taken steps to improve safety and quality of its food and agricultural products. While the EU Chamber of Commerce welcomes these developments, it has raised concerns regarding some issues concerning implementation and feasibility.\(^\text{130}\) In the TRM discussions on SPS issues, the EC emphasised the currently limited market access for its agricultural products to China and pointed to several aspects of China’s SPS measures that are not in conformity with the obligations of the SPS Agreement.

#### 4.7.1 Harmonisation

The SPS Agreement encourages Members to harmonise their SPS requirements around the standards developed by the authoritative international bodies in the area of food safety, animal health and plant health.\(^\text{131}\) If Members choose to apply measures reflecting a higher level of protection than those embodied in international standards, a scientific justification is needed in the form of a risk assessment.\(^\text{132}\)

The EC has pointed out that China’s SPS measures to address risks from H1N1 (swine flu), Bovine Spongiform Encephalitis (BSE or mad cow disease) and several plant health risks, do not conform to the standards set by the relevant international standard-setting organisations referred to in the SPS Agreement.

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\(^{128}\) Committee on Technical Barriers to Trade, China’s Transitional Review Mechanism: Communication from the European Communities, G/TBT/W/326, 29 October 2009, para. 28.

\(^{129}\) Committee on Technical Barriers to Trade, China’s Transitional Review Mechanism: Communication from the European Communities, G/TBT/W/326, 29 October 2009, para. 29.


\(^{131}\) The SPS Agreement specifically refers to the Codex Alimentarius Commission (CAC) for food safety standards, the International Plant Protection Convention (IPPC) for plant health standards and the World Animal Health Organisation, previously called the International Office for Epizootics (OIE), for animal health issues.

\(^{132}\) Article 3.3 and 5.1 of the SPS Agreement.
Agreement. For example, the OIE has listed which bovine products can be safely traded, regardless of the BSE status of the exporting country, including de-boned skeletal muscle meat from cattle. The OIE has also classified 25 EC Member States as "controlled risk" or "negligible risk". Despite this China continues to ban beef and other bovine products from the EU. However, no adequate scientific justification for these stricter measures has been provided by China. If no such justification exists, this would constitute a violation of the SPS Agreement.

Similarly the EU Chamber of Commerce has noted that, with respect to food additives, China's Hygiene Standards for Uses of Food Additives include less than half of the additives approved for food use by the Codex Alimentarius Commission, indicating that the Chinese legislation is lagging behind the development in international standards. This results in unjustified barriers to EU exports.

4.7.2 Transparency and adaptation period

On 1 June 2009, China's new Food Safety Law and the Regulation on the Implementation of the Food Safety Law entered into force. However, contrary to the transparency obligations of the SPS Agreement, neither this new legislation nor its implementing regulation were notified before implementation. Further, there was no 'reasonable adaptation period' to allow time for other Members to adapt to the new requirements, as required by the SPS Agreement between the publication of a sanitary and phytosanitary regulation and its entry into force.

4.7.3 Undue trade restrictiveness

In addition to lack of transparency, the EC has raised doubts as to the compatibility of the chapters on imports and exports in the new Food Safety Law with the requirement of the SPS Agreement that such measures may not be more trade-restrictive than necessary to achieve their objective. The EC noted the vagueness on how different procedures will work in practice, and was concerned that these may delay the processing of imports or cause trade disruptions. If alternative, less trade-restrictive measures are available that achieve the requisite level of protection from food safety risks then the relevant chapters would be in violation of the SPS Agreement.

One of the most important trade restrictive measures facing agri-food exporters to China is the requirement of a Quarantine Inspection Permit (QIP) before a contract may be signed for these exports to be purchased. China's State Administration of Quality Supervision, Inspection and Quarantine (SAQSIQ) has discretion to annul QIPs without prior notification or explanation of reasons, creating unpredictability for exporters. Further, the delays in granting QIPs have led to shipments of agricultural products arriving in Chinese ports of entry without QIPs leading to delays in product discharge and discharge and

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133 Committee on Sanitary and Phytosanitary Measures, Transitional Review Mechanism Pursuant to Paragraph 18 of the Protocol on The Accession of the People's Republic of China, Questions from the European Communities to China concerning Sanitary and Phytosanitary Measures, G/SPS/GEN/968, 20 October 2009, paras 7, 8 and 11.


135 Article 7 and Annex B of the SPS Agreement.


137 Article 2.2 and 5.6 of the SPS Agreement.


139 United States Trade Representative, 2010 Report to Congress On China's WTO Compliance, 81.
unnecessary costs for demurrage for Chinese purchasers. QIPs are granted for limited periods (extended from three months to six months) which locks purchasers into a tight window in which to purchase, transport and discharge cargoes.

Another example of a Chinese SPS measure that appears to be more trade restrictive than necessary is the limitation of the level of yeast in cheese to a maximum of 50 cfu/g. In other markets where cheese consumption has a longer history, it is recognised that yeast in cheese poses no safety concern and no maximum limit is needed.

In addition, China imposes a ‘zero-tolerance’ standard for pathogens in food, such as Salmonella and Listeria, which has led to several foreign meat and poultry facilities being ‘delisted’ (i.e. removed from the list of facilities authorised to export to China). This measure can be seen as unduly trade restrictive as zero tolerance is in many cases an unattainable standard since certain pathogen levels are unavoidable, and do not pose risks to consumers.

4.8 Further discrimination vis-à-vis foreign operators

4.8.1 The ‘Indigenous innovation’ initiative

European firms want non-discriminatory access to the Chinese market. But, the plethora of regulations in place in China does not always treat foreign companies the same as domestic companies. In some cases the discrimination is explicit, such as the ‘Buy Chinese’ initiative launched in 2009 (see above under Government Procurement) whereas in other cases it materialises in practice due to the way the relevant regulation is formulated or applied.

One particularly controversial example of discriminatory treatment is the ‘Indigenous Innovation’ initiative. This is a large-scale government campaign that aims to decrease China’s dependence on foreign technology and to enhance China’s economy and national security, with the final objective of enabling China to become a global technology leader by 2050. In November 2009, three government departments issued the Circular on Launching 2009 National Indigenous Innovation Accreditation Work, granting preferences in government procurement to products that are (1) produced by an enterprise in China that own the intellectual property; (2) covered by a trademark that was first registered in China by a Chinese company; (3) innovative and internationally competitive; and (4) meet Chinese technical standards. By basing preferential treatment on the origin of the creation of the product, China discriminates against foreign and foreign invested companies, discouraging them from developing and marketing innovations in China. Consultations between the European Chamber of

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141 United States Trade Representative, 2010 Report to Congress On China’s WTO Compliance, 82.
145 It should be noted that the Chinese government has encouraged indigenous innovation for several years and it is one of the guiding principles’ of China’s National Medium- and Long-Term Program for Science and Technology Development (2006–2020). Indigenous innovation in government procurement is expressly called for in the 2007 Administrative Measures for Government Procurement of Imported Parts. They require the procurement of imported parts to facilitate indigenous innovation by bringing into China technologies that China then can assimilate. Some of China’s industrial policies also call for indigenous innovation (e.g. the 2004 Auto Industrial Policy, which calls for indigenous innovation in the auto sector.)
Commerce and the Ministry of Science and Technology of China revealed that the discrimination against foreign/foreign invested companies was inadvertent. A revision of this policy was issued in April 2010 by the Ministry of Science and Technology, which relaxed requirement (1) and allowed products based on technology and trademarks licensed to a licensee in China to qualify for preferences. However the implementation of the revision is still doubtful.

4.8.2 Restrictions on pharmaceuticals – the National Drug Reimbursement List (NDRL)

In 2000, China introduced the National Drug Reimbursement List (NDRL). Only pharmaceutical products on the list can be reimbursed under health insurance schemes. The NDRL was last updated in 2004, although current Chinese regulations require it to be reviewed bi-annually. This delay in reviewing the NDRL means that new medicines have no opportunity to obtain reimbursement status, putting recent and innovative drugs at a competitive disadvantage. In 2009, in the context of the TRM of China, the EC pointed out that despite its repeated requests to address this problem, there are currently 106 new molecules approved by China’s State Food and Drug Administration for sale in China awaiting NDRL review. The EC raised its concern that this may lead to de facto discrimination as it has a disproportionate impact on imported products. The Chinese representative responded to this concern by noting that China was in the process of modifying the NDRL for basic medical, occupational injury and maternity insurance. He also pointed out that responsibility for deciding whether some medicines including innovative new medicines should be listed in the catalogue, rests with an expert group composed of over 300 consultants and 20,000 experts, which decides on the basis of coverage, capacity, health, economic assessments and other appraisal thresholds and criteria. The review of the NDRL in November 2009 was hailed as ‘the key advancement of the year’ by the Pharmaceutical Working Group of the European Union Chamber of Commerce. However, it noted that the law has not been strictly enforced and that the irregularity of the updates to the NDRL remains a problem.

Another concern with discrimination in the pharmaceutical sector relates to the long process for clinical trial applications. In order to register an innovative pharmaceutical product, the product must first have been registered in its country of origin and thereafter the clinical trials must be repeated in China. The long approval process, combined with the need to duplicate the clinical trials, results in a delay of 3-4 years between registration of the pharmaceutical in Europe and in China. This may disproportionately disadvantage foreign producers of pharmaceuticals.

If indeed new delays in the process of reviewing the NDRL, which has the effect of excluding new innovative medicines from reimbursement under insurance schemes, and the duplicative requirements for registration of pharmaceuticals disproportionately impact foreign pharmaceutical firms, the EC could challenge this under the national treatment obligation in Art III of the GATT 1994, which obliges WTO Members to grant treatment no less favourable to imported products than to like domestic products.

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148 Committee on Market Access, China’s Transitional Review Mechanism; Communication from the European Communities, G/MA/W/97, 22 September 2009, para. 3.
149 See Committee on Market Access, Minutes of the Meeting Held on 2 October 2009, G/MA/M/50, 22 October 2009, para. 10.4.
4.9 Restrictions to trade in agricultural products

The importance of the agricultural sector for China’s GDP has diminished.\footnote{Agriculture’s share in overall GDP fell from 27% in 1990 to below 12% in 2006.} Yet agriculture still accounts for 39% of total employment, making it crucial in addressing poverty and improving rural livelihoods. Thus government support in the agricultural sector is prevalent. In addition, China’s intervention in the agricultural sector is motivated by food security concerns. The share of food in household spending is high, due to soaring food and energy costs driving inflation. Tackling inflation is therefore now a key government policy objective, given effect to through price controls for key products (such as grains, edible oils, meat, milk and eggs), trade restrictions and increased incentives for the production of staples.\footnote{European Commission, Directorate General for Agriculture and Rural Development, ‘China: Out of the Dragon’s Den?’ Monitoring Agri-Trade Policy No. 01-08.} These measures create obstacles to market access for EU agricultural exports.

As part of its accession commitments when joining the WTO, China agreed to assume the obligations contained in the Agreement on Agriculture, which address market access (tariffs), domestic support to agriculture, and export subsidies. China also made some additional commitments in its Protocol of Accession. Nevertheless, certain significant barriers to trade remain.

The following subsections will address the main barriers to EU agricultural exports. In addition to the barriers discussed here, it should be born in mind that regulatory barriers to trade in the form of sanitary and phytosanitary requirements and technical barriers to trade (which were discussed above) also operate to impede significantly market access for agricultural products.

4.9.1 Tariffs and tariff-rate quotas

In the area of market access, China committed to the establishment of a tariff-only regime, tariff reduction and the binding of all tariffs under the Agreement on Agriculture. In its accession negotiations, China agreed to significant reductions in its tariff rates on a wide range of agricultural products. China has implemented its tariff reduction commitments in a timely manner. China’s trade restrictive measures in the agricultural sector therefore no longer take the form of high average tariff protection, as tariffs are no longer a significant obstacle to market access.

However, tariff rate quotas (i.e. where low tariffs are charged on quantities of imports up to a specified quota limit, and higher tariffs are imposed on the out-of-quota imports) are still commonly used. In its accession negotiations, China committed to eliminate quotas and implement a system of tariff rate quotas designed to provide significant market access for certain bulk commodities. However, in China, the out-of-quota tariff is particularly high and in many cases operates to close market access completely due to the prohibitive level.\footnote{Emerging Markets Group & Development Solutions, Study on the Future Opportunities and Challenges of EU-China Trade and Investment Relations, Study 6: Agriculture, Study Commissioned by the European Commission, February 2007, 18.} The trade restrictive effect of tariff rate quotas however lies not only in the high tariff for out-of-quota imports but also in the manner in which the administration and allocation of the in-quota imports takes place. In China’s Schedule of Concessions for trade in goods, detailed rules are set out intended to limit the discretion of the agriculture TRQ administrator and to require it to operate with transparency and according to precise procedures for accepting quota applications, allocating quotas and reallocating unused quotas. However, as reported by the US Trade Representative in 2010, China’s administration of tariff rate quotas still lacks the necessary
In China, the tariff rate quotas are administered and allocated by the National Development and Reform Commission (for grains and cotton) and the Ministry of Commerce (for sugar and vegetable oils). In-quota imports are distributed among State Trading Enterprises (STEs) and private enterprises, in such a manner that STEs control major shares of key products (such as maize, sugar, cotton and rice). 157

4.9.2 Domestic support

In the area of domestic support, the Agreement on Agriculture promotes a shift in policy to the use of support measures that minimize trade distortions. WTO members are bound to reduction commitments over time in respect of domestic subsidies and other support measures that distort production and trade (calculated as the Aggregate Measure of Support (AMS)), but remain free to implement support measures that have little or no distorting effect (such as agricultural research or training by the government). In its Accession Protocol, China committed to a maximum level of trade- and production-distorting domestic subsidies (AMS) that is lower than that permitted for developing countries in the Agreement on Agriculture, and that includes the same elements that developed countries use in determining whether the maximum level has been reached.

When China shifted away from taxing agriculture to providing support for this sector to support rural incomes, in 2004, a minimum purchase price scheme was introduced for key grains. China’s protective price support system was notified to the WTO as part of its AMS. However, it was calculated as negative AMS for 1999-2001 (the latest period of notification), because the world market reference price was above the domestic price for rice, wheat and maize (although cotton support was positive). 158

Export subsidies

In the area of export subsidies, the Agreement on Agriculture obliges WTO Members to refrain from using such subsidies unless they fall within one of four categories of exceptions. The main exception permits certain export subsidies but subjects them to reduction commitments. However, China agreed to eliminate all export subsidies upon its accession to the WTO without any exceptions.

The US Trade Representative reports that it is difficult to assess whether China is living up to its commitment to eliminate agricultural export subsidies due to its incomplete notification of subsidies (discussed above). In particular, US exporters were concerned that China was providing export subsidies to its corn industry shortly after China’s accession. 159 China’s use of VAT rebates in the agricultural sector, discussed below, was also flagged as a possible export subsidy. According to the US, it seems that a VAT rebate is available upon the export of some agricultural products, including ones for which payment of the VAT was imputed rather than actually paid at a prior stage because of an exemption (as discussed below). China has not responded to the US question how China ensures that the VAT rebate

156 United States Trade Representative, 2010 Report to Congress On China’s WTO Compliance, 73, 75.
159 United States Trade Representative, 2010 Report to Congress On China’s WTO Compliance, 82-83.
in such cases is not excessive,\textsuperscript{160} which would lead to an export subsidy (benefit contingent on export performance).

Further, as discussed above, the China World Top Brand Programme and the Chinese Famous Export Brand Programme have been challenged in WTO dispute proceedings as possible agricultural export subsidies in violation of China’s commitments, to the extent that they apply to agricultural goods.

4.9.3 Import licensing procedures

All imports into China are subject to the requirement of an import licence. Most agricultural products (33 tariff lines including chicken and tobacco) are subject to automatic import licensing which is used to monitor imports. However, selected agricultural products (5 tariff lines) are subject to non-automatic licensing requirements. As the licensing procedure is long and arbitrary (it is reported that processing times vary between two weeks and four months),\textsuperscript{161} this may act as a hindrance to exporters. Exporters have the option of using the services of a registered foreign trade operator to clear their products through customs and quarantine, but this entails additional costs.

4.9.4 Value added tax

Value added tax (VAT) imposed on the sale, import and processing of goods is an important source of revenue for China.\textsuperscript{162} While VAT is imposed neutrally on domestic products and imports in principle, the complexity of China’s VAT system may act as a barrier to trade. While relatively unprocessed agricultural goods are subject to 13\% VAT, more processed products are subject to 17\% VAT. Different VAT rates apply to small taxpayers with a turnover of less than 1 million RMB than to wholesalers. In addition, VAT is calculated differently for domestic and imported goods, the latter being subject to VAT equivalent to the CIF price plus applicable import duties and other domestic taxes, multiplied by the appropriate VAT rate. This may lead to significantly higher VAT charges for imported products.\textsuperscript{163}

Further, several agricultural products are exempted from China’s 13\% VAT rate normally applicable to agricultural products. According to the United States, it appears that sales of certain agricultural products produced and sold by farmers in China (such as wheat, cotton and corn) are exempted from VAT as are sales of agricultural inputs produced and sold in China (such as seed, pesticide, herbicide, agricultural machinery and certain fertilizers). However, when the same products are imported, the normal VAT rate of 13\% applies.\textsuperscript{164} This would amount to a violation of the national treatment obligation of the GATT, which prohibits less favourable treatment of imported products as compared to like domestic products.

\textsuperscript{160}Committee on Subsidies and Countervailing Measures, Transitional Review Mechanism pursuant to Section 18 of the Protocol on the Accession of the People’s Republic of China: Questions from the United States to China, G/SCM/Q2/CHN/41, 23 October 2008, para.10.


\textsuperscript{162}It is reported that in 2002 VAT accounted for almost half of central government revenue in China. See Emerging Markets Group & Development Solutions, Study on the Future Opportunities and Challenges of EU-China Trade and Investment Relations, Study 6: Agriculture, Study Commissioned by the European Commission, February 2007, 22.


\textsuperscript{164}Committee on Subsidies and Countervailing Measures, Transitional Review Mechanism pursuant to Section 18 of the Protocol on the Accession of the People’s Republic of China: Questions from the United States to China, G/SCM/Q2/CHN/41, 23 October 2008, para. 9.
The Chinese government also uses selective exemption of VAT charges to influence import decisions. For example, in 1999 China addressed the domestic over-supply of grain by removing the VAT exemption that applied to grain imports. This resulted in an increase in the price of imported grain and thus an improvement of the competitive position of domestic grain.165

4.9.5 State Trading Enterprises

State Trading Enterprises (STEs) can distort trade in the agricultural sector and operate as an instrument through which the government can retain some influence on imports and exports of key products.166 In particular, STEs are able to restrict imports of certain agricultural products into China as they have exclusive rights to import a large share of China’s total imports of particular products. In addition to its commitments under the Agreement on Agriculture, China also made several additional commitments to address other problematic agricultural policies, either upon accession or after specific transition periods. One of these additional commitments relates to the role of STEs in the agricultural sector.

In China’s Protocol of Accession, agricultural products that are subject to import by STEs are grains (such as maize, rice and wheat), vegetable oils, sugar, tobacco and cotton. While the share of vegetable oils (palm, rapeseed, and soybean) imported by STEs is relatively low, major shares of maize, cotton, rice, sugar, and wheat imports are controlled by STEs, and tobacco remains a state monopoly.

In its Protocol of Accession, China committed to allow non-STEs to import specified tariff rate quota shares of wheat, corn, rice, cotton, wool and vegetable oil.167 However, as noted above, the non-transparent administration of tariff rate quotas in China has led to concerns that in-quota shares are mainly allocated to STEs.

4.10 Barriers to trade in services

China has been taking measures to liberalise trade in services, particularly financial services, telecommunications and tourism.168 However, important restrictions remain on foreign investment and private sector activities (including investment and foreign ownership caps). The presence of State Owned Enterprises in several key service sectors also distort competition and act as barriers to market entry to EU service providers.169

4.10.1 Banking

Discriminatory treatment of foreign banks and their branches remains in some areas. The minimum asset requirements for the establishment of branches of foreign banks are higher than those for locally incorporated banks. Branches of foreign banks may also not issue credit cards.

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166 It has been noted ‘Where China’s import prices are controlled by STEs, they may also be able to exert market power as a purchaser on the world market for commodities where China is a significant importer. That is, if the Chinese STE restricts its imports to maintain high domestic prices, then the decrease in import demand could also reduce the prices it pays for imports in the global market.’ See Emerging Markets Group & Development Solutions, Study on the Future Opportunities and Challenges of EU-China Trade and Investment Relations, Study 6: Agriculture, Study Commissioned by the European Commission, February 2007, 25.
167 United States Trade Representative, 2010 Report to Congress On China’s WTO Compliance, 73.
While wholly foreign funded banks and joint ventures between foreign and Chinese banks may now engage in the same business operations as Chinese banks, both in local and foreign currency, foreign funded banks that want to do business in local currency (RMB) must have been operational in China for at least 3 years and have been profitable for at least 2 years prior to their application.\textsuperscript{170} The EU Chamber of Commerce in China views this 3 year waiting period for an RMB license as a considerable barrier to market access and discrimination against foreign banks.\textsuperscript{171} In addition, it points to inconsistencies in the application of the 2-year profitability requirement leading to unpredictability for foreign banks.\textsuperscript{172} At the end of 2011, a new requirement of 75% ratio between loans and the balance of deposits will come into force. The EU Chamber of Commerce in China has noted that this will adversely affect new market entrants, such as foreign banks, as they have a limited branch network to gather the necessary deposits.

4.10.2 Insurance

The insurance market in China remains highly concentrated in a few national companies.\textsuperscript{173} Foreign insurance companies may enter the Chinese market as 100% foreign-owned subsidiaries for non-life insurance, but only 50% foreign-owned in the case of life-insurance.\textsuperscript{174} Foreign health insurers are also required to set up a joint venture with a Chinese partner, with a maximum of 50% foreign shareholding.\textsuperscript{175} This creates a market access barrier. Under China’s Insurance Law, all insurance companies operating in China must be registered and all persons or organizations requiring coverage in China must obtain insurance from an insurance company established and registered in China. While most licensed foreign insurers and all life insurers are fully incorporated in China, they are still considered ‘non-Chinese’ and therefore subject to additional regulatory requirements and limitations, beyond those applicable to local insurance companies.\textsuperscript{176}

China’s WTO Schedule of Commitments in the services sector specifies that insurance services are subject to restrictions, including 50% maximum foreign ownership. His limitation is therefore not WTO-inconsistent.

4.10.3 Telecommunications

China has three nationwide basic telecommunication service providers, all of which are State Owned Enterprises (where the state is the majority shareholder but private and foreign investment has been

\textsuperscript{172} Specifically, the fact that a number of foreign banks’ RMB licence applications were rejected due to accumulated losses in the banks’ balance sheets raised concerns as the rules governing licensing to not refer to accumulated losses but only to profitability over the last 2 years. European Union Chamber of Commerce in China, European Business in China Position Paper 2010/11, 483.
\textsuperscript{173} Trade Policy Review Body, Trade Policy Review: Report by the Secretariat – China (Revision), WT/TPR/S/230/Rev.1, 5 July 2010, Section IV para. 61. As noted by the EU Chamber of Commerce, in 2009 foreign insurance firms had captured only 1.09% of the market for property and casualty insurance and 4.92% of the market for life insurance. See European Union Chamber of Commerce in China, European Business in China Position Paper 2010/11, 518.
gradually allowed). The telecoms regulator, the Ministry of Information Industries and Technology, sets the tariffs and tariff caps for basic telecom services. In addition, several ministries and departments regulate internet services.

It has been reported that although since its accession in 2001, China has granted 22,000 telecoms licenses in China, only seven were granted to foreign companies.

4.10.4 Construction

Although the construction services sector in China is booming following China’s stimulus package of 4 trillion RMB, which has had a significant role in infrastructure construction, foreign construction companies were awarded only 2% of construction contracts. In addition, foreign construction services are limited to designated areas, such as contracts wholly financed through foreign investment.

Qualification requirements and performance criteria are laid down for foreign-invested construction companies that wish to provide project management services. However, the EU Chamber of Commerce in China has complained of the lack of clarity regarding the qualification requirements and performance criteria against which an application will be assessed.

Further, concerns have been raised regarding the fact that China’s Regulations on the Administration of Foreign-Invested Construction Enterprises limits the ability of wholly foreign owned firms to undertake construction projects to those either financed by international institutions (fully or partly); or Sino-foreign projects where foreign investment exceeds 50%; or domestic construction projects which cannot be undertaken by local companies for technical reasons.

4.11 Foreign Direct Investment

As noted above, in 2009, European direct investment in China (including reinvested earnings of firms controlled by European companies) amounted to €5.9 billion, and the total stock of EU direct investment amounted to €58.3 billion (including reinvested earnings). According to UNCTAD China was the third largest recipient of FDI in the world, after the United States and France in 2008. In 2009, the volume of FDI fell only by 2.6% despite a 39% decrease in FDI flows globally and despite a relatively complicated regulatory regime. According to UNCTAD again, China received 90 USD billion in FDI in 2009, making China the second largest recipient of FDI after the United States.

Nevertheless, investors continue to complain about a lack of transparency and uniformity in the drafting and application of the investment regime. They denounce the weak IPR protection, high levels of corruption and an unreliable legal system that fails to enforce contractual obligations. All these rule
of law related barriers originate in the Chinese legal and political system. While China’s membership to the WTO has played a very impressive role in the reform, it is illusory to expect rapid or profound transformations in the basic legal and political order in China. Investors are therefore likely to face these types of barriers for years to come unless the EU finds new entry points in the negotiations and maintains a firm and united stand.

China had signed 113 bilateral investment (protection) agreements by the end of September 2009. China seems to be very interested to engage in negotiations with the EU on an EU Investment Treaty. China will surely see advantages in a unified set of rules when investing in the EU. China’s Closer Economic Partnership Arrangements (CEPAs) with the Special administrative Regions of Hong Kong and Macao also provide certain privileges to the investors from these territories. But China’s foreign investment policy objectives are primarily defined through its Catalogue Guiding Foreign Investment Industry, which was last updated in November 2007. The new Catalogue divides industries into three basic categories (encouraged, restricted, and prohibited) and suggests that China may become more selective and target specific sectors when it comes to FDI. Other measures have been adopted at the national level such as the measures for Administration of Establishment of Partnership Enterprise by Foreign Enterprises or Individuals within China published on 25 November 2009 and entered into force in March 2010 or the 2009 revisions to the 2006 Provisions on the Mergers and Acquisitions of Domestic Enterprises by Foreign Investors promulgated by MOFCOM and five other government agencies.

But the major problems lie at the local level and largely depend on China’s multilayer governance system. In 2005 the Central government began delegating to local governments licensing authority for the establishment and modification of operations of “encouraged” Foreign Invested Enterprises (FIEs) and certain sectors. Since 1 May 2009, MOFCOM has officially delegated the authority of examination and approval of foreign FDI to the local commerce authorities of various provinces, autonomous regions, and municipalities. This was originally to facilitate FDI approval, but has resulted, as one could have expected, in higher degrees of procedural complexity if not corruption.

In 2009, during the last transitional review mechanism exercise, the representative of the European Union expressed a number of concerns relating to China’s investment regime including the following issues are of particular importance:

- the limitations on foreign ownership resulting from China’s industrial policy in steel;
- contractual incoherence and limitations in China’s application of the WTO Accession Protocol with regards to the approval of foreign investment by national and local authorities (i.e. approval conditional on local content or other performance requirements including transfers of technology);
- limitations on the Joint Venture ownerships

These major concerns are underlined in many other EU reports including the recent Business Confidence Survey of the European Chamber of Commerce in China or reports made by EU firms to Business Europe. The following EU industries are particularly worried: heavy industry (steel especially), the textile Industry, and the automobile Industry to a lesser extent.

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185 Bilateral investment agreements provide notably for protection against expropriation without adequate compensation and include provisions on dispute settlement. See the complete list of China’s investment agreements from the UNCTAD repertory at [http://www.unctad.org/templates/Page.asp?intItemID=2344&lang=1].


187 Interviews conducted with Business Europe.
**EU-China Trade Relations**

**GOVERNMENTAL POLICIES PERCEIVED AS DISCRIMINATING AGAINST FOREIGN INVESTED ENTERPRISES (FIE), 2010-2011**

<table>
<thead>
<tr>
<th>Perception over last 2 years</th>
<th>Outlook for next 2 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>2011</td>
</tr>
<tr>
<td>Gallernental policies discriminate against FIEs</td>
<td>33%</td>
</tr>
</tbody>
</table>

**TOP 3 KEY DRIVERS FOR CHINA’S FUTURE ECONOMIC PERFORMANCE, 2011**

<table>
<thead>
<tr>
<th>Key drivers for China’s economic performance</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rule of law/transparent policy-making and implementation</td>
<td>88%</td>
</tr>
<tr>
<td>Domestic consumption</td>
<td>87%</td>
</tr>
<tr>
<td>Promote fairer competition and fewer monopolies</td>
<td>83%</td>
</tr>
</tbody>
</table>


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**Figure 23: RESPONDENTS’ 5 MOST SIGNIFICANT REGULATORY OBSTACLES, 2011 [%]**

**Question:** How significant are the following regulatory obstacles to you when doing business in Mainland China?

<table>
<thead>
<tr>
<th>Top five regulatory obstacles</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discretionary enforcement of broadly drafted laws and regulations</td>
<td>42%</td>
</tr>
<tr>
<td>Lack of coordination of different regulators</td>
<td>40%</td>
</tr>
<tr>
<td>Lack of harmonisation with global standards</td>
<td>39%</td>
</tr>
<tr>
<td>Registration processes for companies/products</td>
<td>38%</td>
</tr>
<tr>
<td>Local implementation of Chinese standards</td>
<td>35%</td>
</tr>
</tbody>
</table>

4.11.1 Intellectual Property

Ten years after China’s accession to the WTO, a comprehensive structure of intellectual property rights (IPR) protection laws has been put in place. This legislative structure basically complies with China’s international commitments\(^\text{188}\). However, two major barriers can be identified in the sphere of IPR.

First, poor enforcement of IPR laws remains a significant problem. This continues to impede the development of Chinese intellectual property and is a significant problem for European companies wishing to enter the Chinese market. In the field of cultural products, such as films, television programmes and computer games, China’s continuing restrictions on what can be imported and who can be licensed to import and distribute these products, has fuelled a market for pirated versions of these products, which in turn has spilled over into related fields such as computer software. China has a range of different administrative institutions, charged with protecting IPR, but these have overlapping mandates, and do not coordinate or cooperate adequately. They also suffer from capacity problems, resource constraints, lack of training, lack of transparency in the enforcement process, as well in the final disposal of infringing products, local protectionism and endemic corruption\(^\text{189}\). While China has made significant efforts to establish specialized civil IP courts, these courts suffer from a high caseload, lack of independence, and the difficulty of enforcing civil verdicts in China\(^\text{190}\). Furthermore, the methodology of calculating economic compensation for infringement results in very low damage awards. In 2009, the average damage awarded in IP infringement cases was 41,059 RMB (~4250 Euro)\(^\text{191}\). As a result, infringement remains rampant in all fields of IP, reducing business opportunities and the profitability of European companies.

Second, as part of the drive to promote indigenous innovation, the Chinese government extends preferential treatment to products with Chinese-owned IPR. These policies are often embedded in public procurement, technical standards, tax and anti-monopoly laws and regulations and aim to build domestic R&D capacity, in order to increase Chinese enterprises’ international competitiveness and decrease reliance on foreign technologies\(^\text{192}\). This discriminates against foreign and foreign-financed enterprises, deterring them from developing and marketing innovative products on the Chinese market.

There are a number of other concerns. In the judicial field, the complex requirements for notarisation and legislation of powers of attorney and evidence from outside China remain a burden on rights holders in enforcement proceedings\(^\text{193}\). The criminal enforcement thresholds – although not expressly deemed a violation of WTO commitments in the China Intellectual Property case in the WTO – may induce strategic behaviour by infringers to avoid criminal prosecution\(^\text{194}\).

The decision to conduct R&D in China is further influenced by Article 20 of the Patent Law, which indicates that, regardless of the nationality of the applicant, all patent applications outside of China for an “invention or utility model accomplished in China” are subject to confidentiality review. The interpretation of “accomplished in China”, is unclear possibly resulting in companies in good faith

\(^{191}\) Figure compiled from CIELA database, \text{http://www.ciela.cn}, 15 April 2011.
\(^{192}\) These policies are based on the National Intellectual Property Rights Strategy of 2006, see also European Union Chamber of Commerce in China, European Business in China Position Paper 2010/11, 73.
\(^{194}\) This has been a particular concern of the United States, see for example United States Trade Representative, 2010 Report to Congress On China’s WTO Compliance, 83-84.
applying for patents outside of China for inventions which they did not consider to be “accomplished in China”. The legal consequence of this would be that the State Intellectual Property Office (SIPO) could reject or invalidate the patent application in China, or that third parties could initiate patent invalidation procedures.\footnote{195See European Union Chamber of Commerce in China, European Business in China Position Paper 2010/11, 74.}

Lastly, there has been an increase in the number of bad faith trademark applications. While the Supreme People’s Court (SPC) has already issued a number of useful guidelines for courts and trademark authorities, procedural issues and loopholes remain. The duration of trademark opposition or cancellation procedures and the lack of coordination between different administrative departments impede registry or recovery of trademarks subject to bad faith applications.\footnote{196See European Union Chamber of Commerce in China, European Business in China Position Paper 2010/11, 76.}

**China — Measures Affecting the Protection and Enforcement of Intellectual Property Rights (DS362)**

**A Landmark Case**

On 10 April 2007, the United States requested consultations with China regarding four matters related to protection and enforcement of intellectual property rights. One issue related to a question of translation was resolved during the consultation phase, but three measures remained to be settled at the panel stage. These concerned:

- Thresholds for criminal procedure and penalties in cases of trademark counterfeiting and copyright piracy
- The disposal by Customs officials of confiscated infringing goods after removal of their infringing features
- The denial of copyright protection and enforcement to works that have not been authorized for publication or distribution in China.

On 13 November 2008, the Panel circulated its report in which it found that:

- The exclusion of a number of copyright and trademark infringements by China’s enforcement thresholds, is not enough to find a violation of Article 61 TRIPS, as this only requires criminal measures against “willful trademark counterfeiting or copyright piracy on a commercial scale”. It further found that the United States had not proved that the Chinese thresholds would fail to meet this test.
- There was a technicality with the disposal of confiscated infringing goods, as TRIPS required the auction of goods after removal of infringing features to be permitted only in exceptional cases. The Chinese regulation did not contain this proviso.
- Article 4 of the Chinese Copyright Law denies copyright to works not authorized for publication or distribution in China, which is a violation of Article 5(1) Berne Convention and hence of Article 9.1 TRIPS, which incorporates this provision into WTO Law

By March 2010, the National People’s Congress and the State Council had approved the necessary revisions to the measures at issue.

**Source:** WTO Website, Dispute Page DS 362 – China – Intellectual Property Rights, [http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds362_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds362_e.htm), retrieved on 26 May 2011
### Intellectual property enforcement, 2006-08

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Intellectual property cases dealt with by administrative actions</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Patents</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of disputes</td>
<td>1,270</td>
<td>1,013</td>
<td>1,126</td>
</tr>
<tr>
<td>Number concluded</td>
<td>973</td>
<td>749</td>
<td>868</td>
</tr>
<tr>
<td><strong>Copyright</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of disputes/administrative penalties</td>
<td>10,559</td>
<td>9,816</td>
<td>9,032</td>
</tr>
<tr>
<td>Number concluded</td>
<td>10,344</td>
<td>..</td>
<td>..</td>
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<tr>
<td>Imposition of fines (Y million)</td>
<td>7.6</td>
<td>19.1</td>
<td>14.2</td>
</tr>
<tr>
<td>Cases transferred to judicial agencies</td>
<td>235</td>
<td>268</td>
<td>238</td>
</tr>
<tr>
<td>Business inspected</td>
<td>..</td>
<td>548,646</td>
<td>782,670</td>
</tr>
<tr>
<td>Illegal operation units banned</td>
<td>..</td>
<td>13,170</td>
<td>36,601</td>
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<tr>
<td>Underground dens detected</td>
<td>..</td>
<td>1,224</td>
<td>694</td>
</tr>
<tr>
<td><strong>Trade marks</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of disputes</td>
<td>50,534</td>
<td>50,318</td>
<td>56,634</td>
</tr>
<tr>
<td>Trade mark infringements</td>
<td>41,214</td>
<td>42,314</td>
<td>47,045</td>
</tr>
<tr>
<td>Other</td>
<td>9,320</td>
<td>8,004</td>
<td>9,589</td>
</tr>
<tr>
<td>Cases transferred to judicial agencies</td>
<td>252</td>
<td>229</td>
<td>137</td>
</tr>
<tr>
<td>Value of fine (Y million)</td>
<td>398</td>
<td>417.6</td>
<td>467.4</td>
</tr>
<tr>
<td><strong>IPR cases handled by Customs at the border</strong></td>
<td>2,475</td>
<td>7,456</td>
<td>11,135</td>
</tr>
<tr>
<td>Value (US$ million)</td>
<td>27.2</td>
<td>64.5</td>
<td>43.2</td>
</tr>
<tr>
<td><strong>Intellectual property cases dealt with by courts</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>First instance civil IPR cases accepted</td>
<td>14,219</td>
<td>17,877</td>
<td>24,406</td>
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<tr>
<td>First instance civil IPR cases closed</td>
<td>14,056</td>
<td>17,395</td>
<td>23,518</td>
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<tr>
<td>Patent cases accepted</td>
<td>3,196</td>
<td>4,041</td>
<td>4,047</td>
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<tr>
<td>Patent cases closed</td>
<td>3,227</td>
<td>3,847</td>
<td>4,132</td>
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<td>Trademark cases accepted</td>
<td>..</td>
<td>3,855</td>
<td>6,233</td>
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### EU-China Trade Relations

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
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</thead>
<tbody>
<tr>
<td>Trademark cases closed</td>
<td>..</td>
<td>3,617</td>
<td>6,068</td>
</tr>
<tr>
<td>Copyright cases accepted</td>
<td>5,719</td>
<td>7,263</td>
<td>10,951</td>
</tr>
<tr>
<td>Copyright cases closed</td>
<td>5,751</td>
<td>7,226</td>
<td>10,255</td>
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<tr>
<td>Technical contract cases accepted</td>
<td>681</td>
<td>669</td>
<td>623</td>
</tr>
<tr>
<td>Technical contract cases closed</td>
<td>668</td>
<td>649</td>
<td>636</td>
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<tr>
<td>Unfair competition cases accepted</td>
<td>1,256</td>
<td>1,204</td>
<td>1,185</td>
</tr>
<tr>
<td>Unfair competition cases closed</td>
<td>1,188</td>
<td>1,230</td>
<td>1,210</td>
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<tr>
<td>Other IPR cases accepted</td>
<td>846</td>
<td>727</td>
<td>1,340</td>
</tr>
<tr>
<td>Other IPR cases closed</td>
<td>844</td>
<td>705</td>
<td>1,217</td>
</tr>
<tr>
<td>Second instance civil IPR cases accepted</td>
<td>2,686</td>
<td>2,862</td>
<td>4,759</td>
</tr>
<tr>
<td>Second instance civil IPR cases closed</td>
<td>2,652</td>
<td>2,870</td>
<td>4,699</td>
</tr>
</tbody>
</table>

.. Not available.

a The Chinese authorities changed their statistical methods in 2007 so the number of cases concluded regarding copyright is no longer available.

**Source:** WTO Trade Review Mechanism 2010 (WT/TPR/S/230/Rev.1), Data provided by the Chinese authorities.

## 5 BARRIERS TO TRADE IN THE EU

The EU is currently the main export destination of China. Consequently, barriers to trade in the EU can have a significant impact on Chinese exports. China has noted its concerns regarding several EU trade barriers in the context of the most recent Trade Policy Review (TPR) of the EU, and has outlined these further in its Foreign Market Access Report of 2010. This Chapter highlights the main areas in which EU market access restrictions have raised concerns for China, namely tariffs, technical regulations, sanitary and phytosanitary measures, trade remedies, government procurement, agricultural subsidies, and investment barriers.

### 5.1 Tariffs

#### 5.1.1 Complex system of tariff rates for agriculture

China has raised concerns regarding the complicated tariff system of the EC, which creates difficulties for foreign exporters when applying to the border customs authorities in the EU. China has noted that the WTO Secretariat report in the context of the EU's TPR of 2009 has pointed to a wide dispersion of tariff rates, particularly on agricultural products. In addition, the EU maintains 'seasonal tariffs' for fresh fruit and vegetables, which aim to provide some protection to domestic producers. The EU also mixes different types of tariff, namely specific, alternate and compound duties and together with the frequent

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changes in the standard import price for agricultural products in the EU, this complex tariff system creates difficulties for Chinese exporters.\textsuperscript{198}

It should be noted, however, that the entry price system of the EC and its seasonal tariffs were agreed upon at the time of the Uruguay Round negotiations.\textsuperscript{199} Thus, although the complexity may create obstacles for exporters, it is WTO consistent.

5.1.2 Modification of Tariffs on Poultry Meat

The EU has modified its schedule of tariff concessions in respect of poultry meat, by converting its single tariff to a tariff rate quota. Under WTO rules, such modification is permissible, but the member that does so must negotiate equivalent concessions to compensate the principal suppliers of the product.\textsuperscript{200}

China is one of the world’s largest exporters of poultry products. It has complained that under the new EU system, China, together with third countries, can obtain only 10% of the quota at the lower tariff rate per year. However, the EU has refused to negotiate compensation for China, arguing that in the reference period used to determine negotiating rights (2003-2005), there were no significant imports of poultry from China. China has asked that this matter be resolved bilaterally, or it ‘will be obliged to consider other options.’\textsuperscript{201}

5.2 Technical barriers to trade, including SPS measures

China has noted that in the 2-year period covered by the EU’s latest Trade Policy Review, the EU had modified hundreds of technical barriers to trade and sanitary and phytosanitary measures. China considers some of these measures unnecessary and creating excessive burdens on exporters, and has requested the EU to phase them out. It reports that the EU has instead increased the trade restrictions it maintains in the form of technical barriers to trade and SPS measures.\textsuperscript{202}

5.2.1 Technical barriers to trade

A particular example of a TBT referred to by China as of great concern is the REACH (Registration, Evaluation, Authorisation and Restriction of Chemical substances) system of the EU that covers hundreds of chemical substances.\textsuperscript{203} This came into force on 1 June 2007 and has been the subject of much criticism. China has noted that it has been raised 19 times by as many WTO members.\textsuperscript{204} Specific concerns about REACH are; the burdensome nature of its procedures, particularly for small and medium

\textsuperscript{198} Trade Policy Review Body, Trade Policy Review: European Communities. Minutes of the Meeting – Addendum, WT/TPR/M/214/Add.1, 2 July 2009, p. 34.
\textsuperscript{200} Article XXVIII GATT 1944.
sized enterprises; the high registration fees; and the insufficiency of the technical assistance provided by the EU. The EU refutes all these allegations.\(^{205}\)

China also claims there are TBTs restricting trade in traditional herbal medicines. The EU Directive in this area\(^{206}\) allows traditional herbal medicines without safety or efficacy trials. But China has argued that in practice the Directive functions as a market access barrier, laying down numerous obstacles for Chinese traditional medicines. For example, the composition requirements of the Directive allow only plant products and in limited cases minerals to form part of the medicine. Whereas Chinese traditional medicines are more complex and include plant, mineral and animal products. The Directive also requires evidence of at least 30 years of medicinal use, including at least 15 years within the EU. China argues that classical Chinese medicines, which have been widely used for many years and have demonstrated no toxicity, should be exempt from the 15 years of use in the EU requirement.

5.2.2 Sanitary and phytosanitary measures

With regard to sanitary and phytosanitary measures, China argues that risk management in the EU, and in particular its maximum residue levels for contaminants in food are not purely based on scientific analysis as required by the SPS Agreement.\(^{207}\)

A particular example is the proposal to place goji berries on the EC novel foods list, if no historical evidence of significant consumption of goji berries in the EU prior to May 1997 is provided. If this occurs, goji berries may not be marketed in the EU before going through a complicated process of risk assessment and authorisation.\(^{208}\) This would amount to a provisional ban on a product purely on the basis that it is ‘novel’ in the EU market, in the absence of a scientific assessment demonstrating that it poses a health risk. Such a ban is difficult to justify under the rules of the SPS Agreement.

Another SPS measure noted by China is the regulation of 2007 on maximum residue levels (MRLs) for agricultural chemicals on tea leaves. Of the 227 chemicals addressed, 207 have MRLs set at the lowest limits of analytical determination (0.1mg/kg). The EU applies such limits to avoid any potential risk when it does not have sufficient information on toxicological endpoints and residue trials. China notes that this greatly increases the difficulty of exporting tea to the EU, particularly from developing countries. Further, inspection for pesticide residues since 1998 is conducted on 1 kg samples of dried tea leaves rather than liquid tea. This increases the likelihood that exports will be found to exceed the MRLs. China’s exports of tea leaves to the EU have dropped by 58.7% since 1998.\(^{209}\)

5.3 Trade remedies

The use of trade remedies have been the cause of some concern for China. These can take the form of countervailing duties (to counteract the effects of subsidies) or anti-dumping duties (in response to sales on the export market below the normal value of the product).


\(^{208}\) This procedure is set out in Regulation (EC) No. 258/97 of the European Parliament and the Council of 27 January 1997 concerning novel foods and food ingredients.

In the context of the Trade Policy Review of the EC in 2009, China noted that the EU has become one of the major users of trade remedies, such as anti-dumping measures. In the first half of 2008, the EC had 131 definitive anti-dumping measures in place, 45 of which were against Chinese exports.\(^{210}\) China emphasised the negative impact such measures have on its trade with the EU, and asked the EU to ‘refrain from abusing trade remedy measures in the future.’\(^{211}\) In July 2009, China initiated WTO dispute settlement proceedings against the EU, challenging the EU’s imposition of anti-dumping duties against steel fasteners from China.\(^{212}\) According to the Panel in that case,\(^{213}\) the EC’s Anti-Dumping Regulation violates inter alia the Anti-Dumping Agreement because, with respect to producers from non-market economy countries, the calculation of individual dumping margins and the imposition of individual duties is conditioned on the fulfilment of certain criteria in the case of imports from non-market economy countries.\(^{214}\) This panel report was appealed in March 2011 and is pending a decision by the Appellate Body.\(^{215}\)

A very recent example of the EU’s application of trade remedies against China is the decision, on 14 May 2011, by the EU to impose both countervailing and anti-dumping duties on imports of coated fine paper from China. A 15-month investigation by the EU found that China provided subsidies to this industry in the form of cheap loans, tax incentives and land use at lower than market prices.\(^{216}\) In addition, it established that Chinese producers of coated fine paper were engaging in dumping (i.e. exporting their products to the EU at prices below normal value). The countervailing duties announced will range between 4 to 12 percent, while anti-dumping duties will be set at 8 to 35.1 percent depending on the producer. Both duties will be in place for 5 years with possible extension.\(^{217}\) Although anti-dumping duties have been applied several times by the EU to China, this will be the first time that countervailing duties are imposed.\(^{218}\)

### 5.4 Agricultural subsidies

The EU subsidies to the agricultural sector under the CAP have significant implications for foreign exporters of agricultural products and constitute barriers to market entry. The WTO Agreement on Agriculture (AoA) has a specific set of disciplines that apply to subsidies in the agricultural sector. These

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\(^{212}\) The imposition of anti-dumping measures on 31 January 2009 was the result of an investigation by the EU that established that dumping that was harming domestic EU industry, as Chinese producers of fasteners benefited from artificially low prices on raw materials. The duties range from 0 - 85% and are applicable for five years from entry into force.

\(^{213}\) Panel Report, European Communities — Definitive Anti-Dumping Measures on Certain Iron or Steel Fasteners from China, WT/DS397/R, 3 December 2010.

\(^{214}\) Article 9(S) of Council Regulation (EC) No. 384/96

\(^{215}\) Note China’s application of anti-dumping duties on steel fasteners from the EU in response, which was correspondingly challenged by the EU (discussed in Chapter 3 above).


\(^{218}\) It is possible that the EU’s change of approach, and its decision to impose countervailing duties in respect of a non-market economy was influenced by the Appellate Body decision in United States — Definitive Anti-Dumping and Countervailing Duties on Certain Products from China, WT/DS379/AB. Here the Appellate Body upheld the Panel’s interpretation of Article 14(d) of the SCM Agreement as allowing an investigating authority to reject in-country private prices if these are distorted due to the government’s predominant role in the market. It agreed with the Panel’s conclusion, given the evidence of the Chinese Government’s predominant role as a supplier of hot-rolled steel, and having considered evidence of other factors, the US Department of Commerce could determine that private prices in China were distorted and could not be used as benchmarks for calculating the amount of the benefit.
are less strict than the general subsidy rules contained in the SCM Agreement. The AoA distinguishes export subsidies and domestic support measures.

The WTO Secretariat has reported, in the context of the 2009 TRP of the EU, on the variety of forms of market intervention in the agricultural sector and aid for the promotion of food and agricultural products maintained by the EU. China has raised these ‘domestic support’ measures, but they are permissible under the WTO Agreement on Agriculture if they are notified and stay within the maximum limits established for domestic support. Under the reform of the CAP many domestic support subsidies were decoupled from production, thus diminishing their trade distorting effect. Direct income support for farmers was introduced instead. However, in the heavily protected agricultural subsectors of beef, veal, mutton and poultry, payments linked to production continue to play an important role. China has asked the EU whether it plans to phase out this support. In response, the EU has indicated that after the recent agreement on the so-called Health Check, coupled payments will decline further leading to over 90% of support taking the form of decoupled payments. Those that remain coupled are for reasons of landscape maintenance in member states where land abandonment is a real threat.

Export subsidies by the EU in the sugar and dairy sector reportedly accounted for a third of total export subsidies in 2006-2007. Export subsidies for butter and cheese, which had been terminated, were reintroduced in 2009. China has asked the EU to share its ideas on the phasing out of these export subsidies.219 The EU has pointed out that the export subsidies for sugar have been suspended since October 2008, but that the dairy subsidies were reactivated due to the market situation. No end date is fixed for these subsidies.

5.5 Government procurement

China, unlike the EC, is not a party to the WTO Agreement on Government Procurement (GPA). As a result, it does not benefit from the non-discrimination obligations set out under this agreement. China has asked the EU to specify the differences in the requirements for GPA parties and non-GPA parties wishing to participate in EU government procurement. The EU has clarified that in EU tendering procedures, suppliers from third countries have the right to participate on a non-discriminatory basis only if such a right is granted to them under an international agreement concluded by the EU in the field of government procurement (i.e. the GPA or a bilateral agreement). In the absence of such an agreement, there is no legal certainty for such third country suppliers seeking to participate in EU tendering procedures.220

5.6 Investment barriers

China has argued that some of the restrictions on foreign investment maintained in certain EU Member States seem unnecessary and burdensome. In particular it has pointed to the following measures in four Member States.221

1. France limits investment in the following sectors to French nationals, nationals of other EU Member States, and nationals of countries with which France as bilateral agreements: gambling institutions, insurance and commodity brokerages, private research institutions, forwarding institutions, etc.

agencies, public market trading, audio-visual communications, telecommunications, French-language publishing firms, theatrical and artistic performing companies, tobacco and beverage retailing, private security companies and pharmacists.

2. Spain requires investments in the following fields (except those from other EU member states) to be licensed by the Directorate General of Trade Policy: casinos, television and radio broadcasting, air transport and national defense. Furthermore, licences are required for investments by non-EU governments and enterprises owned or controlled by governments.

3. The Czech Republic prohibits foreign nationals from buying agricultural farmland on its territory for 7 years after its accession to the EU. It also applies investment restrictions in the following fields: mortgage banking, asset management, passenger airlines, passenger and freight road transport, bonds underwriting and construction engineering services.

4. Hungary prohibits foreign nationals from buying agricultural farmland on its territory for 10 years after its accession to the EU. It also restricts foreign ownership in the following fields: civil aviation, television and broadcasting.

China would like the EU to relax these restrictions in the spirit of trade facilitation. However the EU regards its free movement of capital regime as one of the most liberal in the world. It has nevertheless stated that it remains ‘committed to maintaining and furthering an open investment environment’.222

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6 CONCLUSIONS AND RECOMMENDATIONS

6.1 Grasping the China Opportunity: EU States at the Core of a New Strategic Partnership

EU companies are well equipped to overcome the current China challenges, but they need to be better supported by a more unified EU that takes more account of the specificities of the China’s situation including the limits and incoherence of China’s Protocol of accession to the WTO. To do so, we feel the EU could concentrate on the following targets:

- Overcoming Fragmentation and Reaching an Operational Consensus

A lack of unity among the various EU (and Member State) links and discourses with China impedes the development of a coherent EU economic strategy vis-à-vis China. The EU needs a single voice if it is to be more effective in its policy aims.

There are currently too many institutions concerned with the EU-China relations, which results in inefficiencies. A more streamlined institutional structure would help the EU better achieve its political and economic strategies.

As discussed in this report, the institutional framework of EU-China trade relations is very complex and suffers from serious coordination problems. The latest organization chart available on the Commission website dates from 2005, and it seems there is disagreement as to how many dialogues and working groups are there. Economic relations, on the other hand, are governed by the High-Level Economic and Trade Dialogue, the EC-China Joint Committee established by the TCA, ministerial and senior official meetings, and economic and trade working groups. Under these there are over 25 dialogues and working groups, involving a variety of participants and in various forms from informal exchanges to conferences and formal annual meetings. Many dialogues and working groups involve more than one DG or Chinese administrative body and work autonomously. This lack of coordination is not only present horizontally, within the Union, but also vertically, between Union, national and sub-national levels. Member States, or individual regions and municipalities conduct their own China policy outside of the Union’s activity. This crucial issue should be seen in the context of internal tensions within the EU that influence trade policy towards China. Not all Member States stand to gain from increased trade with China, as jobs are endangered and sectors opened up to strong Chinese competition. However, we feel that this lack of coordination impairs the realization of EU objectives and plays a key role in its limited credibility as a united Organisation in China.

- Visibility

Along the same lines, EU policies and measures vis-à-vis China suffer from a lack of visibility compared, for example, with the USA. This is in part due to the institutional fragmentation mentioned above and an apparent absence of political unity.

EU reports and analysis are not easily accessible and the EU seems often absent in the media compared to a very systematic and hence powerful American discourse.

EU uses the WTO mechanisms to point out a number of specific trades concerns and so make public its major claims. Amongst those, the WTO Trade Policy Review (TPR) mechanism plays a key role. But this is not sufficient and does not help the EU produce an original, coherent and visible discourse.

One concrete measure that would enhance the visibility of EU policy would be to publish a yearly assessment report of China’s compliance to the WTO based on the USTR model. This would not require a massive effort as relevant information is already available but not yet summarized in a single readable document. Yet, the quality of EU technical publications on China may need to be improved. To do so,
the EU, on the US model again, may have to collaborate more systematically with external experts specializing in very precise legal and economic issues. This, of course, will require a real investment. The 10th anniversary of China’s accession to the WTO (December 2011) certainly deserves special attention and landmark publications should be released by the EU.

— What economic model for the EU vis-à-vis China?

Although the adoption of a unified industrial policy is unlikely to happen soon at the EU level, we feel priority should be given to a re-evaluation of the role of the State. As demonstrated in this report, this lack of unity and coherence is evidenced in the EU approach to anti-dumping and subsidies or the granting of Market Economy Status. EU member states do not necessarily have the same policy objectives while China or the US maintains a clear stance. Furthermore, China (and India) still very much relies on the role of the State in its economic and industrial policies and has recently succeeded in gaining new developing countries markets. A difficult debate needs to be open in this regard. The European Parliament, with its technical expertise and diversity of approaches could play a leading role in thinking new economic policies forward.
POLICY DEPARTMENT

Role
Policy departments are research units that provide specialised advice to committees, inter-parliamentary delegations and other parliamentary bodies.

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