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China and the WTO
- Legal Restructuring in Preparation for the Accession

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Summary

Finally, after 15 years of effort, China is expected to become a member of the World Trade Organization (WTO) later this year. China has experienced a rapid economic growth in the last 20 years. With the world's largest population, China could very well become the largest market in the world. It is therefore understandable that China's entry into the WTO is a major event in the world trade.

China has worked hard to become a WTO member. In the transformation from a planned economy toward a market economy there have been extensive reforms. In the bilateral WTO accession agreements, China has agreed to open up its markets, and to lower its tariffs and other trade barriers. The advantages of a WTO membership are many, but China will also have to make a lot of difficult adjustments. With the opening of new markets to foreign companies the state-owned enterprises will have to face new competition.

To adjust to the WTO it is necessary for China to improve its legal system. China has already made some preparation in the legal field, but still hundreds of laws need to be examined and amended. Much of China's legal system has been established after the late 1970s. The speed of the lawmaking has been very rapid. In order to comply with the WTO principles and create a more transparent business environment, changes have been made in the legal framework for foreign investment and trade. In 1999, China's long anticipated unified Contract Law was issued, clearly showing China's willingness to adopt international principles. There has also been great improvement in the field of intellectual property right, however the enforcement of the rules needs to be strengthened. A new Tax Law unifying the current domestic and foreign income tax laws is also expected to be drafted.

The WTO accession will have great impact on China's trade regime and it will help China to become a full member of the international trading system.

Preface

My interest for China began in 1997, when I started to study Chinese at the Department of East Asian Languages, Lund University. The following summer I had the opportunity to do an internship with a joint-venture company in Beijing, and my interest for China grew even stronger. In the year 1999-2000 I was an exchange student of Fudan University, Shanghai. The pace of the economic and infrastructure development in Shanghai was astonishing. It was not seldom when chatting with a taxi driver, that he would tell me that the reason for him becoming a taxi driver was that the state-owned enterprise he had worked for had been shut down. This is another side of the social and economic reforms in today's China.

Now China's negotiations for a WTO membership finally seem to succeed. It has been very interesting to try to follow and evaluate China's impending WTO Accession.

I would like to thank Professor Michael Bogdan at Lund University, who let me write my diploma thesis on the legal aspects of China's WTO accession.

Lund, 19 January 2001

Malin Truedsson

Abbreviations

CIRC	China Insurance Regulatory Commission
CJV	Contractual Joint Venture
CLSPH	China Legal System Publishing House
CPC	Communist Party of China
EJV	Equity Joint Venture
FDI	Foreign Direct Investment
FIE	Foreign Invested Enterprises
FTL	Foreign Trade Law
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
IPR	Intellectual Property Rights
ITA	Information Technology Agreement
MFN	Most Favoured Nation
NIC	Newly Industrializing Countries
NPC	National People's Congress
NTB	Non-Tariff Barriers
NTR	Normal Trade Relations
PBOC	People's Bank of China
PNTR	Permanent Normal Trade Relations
PRC	People's Republic of China
SAT	State Administration of Taxation
SEZ	Special Economic Zones
TRIM	Trade Related Investment Measures
TRIPS	Agreement on Trade Related Aspects of Intellectual Property Rights
TRQ	Tariff Rate Quota System
UNIDROIT	International Institute for the Unification of Private Law
VAT	Value Added Tax
WFOE	Wholly Foreign Owned Enterprise
WTO	World Trade Organization

1 Introduction

1.1 The Subject of the Study

China's anticipated accession to the WTO is by many said to be the most important economic event in China since Deng Xiaoping started the "open-door" policy in 1978. The accession effects many different areas, and many reforms and changes are necessary. Understanding the impact of China joining the WTO is a very complex issue, and it would not be possible to cover all aspects of the accession in this thesis. I have chosen to study the existing laws and tried to explore the future development of the legal framework affected by a WTO accession.

The trend in the economic world today is that most countries are adopting internationally recognized principles in conducting their economic activities, this also includes developing countries, as in this case China. In order to take part in the international economic exchanges it is also necessary to play the rules formulated by the leading industrialized countries and manifested in the legal framework of major international economic organizations.

1.2 Purpose and Delimitation

The purpose of this study was to evaluate the legal aspects of China's accession to the WTO. I have analyzed how the Chinese laws have been changed in order to prepare for the WTO entry, and have made a comparison study how these rules correspond to the international law in relevant areas. The WTO entry affects many areas of the legal system. At present the Chinese government is working hard to make preparations for the impending WTO accession. Hundreds of laws need to be examined and amended when necessary. It would be an impossible task to cover all of these laws. I have therefore chosen to focus on the major areas that are affected by joining the WTO, such as foreign trade and investment, intellectual property rights, contract law, taxation and financial services.

1.3 Method, Outline and Materials

I have conducted research in Lund, Sweden and Shanghai, China. The literature that I have used is almost entirely in English, either in original or translated from Chinese. Most of the materials have been found in the Shanghai Library, the East Asia Library of Lund University, and the Lund

Faculty of Law Library. A large number of articles have been found on the Internet. Due to the nature of the subject, the Internet is the source where the latest developments in Chinese law, and the WTO accession process are to be found.

To fully understand the legal development in today's China I find that it is necessary to open the thesis with an overview of China's economic and political system. This is followed by a presentation of the WTO and China's accession process. After this I describe the legal system of the PRC and account for the different law areas affected by the WTO entry.

There is no government organ responsible for producing official translations of Chinese laws. However, there are some exclusive arrangements with some publishing houses such as the China Legal System Publishing House (CLSPH). In any case "unofficial" commercial translations are often far better than officially approved translations.

There are a number of websites that provide English-language translations of PRC law free of charge:

- <http://www.qis.net/chinalaw> (Contains information about Chinese law and legal texts in English and Chinese)
- <http://www.chinaonline.com> (Look under "Reference Tools" and you will find a collection of recent legislation)
- <http://www.chinasite.com/Law.html>
- <http://www.isinolaw.com> (A large collection of PRC laws and regulations)
- <http://www.findlaw.com/12international/countries/cn.html>
- <http://www.chinalegal.net/>
- <http://www.chinatoday.com/law/a.htm>

If you can read Chinese, and are looking for Chinese texts, I also recommend these websites:

- http://www.cn99.com/cgi-bin/get_lsts?listname=newlaw (Provides an email update service on recent legislation)
- <http://www.lawbook.com.cn/law/index.htm>

2 Policies of Economic Reform and Lawmaking

To understand the legal development in China it is necessary to have basic knowledge about the background for the economic changes and the political system in China.

2.1 Economic Reforms in Post-Mao China

In the last years China has been trying hard to create a market economy. It all started in 1978 when the Communist Party led by Deng Xiaoping introduced the “open-door” policy. The Party, influenced by the experience of the East Asian Newly Industrializing Countries (NICs), and affected by the growing domestic discontent, started to question the country’s isolation from the rest of the world. The shift in economic policy from a planned economy toward a market economy where market forces to a larger extent determine the market prices, wages and production, was a fundamental change in China’s development.¹

The centralized planned economy system came into use during the first five-year plan² after the founding of the PRC. This strict system with too tight control over the enterprises and a too high level of centralisation seriously undermined productivity. During this period enterprises had no autonomy at all. Although these problems became evident already after this first five-year period and a few reforms had been made, it was not until 1978, and the Third Session of the Eleventh Congress of the Chinese Communist Party that new fundamental reforms were introduced.³

2.1.1 A Socialist Market Economy

In 1993, China declared to the world that the goal of China’s economic reform is to establish a “socialist market economy”. This was clearly stated in the Amendments to the Constitution of the PRC.

The original version of Article 15 of the Constitution of the PRC states:

The state practises planned economy on the basis of socialist public ownership. It ensures the proportionate and co-ordinated growth of the

¹ Denny Roy, *China’s Foreign Relations* (UK: Macmillan Press, 1998), pp.85-86.

² The first five-year plan was implemented in 1953, since then a new five-year plan has been made every five years.

³ Shangquan Gao, *China’s Economic Reform* (UK: Macmillan Press, 1996), p. 2.

*national economy through overall balancing by economic planning and the supplementary role of regulation by the market. Disturbance of the socioeconomic order or disruption of the state economic plan by any organization or individual is prohibited.*⁴

The new version of Article 15 after the amendment states:

*The state practices socialist market economy. The state shall enhance economic legislation and improve macro-control of the economy. The state shall, in accordance with the law, prohibit disturbance of the socioeconomic order by any organization or individual.*⁵

What is meant by a socialist market economy? A social market economy is a market economy operating under socialist conditions. The socialist market economy is still based on public ownership, but this is not the sole form of ownership. In order for China to enter the world trade and follow the open-door policy it was required to transform into a market economy.⁶ As part of the transformation China tries to strengthen the function of the market mechanism and has in this process abolished the people's communes and the state monopoly on purchase of farm products. The state-owned enterprises have been given greater freedom in regulating their business activities. An important step was to remove restrictions on pricing so that a market-behaviour can be created.⁷ China has also set up a number of "special economic development zones" (SEZs).⁸ These zones are used as experimental zones for the economic reform in the country. The zones also aim at opening China to the outside world and promote trade, new technology and management, and they have shown to be very successful.

2.1.2 Recent Developments

Since the economic reforms started in the late 70's China has experienced high economic growth rates, with a growth of China's Gross Domestic Product (GDP) at an annual average of 8 percent during 1978-96. This growth has mostly been a result of a catch-up growth due to the disbanding of the agriculture sector. Those high growth rates are now gone and the economy suffers from the effect of massive, and accelerating restructuring. China's preparations to enter the WTO will accelerate the pace of the toughest reforms yet in agriculture, the state-owned sector and banking.⁹

⁴ Art 15, Constitution of the PRC, adopted in 1982.

⁵ Art 7, Amendments to the Constitution of the PRC, adopted on March 29, 1993.

⁶ Gao, p.6.

⁷ Pan Zhihong, *Investing in China: Questions and Answers* (Beijing: Foreign Language Press, 1999), pp. 3-5.

⁸ Special Economic Zones were first established in the early 1980's, today these zones include Shenzhen, Zhuhai, Shantou, Xiamen, and Hainan Island.

⁹ *The Economist*, "Survey China", 8 April 2000, pp. 1-2.

In 1978 China was among the world's poorest countries, and even though the economic reforms, and the structural change has transformed China, in the end of 1998 there was still 110 million people in China with incomes of less than US \$1 a day. The economic development has not reached all parts of the vast country. It is mostly in the coastal areas that China has seen this dramatic change. The interior parts, and the western part of China are lagging behind. The Chinese government is therefore trying to increase investments in these areas through different development programmes.¹⁰

The Chinese government is pushing through tough economic and legal reforms in an attempt to move from relations-based to rules-based governance. For a long time the Chinese economy has been based on relationships. Now China has to produce a large number of commercial laws in order to develop a functional market economy. In this time of transition China faces a number of problems such as the structural reform of the state-owned industry resulting in mass unemployment, lack of rules and enforcement of the rules.

2.2 The Political System

2.2.1 Constitution and Government

The present Constitution of the PRC was adopted in 1982, amendments have been made in 1991 and 1993. Even though the Constitution of the PRC does not have the same long history and important status as constitutions in many Western countries, it establishes the principle of supremacy of the constitution.¹¹ The Constitution also establishes a constitutional form with a division of powers. However, it is important to point out the central position held by the Communist Party of China (CPC).

In China, a distinction is often made between the "form of the state" and the "form of the political system", that is the CPC and the National People's Congress (NPC).¹² The CPC is not explicitly mentioned in the Constitution, with the exception of the Preamble, but the first article stipulates that "the PRC is a socialist state under the people's democratic dictatorship led by the working class and based on the alliance of workers and peasants". Also, according to the "four basic principles" drawn up in the Preamble to the Constitution, the first principle is the leadership of the CPC.

¹⁰ The World Bank, See Country Overview, "The World Bank and China", at www.worldbank.com.

¹¹ According to Article 5 of the Constitution "No laws or administrative or local rules and regulations may contravene the Constitution".

¹² Albert HY. Chen, *An Introduction to the Legal System of the People's Republic of China* (Butterworths Asia, 1992), pp. 45-47.

2.2.2 The Role of Law

To understand the magnitude of the lawmaking process that now takes place in China, it is necessary to have the historical perspective on how law has been looked upon earlier in China. China was often said to be a country where there was no rule of law. The explanation is that traditionally the Chinese society has been very influenced by the great philosopher Confucius (551-479 BC). The Confucian values are a set of hierarchical moral norms and rituals that regulate human relationships. By following these norms the goal is to achieve peace, harmony, and social stability. According to the Confucian ideology, the way to control the people should not be by the use of law (*fa*), but by following the moral norms (*li*). If the people would follow these moral norms, disputes could easily be settled through friendly negotiations, and laws would not be necessary. Laws played only a secondary role and were only needed to punish criminals.¹³

Confucianism has been the dominant philosophy in China for almost two thousand years. In the traditional Chinese society law, and the practice of law, was never considered to be of such importance as in the Western world. The strong influence by the Confucian values explains why the role of law in China, compared to other countries, has been very weak. It is therefore easy to understand that China is now facing a great challenge in establishing a modern legal system.

2.2.3 Lawmaking Institutions

There are several authorities at different levels that are responsible for making laws and regulations in the PRC. The highest legislative organ is the NPC.¹⁴ The NPC is an elected body comprising about 3000 members that meet once a year.¹⁵ The NPC has the power to revise the Constitution (requires a special procedure), and create major legal codes referred to as “basic laws”.¹⁶

The second highest legislative organ is the NPC Standing Committee. The NPC Standing Committee is a group of about 130 people, elected by the NPC that meet every two months. When the NPC is not in session the NPC Standing Committee can revise basic laws. It also has the power to enact laws that are not basic laws.¹⁷ Since the NPC is only in session for a few weeks

¹³ Michael Bogdan, *Komparativ rättskunskap* (Stockholm: Nordstedts Juridik, 1993), p. 211.

¹⁴ Art 57, Constitution.

¹⁵ Murray S. Tanner, *The Politics of Lawmaking in Post-Mao China* (New York: Oxford University Press, 1999), p. 44.

¹⁶ Art 62, Constitution.

¹⁷ Art 67, Constitution.

every year, the permanent organ that exercises the legislative power, is the Standing Committee of the NPC.¹⁸

The day-to-day running of the country lies with the State Council also called the “Central People’s Government”¹⁹. It is the highest organ of state administration and has the powers to issue administrative regulations in accordance with the Constitution and the laws. The State Council is lead by the Premier. The Legislation Bureau is the State Council’s office for lawmaking, this is where many drafts on laws are made and examined.²⁰

In addition to these state organs, there are also various local authorities, such as people’s congresses, and people’s governments in provinces, municipalities and capital cities of provinces, that provide local regulations.²¹

The CPC is also part of the Chinese lawmaking system. In the Western world it is not clear exactly which role the Party has in the lawmaking process and how the leadership works. The Politburo, the Party’s Central Secretariat and their leading groups and departments are involved in lawmaking. Party leadership over lawmaking is accomplished through organizational penetration of the NPC and control over key NPC appointments. The members of the NPC have to be approved by the CPC. The CPC has heavy influence in the legal debate and through its organizations it oversees the legal drafting.²²

¹⁸ A. Chen, p. 56.

¹⁹ Art 85, Constitution.

²⁰ Tanner, p. 44.

²¹ A. Chen, p. 85.

²² Tanner, pp. 55-57.

3 China and the WTO

3.1 The World Trade Organization (WTO)

The WTO is the successor to the General Agreement on Tariffs and Trade (GATT).²³ Near the end of the Second World War countries started to discuss plans for a post-war system of regulating world trade and significant tariff reduction negotiations were held which resulted in the creation of GATT.²⁴ The multilateral trading system has developed through several rounds, or negotiations, the last one, the Uruguay Round, leading to the creation of WTO in 1995. The multilateral negotiations create a kind of international constitution for trade and market access, and put pressure on each country to open up its trade with other countries and in that way give broader access to its markets. Today WTO has 140²⁵ members, and together they make up for over 90% of the world trade.

The WTO rules consist of the different agreements created during the negotiation rounds. The GATT is the oldest agreement, and it constitutes the basis of the WTO rules. Together with the Uruguay Round came the General Agreement on Trade in Services (GATS) and the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS). The rules deal with trade in goods, trade in services, the protection of intellectual property rights, and dispute settlements.

Through these agreements the members are guaranteed that their exports will be treated fairly and in return they are expected to do the same for imports into its own country.²⁶ In the beginning GATT dealt with trade in goods, trying to take away trade barriers and lowering customs duty rates etc. Later also the service sectors such as banks, insurance firms, telecommunications companies etc became part of the trade agreements in the GATS.²⁷ Unlike GATT the WTO rules also contain rules for the protection of intellectual property rights. Today, intellectual property rights in one form or another regulate a large volume of the world trade. The breaches of the intellectual property rights present barriers to fair trade. Some industrialized countries have experienced a considerable loss in export revenues due to the illegal copying. To prevent such abuse and to create a fairer trade market the TRIPS was created.

²³ The GATT was an international agreement setting out the rules for conducting international trade, but it was also an organization created later to support the agreement, now replaced by the WTO.

²⁴ The GATT was signed by twenty-three nations on 30 October 1947.

²⁵ As of 30 November 2000 the WTO has 140 members, see www.wto.org/.

²⁶ This is manifested in the principle of national treatment, Article III GATT, Article XVII GATS, and Article III TRIPS.

²⁷ See <http://www.wto.org/>.

In order to enforce the WTO rules, the WTO has created as a system for dispute settlement. If a country's government feels that its rights according to the agreements are being infringed they can bring a dispute to the WTO. The dispute is then being settled through consultation with the help from independent experts.²⁸

3.2 History of China's WTO Accession Process

China was one of the original twenty-three signatories to the GATT in 1947, one of the founding members. As a result of the civil war in China, the Kuomintang government of the Republic of China had to flee to Taiwan. After the establishment of the People's Republic of China in October 1949, the Taiwan government continued to occupy the "China seat" in many international organizations, including the GATT and the United Nations. But according to GATT it was necessary for a member state to have complete autonomy over the customs area and be able to decide on tariffs, therefore the government on Taiwan had to withdraw its membership in 1950. Since then China has not been a member of the GATT.²⁹

The Chinese government has never recognized the withdrawal made by the Taiwanese government. It argues that the Nationalist regime in Taiwan ceased to be the legitimate government of China in 1949, and since the PRC has never consented to the withdrawal, China has continued to be a contracting party.

In 1986 China officially notified the GATT Director-General of its intention to resume its membership in the treaty. In 1987 a working party, consisting of all interested member governments, was established to examine China's status. This working party was later transformed to a WTO Working Party.³⁰ Since then China has made continuous efforts to obtain approval for its application.

The US is China's second largest trading partner. The US-China negotiations have been in forefront of the discussions concerning China's remaining obstacles to WTO membership. The discussions between the US and the PRC have seen many ups and downs. There have been issues in several areas such as human rights and the Taiwan question, but the most common factors against the accession were China's partial market economy and its weak legal-system.³¹

²⁸ See <http://www.wto.org/>.

²⁹ Alka Acharya and G P Deshpande, "A Season of Opportunities: China's Impending Entry to the WTO", *China Report*, Vol. 36, No. 2, April-June 2000, p. 167.

³⁰ See <http://www.wto.org/>.

³¹ Acharya and Deshpande, p. 172.

In 1989 following the so-called Tiananmen incident, the Working Group was suspended for two years. In 1994 during the Uruguay Round China made efforts to conclude GATT negotiations, but failed. Although China was granted observer status in 1995, it was still excluded as a member of WTO.

After a fourteen-year long process of negotiations it finally seems that China's accession to the WTO is close to completion. After numerous work group meetings and bilateral negotiations with the member countries, it looks as if China soon will become a member of the WTO. As China moves into the final stages of WTO accession, a few important phases yet remain. The finalization of the "draft protocol of accession", and the submitting of the protocol to the WTO General Council. After this there will be a vote on the draft protocol requiring two-thirds majority, and finally the NPC would have to ratify the agreement.³²

3.3 The WTO Agreements

The final details of China's WTO package will not be known until agreements have been reached with all the members of the Working Party, and approved by the members of the WTO. However it seems likely that the bilateral agreements between the US and China, and the agreement with the EU will form the basis for the final agreement. Since the final "Protocol of Accession" is not yet available it is therefore of interest to study the major outlines of the bilateral agreements.

3.3.1 The US-China Bilateral WTO Agreement

An important step in the process of joining the WTO was for China to reach an agreement with the US. Due to the impending WTO meeting in Seattle in November 1999, China was keen on reaching an agreement so that it could be part of the global trade debates. Negotiations were held with the US in April 1999, but they failed. This was followed by the Kosovo crisis, the bombing of the Chinese Embassy in Belgrade in May 1999, which led to a temporary breakdown in the China-US negotiations. After new negotiations in November 1999, the China and US finally reached an agreement.³³

³² Hong Kong Trade Development Council, "China's Entry to the WTO", July 2000, at www.tdctrade.com/econforum/citi/000702.htm.

³³ Acharya and Deshpande, pp. 169-171.

Another problem in the US-China WTO relation is the issue of Most Favoured Nation (MFN)³⁴ also called Normal Trade Relations (NTR). China and the US established diplomatic ties in 1979 and signed a bilateral trade agreement in the same year, under which the two countries are required to give each other the MFN treatment. Due to the Jackson-Vanik amendment of 1973, which was designed to deny MFN trade status to communist countries, the American Congress has for the last ten years annually been reviewing China's MFN status. Human rights issues have often been part of the debate.³⁵ According to Article I of the GATT unconditional MFN, Permanent Normal Trade Relations (PNTR) is required from all members. The US Senate voted in favour of granting China PNTR on September 19 2000, thereby nullifying China's need for annual review of NTR status.

In the US there has been many groups against granting China PNTR. Labour unions and human rights organizations have argued that by granting the bill, this would reward a country that oppresses its citizens. The US labour-intensive industries have strongly opposed to China's WTO accession. But on the other hand there are those that consider China's WTO accession to contribute to a more stable development in Chinese politics. After numerous negotiations the governments of China and the US reached a bilateral agreement on China's accession to the WTO on 15 November 1999. Jiang Zemin, the president of the PRC, refers to the agreement as a "win-win" outcome for both sides.³⁶ He argues that China's accession to the WTO serves great interests to both nations. China is the fourth-largest trading partner of the US, and the US is China's second-largest overseas investor and trading partner. The US-China accession agreement will increase American firms' access on Chinese markets and improve China-US relations.³⁷

The agreement covers all agriculture products, all industrial goods and all service areas. The full text version of the agreement consists of a several hundred pages and it can be downloaded from the Internet³⁸. I will here try to summarize the most important commitments.

- Agriculture -

China and the US are the two largest agriculture producers in the world. In a wider agriculture trade between these two nations they will be able to

³⁴ According to the MFN-principle, if one member is granted a special favour, such as lower duty rates, it has to include all the other members as well. All member countries have to be treated equally.

³⁵ Acharya and Deshpande, p. 174.

³⁶ Jiang Zemin, "China's Accession to the WTO Serves the Common Interests of China, The United States, and the World", *China Business Review*, Jan-Feb 2000, at www.chinabusinessreview.com/0001/zemin.html.

³⁷ Zemin, at www.chinabusinessreview.com/0001/zemin.html.

³⁸ For details of the Sino-US Bilateral WTO Agreement, see www.uschina.org/.

increase the use of their comparative advantages. It seems that China is now prepared to leave its traditional principle of self-sufficiency in food-grains and allow more imports.³⁹ The agreement provides the American agriculture sector wider access to the Chinese market. Commitments include:

- Cuts in tariffs on agriculture products that will be completed by 2004. Average tariffs will fall to 14.5% for US priority products and to 17% on all other products.
- Eliminate export subsidies for agriculture products.
- Right to import and distribute products without going through a state-trading enterprise or middleman.
- Establishment of a tariff-rate quota system (TRQ) for import of bulk commodities.

- Industry -

China will eliminate a wide range of systemic barriers to US exports, such as limits on import and distribution rights, and barriers such as quotas and licenses.

- Average tariffs will fall to 9.4% by 2005, and for priority products to 7.1%.
- New opportunities for US auto exporters. Tariffs will be cut from 100% or 80% to 24% by 2006.
- China will participate in the Information Technology Agreement (ITA), eliminating all tariffs on products such as computers, telecommunications equipment and other high technology products by 2005.

-Services-

China has made commitments in all major service sectors and has agreed to eliminate most foreign-equity restrictions. For the first time China has agreed to open up its telecommunications sector. China has also acceded to the WTO Basic Telecommunications and Financial Services agreements and agreed to “grandfather” the current market-access activities.

- China will allow 49% foreign ownership in mobile services within 5 years of accession.
- China will expand the scope of activities for foreign insurance companies and within 3 years eliminate all geographical limitations.

³⁹ Pieter Bottelier, “The Impact of WTO Membership on China’s Domestic Economy, Part II”, at www.chinaonline.com/commentary_analysis/wtocom/currentnews/secure/c01010260.asp.

- Foreign banks will be given greater market access. Within 5 years they will gain full market access and be able to conduct local-currency transactions.

- Special Safeguards and Anti-dumping Provisions -

The US has negotiated extensive safeguards and anti-dumping provisions in the US-China agreement. According to the MFN principle these provisions will also be available to all the other member states.

- The US can continue to apply the current non-market economy methodology in anti-dumping cases involving imports from China for no less than 15 years.
- China has agreed to a special safeguard mechanism that will remain in place for 12 years after the accession, whenever unexpected import surges are considered to be disruptive to the domestic markets.

3.3.2 The EU-China Bilateral WTO Accession Agreement

The trade between Europe and China started already 2000 years ago, between the Roman Empire and the Han dynasty. In 1979 China was only Europe's number 34 trading partner, where as today China is the EU's fourth largest trading partner. Today many European companies have invested in China. These investments give benefits to China in form of new technology and management know-how.⁴⁰ In recent years there has also been an increase of Chinese companies investing in the EU. With China as a member of the WTO, the EU-China investment is expected to rise dramatically in the coming years.⁴¹

In May 2000, European Trade Commissioner, Pascal Lamy, signed an agreement with China concluding the bilateral market access agreement with China. The EU agreement and the US agreement are both important steps towards China's WTO membership. The agreements are considered to be a great success, and even include areas that previously were generally believed to be impossible.⁴² Since the US-China agreement was concluded prior to the EU-China agreement, many topics were covered by the US agreement. The EU agreement therefore covers questions that are of specific interest to

⁴⁰ Opening Statement by Ambassador Endymion Wilkinson, Seminar on WTO and New Regulatory Environment of Exchanges between China and EU, 22 June 2000, at www.delchn.cec.eu.int/WTO/osa.htm.

⁴¹ Wenhua Shan, "Towards a Legal Framework for EU-China Investment Relations", *Journal of World Trade*, Vol. 34, No. 5 (2000), p. 137.

⁴² Kommerskollegium, "Bilateralt anslutningsavtal till WTO: EU-Kina – information och utvärdering", at www.kommers.se/dokument/files/utv%e4rdering%20av%20avtalet%20eu%20kina%202edoc.

the EU countries. The rest of the WTO members according to the MFN principle can also enjoy the undertakings made to the US.⁴³

In general the EU-China agreement resulted in the lowering of import tariffs on over 150 leading European exports, agreed levels generally around 8-10 percent. Great progress was made in the service sector, and the scope of insurance business will expand for foreign companies.⁴⁴ The highlights of the EU-China agreement are as follows:

- The timetable for opening up the telecommunication sector has been accelerated, in three years foreign investment will be allowed at 49% in mobile telecommunications.
- European insurance companies will be able to conduct the same business as Chinese companies, with a few exceptions, already in three years.
- European carmakers will be able to produce a larger variety of vehicles.
- Many EU key agriculture products will be given greater market access.
- Improved market access in many service sectors, such as banking, legal services, accountancy, and tourism.

3.4 Analysis of China's Accession to the WTO

Prime Minister Zhu Rongji has worked hard to speed up China's accession to the WTO. For China the WTO membership is expected to improve the domestic economy that has been weakening in the last years. This has been in part a result of the Asian Crisis, but also because of the domestic problems with the state-owned enterprises. The accession is expected to increase foreign investment, as new markets will be opened to the WTO members. As the markets open there will be more competition and the pressure on the state-owned enterprises will increase, forcing them to become more efficient. Joining the WTO will not only open the door for foreign products but will also lead to wider access for Chinese products on the international markets.

3.4.1 Impact on China

From an economic point of view, open trade will allow the country to show its comparative advantages and will permit the people to acquire the goods at the lowest cost. The reduced trade barriers will benefit Chinese consumers, and they will be able to buy many products at a lower price, for example cars. But the WTO accession will also have a negative impact on China. There are many sectors in China that have been protected by the

⁴³ See www.kommers.se.

⁴⁴ The European Commission Directorate-General for Trade, "Highlights of the EU-China Agreement on WTO", at <http://europa.eu.int/comm/trade/bilateral/china/high.htm>.

government and thus have not had to face the competition from the outside.⁴⁵ China will be forced to do restructuring in key sectors such as telecommunications, banking, autos, and agriculture. In contrary the WTO membership and the lowering of export barriers are expected to help China in such sectors as textiles, toys and light-manufactured goods.⁴⁶ In addition to the opening of new markets and lowering of trade barriers the WTO membership will force China to strengthen the rule of law, legal and regulatory reforms that are needed to conform to the WTO.

China has to make many adjustments in order to be able to join the WTO. One might ask why China is so keen to join the WTO? China's economy has undergone enormous development in the last 15 years with an average yearly GDP increase of 8%, but China can still gain a lot from a WTO membership. From a political point of view a membership in the WTO increases China's influence on world trade and gives the US a less dominant part in world politics. Since the Kuomintang government fled to Taiwan in 1949 and the membership in international organisations moved with it, it has been important for China to become a member of the WTO before Taiwan.⁴⁷

China is hoping that a WTO membership will help enhance a high and efficient economic growth. The opening of many sectors will attract foreign investment and this will help China fight the employment problems. The opening of the service sectors to foreign firms, and the speeding up of these industries will help generate new jobs and bring in scarce skills. The membership is believed to give China a more stable access to foreign markets. There will be less unpredictable policy shifts and this will reduce trade disruptions. A more secure and open market will attract foreign investors. The foreign direct investment (FDI) is very important to China, it does not only bring capital but also technology, management and market information.⁴⁸

By joining the WTO there will be even more pressure on the leaders to push through difficult reforms that are required for the membership. As a part of the economic reform China will now have to restructure the state-owned enterprises that for a long time have been an obstacle for the economic development. As the markets open up there will be greater competition between Chinese firms and foreign firms. Market forces will control the firms, and this will automatically lead to more efficient organisation and control within the Chinese firms.⁴⁹

⁴⁵ "The Unfathomable Consequences of China's WTO Entry", *Economic Daily News* (translated from Chinese), 19 November 1999, at <http://news.cens.com/bilingual/wto/b.htm>.

⁴⁶ "EU, Beijing Clear Major Hurdle to China Trade Status", *Washington Post*, 19 May 2000, at <http://www.washingtonpost.com/wp-dyn/articles/A36576-2000May19.html>.

⁴⁷ Pieter Bottelier, "The Impact of WTO Membership on China's Domestic Economy, Part I", January 2001, at <http://www.chinaonline.com/issues/wto/currentnews/secure/c01010160.asp>.

⁴⁸ Leonard K. Cheng, "China's Economic Benefits from Its WTO Membership", Dec 1999, Center for Economic Development, at www.bm.ust.hk/~ced/wto.htm.

⁴⁹ Cf.48. www.bm.ust.hk/~ced/wto.htm.

The WTO membership will force China to regulatory reforms and building up institutions. Chinese laws need to be changed in order to conform to the WTO regulations. This will lead to a more modern and transparent legal system. A better legal system will also make it easier for foreign investors.

3.4.2 Is China Ready to Join the WTO?

It will be difficult for China to meet all the conditions for the accession. Even though China in most cases has been given adjustment periods over five years, it is still a challenging task. If China does not implement agreed reforms in time there will be disputes with WTO partners. As said above there are many long-term benefits for China as a member of the WTO. But there are significant short-terms adjustment costs. With the opening of new markets to foreign firms there will be greater competition and many domestic companies are expected to become bankrupt. This will lead to increased unemployment.

Risk lies in the opening of the banking sector since this could cause great problems, and even a financial crisis. The performance of the major state banks suffers from losses on loans to state-owned enterprises.

After the WTO entry the state-owned enterprises will no longer have the same protection of the central government, or the same privileges in conducting trade. The enterprises will have to compete with other domestic and foreign enterprises. In order for these state-owned or state-run enterprises to survive and not be driven to bankruptcy they will have to establish new ways of doing business and take an active part in the international economic co-operation. It is also important to further develop the industries where China has a competitive advantage, such as textiles, clothing, footwear and toys.⁵⁰ Even though it is feared that inefficient domestic enterprises will be forced to close down and the unemployment rate would increase rapidly; domestic enterprises have some advantages. The Chinese local firms understand the domestic markets and are familiar with the distribution network.⁵¹

As an effect of lowered tariffs and reduction of other trade barriers China is expected to lead to a surge in imports and a reduction in China's trade surplus. On the other hand China is expecting an increase of foreign

⁵⁰ Liang Yanfen, "The Impact on China's Enterprises of Joining the WTO", *The Chinese Economy*, Vol. 33, No. 2, March-April 2000, p. 38.

⁵¹ Hong Kong Trade Development Council, "China's Entry to the WTO", July 2000, at <http://www.tdctrade.com/econforum/citi/000702.htm>.

investors seeking to get a piece of China's vast markets and this will help to reduce the negative impact on the balance of payments.⁵²

⁵² Cf. 51, at <http://www.tdctrade.com/econforum/citi/000702.htm>.

4 The Chinese Legal System and the WTO Rules

I will here give a short presentation over the development of the Chinese legal system. After this I will present some important principles of the WTO and elucidate how these correspond with the Chinese legal system.

4.1 Establishment of the PRC Legal System

When the People's Republic of China was founded in 1949 the Kuomintang legal system was abolished, and law was seen basically as a political weapon that could be used as a threat of force. Under the leadership of Mao Ze Dong China was a country practically without a legal system. Efforts were made in the late 1950s to rebuild the legal system and Soviet models were used. With interruptions such as the Cultural Revolution of 1966-1976, where virtually all the laws were destroyed, the turning point in China's legal development came first in 1978.⁵³

In line with the theories of Marx and Lenin the law and the legal system was seen as the will of the ruling society in a class society. Using laws was a way to oppress the governed class. This is also the reason for the negative attitude toward the legal system of Western countries where we have legal concepts as "public law" and "private law". It was important to stress that the legal system of the PRC was a socialist one. In the 1950's China invited many legal experts and scholars from the Soviet Union.⁵⁴

In 1978 under the leadership of Deng Xiaoping it was declared that a legal system was necessary for the modernisation of socialist China. A legal system was needed in order to provide social order and enhance the economic development. During this time, as the "open-door policy" was introduced China began making a vast number of new laws, especially rules regulating economic and commercial relations.⁵⁵ When Deng Xiaoping came to power only a few rules existed in China, but by 1998 the National People's Congress (NPC) had promulgated no less than 328 statutes, and more than 700 regulations had been issued by the State Council. In the last 15 years the speed of the lawmaking has been extremely rapid.⁵⁶

⁵³ Jianfu Chen, *Chinese Law: Towards an Understanding of Chinese Law, Its Nature, and Development* (Hague: Kluwer Law Int., 1999), pp. 37-40.

⁵⁴ Xin Chunying, *Chinese Legal System & Current Legal Reform* (Beijing: KAS-Occasional Papers, 1999), pp. 333-334.

⁵⁵ J. Chen. pp. 40-41.

⁵⁶ J. Chen p. 97.

The adoption of the economic reform in China, to change from a socialist planned economy to a socialist market economy, also has great implications for the legal development in China. In the process of constructing new laws large attention has been given to foreign legal models. It is often said that the new Chinese laws should be made in accordance and in harmony with the international practice. One early example is the Joint Venture Law first promulgated in 1979, where large parts were borrowed from foreign law practices. Foreign law was to be used mainly as a reference for constructing socialist law with Chinese characteristics. The borrowing from international practice is also considered important since it is said to attract foreign investment and advanced technologies. Many of the commercial and economic related laws made in the 1980s, such as the Foreign Economic Contract Law, the Trade Marks Law and the Patent Law, show clear signs of western influence in their structure and language.⁵⁷

4.2 Major Obstacles to China's Accession to the WTO

The fundamental difficulties for China lie in the fact that it has inherited a non-market foreign trade legal regime, which in many cases is incompatible with the market-based principles of the WTO. Although China has made substantial progress in transforming from a planned economy to a socialist market economy it will still face considerable obstacles in joining the WTO.

One of the general principles of the WTO is the principle of non-discrimination. This principle ensures that all benefits given to any contracting party through multinational or bilateral negotiations should automatically be given to all other contracting parties. A country is not allowed to discriminate between its trading partners. This principle of reciprocity, known as MFN treatment is stipulated in Article I GATT.⁵⁸ There are some exceptions although where discrimination is allowed.⁵⁹

In China the pre-reform foreign trade regime was highly discriminatory. The government monopolized all trade activities. The purpose of foreign trade was not exchanging goods but, for the government to get hold of necessary products and foreign currency. The state did not only treat domestic and foreign enterprises differently, but did also give different treatment to certain industries depending on its policy needs. When China enters the WTO and lowers its trade barriers and opens its markets, it will have to do so to all of its trading partners.

⁵⁷ J. Chen pp. 48-52.

⁵⁸ The principle of MFN is also found in Article II GATS, and Article IV TRIPS.

⁵⁹ See Article I, XIV, GATT.

The second general principle of the WTO is the principle of national treatment. According to this principle, imported and locally produced goods should be treated equally. National treatment only applies when the goods have entered the market. This principle is stipulated in Article III of GATT. The principle also applies to services (Article XVII of GATS) and intellectual property rights (Article III of TRIPS). National treatment requires that internal taxes and other charges, laws, regulations and other requirements affecting business transactions must be applied to domestic and foreign entities on an equal basis.⁶⁰

The lowering of tariffs and other trade barriers encourage trade, this is the very idea behind the creation of GATT. In the beginning the GATT negotiations focused on the lowering of tariffs, later in the 1980s non-tariff barriers (NTBs) were included in the negotiations.⁶¹ The GATT framework is built on the principle that tariffs cuts are presumed to have direct effect on prices and thereby also influence consumers. However, in a non-market economy where prices are controlled by the government, the effect of changes in tariffs is not the same. China has a history of a large use of NTBs to trade.⁶² This does not comply with the GATT principle of free trade and fair competition. As China joins the WTO it will have to reduce the use of NTBs.

When it comes to technical barriers of trade, China is still insisting on its right to maintain different standards approval agencies for foreign and domestic goods. Many WTO members have complained about this since it could be used as a way for China to block unwanted imports, and does not comply with the principle of national treatment.⁶³

Another fundamental principle according to GATT is the principle of transparency. It requires that all government regulations and dispute resolution procedures on foreign trade should be open to all concerned parties. Under Article X GATT, the Contracting Parties must make known, among other things, their trade polices and laws import and export systems, and other domestic regulations concerning trade. It has many times been difficult for foreign companies to easily get access to laws and regulations in China. There has also been a frequent use of so called "internal documents" which has made it difficult for foreigners to conduct business in China. In China's WTO negotiations the lack of transparency has often been mentioned as one of the largest obstacles.

⁶⁰ Article III, GATT.

⁶¹ WTO, *Trading into the future*, 1999, p. 6.

⁶² The trade barriers have taken the forms of a mandatory import plan, canalization of imports through national foreign trade companies, and import licensing. See the study made by The World Bank, *China Foreign Trade Reform*, 1994, p. 63.

⁶³ "China and WTO, not so fast", *The Economist*, Oct 7-13th 2000, p. 113.

5 Legal Restructuring in Accordance with International Standards

China is developing very quickly, and new social and economic reforms are introduced at an incredible pace. In this state of transformation there is also a constant flow of new laws and changes in the existing laws and it is difficult to keep up with all the changes. As China will enter the WTO a vast number of laws need to be changed so that they will comply with international trade standards and the regulations of the WTO. The scope of the WTO rules is very extensive. The rules concern trade in goods and services and protection of IPR, and have effect on a large number of laws. Among the areas affected by the WTO accession are laws regulating: foreign trade and investment, taxation, intellectual property rights, contracts and financial institutions.

During a lecture on law held in Beijing attended by members of the Standing Committee of the NPC, it was said that in China's transition from a planned economy to a market economy it is important for China to try to create laws that comply with the WTO rules. This will ensure that China fulfils its commitment to abide the WTO rules.⁶⁴

I will here try to provide an overview of the largest changes made in the Chinese legal framework in its preparation for the WTO accession. A large number of reforms and changes are expected in the near future.

5.1 Foreign Trade and Investment

The foreign trade and direct foreign investment in China are important factors to the great economic growth that China has experienced in the last twenty years. China has been one of the largest foreign investment recipients and investors come from more than 160 countries.⁶⁵ In order for China to raise the standard of living and increase the economic development China does not only need foreign investment but also foreign technology. Foreign investment is encouraged in some areas and prohibited in others, this often changes on an *ad hoc* basis reflected by the state policies at that time.⁶⁶

The legal framework for foreign investment in China has been a complex system consisting of published laws and unpublished internal rules. There

⁶⁴ "Economic Laws Need to Match WTO Rules: Professor", *Xinhua News*, 1 Nov 2000, at www.chinadaily.com.cn/highlights/wto/opinion/b01professor.html.

⁶⁵ J. Chen p.318.

⁶⁶ J. Chen p.319.

have been different rules in the SEZ, “open cities” and other specially favoured areas.⁶⁷

5.1.1 Foreign Trade Law

In 1994 the Standing Committee of the 8th National People’s Congress passed the first comprehensive foreign trade legislation in modern Chinese history, the Foreign Trade Law of the People’s Republic of China (FTL), effective as of July 1 1994.

In the general provisions Article 1 of the FTL it is said that the law is formulated to promote the development of foreign trade and a socialist market economy. Next, it defines the term “foreign trade” as including “import and export of goods and technologies, and the international service trade”.⁶⁸ Article 6 stipulates that China will grant MFN treatment and national treatment to other signatories of international agreements. This clearly shows influence of GATT principles and China’s readiness to assume obligations under such international organizations as the WTO.

The FTL also includes articles that deal with trade surge, dumping and subsidies, and some of these are directly borrowed from the GATT. Articles 29 (on safeguards), 30 (on dumping), and 31 (on subsidies) of the FTL very much resemble to the Articles XIX (escape clause), VI (anti-dumping), and XVI (subsidies) of GATT. This shows how China’s foreign legal trade regime is getting closer to the international practice.

Antidumping measures are regulated in the FTL Article 30. In 1997 the State Council promulgated Antidumping and Anti-subsidy Regulations that implement Article 30 of the FTL. The FTL rules have been drafted to comply with the international practice and Article VI of the GATT. The implementing regulations also seem to comply with the Agreement of Implementation of Article VI of the GATT.⁶⁹ In order for China’s antidumping regulations to conform to the WTO rules it is also important that the enforcement of the regulations follow the WTO agreement. When China becomes a member of the WTO other members could bring China to a dispute settlement if it fails to follow the requirements of the WTO. It is therefore very important that the Chinese authorities make relevant changes in areas where they do not completely live up to the standards of the WTO.

Some of the complaints that have been mentioned regarding China’s antidumping laws are the lack of transparency in antidumping proceedings,

⁶⁷ Jari Vepsäläinen, *Foreign Investment in the People’s Republic of China* (Helsinki: Finnish Lawyers’ Publishing House, 1989), p. 13.

⁶⁸ Article 2, FTL.

⁶⁹ Kermit W. Almstedt and Patrick M. Norton, “China’s Antidumping Laws and the WTO Antidumping Agreement”, *Journal of World Trade*, Vol. 34, No. 6 (2000), p. 76.

and the fact that Chinese antidumping determinations are made without clear legal reasoning or evidence. Perhaps some of these problems are due to the Chinese authorities' lack in experience in the area of international antidumping practice.⁷⁰

5.1.2 Foreign Investment Laws

There was no foreign investment in China until the late 1970s⁷¹, nor was there any existing legal framework for direct foreign investment. Various laws and regulations appeared at both central and local level and efforts were made to unify these rules in the late 1980s.⁷²

Foreign investment in China started in the form of joint ventures that were intended to bring foreign capital to Chinese state-owned enterprises. Eventually other forms of enterprises were allowed, including wholly foreign-owned enterprises and representative offices. The three major forms of foreign investment are: equity joint ventures (EJVs), contractual joint ventures (CJVs) also called co-operative enterprises, and wholly foreign owned enterprises (WFOEs).⁷³

An EJV is a limited liability business association with each party taking an equity share, sharing profits and losses in accordance with the proportion of its contribution to the registered capital of the venture. A CJV is primarily a contractual arrangement and it is not a limited liability company, although it can obtain the status of a legal person. The parties undertake certain tasks and the contract negotiated between the parties plays a vital role both in establishing and operating the joint venture. The advantages with a CJV are that it offers more flexibility and less economic restrictions. The WFOEs is an enterprise established with capital provided totally by foreign investors. The foreign investor bears all the responsibility for all profits and losses. A WFOE takes the form of a limited liability company.⁷⁴

The laws regulating foreign trade and investment are many and the system complex. The three central laws are: Law of the People's Republic of China on Sino-foreign Equity Joint Enterprises (the Joint Venture Law, EJV Law), the Law of the People's Republic of China on Sino-foreign Co-operative Enterprises (the Contractual Joint Venture Law) (CJV Law), and the Law of People's Republic of China on Wholly-Foreign Owned Enterprises (WFOE Law). In addition to these laws the legal framework also consists of a large

⁷⁰ Almstedt and Norton, p.113.

⁷¹ The promulgation of the first FDI Law, the Equity Joint Ventures Law in 1979, marked a new era of "open door policy" and economic reform.

⁷² J. Chen, pp. 331-332.

⁷³ Pittman B. Potter, "Foreign Investment Law in the People's Republic in China: Dilemmas of State Control" in Stanley B. Lubman (ed), *China's Legal Reforms* (Oxford University Press, 1996), pp. 162-163.

⁷⁴ Potter pp. 163-164.

number of implementation rules and regulations at national and local levels.⁷⁵ To make the system for FDI admission more transparent, the Chinese authority promulgated the Provisional Regulations on the Direction Guide to FDI⁷⁶, in 1995. More recently they have also released a guide for FDI in High-tech Industries.⁷⁷ To pursue a GATT/WTO membership China has made efforts to make their trade regime more transparent and predictable, already in 1992 China published over 70 previous “internal” documents and abolished more than 100 such documents. This pursuit to join the WTO has kept the rules on the foreign trade and investment in a state of change.⁷⁸ In the years 1988-1994 three decisions were taken by the State Council to further deepen and quicken the reform of the foreign trade system, all in the line of China’s effort to join the WTO.⁷⁹

In China’s preparation for the WTO entry the NPC standing Committee will revise the three major statutes regulating foreign investment. The NPC has approved amendments to the CJV Law and the WFOE Law.⁸⁰

The amendments⁸¹ will change the requirement for Co-operative joint ventures to export a certain percentage of their products in order to maintain a balance between their foreign currency income and expenditure. When purchasing raw materials and goods they no longer have to give priority to domestic enterprises. Instead they are free to choose from domestic markets or international markets “in accordance with the principles of fairness and reasonableness”.⁸² This article was previously in conflict with the WTO’s principle of national treatment⁸³. Similar amendments⁸⁴ were made to the WFOE Law removing the requirements on foreign exchange balancing and purchase of raw materials and goods. The WFOE Law has also been changed so that the establishment of WFOEs will be permitted for a wider range of project areas. The amendments came into force on 31 October 2000. Amendments to the EJV Law are expected to be adopted in March 2001.⁸⁵

⁷⁵ Preston M Torbert and Jia Zhao, “People’s Republic of China” in Alan Gutterman and Robert Brown (ed), *Commercial Laws of East Asia* (Hong Kong: Sweet & Maxwell Asia, 1997), p. 321.

⁷⁶ The guide to FDI classified FDI into four different categories: the encouraged, restricted and prohibited, and the permitted.

⁷⁷ Wenhua Shan, “Towards a New Legal Framework for EU-China Investment Relations”, *Journal of World Trade*, Vol. 34, No. 5 (2000), p. 163.

⁷⁸ J. Chen p. 320.

⁷⁹ J. Chen p. 323.

⁸⁰ “China, on Door-step of WTO Accession, Amends Laws on Foreign Investment”, *China Daily*, 24 Oct 2000, at www.chinadaily.com.cn/highlights/wto/news/a24law.html.

⁸¹ Amendments to the CVJ Law were made to articles 19 and 20.

⁸² Article 19, CJV Law.

⁸³ Under the Agreement on Trade Related Investment Measures (TRIM) members are not allowed to apply any trade related investment measures that are contrary to the principles of national treatment, see Article II of the TRIM Agreement, Article III paragraph 4, GATT.

⁸⁴ Amendments to the WFOE Law were made to articles 3, 11, 15 and 18.

⁸⁵ “China Notes”, Freshfields, Nov 2000, at www.freshfields.com.

Under Chinese law, WFOEs have been excluded and restricted in some areas such as insurance, telecommunications etc.⁸⁶ Changes will have to be made as China enters the WTO.⁸⁷ According to the bilateral accession agreements China has agreed to allow foreign companies in these sectors. In the service area a representative office has sometimes been the only choice for conducting or starting business in China. All this will now have to change.

5.2 The Protection of Intellectual Property Rights

As many other Asian countries China showed little interest in the protection of intellectual property rights. It was not until the beginning of the 1980s that China began to establish a legal framework for the protection of intellectual property rights. Before this, all products of technology were thought to be the common heritage of mankind.⁸⁸ As China continued its “open-door” policy it could no longer keep this attitude. In attempts to attract foreign capital and technology it was necessary to make changes.

The weak protection of intellectual property in China has been a major concern of the foreigners investing in China. There has been a lot of pressure on the Chinese government to improve the system, especially from the US.⁸⁹ In the last fifteen years China has also signed a number of international conventions. In 1985 China ratified the Paris Convention for the Protection of Industrial Property. In 1988 the International Classification of Goods and Services under the Nice Agreement was adopted. China has also signed the Madrid Agreement Concerning the International Registration of Trademarks (in 1989), and in 1992 the Berne Convention for the Protection of Literary and Artistic Works and the Universal Copyright Convention.⁹⁰

The Chinese legal framework for the protection of intellectual property consists of the Patent Law (1985), the Trademark Law (1982), the Copyright

⁸⁶ Article 4, WFOE Law.

⁸⁷ Regulations of the PRC on Telecommunication were promulgated in 25 Nov 2000. According to Article 10 of the regulations, operators involved in telecommunication business must have at least 51% Chinese stock rights. Article 80 states that detailed measures for foreign invested telecommunication business will be formulated by the State Council.

⁸⁸ J. Chen, p. 347.

⁸⁹ An agreement for the protection of intellectual property rights was signed by the US and China in 1995. An action plan was attached to the agreement, helping China with the enforcement of IPR laws. This was an agreement in a long series of so called Memoranda of Understanding (MOUs) concluded in 1989-1995.

⁹⁰ Preston M. Torbert and Jia Zhao, “People’s Republic of China” in Alan Gutterman and Robert Brown (ed), *Intellectual Property Laws of East Asia* (Hong Kong: Sweet & Maxwell Asia, 1997), pp. 233-234.

Law (1990), and the Unfair Competition Law (protects trade secrets). These laws, together with their implementation rules and international conventions form the basis of the legal protection for intellectual property in China.⁹¹

Although China has made great progress the last years when it comes to intellectual property rights, there are still areas where China needs to improve the legislation, especially in the area of enforcement. If China does not revise its patent and trademark laws before the WTO accession other member states could bring action against China. A tightening of the anti-piracy law with stronger sanctions against offenders is necessary. A problem with the present anti-counterfeiting regulations is that the regulations are more administrative than criminal. Every year foreign investors loose tens of billions of dollars due to bootlegging.⁹²

China has passed several new IPR-related laws in the last years. Millions of illegal audio-visual products have been seized, and IPR violators have been fined and imprisoned. However, the IPR enforcement still remains a serious problem. The IPR violations continue on a large scale, and resistance from the provincial and local level often hampers enforcement efforts.

5.2.1 Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS)

The TRIPS Agreement was created during the Uruguay Round and is now part of the WTO rules. The TRIPS Agreement is built on the principles of GATT, and relevant international intellectual property agreements.⁹³ A unified standard form of protection will help avoid tension in international economic relations. China's intellectual property laws must comply with these rules after the WTO entry.

Basic principles are set out in the first part of the agreement and include the principle of national-treatment, and a most-favoured nation clause. In the second part all the intellectual property rights are addressed. Part III of the Agreement deals with enforcement of the rules, and action against infringement of intellectual property rights.⁹⁴

Some of the basic rules according to the TRIPS Agreement that China need to introduce are the most-favoured-nation treatment, transparency, dispute settlement, judicial examination, and recognition of intellectual property rights as private rights. A problem in China is the weak awareness of the protection of intellectual property rights. Infringers do not always know that

⁹¹ Torbert and Zhao, *Intellectual Property Laws of East Asia*, pp. 233-234.

⁹² "US Urges China to Tighten Anti-Piracy Laws", *Reuters*, 16 October 2000.

⁹³ See <http://www.wto.org>.

⁹⁴ See Agreement on Trade Related Aspects of Intellectual Property Rights, Including Trade in Counterfeit Goods, at www.wto.org/english/docs_e/legal_e/ursum_e.htm#nAgreement.

they have committed a crime, and the right property holders do not always realize that they should protect their property.⁹⁵

5.2.2 Patent Law

The Patent Law and its implementation rules came into force in 1985. The Patent Law saw some major amendments in 1992, as the scope of the protection was extended to include pharmaceutical products and substances obtained by means of chemical process. The duration of the protection was also extended from fifteen to twenty years.⁹⁶ These amendments made China's legal regime for patents closer to the international standards. According to the TRIPS agreement protection term of twenty years is required for patents.⁹⁷

In preparation for the WTO entry China is expected to amend a series of intellectual property laws, so that they will comply with the TRIPS Agreement. In line with this, a new revised Patent Law was issued by the NPC on 25 August 2000, and it will come into force on 1 July 2001. The revised Patent Law offers a wider scope of patent protection. It introduces a system of judicial review, the concept of preliminary injunctions, clearer provisions on penalties for infringements and clearer provisions on what constitutes job-related inventions.⁹⁸ According to the TRIPS Agreement parties must be given the opportunity of judicial review in final administrative decisions.⁹⁹ Previously, according to the Patent Law judicial reviews were unavailable for decisions made by the Patent Re-examination Board regarding utility models and industrial designs.

5.2.3 Trademark Law

The Trademark Law of the PRC was issued in 1982, and the Detailed Implementing Regulations of the Trademark Law in 1983. Substantial amendments were made in 1993. A number of regulations have been issued over the years, including Regulations on Identification and Administration of Well-Known Trademarks, in 1996.¹⁰⁰

To improve the protection of trademarks in China, and to facilitate a WTO accession, the Chinese government has decided to make amendments to the Trademark Law. The State Council passed a draft with amendments to the

⁹⁵ "Changes in China's IPR System", *Business Alert – China*, Issue 10, 15 October 2000, at <http://www.tdctrade.com/alert/ch0010b.htm>.

⁹⁶ Torbert and Zhao, *Intellectual Property Laws of East Asia*, pp. 235-236.

⁹⁷ Article XXXIII, TRIPS.

⁹⁸ "China Notes", Freshfields, Oct 2000, at <http://www.freshfields.com>.

⁹⁹ Article XXXII, TRIPS.

¹⁰⁰ J. Chen, p.348.

Trademark Law on November 22, 2000. The draft will be submitted to the NPC Standing Committee for review. According to the suggested amendments a system of judicial review of decisions concerning trademarks will be established. The scope of the protection of trademarks will be extended.¹⁰¹

5.2.4 Copyright Law

China's Copyright Law was adopted in 1990 and together with its implementation rules it became effective in 1991.¹⁰² In 1991, the Regulations for the Protection of Computer Software were adopted. The works of foreigners that have been published outside China are protected in accordance with international agreements.¹⁰³ In 1992 China acceded the Berne Convention and the Universal Copyright Convention and the Copyright Law was upgraded.¹⁰⁴ The TRIPS rules concerning copyright are to a large extent built on the Berne Convention.¹⁰⁵

To meet the requirements of the TRIPS Agreement China will make amendments to the Copyright Law. A draft was submitted to the NPC Standing Committee for further revision, on 22 December 2000.¹⁰⁶ Changes are likely to be made to the Copyright Law so that better protection will be offered to performers. Also rental rights¹⁰⁷ will be extended to include Chinese copyright holders of computer programmes and cinematographic works and phonograms. Rental rights give the copyright owner the right to decide over the commercial rental to the public of the copyright work.¹⁰⁸

5.3 Tax Law

In the 1980s the Chinese tax regime consisted of a large number of different laws and regulations, including a large number of internal provisions. It was a complicated system and was met by suspicion from the foreign investors.

¹⁰¹ "China Approves Drafts on Amendments to Two Laws", *People's Daily* (English version), 22 Nov 2000, See also, "China to Amend Trademark Law to Facilitate WTO Accession", *People's Daily*, 22 Dec 2000, at <http://english.peopledaily.com.cn>.

¹⁰² In the society of traditional China, copying was not viewed with disdain. To copy paintings, poetry or Confucian classics were often part of examinations.

¹⁰³ Article 2, Copyright Law.

¹⁰⁴ Torbert and Zhao, *Intellectual Property Laws of East Asia*, p. 233.

¹⁰⁵ Article IX, TRIPS.

¹⁰⁶ "Copyright Law Amended in Preparation for WTO Entry", *People's Daily* (English version), 22 Dec 2000, at <http://english.peopledaily.com.cn>.

¹⁰⁷ Rental Rights are regulated in Article XI, TRIPS.

¹⁰⁸ "Changes in China's IPR System", *Business Alert - China*, Issue 10, 15 Oct 2000, at www.tdctrade.com/alert/ch0010b.htm.

China's tax system was characterized by unequal treatment, and it contradicted the GATT principle of national treatment. If internal taxation is applied discriminatorily to foreign businesses or imported goods, this could work as a disguised protection against imports and it would contradict to WTO rules. The tax system was not only unequal among domestic enterprises, foreign companies, and enterprises with foreign investment, but also among domestic enterprises under different forms of ownership.

In the area of foreign investment taxation the first unified tax law was introduced in 1991 in the Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises. This was a unification of two income tax laws concerning foreign investment and a number of rulings and regulations.¹⁰⁹ Although this system laid a basis for further development and reform in an effort to conform the tax regime to international practice, it still maintains two separate income tax systems, one for domestic invested enterprises and one for foreign invested enterprises. In 1994 a more fundamental tax reform was introduced with the purpose of unifying the tax regime for all enterprises, domestic and foreign-invested. This reform has not yet been completed.¹¹⁰

The Chinese government has adopted many tax incentives in order to attract more FDI. Taxes often vary depending on location, trade projects, and industries. In special economic areas and SEZs foreign investors have enjoyed even more privileges.¹¹¹ At present the Chinese government wants to increase FDI in western China. The new tax incentives for FDI in western China came into effect in the beginning of year 2000. The FIEs will enjoy an enterprise income tax rate of 15% for three years.¹¹²

In an effort to attract foreign investment, the Chinese government has granted considerable preferential tax treatment to enterprises with foreign investment.¹¹³ In 1993 new taxes were introduced, and in addition to the income tax enterprises were subject to value-added tax (VAT), business tax and consumption tax. These turnover taxes are applicable to both domestic and foreign enterprises.¹¹⁴

As a part of the WTO preparation efforts have been made to remove the differences in the legal treatment of Chinese and foreign businesses, including reforms of the tax system. The reform of the tax law system is currently taking place. According to the deputy director of the State Administration of Taxation (SAT), Li Wanfu, a number of proposed policy

¹⁰⁹ Torbert and Zhao, *Commercial Laws of East Asia*, p. 326.

¹¹⁰ J. Chen, pp.344-345.

¹¹¹ Shan, p.165.

¹¹² Vinge, China Newsletter, May 2000, at <http://www.vinge.se>.

¹¹³ In SEZs the tax rate is reduced from 30% to 15%, and to 24% in Coastal Open Cities. See Article 7 of the Income Tax Law of the PRC concerning Foreign Investment Enterprises and Foreign Companies (1991).

¹¹⁴ Torbert and Zhao, *Commercial Laws of East Asia*, p. 326.

changes have been submitted to relevant government bodies for the drafting of new regulations. After the WTO entry China will open up its financial and insurance sectors, and domestic companies will compete with foreign companies. At present the tax on Chinese enterprises differs from the tax on foreign enterprises. It is therefore necessary to unify the tax policy in these sectors.¹¹⁵

The proposed changes include a zero tax rate on exports upon China's WTO accession. In line with the policy of Japan and Korea, China wishes to impose discriminatory import tax on health and environmentally friendly products, in order to keep out foreign products not meeting required standards. For the purpose of protecting infant industries, there will be a shift in the VAT from production to consumption.¹¹⁶

5.4 Contract Law

The long anticipated unified Contract Law of the PRC was finally promulgated in March 1999. The new Contract Law is the result of nearly six years of work by the NPC, which made several previous drafts that were reviewed by scholars and academics before creating the final draft.¹¹⁷ Before the new Contract Law China had several laws regulating contracts. There was one contract law concerning domestic contractual transactions, the Economic Contract Law of the PRC (1981), and another one concerning foreign-related contracts, the Foreign-Related Economic Contract Law (1985). In addition to these there was also the Technology Contract Law (1987), Implementation Explanations and a number of statutes concerning specific types of contracts.

The rules concerning contracts are closely connected with the political-economic system. Contracts were regarded as a means for economic transactions in a market economy, and in a socialist country, dominated by public ownership, contracts were merely used as a way of implementing state economic plans. As China was starting to transform into a "socialist market economy" it became necessary to change this attitude.¹¹⁸

With the move from a planned economy toward a market economy and China's eagerness to establish ties with the international business community, the system of having three contract laws was no longer functioning. The laws no longer reflected the modern commercial situation in China. The three contract laws treated domestic and foreign entities

¹¹⁵ "Tax system Set for Reform", *Business Alert – China*, Issue 11, 15 Nov 2000, at www.tdctrade.com/alert/ch0011b.htm#1.

¹¹⁶ "Tax System Set for Reform", *Business Alert – China*, Issue 11, 15 Nov 2000, at www.tdctrade.com/alert/ch0011b.htm#1.

¹¹⁷ J. Chen, p. 282.

¹¹⁸ J. Chen, p. 278.

differently. Many of the provisions were too general and vague. The laws were not prepared for new forms of contracts, such as financial leasing contracts.¹¹⁹

The new Contract Law aims at unifying the three old laws as well as clarifying existing principles and prepares for newly emerging issues. The uniform Contract Law has the structure of a basic law, with General Provisions and Specific Provisions. Unlike the previous contract laws the new one is extended to include agreements between individuals.¹²⁰ Another change is that Chinese contract law now has detailed rules on offer and acceptance.¹²¹ There were no provisions regarding offer and acceptance in the old contract laws. The rules on offer and acceptance in the new Contract Law closely follow the Principles of International Commercial Contracts of the International Institute for the Unification of Private Law (UNIDROIT). Unlike the UNIDROIT Principles the new Contract Law does not explicitly provide the principle of freedom of contract. The freedom of contract is the base of a market economy. It therefore seems odd that the Chinese lawmakers chose not to clearly stipulate the principle. Instead there are other provisions which are based on and which indirectly guarantee the principle of freedom of contract.¹²² Overall, the new Contract Law is seen as a big step forward for the Chinese government in meeting international legal standards.

5.5 Financial Services

Having a history of planned economy China's financial services have mostly developed in the last fifteen years. They are not yet ready for a WTO entry and many changes and difficulties are expected in the near future, especially in the banking sector.

5.5.1 Banking

The Chinese bank reform started in the 1980s. In its effort to establish a modern banking system, two major banking laws were promulgated in 1995; the Law of PRC on the People's Bank of China and the Law of the PRC on Commercial Banks.

¹¹⁹ J. Chen, p. 283.

¹²⁰ The Economic Contract Law issued in 1981, Article 2 stated "Economic contracts are agreements between legal entities for the purpose of realizing certain economic goals and clarifying each other's rights and obligations". Article 2 of the new Contract Law states that "A contract in this Law refers to an agreement establishing, modifying and terminating the civil rights and obligations between subjects of equal footing, that is between natural persons, legal persons or other organizations".

¹²¹ See Article 13 and the following articles, Contract Law of the PRC.

¹²² J. Chen, pp. 284-286.

The People's Bank of China (PBOC) is China's central bank and is responsible for the issuing and control of the Chinese currency, Renminbi. China's commercial banks consist of four wholly state-owned banks, a dozen joint stock commercial banks and thousands of local co-operatives. So far, foreign banks have only been permitted to conduct banking business in foreign currency. The foreign banks were initially only allowed in the SEZs, later it expanded to other cities. A few foreign banks have been allowed to do Renminbi business on a trial basis.¹²³

In the WTO accession agreements China has agreed to open up its banking sector. The WTO entry is expected to lead to an overall opening-up of the banking sector in 5 years, providing long-awaited business opportunities to foreign banks. China will have to establish a modern banking system similar to those of industrialized countries. Foreign banks will be permitted to do local currency business.

Many people are afraid that the Chinese banks will collapse after the WTO entry. The four major commercial banks still suffer from losses on loans to state-owned companies. However, the PBOC has introduced a broad program of reforms intended to improve the management of these banks.¹²⁴

The WTO entry will force Chinese banks to become more efficient. It will encourage the development of a banking environment that is more in line with international standards, including the legal framework for financial institutions.

5.5.2 Securities

China lacks a vast banking experience. Before 1979 Chinese enterprises were financed by the state according to the state planning system. China's first stock markets were established in 1990 in Shanghai and Shenzhen. Initially stock exchanges were only available for Chinese entities (A shares). Later in order to attract more foreign currency, limited access to the Chinese securities market was given to foreign companies (B shares).¹²⁵ China's first Securities Law came into effect in 1999.

In the last years the Chinese government has introduced a series of measures to boost trading and improve the administrative and stock-issuing systems. The governmental involvement needs to be reduced and the system has to become more transparent.

¹²³ Torbert and Zhao, *Commercial Laws of East Asia*, pp. 308-309.

¹²⁴ World Bank, "The World Bank and China", Sep 2000, at www.worldbank.com.

¹²⁵ Torbert and Zhao, *Commercial Laws of East Asia*, p. 300.

Many of the accounting rules concerning the securities market need to be amended to meet international standards. In the bilateral WTO accession agreements China has agreed to permit minority foreign owned joint ventures to engage in fund management. Reforms are expected in the near future.

5.5.3 Insurance

The Insurance Law of the PRC was issued in 1995. It will be necessary to make changes when China enters the WTO. In the bilateral agreements China has promised to open up its insurance sector to foreign insurance companies. The Insurance Law Article 69 states that all insurance companies shall take the form of either a stock company with limited liability or a solely state-owned company. This does not apply to foreign insurance companies.

According to the chairman of China Insurance Regulatory Commission (CIRC), China's insurance industry is preparing for the WTO accession. The CIRC has compiled a statute on foreign insurance companies and submitted it to the State Council for approval. The new regulations are changed so that they will comply with WTO principles.¹²⁶

Administrative Rules on Insurance Companies were promulgated in January 2000 by the CIRC. The new regulations were issued on the basis of the Insurance Law and the Company Law. In addition to Chinese insurance companies the regulations also apply to foreign insurance companies.¹²⁷

¹²⁶ "China's Insurance Industry Prepares for WTO Accession", *Xinhua News*, 15 Jan 2001.

¹²⁷ Article 15 of the Regulations for the Administration of Insurance Companies, 13 Jan 2000.

Conclusions

One fundamental objective of China's economic reform and opening policy pursued in the last fifteen years has been full participation in the international economic community by joining major international organizations of finance and trade.

The economic reforms that have transformed China since the "opening to the world" in the late 1970s have generated new institutions and a need for a further development of the legal framework. Since 1979 there has been a "legislative explosion" in China. As China moves away from a planned economy towards a market economy, new transactions appear and new laws are necessary.

The impact of China's entry into the WTO is likely to be far-reaching. It will be a tremendous challenge for China to fulfil the requirements for membership, to transform to a fully functioning market economy, and a fully operational and enforceable rule of law.

China's legal system has improved significantly in the last years. In the drafting of new laws and amendments to existing laws, China has increased the application of international principles. The Chinese government has showed great effort to join the WTO, and in order to become a member the legal trade regime would have to comply with international WTO rules. The restructuring of China's legal regime in preparation for a future WTO membership started already in the beginning of the 1980s. In recent years, the pressure from the Western countries, especially the US, has led to accelerated law development.

One might ask if it is possible for China's government to fully implement the trade liberalization measures it has agreed to in the bilateral WTO agreements? Many people are worried that China will not be able to handle all the changes that a membership requires. China is facing major reforms in the financial sectors and has to restructure the state-owned companies. However, the changes are not likely to happen over night. China has in many cases been given a few years to adjust.

WTO reforms could lead to widespread employment disruptions in the short run, as many inefficient Chinese enterprises will be forced into bankruptcy due to increased foreign competition. In order to maintain social stability, the Chinese government may decide to delay the implementation of economic reforms.

Another problem is that the role of law in China is still rather weak. It might not be possible for the government to reach out and ensure that the local authorities implement rules and regulations that are consistent with the WTO rules.

One thing is certain, China has been eager to join the WTO for the last fifteen years, and it will not give up easily. China has realized that the best way to strengthen its national economy is to adopt and establish international principles and practices.

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