



A-570-053  
Investigation  
**Public Document**  
E&C VI: MJH/TB

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DATE:

October 26, 2017

SUBJECT:

China's Status as a Non-Market Economy

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## EXECUTIVE SUMMARY

The Department of Commerce (“Department”) concludes that China is a non-market economy (NME) country because it does not operate sufficiently on market principles to permit the use of Chinese prices and costs for purposes of the Department’s antidumping analysis. The basis for the Department’s conclusion is that the state’s role in the economy and its relationship with markets and the private sector results in fundamental distortions in China’s economy.

At its core, the framework of China’s economy is set by the Chinese government and the Chinese Communist Party (CCP), which exercise control directly and indirectly over the allocation of resources through instruments such as government ownership and control of key economic actors and government directives. The stated fundamental objective of the government and the CCP is to uphold the “socialist market economy” in which the Chinese government and the CCP direct and channel economic actors to meet the targets of state planning. The Chinese government does not seek economic outcomes that reflect predominantly market forces outside of a larger institutional framework of government and CCP control. In China’s economic framework, state planning through industrial policies conveys instructions regarding sector-specific economic objectives, particularly for those sectors deemed strategic and fundamental.

The Chinese government and the CCP’s legal and actual ownership and control over key economic actors and institutions pervades China’s economy, including the largest financial institutions and leading enterprises in manufacturing, energy, and infrastructure. China’s authorities use this control selectively to affect the interaction of supply and demand and accordingly distort the incentives of market actors. This ability to affect these market forces is apparent in crucial facets of the economy, from the formation of exchange rates and input prices to the movement of labor, the use of land, the allocation of domestic and foreign investment, and market entry and exit. Because of the significant distortions arising from China’s institutional structure and the control the government and the CCP exercise through that structure, the Department finds that China remains a NME country for purposes of the U.S. antidumping law.

The Department’s overall conclusion is based upon its analysis of six factors established in U.S. law. In determining whether a country is an NME under section 771(18)(A) of the Tariff Act of 1930, section 771(18)(B) requires that the Department take into account (1) the extent to which the currency of the foreign country is convertible into the currency of other countries; (2) the extent to which wage rates in the foreign country are determined by free bargaining between labor and management; (3) the extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country; (4) the extent of government ownership or control of the means of production; (5) the extent of government control over the allocation of resources and over the price and output decisions of enterprises; and (6) such other factors as the administering authority considers appropriate.

Under Factor 1, with respect to currency convertibility, the Department observes that the renminbi (RMB) is convertible into foreign currencies for trade purposes, the Chinese government has made market-oriented modifications to its capital account and exchange rate system, and has taken steps to develop its foreign exchange (FOREX) market. However, the Chinese government still maintains significant restrictions on capital account transactions and

intervenes considerably in onshore and offshore FOREX markets. The Chinese government also maintains approval requirements for all major capital account transactions; does not disclose the weights attached to price quotes that are used to calculate the central parity rate for the RMB; and intervenes to limit the extent of price divergence between the onshore and offshore FOREX markets.

Under Factor 2, the Department observes variability in wages across regions, sectors, and enterprises in China. However, the Department continues to find significant institutional constraints on the extent to which wage rates are determined through free bargaining between labor and management. The Chinese government prohibits the formation of independent trade unions to represent labor, and workers do not have the legal right to strike, which is an important lever in collective action and negotiation with management over wages. Labor unions are under the control and direction of the All-China Federation of Trade Unions (ACFTU), a government-affiliated and CCP organ. Certain legal remedies exist for an individual to challenge labor contract and wage-related violations in particular cases; however, significant institutional barriers exist that limit their effectiveness. In addition, government restrictions on labor mobility imposed by the *hukou* (household registration) system continue to inhibit and guide labor flows, causing distortions on the supply side of the labor market.

Under Factor 3, the Department finds that the Chinese government's foreign investment regime is particularly restrictive relative to that of other major economies. Despite some government efforts to streamline procedures, China continues to impose significant barriers to foreign investment, including equity limits and local partner requirements, opaque approval and regulatory procedures, and technology transfer and localization requirements. It is the Chinese government's foreign investment regime, not the market primarily, that channels foreign investment to sectors and technologies the Chinese government determines to support, while limiting foreign investment in those sectors that the Chinese government finds strategically important to maintain under its control alone.

Under Factor 4, the Department finds that the Chinese government continues to exert significant ownership and control over the means of production, as demonstrated by (1) the role and prevalence of state-invested enterprises (SIEs)<sup>1</sup> throughout the enterprise sector and (2) the system of land ownership and land-use rights. The prevalence of SIEs in China's economy is significant, and their relative "economic weight" is substantial in comparison with other major economies. The size of the SIE sector may also understate the actual extent of government ownership and control. The Chinese government allocates resources to SIEs in what it deems strategically important sectors, such that SIEs are not strictly disciplined by market principles of supply and demand. At the same time, however, the government requires that SIEs undertake large-scale investments to help stabilize China's macro-economy. The government also intervenes extensively in the enterprise sector to shield SIEs from the consequences of economic

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<sup>1</sup> This determination uses the term "state-invested enterprise" or "SIE" when referring to an enterprise in which the Government of China has any ownership stake. Though the term generally has the same meaning as "state-owned enterprise" or "SOE," the definition of "SOE" sometimes varies depending on the context in which it is used, and the Department has adopted the term "SIE" to avoid confusion. This determination will use the term "SOE" when citing others' use of that term. The Department used the same approach in its *Memorandum on Public Bodies, Section 129 Proceeding: United States – Countervailing Duty Measures on Certain Products from the People's Republic of China* (WTO/DS437), October 15, 2015.

failure, facilitates mergers and acquisitions to achieve government, not enterprise, objectives, and enables the rise of large enterprise groups under government ownership and control. An important channel for government influence over firm decision-making is the CCP's ability to appoint key personnel in enterprises and participate in corporate decision-making through Party Committees in those enterprises.

The Chinese government exercises significant control over land, another key means of production analyzed under Factor 4. All land in China is property of the state, as either collectively-owned rural land or state-owned urban land. Because the government controls rural land acquisition and monopolizes the distribution of urban land-use rights, the government remains the final arbiter of who uses the land and for what purpose. Government decisions in distributing land-use rights are informed, on one hand, by incentives to generate revenue for local governments, and on the other, by national policies that allocate construction quotas and restrict the use of arable land for non-farming purposes. Land-use rights holders, in turn, face limits with respect to the tenure and the scope of use. Rural land-use rights holders face the additional challenges of incomplete documentation and inadequate compensation for the loss of use rights. The result of these dynamics is an inefficient land market in which rural and urban land are segmented and large swathes of land are misallocated either to small farm plots or to underutilized urban infrastructure.

Under Factor 5, the Department finds that the Chinese government plays a significant role in resource allocations. State planning remains an important feature of the Chinese government's industrial policies, as evidenced by formal mechanisms of plan formulation, tasking, and review, and the scope and specificity of sectoral-level plans. Various institutions participate in plan formulation and execution, including central agencies with legislative and regulatory authority, thousands of local government authorities, various organs of the CCP, and the enterprise sector. The Chinese government employs numerous mechanisms to implement industrial policy objectives, including, *inter alia*, investment approvals, access standards, guidance catalogues, financial supports, and quantitative restrictions. Science and technology development, industrial restructuring and upgrading, and the geographic distribution of industry are three areas that demonstrate the extent to which the government uses industrial policies to influence economic outcomes.

The Chinese government exerts a high degree of control over prices it deems essential or strategic. Its ability to set and guide factor input prices, in particular, results in distorted costs and prices throughout the economy. In the electricity sector, for example, the government owns the largest grid operators, formally sets prices, and employs "differential pricing" as a policy tool to achieve capacity shedding and other industrial policy objectives.

The financial sector plays a pivotal role in misallocating resources in China's economy. The government retains ownership and control over the largest commercial banks, while the majority of bank and interbank loans, as well as corporate bond transactions, occur between state-owned and -controlled parties. Credit continues to be allocated to SIEs in spite of high levels of corporate debt, giving rise to soft budget constraints and implicit government guarantees that undermine the market-determined pricing of risk. The emerging "shadow banking" sector, in turn, serves largely as a means for state-owned and -controlled parties to lend and borrow capital

through opaque institutions and channels outside the formal banking sector. These fundamental distortions permeate throughout China's financial sector.

Under Factor 6, the Department finds China's legal system continues to function as an instrument by which the Chinese government and the CCP can secure discrete economic outcomes, channel broader economic policy, and pursue industrial policy goals. Key legal institutions, such as the courts, are structured to respond to their direction, whether broad or case-specific. Individuals and firms are constrained in their ability to have meaningful independent input into administrative rulemaking or to challenge administrative decisions. As a general matter, to the extent that individuals and firms seek to act independently of government or CCP direction, the legal system does not provide the venue for them to achieve these objectives on a systemic or consistent basis. In addition, firms continue to face challenges in obtaining impartial outcomes, either because of corruption or local protectionism.

After assessing the six factors, the Department finds that the Chinese government continues to maintain and exercise broad discretion to allocate resources with the goal of achieving specific economic outcomes. China's institutional structure and the control the Chinese government and the CCP exercise through that structure result in fundamental economic distortions, such that non-market conditions prevail in the operation of China's economy. These non-market conditions are built upon deeply entrenched institutional and governance features of China's Party-state, and on a legal mandate to "maintain a leading role for the state sector." Accordingly, China is a NME country. It does not operate sufficiently on market principles to permit the use of Chinese prices and costs for purposes of the Department's antidumping analysis.



## INTRODUCTION AND BACKGROUND

The Department initiated an inquiry into China's status as a non-market economy (NME) country. The Department initiated this inquiry in the context of the less-than-fair-value investigation of certain aluminum foil from the People's Republic of China,<sup>2</sup> pursuant section 771(18)(C)(ii) of the Tariff Act of 1930, as amended (the Act), which states that the Department may make a determination with respect to a country's NME status "at any time." To ensure full public and interested party participation in this inquiry, the Department invited public comment on China's economy and ongoing reforms, and all comments received by May 10, 2017, have been posted on the Department website at (<https://www.regulations.gov/docketBrowser?rpp=25&so=DESC&sb=commentDueDate&po=0&D=ITA-2017-0002>). The Department stated that it would issue its findings prior to the preliminary determination in the aluminum investigation and would decide at the time whether to seek additional information from interested parties concerning the calculation of normal value.<sup>3</sup>

This inquiry is being conducted pursuant to section 771(18)(A) of the Act, which defines the term "non-market economy country" as any foreign country determined by the Department not to "operate on market principles of cost or pricing structures, so that sales of merchandise in such country do not reflect the fair value of the merchandise." Section 771(18)(B) of the Act lists six factors (see below) the Department must consider in any inquiry made under section 771(18)(A), and under section 771(18)(C)(i), a country's NME country status remains in effect until revoked. The Department's designation of a country as a NME country applies only to U.S. trade remedy proceedings.

The Department has treated China as a NME country in all past antidumping duty investigations and administrative reviews involving imported products from China. *See, e.g., Seamless Refined Copper Pipe and Tube From the People's Republic of China: Preliminary Results and Partial Rescission of Administrative Review*; 2012-2013, 79 FR 71089 (December 1, 2014), unchanged in *Seamless Refined Copper Pipe and Tube From the People's Republic of China: Final Results of Antidumping Duty Administrative Review*; 2012-2013, 80 FR 32087 (June 5, 2015); *Notice of Final Determination of Sales at Less Than Fair Value, and Affirmative Critical Circumstances, In Part: Certain Lined Paper Products From the People's Republic of China*, 71 FR 53079 (September 8, 2006); and *Final Determination of Sales at Less than Fair Value: Certain Paper Clips from the People's Republic of China*, 59 FR 51168 (October 7, 1994). The Department last reviewed China's NME country status in 2006, in response to a request from a respondent, supported by the Chinese government. *See Final Determination of Sales at Less Than Fair Value, and Affirmative Critical Circumstances, In Part: Certain Lined Paper Products from the People's Republic of China*, 71 FR 53079 (September 8, 2006). In the lined paper investigation, the Department determined that reforms remained incomplete and the Chinese government's role in the economy warranted the continued designation of China as a NME

<sup>2</sup> *See Certain Aluminum Foil from the People's Republic of China: Initiation of Less-Than-Fair-Value Investigation*, signed March 28, 2017.

<sup>3</sup> *Certain Aluminum Foil from the People's Republic of China: Notice of Initiation of Inquiry into the Status of the People's Republic of China as a Nonmarket Economy Country under the Antidumping and Countervailing Duty Laws*, 82 FR 16162, April 3, 2016.



country for purposes of the U.S. antidumping law. See Memorandum for David M. Spooner, Assistant Secretary for Import Administration, “Antidumping Duty Investigation of Certain Lined Paper Products from the People’s Republic of China (‘China’)—China’s Status as a Non-Market Economy (‘NME’)” (August 30, 2006) (“2006 PRC NME Determination”), available at <http://enforcement.trade.gov/download/prc-nme-status/prc-lined-paper-memo-08302006.pdf>.

## SUMMARY OF COMMENTS FROM PARTIES

### *Parties Who Support Revoking China’s NME Country Status*

Two parties have expressed support for graduating China to market economy status: Ministry of Commerce, People’s Republic of China (MOFCOM); and Grunfeld, Desiderio, Lebowitz, Silverman & Klestadt, LLP. Their positions are summarized below:

- MOFCOM urges the United States to comply with the expiration of Section 15(a)(ii) of China’s Accession Protocol and explains that it would not submit comments in response to the notice of inquiry with respect to the criteria set forth in Section 771(18) of the Act because any determinations with respect to the criteria laid out in the Act would have no bearing on the United States’ compliance with the General Agreement on Tariffs and Trade (GATT) and the Agreement on implementation of Article VI of the GATT (“Antidumping Agreement”). It also argues that the United States is obligated to no longer use a surrogate methodology with respect to all antidumping determinations targeting Chinese products after December 11, 2016.
- Grunfeld, Desiderio, Lebowitz, Silverman & Klestadt, LLP argue that China’s economy has been sufficiently reformed that it should be considered a market economy according to the six factors stipulated in the Act. They assert that China has undertaken many banking reforms and that Chinese currency is fully convertible; wages in China are market determined; there have been several reforms in the area of foreign investment such as the relaxation of foreign investment approval requirements; the state has announced that it will increase privatization of companies in specific key sectors; loans to private enterprises have increased significantly when compared to state-owned enterprises; and China passed bankruptcy reform law and has had multiple reforms in the areas of rule of law and property rights. They also argue that the Antidumping Agreement requires the Department to graduate China to market economy status, even without any economic analysis.

### *Parties Who Oppose Revoking China’s NME Country Status*

Parties who have expressed opposition to graduating China to market economy status include the Steel Manufacturers Association; International Brotherhood of Teamsters; International Union; United Automobile; Aerospace and Agricultural Implement Workers of America; Association of American School Paper Suppliers; Southern Shrimp Alliance; American Iron and Steel Institute; American Shrimp Processors Association; Nucor Corporation; Solar World Americas Inc.; Byer Steel Group Inc.; American Federation of Labor & Congress of Industrial Organizations; United Steel Workers; Bio-Lab, Inc.; Chemtrade Solutions LLC; Clearon Corporation; ICL Performance

Products, LP; and Occidental Chemical Corporation; Maverick Tube Corporation; Schagrin Associates; Titan Tire Corporation; Diamond Sawblades Manufacturers' Coalition; Rebar Trade Action Coalition and its individual members; Verso Corporation; S.D. Warren Company d/b/a Sappi North America; Appleton Coated LLC and the United Steel, Paper and Forestry, Rubber, Manufacturing, Energy Allied Industrial and Service Workers International Union AFL-CIO, CLC; Coalition to Enforce AD/CVD Orders; Gerdau Ameristeel U.S. Inc; United States Steel Corporation; Coalition for Fair Trade in Hardwood Plywood and its individual members; Mid Continent Steel & Wire, Inc.; JSW Steel; AK Steel Corporation; the American Furniture Manufacturers Committee for Legal Trade; Anvil International, LLC; Appvion, Inc.; Archer Daniels Midland Company; Colombian Home Products, LLC; Elkay Manufacturing Company; the Laminated Woven Sacks Committee; the Magnesia Carbon Bricks Fair Trade Committee; PCI Nitrogen, LLC; P.H. Glatfelter Company; the Polyethylene Retail Carrier Bag Committee; Tate & Lyle Ingredients Americas LLC; Terphane, Inc.; US Magresium LLC; Verso Corporation; and Zekelman Industries, Seaman Paper Company of Massachusetts, Inc.; Evraz North America; Manufacturers for Trade Enforcement; Commercial Metals Company; Alliance for American Manufacturing; Aluminum Extrusions Fair Trade Committee; Coalition for a Prosperous America; Chinalco Aluminium Co., Ltd.; Aluminum Association Trade Enforcement Working Group; and Wiley Rein LLP. Members of Congress have also expressed opposition to China's graduation to market economy status, including: Senator Al Franken, Senator Tammy Baldwin, Senator Sherrod Brown, and Senator Amy Klobuchar. Their positions are summarized below:

- To a great extent, Chinese currency is not convertible into the currency of other countries; there is government manipulation and misalignment of the *renminbi* (RMB); and China's own leaders acknowledge that its currency needs to move toward convertibility.
- The only legal labor union in China, the ACFTU, is government-controlled. China does not enforce its labor laws and does not recognize International Labor Organization (ILO) rights.
- The government heavily controls foreign direct investment (FDI) flows and the overall investment climate remains challenging. There is a catalogue for foreign investment drafted by MOFCOM that lists industries in which foreign investments are "encouraged," "restricted," or "prohibited." Also, foreign investors worry about protecting their intellectual property in China because firms are forced to commit to significant technology transfers or face restrictions in their ability to complete an investment project.
- Land is cheaper for state-owned enterprises (SOEs) than for private companies because SOEs are state-owned. There is an abundance of SOEs that receive preferential treatment through subsidies and other incentives. The Chinese government manipulates raw material prices for non-Chinese competitors, and restrains exports of raw materials. Also, the government plays a large role in determining the terms of loans and credits to businesses.

- The result of the government’s intervention in the market through its lending policies and large subsidies has been extensive excess capacity in many industrial sectors, such as steel, aluminum, paper, and tires. The government continues to maintain price controls on various products and services such as pharmaceuticals, fertilizer, natural gas, and others.
- State censorship restricts access to economic information; cyber security and intellectual property theft are areas of concern; corruption between business and governmental officials is quite widespread; there is inconsistent due process; and political connections distort market outcomes.

## ANALYSIS

As noted above, a NME country for purposes of the U.S. antidumping law is defined in section 771(18)(A) of the Act as “any country that the administering authority determines does not operate on market principles of cost or pricing structures, so that sales of merchandise in such country do not reflect the fair value of the merchandise.” In making a NME country determination under section 771(18)(A) of the Act, section 771(18)(B) requires that the Department examine an economy as a whole, as opposed to individual industries or companies, and take into account:

1. the extent to which the currency of the foreign country is convertible into the currency of other countries;
2. the extent to which wage rates in the foreign country are determined by free bargaining between labor and management;
3. the extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country;
4. the extent of government ownership or control of the means of production;
5. the extent of government control over the allocation of resources and over the price and output decisions of enterprises; and
6. such other factors as the administering authority considers appropriate.

## **Factor One: The extent to which the currency of the foreign country is convertible into the currency of other countries.**

A country's integration into world markets is dependent upon the convertibility of its currency. This factor examines China's exchange rate regime and capital account restrictions. Part A briefly describes the framework governing China's exchange rate regime. Part B examines capital account restrictions, including statistical measures of capital account convertibility; key policies such as "window guidance" and the Qualified Foreign Institutional Investor (QFII) program; and the effect of capital account convertibility restrictions on the use of the RMB internationally. Part C examines the FOREX market and FOREX regime, including China Foreign Exchange Trade System (CFETS), modifications to China's exchange rate regime over the past decade, and the offshore RMB market.

China has moved from multiple (fixed) exchange rates and closed current and capital accounts to a more flexible, unified exchange rate, an open current account, and a somewhat open capital account. The government continues to develop its FOREX markets, internationalize its currency, and open its capital account. However, China still maintains instruments of control over the valuation of the RMB through the central parity rate-setting process and FOREX market interventions. China also continues to maintain approval requirements for all major capital account transactions, including investment, borrowing, and cross-border account holding.

### **A. Framework of the Foreign Exchange Regime**

The RMB has been the sole official currency of China since the Chinese government adopted a unified exchange rate in 1994.<sup>4</sup> The primary legal instrument governing FOREX administration is the *Regulation on the Foreign Exchange System of the People's Republic of China*.<sup>5</sup>

The *Law of the People's Republic of China on the People's Bank of China (PBOC Law)*, adopted in 1995, sets forth the current functions of China's central bank, the People's Bank of China (PBOC).<sup>6</sup> PBOC is responsible for conducting both monetary policy and FOREX policy, but delegates various powers over FOREX to the State Administration of Foreign Exchange (SAFE), which regulates day-to-day currency transactions.<sup>7</sup> PBOC operates under the guidance of the State Council, the highest authority in the Chinese government, to which PBOC must submit major decisions for approval.<sup>8</sup>

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<sup>4</sup> Economist Intelligence Unit, *Country Profile, China* (March 2006), 53.

<sup>5</sup> *Regulation on the Foreign Exchange System of the People's Republic of China* (State Council, Order No. 532, issued January 29, 1996, amended January 14, 1997, further amended August 1, 2008).

<sup>6</sup> *Law of the People's Republic of China on the People's Bank of China* (adopted by NPC on March 18, 1995, amended December 27, 2003).

<sup>7</sup> *PBOC Law*, Article 4. For currency functions of PBOC and SAFE, see also IMF, *Annual Report on Exchange Arrangements and Exchange Restrictions 2016* (October 2016), China country chapter, 750-793.

<sup>8</sup> *PBOC Law*, Article 5.

## B. Capital Account Restrictions

Compared to other major emerging economies, China's capital account remains one of the most tightly restricted.<sup>9</sup> While China has relaxed some restrictions and reduced regulatory burdens over time, restrictions remain on twelve of thirteen categories of capital account transactions.<sup>10</sup> For example, portfolio investment continues to be controlled by quotas and can only be done through QFIIs, foreign borrowing is still subject to a ceiling (short-term borrowing) or approval requirements (long-term borrowing), and holding cross-border accounts still requires SAFE approval.<sup>11</sup> The Chinn-Ito index measures capital account convertibility, ranging from 2.39 (highest level of convertibility) to -1.89 (lowest level of convertibility). China's score in 2015 was -1.19, which has not changed since the 1990s. According to the index, this score is below average even for developing and emerging markets.<sup>12</sup>

In addition, PBOC also appears to use “window guidance” to SIEs and state-owned commercial banks (SOCBs) to discourage capital outflows.<sup>13</sup> PBOC also appears to use window guidance to encourage SIEs to sell holdings of foreign currency, and to require banks who remit RMB overseas to import a certain amount of RMB based on the RMB remitted to control net capital outflows.<sup>14</sup>

Between 2004 and 2010, large capital inflows placed upward pressure on the RMB, resulting in the tightening of restrictions on FOREX inflows and an easing of restrictions on outflows.<sup>15</sup>

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<sup>9</sup> Mark Kruger and Gurnain Kaur Pasricha, *What to Expect When China Liberalizes Its Capital Account* (Bank of Canada, April 2016), 2.

<sup>10</sup> IMF, *Annual Report on Exchange Arrangements and Exchange Restrictions* (October 2016), 58. The indicators used by the IMF are binary and indicate whether such a restriction exists, but do not indicate the degree to which restrictions in each category may have changed.

<sup>11</sup> WTO, *Trade Policy Review – Report by the Secretariat – China*, WT/TPR/S/342 (June 15, 2016), 25.

<sup>12</sup> Hiro Ito and Menzie Chinn, *Notes on the Chinn-Ito Financial Openness Index 2014 Update* (June 30, 2016). See also Hiro Ito and Menzie Chinn, “What Matters for Financial Development? Capital Controls, Institutions, and Interactions,” *Journal of Development Economics* 81(1) (October 2006): 163-192.

<sup>13</sup> Hongyi Chen et al., *To Guide or Not to Guide? Quantitative Monetary Policy Tools and Macroeconomic Dynamics in China*, BOFIT Discussion Papers (Bank of Finland, March 2017). See also Diego Anzoategui, Mali Chivakul, and Wojciech Maliszewski, *Financial Distortions in China: A General Equilibrium Approach*, IMF Working Paper (IMF, December 2015).

<sup>14</sup> Economist Intelligence Unit, *ViewsWire – China: FOREX Regulations* (February 24, 2017). See also Yusho Cho, “China Seeks Tighter Rein on Yuan-Selling, Capital Flight,” *Nikkei Asian Review*, August 3, 2016. See also Reuters, “China’s Tighter Capital Controls Impeding Western Firms’ Payments, Dividends: Lobbies,” December 7, 2016. See also *Financial Times*, “China Clamps Down on Banks Moving Currency Overseas,” January 22, 2017.

<sup>15</sup> Mark Kruger and Gurnain Kaur Pasricha, *What to Expect When China Liberalizes Its Capital Account* (Bank of Canada, April 2016), 2.

After 2011, certain restrictions were eased, such as RMB raised offshore could be invested onshore. Companies based in China were also given greater access to foreign currency loans and were permitted to issue RMB bonds abroad.<sup>16</sup> However, since 2014, in the face of slowing economic growth, the government re-imposed restrictions on FOREX transactions and FOREX accounts for residents, companies, and financial institutions.<sup>17</sup> In addition, SAFE appears to have stopped issuing new allocations for the Qualified Domestic Institutional Investor (QDII) program, which the government established to allow companies based in China to invest abroad.<sup>18</sup> Since the end of 2016, the government has reportedly increased scrutiny of the size and purpose of individual and company outbound capital account transactions.<sup>19</sup> An annual individual FOREX quota of USD 50,000 resets the first of each year.<sup>20</sup>

China's significant restrictions on capital account convertibility result in relatively low use of the RMB internationally, as shown through various indicators. First, trade with China is most often invoiced and settled in currencies other than the RMB. The share of China's RMB-denominated goods trade, as a percentage of China's total goods trade, fell to approximately 15% in December 2016 from over 34% in August 2015.<sup>21</sup> Second, in terms of global trade finance, the RMB's market share fell to 4.6% in November 2016 from a high of 8.7% in 2013.<sup>22</sup> Third, the RMB has fallen from its position in December 2015 as the fifth most widely used international payments currency to the seventh as of April 2017, accounting for 1.6% of international payments.<sup>23</sup>

### C. Foreign Exchange Market and the Exchange Rate Regime

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<sup>16</sup> *Ibid.*

<sup>17</sup> *Ibid.*

<sup>18</sup> *Ibid.*, 25. See also *Financial Times*, "China Halts Overseas Investment Schemes," February 28, 2016.

<sup>19</sup> Allen & Overy, *China's New Restrictions on Outbound Investments and Remittances* (December 30, 2016). See also Hogan Lovells, *China's New Foreign Exchange Controls Create Fresh Concerns* (January 18, 2017).

<sup>20</sup> *Reuters*, "China Steps Up Scrutiny on Individual Forex Purchases in the New Year," December 31, 2016.

<sup>21</sup> Kelvin Lau, Becky Liu and Chidu Narayanan, *Offshore Renminbi – Market Shrank 10.5% in 2016* (Standard Chartered Global Research, February 2017), 2. For a discussion of the incentives to hedge currency risk by invoicing and settling trade in different currencies with companies operating in China, see also Kathleen Walsh, "RMB Trade Invoicing: Benefits, Impediments and Tipping Points," *JASSA The Finsia Journal of Applied Finance* 2 (2015).

<sup>22</sup> *Reuters*, "Cooling Growth Pulls China's Yuan Down to Third Place in Global Trade Finance: SWIFT," November 22, 2016. For a discussion of the decline in the RMB's market share in world finance, see also Eswar Prasad, "A Middle Ground," *Finance and Development* 54(1) (IMF, March 2017), 30.

<sup>23</sup> Society for Worldwide Interbank Financial Telecommunications (SWIFT), *RMB Tracker – Monthly Reporting and Statistics on Renminbi (RMB) Progress towards Becoming an International Currency – May 2017* (May 23, 2017), 3. The RMB, as of April 2017, ranked behind the U.S. dollar (42.1%), Euro (31.1%), British Pound (7.3%), Japanese Yen (3.5%), Canadian Dollar (1.9%), and Swiss Franc (1.6%).



FOREX transactions traditionally occurred in the CFETS, the centralized interbank FOREX market. All transactions in the CFETS were conducted through a single state-owned entity at state-determined rates until 2006, when an over-the-counter (OTC) FOREX trading system was introduced in which banks were to facilitate transactions on the exchange.<sup>24</sup> The system initially had 15 banks designated as “market makers,” which are banks that conduct OTC FOREX transactions and report the rates to the CFETS, which are then used as a component of the PBOC-set exchange rate.<sup>25</sup> There are now 32 market makers, including policy banks, private banks, local-level city banks, and foreign banks.<sup>26</sup> At the end of 2015, 440 domestic and foreign banks were conducting spot FOREX settlement and sales operations in the interbank market. Since then, PBOC has also permitted foreign central banks, international financial organizations, and sovereign wealth funds to engage in FOREX transactions.<sup>27</sup>

Over the last decade, China has modified its exchange rate regime several times.

- From July 2005 to July 2008, China adopted a managed floating exchange rate regime, which was intended to incorporate market forces and be linked to a basket of currencies, rather than solely to the USD.<sup>28</sup> However, China did not disclose the currencies comprising the basket, leading to the widespread view that the RMB was in fact still pegged to the USD.<sup>29</sup> Indeed, one empirical study found that the RMB continued to follow the USD closely.<sup>30</sup>
- During the global financial crisis, from 2008 to 2010, China formally reverted to a USD peg.<sup>31</sup>
- In June 2010, PBOC again announced its intention to resume a managed float of the RMB against a basket of currencies, but it did not publish any information on the

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<sup>24</sup> IMF, *China: 2015 Article IV Consultation—Staff Report* (August 2015), Informational Annex at 2-3.

<sup>25</sup> *Ibid.*

<sup>26</sup> PBOC and CFETS, *RMB/FX Market Makers*, available at <http://www.chinamoney.com.cn/english/mdtmmmbfmm/>, accessed May 25, 2017. See also IMF, *China: 2016 Article IV Consultation – Staff Report* (November 2016), 46.

<sup>27</sup> IMF, *Annual Report on Exchange Arrangements and Exchange Restrictions 2016* (October 2016), China country chapter at 753.

<sup>28</sup> Yin-Wong Cheung, Cho-Hoi Hui, and Andrew Tsang, *The Renminbi Central Parity: An Empirical Investigation*, (Hong Kong Institute for Monetary Research, June 2016), 4-5.

<sup>29</sup> IMF, *China: 2015 Article IV Consultation – Staff Report* (August 2015), Informational Annex at 2-3.

<sup>30</sup> Yin-Wong Cheung, Cho-Hoi Hui, and Andrew Tsang, *The Renminbi Central Parity: An Empirical Investigation* (Hong Kong Institute for Monetary Research, June 2016), 5. See also Jie Sun, “Retrospect of the Chinese Exchange Rate Regime after Reform: Stylized Facts during the Period from 2005 to 2010,” *China & World Economy* 18(6) (2010): 19-35.

<sup>31</sup> IMF, *China: 2015 Article IV Consultation – Staff Report* (August 2015), Informational Annex at 3.



basket.<sup>32</sup> As a result, the assumption remained that the exchange rate regime was in fact a crawling USD peg, and the International Monetary Fund's (IMF) *Annual Report on Exchange Arrangements and Exchange Restrictions* classified China's exchange rate regime as a "crawl-like arrangement" during that time.<sup>33</sup>

PBOC has gradually widened the trading band around the daily fixing rate, which was  $\pm 2\%$  as of March 2014.<sup>34</sup> Within the trading band, banks determine buying and selling prices on the basis of supply and demand.<sup>35</sup> However, the Chinese government can and does intervene in the market through the buying or selling of FOREX by either PBOC or SOCBs in order to move the exchange rate.<sup>36</sup>

Prior to 2015, market makers provided price quotes to PBOC based on their "sense of the market in the morning" for purposes of setting the central parity (or fixing) rate each morning.<sup>37</sup> However, many of the market makers were state owned and the price quotes given to PBOC were not necessarily actual market transaction data. The process remained opaque and PBOC had wide discretion in setting the fixing rate.<sup>38</sup> As a result, the fixing rate during this period moved only negligibly from day to day.<sup>39</sup>

Since 2015, two notable changes appear in the calculation of the fixing rate. First, in August 2015, PBOC announced the daily fixing rate would reflect the closing rate in the FOREX market the previous day.<sup>40</sup> This change seems intended to bring market forces of supply and demand to bear directly on the daily fixing rate. Second, in December 2015, the CFETS began publishing an exchange rate index that reflects movements in the value of the RMB against a basket of currencies.<sup>41</sup> The CFETS also disclosed the currencies in this basket and the trade weights

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<sup>32</sup> *Ibid.*

<sup>33</sup> *Ibid.*, 2.

<sup>34</sup> Yin-Wong Cheung, Cho-Hoi Hui, and Andrew Tsang, *The Renminbi Central Parity: An Empirical Investigation* (Hong Kong Institute for Monetary Research, June 2016), 5.

<sup>35</sup> IMF, *Annual Report on Exchange Arrangements and Exchange Restrictions 2016* (October 2016), China country chapter at 753.

<sup>36</sup> *Ibid.*, Informational Annex at 2.

<sup>37</sup> *Ibid.*, 46.

<sup>38</sup> *Ibid.*

<sup>39</sup> *Ibid.*

<sup>40</sup> PBOC, *The PBOC Announcement on Improving Quotation of the Central Parity of RMB against USD* (August 2015).

<sup>41</sup> PBOC, *The Launch of the RMB Index Helps to Guide Public View of RMB Exchange Rate* (December 2015).

attached to each currency.<sup>42</sup> With these two changes, the daily fixing rate is now calculated using both a weighted-average of closing rates from the previous day and an adjustment designed to ensure stability in the value of the RMB against the currency basket.<sup>43</sup>

Although these changes are important, a lack of transparency obscures the extent to which market forces affect the rate-setting process. It is not clear whether PBOC collects closing rates from all market makers or only a subset, and if the latter, on what basis the subset is chosen. PBOC apparently calculates the daily fixing rate using only rates from 14 of the market makers.<sup>44</sup> In addition, although the CFETS now publishes the trade weights attached to the currencies in the basket, it still does not publish the weights attached to various closing rates of market makers used to set the daily fixing rate.<sup>45</sup> In fact, studies have found that administrative discretion explains a large percentage of the cumulative change in the fixing rate to date, and that the market-determined component has been small.<sup>46</sup> Indeed, opacity combined with interventions have lowered market participants' expectations in FOREX markets as a reliable measure of the RMB's value. Instead, they remain sensitive to signals from and interventions by Chinese government authorities.<sup>47</sup>

In May 2017, it was reported that PBOC will include, in the calculation of the fixing rate, a coefficient to limit or moderate the tendency toward pro-cyclical adjustment of the fixing rate based on exchange rate movements in the market.<sup>48</sup> What PBOC refers to as the “counter-cyclical coefficient” would effectively reduce the extent of market forces on the fixing rate.<sup>49</sup>

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<sup>42</sup> Yin-Wong Cheung, Cho-Hoi Hui, and Andrew Tsang, *The Renminbi Central Parity: An Empirical Investigation* (Hong Kong Institute for Monetary Research, June 2016), 6-7.

<sup>43</sup> Guan Tao, *8/11 Exchange Rate Reform: Review and Prospects*. [Presentation] Second CF40-PIIE China Economic Forum (Peterson Institute of International Economics, October 5, 2016), slide 26.

<sup>44</sup> Logan Wright, *Distrust but Verify* (Rhodium Group, June 6, 2016), 2. See also Logan Wright, *A Revealing PBOC Adjustment to the Yuan Fixing* (Rhodium Group, May 26, 2017).

<sup>45</sup> IMF, *China: 2015 Article IV Consultation – Staff Report* (August 2015), Informational Annex at 3.

<sup>46</sup> Logan Wright, *A Revealing PBOC Adjustment to the Yuan Fixing* (Rhodium Group, May 26, 2017), 2.

<sup>47</sup> See e.g., U.S. Department of the Treasury, *Foreign Exchange Policies of Major Trading Partners of the United States* (April 14, 2017), 15; Tamim Bayoumi, *A Basket Case? The Future of the Renminbi Exchange Rate Regime: Part 2*, China Economic Watch Blog (Peterson Institute for International Economics, December 22, 2015); Reuters, “Spread Between Onshore, Offshore Yuan Widest Since September 2011,” January 5, 2016.

<sup>48</sup> Barclays Bank, *Reportedly Fine Tuning the CNY Fixing Mechanism*, May 26, 2017. See also China International Capital Corporation Limited (CICC), *PBOC to Add ‘Counter-Cyclical Coefficient’ to CNY Fixing Formula*, CICC Macroeconomy Research – PBOC Watch (May 26, 2017). See also Logan Wright, *A Revealing PBOC Adjustment to the Yuan Fixing* (Rhodium Group, May 26, 2017). See also Bloomberg, “China Considers Changing Yuan Fixing Formula to Curb Swings,” May 25, 2017.

<sup>49</sup> *Ibid.*

This change, if implemented, would signal a step back from PBOC's stated goal of greater exchange rate flexibility.<sup>50</sup>

In December 2015, the IMF began to include the RMB in the currency basket of the Special Drawing Right (SDR), along with the USD, the Euro, the Japanese Yen, and the British Pound.<sup>51</sup> The SDR basket consists of currencies (1) of the largest exporting member countries and (2) that the IMF has determined to be "freely usable."<sup>52</sup> Although this signals an important step toward RMB internationalization, in a report detailing initial considerations of including the RMB in the SDR basket, the IMF expressed some concerns regarding the "freely usable" criteria in the context of existing capital controls, and the observed deviation between onshore and offshore RMB exchange rates.<sup>53</sup> The IMF stated that if the RMB were accepted as an SDR basket currency, "a number of issues would need to be resolved."<sup>54</sup> Even after the IMF added the RMB to the SDR basket, the IMF emphasized that operational challenges remain and that China would need to continue to implement reforms.<sup>55</sup> Shortly after the IMF made its decision to include the RMB in the SDR basket, PBOC announced the components of the currency basket.<sup>56</sup> Analysts believe the inclusion of the RMB in the SDR basket will not, at least in the near term, have a significant effect on the demand for the currency or the allocation of global reserves of central banks, since the RMB is not yet fully convertible.<sup>57</sup>

Controls on many capital account transactions limit the purchase and sale of RMB in the onshore RMB (CNY) market, but the same is not true in the offshore RMB (CNH) market.<sup>58</sup> In addition, the CNH market rate is free-floating and not subject to a trading band.<sup>59</sup> The differences in capital controls and exchange rate regimes are what allow the exchange rates to diverge, and

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<sup>50</sup> Logan Wright, *A Revealing PBOC Adjustment to the Yuan Fixing* (Rhodium Group, May 26, 2017).

<sup>51</sup> IMF, *IMF's Executive Board Completes Review of SDR Basket, Includes Chinese Renminbi* (November 30, 2015).

<sup>52</sup> IMF, *Special Drawing Rights Fact Sheet*, available at <http://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/14/51/Special-Drawing-Right-SDR>, updated April 21, 2017, accessed September 14, 2017.

<sup>53</sup> IMF, *Review of the Method of the Valuation of the SDR – Initial Considerations* (August 3, 2015), 40.

<sup>54</sup> *Ibid.*

<sup>55</sup> IMF, *Review of the Method of the Valuation of the SDR – Initial Considerations* (August 3, 2015), 1, 28, 30-31.

<sup>56</sup> *Xinhua*, "China Releases Yuan Exchange Rate Composite Index," December 12, 2015.

<sup>57</sup> Council on Foreign Relations, *China's Bond Market Can't Handle a Global RMB*, Geo-Graphics Blog (December 2016).

<sup>58</sup> Eswar Prasad, *China's Efforts to Expand the International Use of the Renminbi*, Report prepared for the U.S.-China Economic and Security Review Commission (The Brookings Institution, February 4, 2016).

<sup>59</sup> Wells Fargo, *Conducting Business in China: When to Use Renminbi instead of the U.S. Dollar*, Wells Fargo Global Focus (October 2014). See also J.P. Morgan Chase Bank NA, *One Currency, Two Markets Part 1: Markets, Navigate the Rise of the Global RMB*, Insights from J.P. Morgan (J.P. Morgan, 2013), 3-7.

without such controls, arbitrage would close the gap between the CNH and CNY. However, similar to the onshore CNY market, PBOC reportedly intervenes significantly in the offshore CNH market to prevent the offshore and onshore exchange rates from diverging significantly.<sup>60</sup> In comparison to the onshore CNY market, the offshore CNH market is quite small. The total CNY/CNH combined average daily trading volume in April 2016 was \$202 billion,<sup>61</sup> of which CNH trading comprised approximately \$30 billion.<sup>62</sup>

#### D. Assessment of Factor

The RMB is convertible into foreign currencies for trade purposes. China has made market-oriented modifications to its capital account and exchange rate system. China has also taken steps to develop its FOREX market. However, China still maintains significant restrictions on capital account transactions and intervenes considerably in onshore and offshore FOREX markets. Approval requirements remain for all major capital account transactions, including investment, borrowing, and cross-border accounts. Although participation in the FOREX market is more economically diverse and has increased, PBOC still maintains ultimate control of the value of its currency through FOREX market interventions and the central parity rate-setting process.

The central parity rate against the USD now reflects the closing FOREX market rate of the previous day and an adjustment needed to maintain stability against a basket of currencies. However, the CFETS does not disclose the weights attached to price quotes from the previous day used to calculate the central parity rate. Moreover, significant FOREX interventions are necessary for the RMB to follow the currency basket. For these reasons, it is not clear to what extent China's modifications to its system have brought market forces directly to bear on the exchange rate. Although the offshore CNH market is more open and market-oriented than the onshore CNY market, it is relatively small, and its openness must be qualified by the fact that the PBOC makes significant FOREX interventions that limit the extent of price divergence between the two markets.

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<sup>60</sup> Financial industry publications have published reports of Chinese government intervention in the offshore CNH market. See Neil Gough, "China, Seeking to Stop Weakening Currency, Issues Restrictions," *Deal Book, The New York Times*, January 5, 2017. See also *Financial Times*, "Intervention Speculation as Offshore Renminbi Volatility Rises," September 13, 2016. See also *Bloomberg*, "China Said to Intervene in Offshore Yuan Market to Curb Declines," June 29, 2016.

<sup>61</sup> Bank for International Settlements (BIS), *Turnover of OTC Foreign Exchange Instruments* (April 2016), available at [https://www.bis.org/statistics/d11\\_1.pdf](https://www.bis.org/statistics/d11_1.pdf), accessed September 17, 2017.

<sup>62</sup> John W. Labuszewski and Sandra Ro, *Offshore Chinese Renminbi Market (CNH)* (Chicago Mercantile Exchange Group, March 4, 2014), 2-3.

## **Factor Two: The extent to which wage rates in the foreign country are determined by free bargaining between labor and management.**

Wages are an important component of a producer's costs and prices. This factor examines the extent to which wage rates in China are determined by free bargaining between labor and management. The statutory language concerning "free bargaining between labor and management" reflects concerns about the extent to which wages in an economy are market-based, *i.e.*, about the existence of a market for labor services in which workers and employers are free to bargain over the terms and conditions of employment.

Part A of this section describes the legal and institutional framework governing labor relations in China, including the principal labor laws and the trade union, ACFTU. Part B analyzes the wage formation process in China, beginning with a discussion of wage growth trends, and then proceeding to analyze labor law dispute resolution, trade unions and collective bargaining, and the household registration ("*hukou*") system. Significant institutional constraints on the extent to which wage rates are determined through free bargaining between labor and management in China remain. In addition, the restrictions on labor mobility through the *hukou* system continue to distort the supply side of the labor market.

### **A. Legal and Institutional Framework**

The *Labor Law of the People's Republic of China* ("*Labor Law*") applies to all enterprises, including SIEs, domestic private enterprises, and foreign-invested enterprises (FIEs).<sup>63</sup> The *Labor Law* grants enterprises the right to set their own wages above the government-set minimum wage.<sup>64</sup> Under the 2004 *Minimum Wage Regulations*,<sup>65</sup> minimum wages are set by locality (province or municipality) and each province must set a minimum wage that is between 40% and 60% of the local average wage.<sup>66</sup>

The *Labor Law* provides that employees may join or organize trade unions and negotiate collective contracts,<sup>67</sup> but Chinese law does not permit workers to organize or join unions not approved by the state. China's system of "collective consultation" is characterized by a top-down approach that diverges from the concept of worker-led collective bargaining that exists in many

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<sup>63</sup> *The Labor Law of the People's Republic of China* (adopted by NPC on July 5, 1994, effective January 1, 1995, amended August 27, 2009).

<sup>64</sup> *Labor Law*, Articles 47 and 48.

<sup>65</sup> *Minimum Wage Regulations* (Ministry of Labor and Social Security [now Ministry of Human Resources and Social Security], Order No. 21, issued January 20, 2004).

<sup>66</sup> *Minimum Wage Regulations*, Attachment, Section 2. In September 2016, nine regions in China raised the local minimum wage. People in Shanghai enjoyed the highest increase, of RMB 2,190 per month. *China Daily*, "China Anticipates Booming Job Market in 2016," October 27, 2016.

<sup>67</sup> *Labor Law*, Articles 7 and 33.

Western economies. Workers in China also do not have the right to strike under Chinese law.<sup>68</sup> While the *Constitution of the People's Republic of China* (“PRC Constitution”) provides for the freedom of peaceful assembly, it also stipulates that such activities may not infringe upon the interests of the state.<sup>69</sup>

ACFTU has been China's official trade union since the founding of the People's Republic of China in 1949. ACFTU's legal monopoly on all trade union activities is codified in the *Trade Union Law of the People's Republic of China* (“Trade Union Law”) adopted in 1992, and remains unchanged after amendments to the law in 2001 and 2009.<sup>70</sup> The Chinese government prohibits independent unions and has systemically and, in some cases, forcibly repressed efforts to organize independent unions.<sup>71</sup> The *Trade Union Law* provides for ACFTU to preside over a network of subordinate trade unions that are related to one another in terms of the Leninist concept of “democratic centralism,” which subordinates lower-ranking unions to higher-ranking ones.<sup>72</sup> ACFTU is subject to CCP control, and trade union leaders concurrently hold office at a corresponding rank in the CCP or the government.<sup>73</sup> The current ACFTU chairman is a member of the CCP Politburo.<sup>74</sup>

Trade union officials are officially employees of the Chinese government, further underscoring their status as government actors under CCP control.<sup>75</sup> While the *Trade Union Law* provides that union leaders must be elected, in practice, nearly all leaders are nominated or vetted by

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<sup>68</sup> Kai Chang and Fang Lee Cooke, “Legislating the Right to Strike in China: Historical Development and Prospects,” *Journal of Industrial Relations* 57(3) (2015): 444 and 448. See also Dongtao Qi, *Progress and Dilemmas of Chinese Trade Unions*, East Asian Policy Background Brief 537 (East Asian Institute, National University of Singapore, 2010), 21.

<sup>69</sup> *Constitution of the People's Republic of China*, Articles 35 and 51 (adopted by NPC on December 4, 1982, amended March 29, 1993, further amended March 15, 1999 and March 14, 2004).

<sup>70</sup> *Trade Union Law of the People's Republic of China*, Article 10 (adopted by NPC on April 3, 1992, amended October 27, 2001, further amended August 27, 2009). See also Cynthia Estlund, *A New Deal for China's Workers?* (Cambridge: Harvard University Press, 2017), 47.

<sup>71</sup> *Bloomberg*, “Beijing Wants One Union to Rule Them All,” November 10, 2016.

<sup>72</sup> *Trade Union Law*, Article 9.

<sup>73</sup> *Trade Union Law*, Article 4. See also Rudolf Traub-Merz, *All China Federation of Trade Unions: Structure, Functions and the Challenge of Collective Bargaining*, Working Paper No. 13 (International Labor Office, Global Labour University, September 2011), 8.

<sup>74</sup> Rudolf Traub-Merz, *All China Federation of Trade Unions: Structure, Functions and the Challenge of Collective Bargaining*, Working Paper No. 13 (International Labor Office, Global Labour University, September 2011), 8. See also “ACFTU Leadership” on ACFTU website, available at <http://en.acftu.org/28589/201408/15/140815173447455.shtml>, accessed September 13, 2017.

<sup>75</sup> Rudolf Traub-Merz, *All China Federation of Trade Unions: Structure, Functions and the Challenge of Collective Bargaining*, Working Paper No. 13 (International Labor Office, Global Labour University, September 2011), 10-11.



enterprise management.<sup>76</sup> ACFTU must organize and approve all union activity, but ACFTU is not required to reflect solely, or even primarily, the interests of workers in disputes. Unions are nominally required to safeguard the legitimate rights and interests of the Chinese worker<sup>77</sup> while simultaneously playing their proper role in China's socialist modernization<sup>78</sup> and safeguarding the socialist State power under the people's democratic dictatorship.<sup>79</sup> Because China's trade unions are part of the Chinese government's institutional framework, with a responsibility to preserve harmony and stability in industrial relations,<sup>80</sup> there is an inherent tension in the dual functions they serve.

Over the last decade, the expansion of labor market institutions has coincided with new labor legislation, including the *Labor Contract Law of the People's Republic of China* ("Labor Contract Law")<sup>81</sup> and the *Law on Mediation and Arbitration of Labor Disputes of the People's Republic of China* ("Labor Dispute Law").<sup>82</sup> The *Labor Dispute Law* codifies protections for workers, such as strengthening regulations on termination of employment and establishing penalties for employers that fail to provide written labor contracts, pay wages on a timely basis, provide overtime pay, or provide compensation for terminated labor contracts.<sup>83</sup>

Attempts to resolve individual labor disputes in China generally progress in stages. First, a worker and the employer may attempt to resolve the matter through informal consultations.<sup>84</sup> If consultations fail to resolve the dispute, the parties may submit the matter to the enterprise's mediation commission or to an external government or quasi-governmental mediation committee.<sup>85</sup> If mediation fails or if the parties forego mediation, the parties may apply to the

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<sup>76</sup> *Ibid.*, 18-19.

<sup>77</sup> *Trade Union Law*, Article 6.

<sup>78</sup> *Constitution of the ACFTU*, Section "General Provisions" (adopted by ACFTU on October 22, 2013).

<sup>79</sup> *Trade Union Law*, Article 5.

<sup>80</sup> Sarah Biddulph, "Responding to Industrial Unrest in China: Prospects for Strengthening the Role of Collective Bargaining," *Sydney Law Review* 34 (2012): 48.

<sup>81</sup> *Labor Contract Law of the People's Republic of China* (adopted by NPC on June 29, 2007, effective January 1, 2008, amended December 28, 2012).

<sup>82</sup> *Law on Mediation and Arbitration of Labor Disputes of the People's Republic of China* (adopted by NPC on December 29, 2007, effective May 1, 2008). See also Chang-Hee Lee et al., "What Sort of Collective Bargaining is Emerging in China?" *British Journal of Industrial Relations* 54(1) (March 2016): 220.

<sup>83</sup> *Labor Contract Law*, Articles 82 and 85. See also Chang-Hee Lee et al., "What Sort of Collective Bargaining is Emerging in China?" *British Journal of Industrial Relations* 54(1) (March 2016): 220.

<sup>84</sup> *Labor Law*, Article 77 and *Labor Dispute Law*, Article 4. See also James Zimmerman, *China Law Deskbook, A Legal Guide for Foreign-Invested Enterprises*, 4th edition (Chicago: American Bar Association, 2014), 451.

<sup>85</sup> *Labor Dispute Law*, Article 5. See also James Zimmerman, *China Law Deskbook, A Legal Guide for Foreign-Invested Enterprises*, 4th edition (Chicago: American Bar Association, 2014), 451.



local labor dispute arbitration commission for resolution.<sup>86</sup> The arbitration commission is comprised of representatives of the Ministry of Human Resources and Social Security (MOHRSS) or another government authority, the trade union, and the employer.<sup>87</sup> MOHRSS or another government authority is responsible for administering the arbitration in practice.<sup>88</sup> If a party disagrees with the arbitration commission's decision, the disputing party may file a claim in court within 15 days of receiving the decision.<sup>89</sup>

While the *Labor Contract Law* and the *Labor Dispute Law* have added important protections for employees under the law, they do not advance the fundamental rights of freedom of association and collective bargaining, deemed essential in the ILO's 1998 *Declaration of Fundamental Principles and Rights at Work*.<sup>90</sup>

## B. Constraints on Wage Formation

### 1. Wage Growth Trends

Since the 1980s, China's economy has experienced an increased dispersion of wages across regions, industries, experience, education level, job tenure, migrant status and company ownership category. At the same time, wages are converging across sub-sectors of urban manufacturing, consistent with a decrease in the surplus labor supply and labor market tightening.<sup>91</sup> In the context of China's rapid and sustained economic growth, there has also been a steady rise in real wages over time.<sup>92</sup> According to ILO estimates, between 2008 and 2014, real wages in China's urban units grew at a compound annual rate of 9.1%.<sup>93</sup>

However, growth in real wages has historically lagged labor productivity growth. According to ILO estimates, Chinese workers' average output increased at a compound annual rate of 9.6% between 2000 and 2012, while employees' average real compensation increased at an annual

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<sup>86</sup> *Labor Dispute Law*, Article 5.

<sup>87</sup> *Labor Dispute Law*, Article 19.

<sup>88</sup> James Zimmerman, *China Law Deskbook, A Legal Guide for Foreign-Invested Enterprises, 4th edition* (Chicago: American Bar Association, 2014), 453.

<sup>89</sup> *Labor Dispute Law*, Articles 5 and 48.

<sup>90</sup> ILO, *ILO Declaration on Fundamental Principles and Rights at Work* (adopted by the International Labor Conference at its 86th Session on June 18, 1998, annex revised on June 15, 2010). See also Hillary Josephs, "Measuring Progress under China's Labor Law: Goals, Processes, Outcomes," *Comparative Labor Law & Policy Journal* 30(2) (2008): 391.

<sup>91</sup> O. Hyun Kwon et al., "Evolution of the Interindustry Wage Structure in China since the 1980's," *Pacific Economic Review* 20(1) (2015): 20-21.

<sup>92</sup> ILO, *Wages, Productivity and Labour Share in China*, Research Brief (April 2016), 1-2.

<sup>93</sup> *Ibid.*, 1.

growth rate of 8.2% over the same period.<sup>94</sup> Over the period 2000-2011, the ILO also estimates a decline in the labor income share (ratio of compensation of employees over gross value added).<sup>95</sup> Thus, real wages have not kept pace with worker contributions to output, and Chinese workers' share in China's expanding economy has effectively declined. The ILO points to weak labor institutions and weakening workers' bargaining power as important factors contributing to this trend.<sup>96</sup>

As noted above, the minimum wage in China is set at the local level using a "living wage" approach that focuses on subsistence wage levels, rather than a "wage floor" approach that focuses on labor productivity.<sup>97</sup> As a result, minimum wage growth lags real wage growth, to the point where virtually all workers, local and migrant, men and women, skilled and unskilled, earn above the minimum wage.<sup>98</sup> Accordingly, the minimum wage is not a significant factor in determining whether workers receive a fair wage that reflects contributions to output.<sup>99</sup>

Wage arrears have been a perennial problem in China, particularly in the construction industry.<sup>100</sup> Excess industrial capacity and slower economic growth have exacerbated this problem in recent years. As industrial enterprises shut down, compensation to employees has increasingly gone unpaid.<sup>101</sup> Labor strikes, not expressly permitted under Chinese law but often tolerated by government authorities, have increased in recent years, driven in large part by wage payment and retrenchment compensation issues.<sup>102</sup> Wage arrears are a particular problem for

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<sup>94</sup> *Ibid.*, 5.

<sup>95</sup> *Ibid.*

<sup>96</sup> *Ibid.* ("The reasons for the decline have been debated, but typically include technological changes, globalization, financialization, and weak labour market institutions – all of which contribute to a weakening of workers' bargaining power. Other explanations note the rapid structural transformation (from the agricultural to the non-agricultural sectors) where the capital share is often higher, or the restructuring of state-owned enterprises and increased monopoly power within industry.")

<sup>97</sup> World Bank, *China 2030: Building a Modern, Harmonious, and Creative Society*, Report No. 96299 (March 2013), 327-328.

<sup>98</sup> ILO, *Wages, Productivity and Labour Share in China*, Research Brief (April 2016), 3-4. *See also* World Bank, *China 2030: Building a Modern, Harmonious, and Creative Society*, Report No. 96299 (March 2013), 324.

<sup>99</sup> World Bank, *China 2030: Building a Modern, Harmonious, and Creative Society*, Report No. 96299 (March 2013), 327.

<sup>100</sup> *The Economist*, "Can't Pay, Won't Pay," October 29, 2011. *See also* *China Daily*, "Government Helps 3.7m Workers Get Unpaid Wages," January 26, 2017.

<sup>101</sup> Economist Intelligence Unit, *China Economy: China Hand: Labour Resources* (September 16, 2015).

<sup>102</sup> U.S. Department of State, *2016 Human Rights Report: China* (2016), 68. ("Authorities rarely released statistics for labor disputes, but in November 2015 the official Xinhua News Agency reported a growing number of wage arrears cases totaling 11,007 in the first three quarters of 2015, an increase of 34% over the same period in 2014. Unofficial records from the Hong Kong-based labor rights NGO China Labor Bulletin (CLB) showed that at least 1,050 strikes and collective protests by workers occurred between December 2014 and February 2015, 90[%]

migrant workers, most of whom work without a formal, written labor contract.<sup>103</sup> According to MOHRSS, there were 11,007 migrant worker protests over wage arrears in the first three quarters of 2015, an increase of 34% over the same period in 2014.<sup>104</sup>

## 2. Labor Law Dispute Resolution

The Chinese government has implemented legislation such as the *Labor Contract Law* that provides employees with a cause of action to challenge particular aspects of an employee's labor contract in a Chinese court.<sup>105</sup> As legislation has expanded the scope of labor contracts, employees have increasingly challenged employers in Chinese courts.<sup>106</sup> Nonetheless, the *Labor Contract Law* and the *Labor Dispute Law* do not alter the fundamental relationship between the worker, the union, and the state.

As discussed above, individuals cannot join together to form independent trade unions or collectively bargain outside the institutional framework controlled by the Chinese government and the CCP. Instead, individual workers can only issue individual challenges on a case-by-case basis after the fact of an alleged violation of labor rules.<sup>107</sup> An individual worker's prosecution of a case under these laws can be time-consuming and costly.<sup>108</sup> Migrant workers, who often have few resources and who may not be geographically fixed, face particular challenges in pursuing claims under this system.<sup>109</sup> Official Chinese trade unions are required to provide legal aid to workers as long as workers use the prescribed legal channels to address their concerns. Yet, in many cases, particularly outside of China's wealthiest cities, unions lack the financial resources and legal capacity to provide adequate legal assistance.<sup>110</sup>

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relating to unpaid wages.") See also Economist Intelligence Unit, *China Economy: China Hand: Labour Resources* (September 16, 2015).

<sup>103</sup> Kam Wing Chan and Will Buckingham, "Is China Abolishing the Hukou System?" *China Quarterly* 195 (September 2008): 599.

<sup>104</sup> *China Labor Bulletin*, "China Saw a Dramatic Increase in Wage Arrears Protests in Run Up to New Year," February 3, 2016.

<sup>105</sup> For a detailed discussion, see Hualing Fu, "Bringing Politics Back In: Access to Justice and Labor Dispute Resolution in China." In *Justice: The China Experience*, (eds.) Flora Sapio et al. (Cambridge: Cambridge University Press, 2017), 356-378.

<sup>106</sup> Mimi Zou et al., "Regulating Collective Disputes in China: A Tale of Two Actors," *Journal of Comparative Law* 10(2) (2016): 279-281.

<sup>107</sup> Hualing Fu, "Bringing Politics Back In: Access to Justice and Labor Dispute Resolution in China," In *Justice: The China Experience*, (eds.) Flora Sapio et al. (Cambridge: Cambridge University Press, 2017), 356-378.

<sup>108</sup> *Ibid.*

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

<sup>110</sup> *Ibid.*

Consequently, China's labor dispute resolution system has the effect of containing and controlling labor concerns rather than addressing fundamental issues that affect workers systemically and collectively.

### 3. *Trade Unions and Collective Bargaining*

Limited collective bargaining power constrains real wage growth and frustrates worker efforts to secure a fair wage. As discussed above, workers in China have limited collective bargaining power because they lack the freedom to associate and assemble and the right to strike, and because ACFTU, the only legally sanctioned trade union in China, remains an instrument of the Chinese government and the CCP. Managers of enterprises fill most ACFTU leadership positions, and in general, workers do not directly elect their union representatives.<sup>111</sup> A report by the ILO explains:

ACFTU is not feared for its ability to call millions of workers into action but because it may activate support from the local government or the Party, in particular, as many trade union leaders double as Party secretaries or deputies in people's Congresses. Because a union leader's authority derives from the party-state which values social stability and not strong action against unwilling enterprises, and because company employees are not called into action to bargain for a better deal, employers usually find themselves in a comfortable position and able to give in selectively to union demands, while at the same time withholding substantial concessions. The whole top-down organisational process has become characterised by serious flaws which allow management to largely dominate and control trade unions.<sup>112</sup>

Accordingly, negotiations between labor and management in China have traditionally been described as "collective consultations," which are a "formality."<sup>113</sup> In actuality, either labor and management do not "carry out real bargaining" or "management does not even meet with the trade unions, and just sends them a collective contract for 'approval.'"<sup>114</sup> This context is at odds with the practice of collective bargaining as envisioned by international institutions such as the ILO, in which trade unions are "legitimate units of bargaining."<sup>115</sup> Formal indicia of trade union membership in China do not necessarily support a conclusion that free bargaining between

<sup>111</sup> Mimi Zou et al., "Regulating Collective Disputes in China: A Tale of Two Actors," *Journal of Comparative Law* 10(2) (2016): 282-283.

<sup>112</sup> Rudolf Traub-Merz, *All China Federation of Trade Unions: Structure, Functions and the Challenge of Collective Bargaining*, Working Paper No. 13 (International Labor Office, Global Labour University, September 2011), 18.

<sup>113</sup> Chris King-Chi Chan and Elaine Sio-leng Hui, "The Development of Collective Bargaining in China: From 'Collective Bargaining by Riot' to 'Party State-Led Wage Bargaining,'" *China Quarterly* 217 (March 2014): 226.

<sup>114</sup> *Ibid.*, 226. See also Mimi Zou et al., "Regulating Collective Disputes in China: A Tale of Two Actors," *Journal of Comparative Law* 10(2) (2016): 281-282.

<sup>115</sup> ILO, *International Labor Standards on Collective Bargaining* (2017); ILO, *International Labor Standards on Freedom of Association* (2017); Bernard Gernigon et al., *ILO Principles Concerning the Right to Strike* (ILO, 1998), 3. See also Chris King-Chi Chan and Elaine Sio-leng Hui, "The Development of Collective Bargaining in China: From 'Collective Bargaining by Riot' to 'Party State-Led Wage Bargaining,'" *China Quarterly* 217 (March 2014): 227.

management and labor is occurring.<sup>116</sup> Trade unions controlled by a formal management hierarchy from the top down, under the influence of the Chinese government and the CCP, enjoy little credibility with workers.<sup>117</sup>

The difficulties that workers face in vindicating their interests through the legal system or trade unions has increasingly led them to pursue their grievances through unauthorized strikes and protests, in which they demand to negotiate directly with management.<sup>118</sup> Even though official data is not available, most observers agree that the incidence of unauthorized labor strikes has been on the rise since the 1990s.<sup>119</sup> A notable series of illegal strikes in 2010 at manufacturing sites in southern China brought to the central government's attention the need to address workers' collective demands out of concern that the strikes might cause social unrest or lead to the development of independent and empowered unions.<sup>120</sup> For example, during a strike at a Honda plant in Guangdong province, workers demanded a direct role in union elections. In response to these demands, workers were given some role in electing union representatives. Still, workers were excluded as candidates for leadership positions, which continued to be filled by company managers and supervisors.<sup>121</sup>

The top-down, state-led approach to collective bargaining in China essentially produces government-managed outcomes. In some cases, unauthorized strikes take place outside the institutional framework that governs industrial relations, and the subsequent bargaining between workers and management has moderately improved wages and working conditions.<sup>122</sup> However, this approach is fundamentally different from a market-based, bottom-up, worker-led negotiating

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<sup>116</sup> By 2011, 3.6 million enterprises had signed 1.8 million collective contracts covering 223 million workers. See Mimi Zou et al., "Regulating Collective Disputes in China: A Tale of Two Actors," *Journal of Comparative Law* 10(2) (2016): 281.

<sup>117</sup> *Ibid.*, 283-284.

<sup>118</sup> Chris King-Chi Chan and Elaine Sio-leng Hui, "The Development of Collective Bargaining in China: From 'Collective Bargaining by Riot' to 'Party State-Led Wage Bargaining,'" *China Quarterly* 217 (March 2014): 238.

<sup>119</sup> Chang-Hee Lee et al., "What Sort of Collective Bargaining is Emerging in China?" *British Journal of Industrial Relations* 54(1) (March 2016): 222. According to official statistics, there were 9,000 "mass incidents" in 1994 and 87,000 in 2005, the last year the government released figures. In 2008, the number of incidents was estimated to be 127,000 according to a leaked report. It is unclear how many of these incidents are labor-related. One scholar estimates that approximately 30,000 strikes and protests by workers occurred in 2009. Manfred Elfstrom and Sarosh Kuruvilla, "The Changing Nature of Labor Unrest in China," *ILR Review* 67(2) (April 2014): 454.

<sup>120</sup> Chris King-Chi Chan and Elaine Sio-leng Hui, "The Development of Collective Bargaining in China: From 'Collective Bargaining by Riot' to 'Party State-Led Wage Bargaining,'" *China Quarterly* 217 (March 2014): 228-229, 238-239.

<sup>121</sup> *Ibid.*, 228-234.

<sup>122</sup> Chang-Hee Lee et al., "What Sort of Collective Bargaining is Emerging in China?," *British Journal of Industrial Relations* (March 2016): 232-233.

process in which workers' leverage reflects their right under the law to strike.<sup>123</sup> Recent government campaigns to restrict the operations and activities of labor rights non-governmental organizations (NGOs) suggest that the government's focus will remain on obtaining preferred outcomes, rather than on fundamental changes in the legal role and capacity of trade unions in China.<sup>124</sup>

#### 4. The Hukou System

Under the *hukou* system administered by the Chinese government, every Chinese citizen since the 1950s has been classified at birth as either an "agricultural" (rural) or "non-agricultural" (urban) resident and registered with a local jurisdiction – a city, town, or village – that is considered his or her official and only place of "permanent residence." This local *hukou* typically passes from mother to child and entitles the holder to services including education, housing, healthcare, and social welfare provided by the local jurisdiction.<sup>125</sup> Transferring one's *hukou* classification from agricultural to non-agricultural status or changing the place of registration is a difficult bureaucratic process.<sup>126</sup>

A key purpose for establishing the *hukou* system under China's command economy was to prevent mass migration to cities, while ensuring sufficient supplies of labor for grain production in rural areas and for industrial projects under government control.<sup>127</sup> After 1978, rapid economic growth and urban expansion created a demand for labor that was met by migration from rural to urban areas and from central to coastal regions. Over time, the persistence of the *hukou* system has resulted in an acute imbalance: over half of China's population now lives in urban areas, but only one-third of the urban population holds an urban *hukou*.<sup>128</sup>

Access to low-cost migrant labor has contributed to China's emergence as a low-cost production center in the global economy. As one scholar has noted, the *hukou* system has created a "huge

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<sup>123</sup> Chris King-Chi Chan and Elaine Sio-leng Hui, "The Development of Collective Bargaining in China: From 'Collective Bargaining by Riot' to 'Party State-Led Wage Bargaining,'" *China Quarterly* 217 (March 2014): 238. See also Bernard Gernigon et al., *ILO Principles Concerning the Right to Strike* (ILO, 1998), 9, 11-12.

<sup>124</sup> *Financial Times*, "China Police Arrest Activists in Campaign Against Labour Unrest," January 11, 2016.

<sup>125</sup> Kam Wing Chan, "The Chinese Hukou System at 50," *Eurasian Geography & Economics* 50(2) (2009): 201-202. See also Charlotte Goodburn, *The End of the Hukou System? Not Yet*, China Policy Institute Policy Paper (China Policy Institute, University of Nottingham, September 2014), 2.

<sup>126</sup> Charlotte Goodburn, *The End of the Hukou System? Not Yet*, China Policy Institute Policy Paper (China Policy Institute, University of Nottingham, September 2014), 3.

<sup>127</sup> Maarten Bosker et al., *Hukou and Highways: The Impact of China's Spatial Development Policies on Urbanization and Regional Inequality*, Policy Research Working Paper WPS7350 (World Bank Group, Development Research Group, June 2015), 7. See also Charlotte Goodburn, *The End of the Hukou System? Not Yet*, China Policy Institute Policy Paper (China Policy Institute, University of Nottingham, September 2014), 2.

<sup>128</sup> Kam Wing Chan, "The Household Registration System and Migrant Labor in China: Notes on a Debate," *Population and Development Review* 36(2) (June 2010): 359.



class of super-exploitable, yet highly mobile or flexible industrial workers for China's new economy, now closely integrated into global trade networks."<sup>129</sup> For example, in China's largest migrant labor city, Shenzhen, often referred to as the "world's factory," local government officials have acknowledged that the city could not have achieved its rapid economic growth without rural migrant labor.<sup>130</sup>

Several *hukou*-related factors continue to limit labor mobility. First, rural *hukou* holders have shown reluctance to transfer their *hukou* to an urban location because it requires them to relinquish their increasingly valuable rural land-use rights, which in many cases represents the only retirement security that rural residents and their families have.<sup>131</sup> Second, rural residents that migrate outside the geographical area of their *hukou* registration may not have access to public services, healthcare benefits, housing, the educational system and formal employment under a written labor contract.<sup>132</sup>

The Chinese government has recently taken steps to modify the *hukou* system. The State Council *Opinion on Further Promoting Hukou System Reforms* ("*Opinion on Hukou Reform*")<sup>133</sup> issued in 2014 calls for several changes, including: removing the distinction between agricultural and non-agricultural *hukou*, and instead registering citizens by their place of origin;<sup>134</sup> allowing migrants to apply for a local *hukou* after holding a mandatory residence permit in an urban area for a certain period of time;<sup>135</sup> and permitting rural land-use rights holders to retain at least some of the value of their land-use right after obtaining an urban *hukou*.<sup>136</sup>

Nevertheless, these changes represent a modification of the *hukou* system rather than its elimination, and many aspects of the *hukou* system continue to limit labor mobility in China.<sup>137</sup>

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<sup>129</sup> Kam Wing Chan, "The Chinese Hukou System at 50," *Eurasian Geography & Economics* 50(2) (2009): 206-207.

<sup>130</sup> *Ibid.*, 208. See also Kam Wing Chan, "The Household Registration System and Migrant Labor in China: Notes on a Debate," *Population and Development Review* 36(2) (June 2010): 359-360.

<sup>131</sup> Kam Wing Chan, "The Chinese Hukou System at 50," *Eurasian Geography & Economics* 50(2) (2009): 205. See also Charlotte Goodburn, *The End of the Hukou System? Not Yet*, China Policy Institute Policy Paper (China Policy Institute, University of Nottingham, September 2014), 6.

<sup>132</sup> Ming Lu and Yiran Xia, *Migration in the People's Republic of China*, Working Paper No. 593 (ADB, September 2016), 5-7. See also Jason Gagnon et al., "Are Migrants Discriminated Against in Chinese Labor Markets?" *IZA Journal of Labor and Development* 3(17) (2014): 9-12.

<sup>133</sup> *State Council Opinion on Further Promoting Hukou System Reforms* (State Council, Guo Fa [2014] No. 25, issued July 24, 2014).

<sup>134</sup> Charlotte Goodburn, *The End of the Hukou System? Not Yet*, China Policy Institute Policy Paper (China Policy Institute, University of Nottingham, September 2014), 3.

<sup>135</sup> *Opinion on Hukou Reform*, Article 10.

<sup>136</sup> *Opinion on Hukou Reform*, Article 12.

<sup>137</sup> *Ibid.*, 6.



The State Council's recent proposals have not been enshrined in major laws, and are often implemented on only a partial or pilot basis. Notably, the *Opinion on Hukou Reform* provides that controls be stricter in large cities, particularly mega-cities such as Beijing, Shanghai, and Shenzhen, than in small and medium-sized cities.<sup>138</sup> This concept of basing *hukou* policy on city size was first put forward in the *Decision on Several Major Issues for Comprehensively Deepening Reform* (“*Third Plenum Decision*”) adopted by the CCP Central Committee (CCPCC) and the State Council in 2013.<sup>139</sup> Restrictions in larger cities make it difficult, if not impossible, for the vast majority of migrants to obtain an urban *hukou* in the urban areas where the best economic opportunities are located. Those migrants and their dependents who still choose to live in the larger cities will continue to face uncertainty regarding access to social services, education and healthcare.<sup>140</sup> Conversely, in the small and medium-sized cities where the Chinese government is relaxing controls on labor flows, economic opportunities are fewer and social services more limited.

Fiscal budget constraints, discussed further in Factor 4.B. of this report, are key impediments to achieving meaningful *hukou* reform. Local governments bear inordinate responsibility for financing public services such as policing, schools, hospitals, and roads.<sup>141</sup> A relaxation of the *hukou* system could accentuate this imbalance by increasing demand for municipal services. In 2016, the Chinese government announced further *hukou*-related changes aimed at increasing the “carrying capacity” of social services in local government budgets.<sup>142</sup> As this is a very recent development, it is difficult to assess its efficacy at this stage.

### C. Assessment of Factor

The Department observes variability in wages across regions, sectors, and enterprises in China, and the steady rise of real wages in China's economy. Nonetheless, a number of institutional constraints limit the extent to which market forces contribute to wage formation in China. While China has expanded legislation to protect workers' legal rights, these developments have not

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<sup>138</sup> Chapter II of the *Opinion on Hukou Reform* calls for exercising strict control over the population of megacities, which are defined as cities with populations greater than five million. “Strict control” involves establishing a number of *hukou* eligibility criteria, to be evaluated according to a points system. A more relaxed set of criteria is applied to large cities with one million to three million and three million to five million residents, respectively.

<sup>139</sup> *Decision on Several Major Issues for Comprehensively Deepening Reform*, Article 23 (adopted by CCPCC at the Third Plenary Session of the 18th National Congress of the CCP on November 12, 2013). (“We will introduce new population management methods, accelerate the reform of household registration system, completely lift restrictions on new residence registration in administrative townships and small cities, relax restrictions on new residence registration in medium-sized cities in an orderly manner, lay down appropriate conditions for new residence registration in large cities, and strictly control the population size of megacities.”)

<sup>140</sup> Charlotte Goodburn, *The End of the Hukou System? Not Yet*, China Policy Institute Policy Paper (China Policy Institute, University of Nottingham, September 2014), 4-5.

<sup>141</sup> See Athar Hussain and Nicholas Stern, “Public Finances, the Role of the State, and Economic Transformation, 1978-2020,” In *Public Finance in China: Reform and Growth for a Harmonious Society*, (eds.) Jiwei Lou and Shuilin Wang (Washington, DC: World Bank, 2008), 13-38.

<sup>142</sup> *Program to Promote 100 million of the Non-Registered Population to Settle in the City* (State Council, Guo Ban Fa [2016] No. 72, issued September 30, 2016).

reduced restrictions on collective bargaining. Workers do not have the legal right to strike or organize independently, and as such, have no meaningful freedom of association. All trade unions are affiliates of the government-controlled ACFTU and its branches at the local and enterprise level. The legal and institutional relationship with the government inhibits unions from acting as true advocates of workers' rights and as a meaningful counterweight to management. Collective action has been on the rise, but these incidents are generally outside of the institutional process, and the Chinese government only condones them when they do not threaten social stability.

In addition, restrictions on labor mobility through the *hukou* system continue to inhibit and guide labor flows within China and to distort the supply side of the labor market. The Department notes recent efforts by the Chinese government to modify the *hukou* system by relaxing eligibility, allowing some rural residents to retain the value of rural land-use rights, and addressing local government budgetary constraints that affect the provision of municipal services. Nonetheless, the *hukou* system continues to limit wages and mobility, particularly in the largest cities that afford the best economic opportunities. Millions of migrant workers across China, who play a central role in China's low-cost labor force, continue to lack access to basic amenities and worker protections.

### **Factor Three: The extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country.**

Opening an economy to foreign investment tends to expose domestic industry to foreign competition, including the management, production and sales practices that foreign enterprises bring to the host economy together with their investments. It also tends to reduce the scope and extent of government control over the market, since foreign investors, as a general rule, demand a certain degree of autonomous control over their investments.

Under this factor, the Department analyzes the Chinese government's foreign investment regime to assess the extent to which foreign investors are able to access China's market and how government interventions serve as barriers to foreign investment. (In Factor 5, the Department will further analyze how the Chinese government's foreign investment regime distorts resource allocations and market outcomes.) Part A of this section reviews the legal and institutional framework governing foreign investment, including the laws related to establishing an FIE, the foreign investment catalogue, and the foreign investment approval processes. Part B describes trends in China's inbound FDI flows, and then proceeds to analyze some of the key constraints on foreign investment, including equity limits and local partner requirements; the investment approval and regulatory process; technology transfer and localization requirements; and anti-monopoly enforcement and national security reviews.

In 2017, the Chinese government continues to rely on a foreign investment catalogue to encourage foreign investment in some sectors of the economy, while restricting or prohibiting it in others. The Chinese government continues to be ranked by the OECD as one of the most restrictive FDI regimes in the world. Although China has opened its economy to foreign investment over the last few decades in many respects, China's foreign investment regime continues to shield Chinese enterprises from competition, particularly those the Chinese government is trying to cultivate as market leaders. The Chinese government recently introduced a "negative list" system to its foreign investment regime, but substantial barriers to foreign investment remain.

#### **A. Legal and Institutional Framework**

##### *1. Laws Establishing FIEs*

The three most common corporate forms of FIEs in China are contractual joint ventures (CJV), equity joint ventures (EJV), and wholly foreign-owned enterprises (WFOE). These three corporate forms are governed by three separate laws, namely the *Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures*, the *Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures*, and the *Law of the People's Republic of China*

on *Wholly Foreign-Owned Enterprises*.<sup>143</sup> Each of these forms of investment have different requirements and restrictions under Chinese law.<sup>144</sup>

When the Chinese government first began to open the economy to foreign investment, foreign companies often found that a Chinese joint venture partner was necessary for a successful market entry strategy, and in some cases, market access for foreign investment has been conditioned on forming a joint venture with a Chinese partner. Over time, as restrictions loosened, the WFOE became the dominant form of foreign investment in China because it provides a foreign investor with more control than a joint venture.<sup>145</sup> However, the Chinese government continues to prohibit WFOEs in certain sectors, and as a result, joint ventures with a Chinese firm remain an important facet of the foreign investment environment in China today.

## 2. *Foreign Investment Catalogue*

All FIEs must comply with the *Catalogue of Industries for Guiding Foreign Investment* (“*Foreign Investment Catalogue*”).<sup>146</sup> Since the *Foreign Investment Catalogue* was first issued in 1995, it has been one of the fundamental legal documents regulating foreign investment in China, and it is the starting point for analyzing the potential restrictions on foreign investment in any particular industry.<sup>147</sup> The *Foreign Investment Catalogue* divides industries into three basic categories for foreign investment purposes: (1) “encouraged,” (2) “restricted,” and (3) “prohibited.” Those industries not explicitly listed in the *Foreign Investment Catalogue* are

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<sup>143</sup> *Law of the People’s Republic of China on Chinese-Foreign Contractual Joint Ventures* (adopted by NPC on April 13, 1988, amended October 31, 2000, further amended September 3, 2016 and November 7, 2016); *Law of the People’s Republic of China on Chinese-Foreign Equity Joint Ventures* (adopted by NPC on July 8, 1979, amended April 4, 1990, further amended March 15, 2001 and September 3, 2016); *Law of the People’s Republic of China on Wholly Foreign-Owned Enterprises* (adopted by NPC on April 12, 1986, amended October 31, 2000, further amended September 3, 2016). In January 2015, China released a draft *Foreign Investment Law* for public comment, which if adopted, would create one law that would govern each of these different forms of foreign investment. *Notice on Seeking Comments to the “Foreign Investment Law of the People’s Republic of China” (Draft for Public Comment)* (MOFCOM, issued January 19, 2015).

<sup>144</sup> James Zimmerman, *China Law Deskbook, A Legal Guide for Foreign-Invested Enterprises, 4th edition* (Chicago: American Bar Association, 2014), 103. One difference between a CJV and an EJV is that parties to a CJV may agree to the entity’s management structure, whereas the management structure of an EJV must comply with relevant laws and regulations. *Ibid.*, 94.

<sup>145</sup> *Ibid.*, 93. See also Ken Davies, *International Investment – China Investment Policy: An Update*, OECD Working Papers on International Investment 2013/01 (OECD, 2013), 52.

<sup>146</sup> *Catalogue of Industries for Guiding Foreign Investment (2017Amendment)* (NDRC and MOFCOM, Order No. 4, issued June 28, 2017).

<sup>147</sup> In addition to the *Foreign Investment Catalogue*, China also issues the *Catalogue of Advantageous Industries for Foreign Investment in the Central and Western Regions* (NDRC and MOFCOM, Order No. 33, issued February 17, 2017, effective March 20, 2017), which encourages foreign investment in China’s less developed regions. The most recent revision to this catalogue in February 2017 was the fourth since the catalogue was first issued in 2000. It covers 22 provinces and municipalities. See also the *Provisions Guiding the Direction of Foreign Investment* (State Council, Order No. 346, issued February 1, 2002, effective April 1, 2002).

deemed to be “permitted.”<sup>148</sup> Different categories of investment in the *Foreign Investment Catalogue* generally lead to different degrees of approval scrutiny or application requirements. For example, foreign investment in “restricted” industries is often subject to stricter government review and more burdensome application requirements. For some industries, the *Foreign Investment Catalogue* requires that investment take a particular form (such as a CJV or EJV), that the proportion of foreign equity investment in the enterprise be capped at a particular level, or that the Chinese party must have a controlling interest.

The *Foreign Investment Catalogue* was amended in 2002 and 2005 to reflect China’s WTO commitments to open certain sectors to foreign investment. An additional revision in 2007 placed new restrictions on several industries, including chemicals, auto parts, rare earths and processing, biofuel production, and edible oil processing.<sup>149</sup> The *Foreign Investment Catalogue* was again revised in 2011, with only minor changes, which, *inter alia*, added wholly foreign-owned medical establishments and removed the retailing of OTC medicines from the “restricted” category.<sup>150</sup> The *Foreign Investment Catalogue* was amended again in 2015 with 38 sectors remaining in the “restricted” category and 36 sectors in the “prohibited” category.<sup>151</sup> While the 2015 *Foreign Investment Catalogue* liberalized investment in a few areas, including the manufacture of chemicals and chemical raw materials, it did not liberalize many of the sectors important to foreign investors, such as services, agriculture, extractive industries, and other manufacturing sectors.<sup>152</sup>

China released a revised *Foreign Investment Catalogue* in June 2017, which continues to contain an “encouraged” category and places “restricted” and “prohibited” investments under a “Negative List for Foreign Investment Access” (“Negative List”). Encouraged industries may benefit from special incentives, but can still be subject to certain restrictions on foreign investment if they are also included on the Negative List.<sup>153</sup> China has indicated that it intends to move to a comprehensive negative list approach, in which foreign investment in all sectors is

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<sup>148</sup> *Provisions Guiding the Direction of Foreign Investment*, Article 4 (State Council, Order No. 346, issued February 1, 2002, effective April 1, 2002).

<sup>149</sup> *Catalogue of Industries for Guiding Foreign Investment (2007 Amendment)* (NDRC and MOFCOM, Order No. 57, issued October 31, 2007, effective December 1, 2007).

<sup>150</sup> *Catalogue of Industries for Guiding Foreign Investment (2011 Amendment)* (NDRC and MOFCOM, Order No. 12, issued December 24, 2011, effective January 30, 2012).

<sup>151</sup> *Catalogue of Industries for Guiding Foreign Investment (2015 Amendment)* (NDRC and MOFCOM, Order No. 22, issued March 10, 2015, effective April 10, 2015). See also AmCham China, *China’s Investment Environment: Overcoming Impediments to the US-China BIT* (October 2015), 10.

<sup>152</sup> *Catalogue of Industries for Guiding Foreign Investment (2015 Amendment)* (NDRC and MOFCOM, Order No. 22, issued March 10, 2015, effective April 10, 2015).

<sup>153</sup> *Catalogue of Industries for Guiding Foreign Investment (2017 Amendment)* (NDRC and MOFCOM, Order No. 4, issued June 28, 2017). Encouraged industries subject to foreign equity restrictions are listed twice, once under the encouraged category and then again under the restricted category.

permitted unless it is expressly included on a negative list.<sup>154</sup> Nonetheless, China is still using an approach that is fundamentally similar to previous versions of the *Foreign Investment Catalogue*.

By promoting foreign investment in certain industries while limiting or altogether prohibiting foreign investment in others, the *Foreign Investment Catalogue* reflects the Chinese government's policy priorities by channeling foreign investment into industries of its choosing.<sup>155</sup> As discussed under Factor 5, the Chinese government's industrial policies include encouraging foreign investment in high-technology industries, promoting indigenous innovation, developing national champions, guiding the development of Chinese domestic industries up the value chain and protecting sensitive and strategic industries from foreign investment.<sup>156</sup> The Chinese government's industrial policies are set forth in a multitude of other planning documents, such as five-year plans, which lay out its economic and development objectives for a five-year period, as well as other administrative regulations, departmental rules, and regulatory documents.

### 3. *Foreign Investment Approval Process*

In contrast to many market economies where corporate registration for any company, foreign or domestic, consists of filing the articles of incorporation with the relevant authorities, foreign investors in China are required to seek approvals from, or register with, multiple Chinese government agencies before an FIE can be established. In addition, after an FIE has been established, further government approvals may be required for significant changes to the enterprise, such as changes to the corporate structure, as well as expansion plans, such as opening new facilities or expanding product lines.<sup>157</sup>

Historically, Chinese law has required a foreign investor to file an application to obtain a certificate of approval by MOFCOM or its local branch in order to establish an FIE. This process typically includes submitting the relevant contracts and articles of association of the proposed

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<sup>154</sup> *Opinions on the Implementation of the Market Access Negative List System*, Section 1(1) (State Council, Guo Fa [2015] No. 55, issued October 19, 2015, effective from December 1, 2015 to December 31, 2017).

<sup>155</sup> Wenbo Gu, "A Comparative Study on Foreign Investment Legal System in China," *Frontiers of Law in China* 5(3) (September 2010): 458, 460-461. See also European Chamber of Commerce and Roland Berger Strategy Consultants, *European Business in China: Business Confidence Survey 2016* (2016), 19; Office of the U.S. Trade Representative, *2016 Report to Congress on China's WTO Compliance* (January 2017), 102, 105-106.

<sup>156</sup> U.S. Chamber of Commerce, *China's Approval Process for Inbound Foreign Investment: Impact on Market Access, National Treatment and Transparency* (November 2012), 8-9; Office of the U.S. Trade Representative, *2016 Report to Congress on China's WTO Compliance* (January 2017), 16-17, 103-104.

<sup>157</sup> James Zimmerman, *China Law Deskbook, A Legal Guide for Foreign-Invested Enterprises, 4th edition* (Chicago: American Bar Association, 2014), Chapter 4.F. See also U.S. Chamber of Commerce, *China's Approval Process for Inbound Foreign Investment: Impact on Market Access, National Treatment and Transparency* (November 2012), 20-22.



FIE.<sup>158</sup> According to the regulations establishing FIEs, MOFCOM or its local branch will not grant approval to a foreign investment in certain circumstances, including, *inter alia*, if (i) an investment would injure China’s sovereignty or the public interest or would endanger state security; (ii) a CJV arrangement would violate Chinese laws, regulations or industrial policies; (iii) an EJV or a WFOE would not meet the “requirements of the development of China’s national economy”; or (iv) an EJV arrangement includes obvious unfairness and harms the rights and interests of the Chinese party to the EJV.<sup>159</sup> In contrast, domestic investors generally only need to submit a “record” filing with the relevant government authority, rather than seeking approval from MOFCOM or its local branch.<sup>160</sup>

In September 2016, the Chinese government amended the laws governing CJVs, EJVs, and WFOEs, such that foreign investors in industries that are not listed in the Negative List are generally no longer required to seek MOFCOM approval for establishment of an FIE and post-establishment expansions, and instead may simply “record file” with the relevant MOFCOM authorities.<sup>161</sup> As discussed in more detail below, a comprehensive negative list for foreign investment has yet to be released. As a result, foreign investment in industries in the “restricted” or “prohibited” categories remain subject to MOFCOM approval.<sup>162</sup>

Foreign investment projects in restricted industries are also required to seek approval from the National Development and Reform Commission (NDRC) or its local branch.<sup>163</sup> For larger investments, State Council approval may be required. In reviewing the investment, NDRC will

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<sup>158</sup> *Provisions Guiding the Direction of Foreign Investment*, Article 12 (State Council, Order No. 346, issued February 1, 2002, effective April 1, 2002).

<sup>159</sup> *Implementing Rules for the Law of the People’s Republic of China on Wholly Foreign-Owned Enterprises*, Article 5 (State Council, Order No. 301, issued December 12, 1990, amended April 12, 2001, further amended February 19, 2014); *Implementing Rules for the Law of the People’s Republic of China on Chinese-Foreign Contractual Joint Ventures*, Article 9 (State Council, issued September 4, 1995, amended February 19, 2014, further amended March 1, 2017); and *Implementing Regulations for the Law of the People’s Republic of China on Chinese-Foreign Equity Joint Ventures*, Article 4 (State Council, issued September 20, 1983, amended July 22, 2001, further amended January 8, 2011 and February 19, 2014). *See also* U.S. Chamber of Commerce, *China’s Approval Process for Inbound Foreign Investment: Impact on Market Access, National Treatment and Transparency* (November 2012), 17.

<sup>160</sup> U.S. Chamber of Commerce, *China’s Approval Process for Inbound Foreign Investment: Impact on Market Access, National Treatment and Transparency* (November 2012), 30.

<sup>161</sup> *Decision to Amend Four Laws including the Wholly Foreign-Owned Enterprise Law of the People’s Republic of China*, Section (1) (adopted by NPC on September 3, 2016).

<sup>162</sup> *Announcement on Implementing the State’s Requirement on the Establishment and Modification of Foreign-Invested Enterprises that Do Not Involve Special Access Management Measures Regarding Recordation Administration In Lieu of Approval* (NDRC and MOFCOM, Order No. 22, issued October 8, 2016).

<sup>163</sup> *Catalogue of Investment Projects Subject to Ratification by the Government*, Section 11 (State Council, Guo Fa [2016] No. 72, issued December 12, 2016, effective December 20, 2016). *See also* James Zimmerman, *China Law Deskbook, A Legal Guide for Foreign-Invested Enterprises*, 4th edition (Chicago: American Bar Association, 2014), 146.



consider, *inter alia*, whether it (i) conforms to relevant laws and regulations as well as the provisions of the *Foreign Investment Catalogue*; (ii) conforms with development plans, industrial policies and access standards; and (iii) does not have a significant negative impact on the public.<sup>164</sup>

Foreign investments may also be subject to review under the *Anti-Monopoly Law of the People's Republic of China* (“AML”) if a “concentration” results in a foreign investor gaining control and the transaction exceeds certain monetary thresholds. In such cases, MOFCOM pre-approval is required for the investment to proceed.<sup>165</sup> In addition, a foreign investment may be subject to national security review if a foreign investor would obtain control of certain domestic enterprises. Similar to AML approval, national security approval is required prior to seeking MOFCOM investment approval.<sup>166</sup>

Once project approval from NDRC is secured and a certificate of approval from MOFCOM is received, a foreign investor files an application with the State Administration of Industry and Commerce (SAIC) or its local branch to obtain a business license.<sup>167</sup> An enterprise cannot operate or exist in China without a valid business license that defines its “business scope.”<sup>168</sup> Business activities must operate within the business scope, which is often narrowly defined, in order for the enterprise to maintain and renew its business license.<sup>169</sup>

The Chinese government imposes additional licensing requirements on a wide array of business activities, including food and drug production, pesticide manufacturing, and mining.<sup>170</sup> FIEs must obtain an industry-specific license prior to engaging in these activities and, in some cases, before applying for investment approval.<sup>171</sup> The specific requirements and the timelines for this approval process may vary widely depending on the industry in question. For heavily regulated industries, the industry regulator review process may take more than a year.<sup>172</sup> As a result, it is

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<sup>164</sup> *Administrative Measures for the Confirmation and Recordation of Foreign-Funded Projects*, Article 16 (NDRC, Order No. 12, issued May 17, 2014).

<sup>165</sup> *Anti-Monopoly Law of the People's Republic of China*, Chapter 4 (adopted by NPC on August 30, 2007).

<sup>166</sup> AML, Article 31. See also James Zimmerman, *China Law Deskbook, A Legal Guide for Foreign-Invested Enterprises*, 4th edition (Chicago: American Bar Association, 2014), 981.

<sup>167</sup> James Zimmerman, *China Law Deskbook, A Legal Guide for Foreign-Invested Enterprises*, 4th edition (Chicago: American Bar Association, 2014), 146.

<sup>168</sup> *Ibid.*, 147.

<sup>169</sup> *Ibid.*

<sup>170</sup> U.S. Chamber of Commerce, *China's Approval Process for Inbound Foreign Investment: Impact on Market Access, National Treatment and Transparency* (November 2012), 17.

<sup>171</sup> *Ibid.*, 17-18.

<sup>172</sup> *Ibid.*, 19.

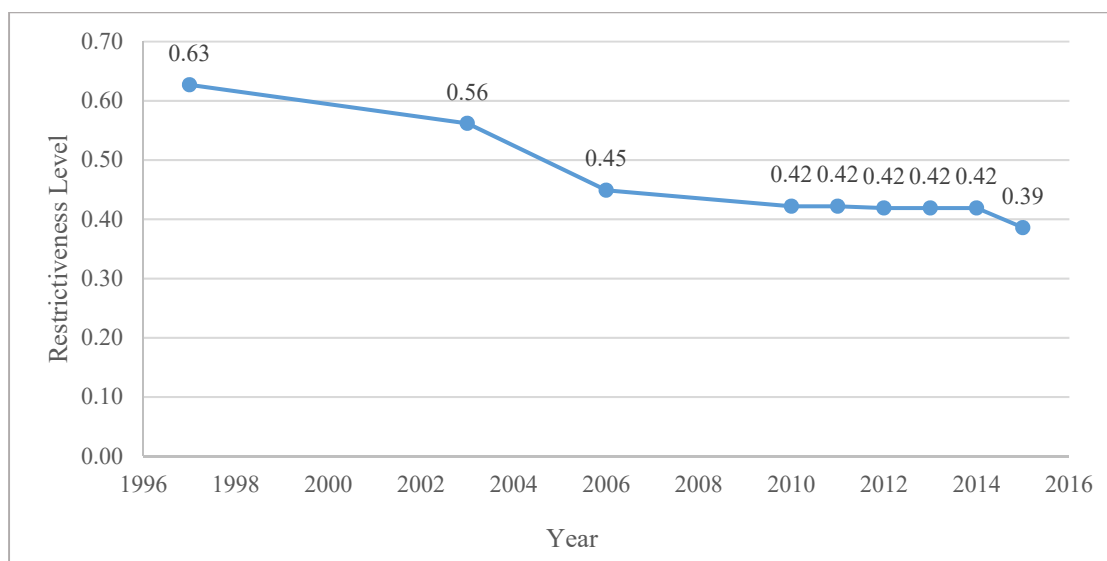
necessary for foreign investors to consult various specific regulations (both at the central and local government levels) and for the industry regulator to understand what specific procedures may be required for a particular investment.

## B. Constraints on Foreign Investment

### 1. Foreign Investment Trends

The OECD, in its FDI Regulatory Restrictiveness Index, has continually ranked the Chinese government's foreign investment regime as one of the most restrictive in the world, even after some initial improvements following China's accession to the WTO (see **Figure 1**).<sup>173</sup> In 2016, the OECD FDI Regulatory Restrictiveness Index ranked China 59<sup>th</sup> out of 62 countries in 2016, just after Myanmar and five times as restrictive as the country average (see **Figure 2**).<sup>174</sup>

**Figure 1: OECD FDI Regulatory Restrictiveness Index – China, 1997-2015**  
(0 = open, 1 = closed)



Source: OECD.

Notably, the OECD evaluates FDI restrictiveness solely based on a country's written measures governing FDI, and does not take into account enforcement, implementation, and government practices that are not codified in laws and regulations.<sup>175</sup> As a result, the OECD acknowledges

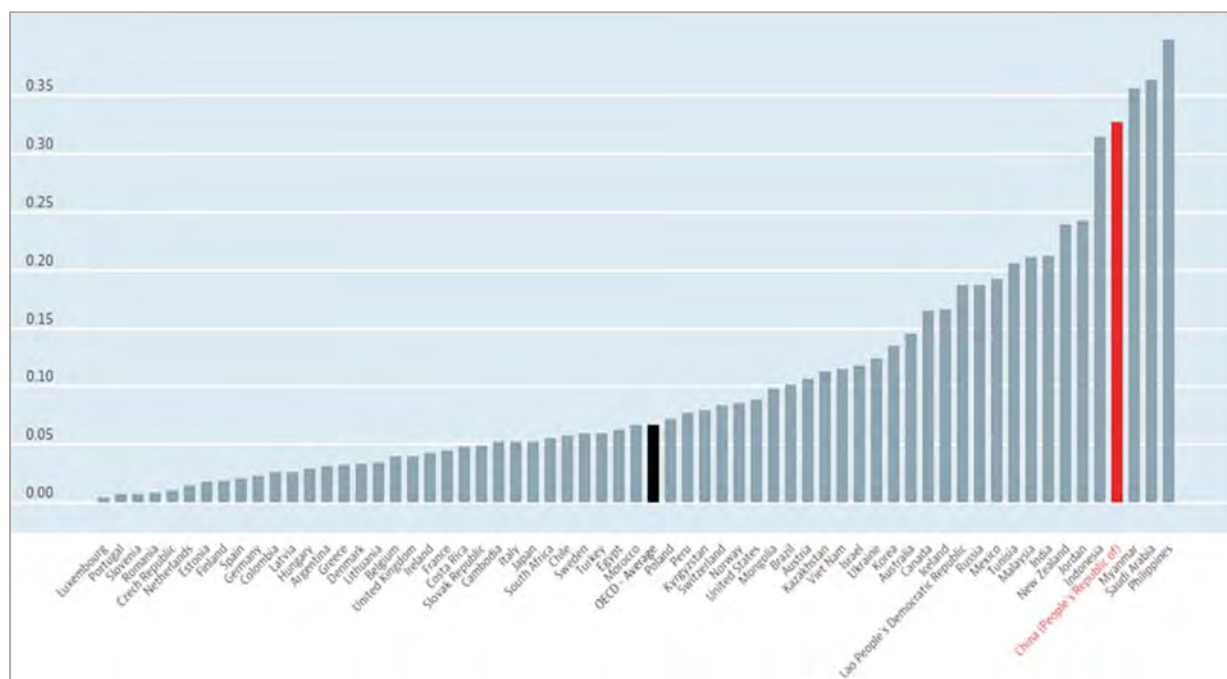
<sup>173</sup> OECD, *FDI Regulatory Restrictiveness Index – Rankings* (December 2016), available at <http://www.oecd.org/investment/fdiindex.htm>, accessed September 17, 2017.

<sup>174</sup> *Ibid.*

<sup>175</sup> The OECD FDI Regulatory Restrictiveness Index examines the following factors across a wide range of sectors: (i) the level of foreign equity ownership permitted; (ii) the screening and approval procedures applied to inward foreign direct investment; (iii) restrictions on key foreign personnel; and (iv) other restrictions such as on land

that by looking only at discrimination “on the books” and not at how the laws and regulations are implemented in practice, it is unable to evaluate the foreign investment environment in its entirety.<sup>176</sup> Foreign investors in China have long raised concerns about *de facto* restrictions on investment that are not contained in the government’s written measures,<sup>177</sup> which will be discussed in more detail below.

**Figure 2: OECD FDI Regulatory Restrictiveness Index – By country, 2016**  
(0 = open, 1 = closed)



Source: OECD.

Foreign investors have become increasingly concerned about the prospects for foreign investment in China in recent years, and FDI in China has begun to decline after many years of growth. In 2016, China attracted US\$170.6 billion in FDI, representing a significant decrease from US\$242.5 billion in 2015 and well below the average of \$261.1 billion over the 2010-2015

ownership, corporate organization. See Stephen Thomsen and Fernando Mistura, *Is Investment Protectionism on the Rise?* Global Forum on International Investment (OECD, March 2017), 1.

<sup>176</sup> Stephen Thomsen and Fernando Mistura, *Is Investment Protectionism on the Rise?* Global Forum on International Investment (OECD, March 2017), 1.

<sup>177</sup> See European Commission, *Impact Assessment Report on the EU-China Investment Relations*, Commission Staff Working Document SWD(2013) 185 final (May 23, 2013), 13-14. See also European Chamber of Commerce and Roland Berger Strategy Consultants, *European Business in China: Business Confidence Survey 2016* (2016) and Office of the U.S. Trade Representative, *2016 Report to Congress on China's WTO Compliance* (January 2017), 103.

period.<sup>178</sup> A three-year downward trend in China's inbound FDI that began in 2013 continued in 2016, marking a seven-year low in China's inbound FDI.<sup>179</sup> According to survey data, market access restrictions, concerns about government policies, and the perception that foreign businesses face a less welcome environment than before have contributed to this decline.<sup>180</sup>

Over the years, the United States and other WTO members, including the European Union (EU) and Japan, have consistently raised concerns about the Chinese government's foreign investment restrictions during meetings of the WTO Committee on Trade-Related Investment Measures (TRIMS). The United States and several other WTO members have also highlighted these issues during China's Trade Policy Reviews, including the most recent one, which occurred in July 2016.<sup>181</sup> Some of the top concerns voiced by foreign investors in China include: market access restrictions in the form of equity limits and local partner requirements; an opaque approval and licensing process; technology transfer and localization requirements; and anti-monopoly law enforcement and national security reviews.<sup>182</sup>

## 2. *Equity Limits and Local Partner Requirements*

Despite some liberalization since China's accession to the WTO, foreign investment in many sectors remains subject to a joint venture requirement or other equity restrictions. While the 2017 *Foreign Investment Catalogue* liberalized investment in some areas, it did not liberalize many of the sectors important to foreign investors, such as services, agriculture, extractive industries, and other manufacturing sectors.<sup>183</sup> Currently, 35 sectors remain in the "restricted" category of the *Foreign Investment Catalogue*, including the following sectors, which are subject to equity limits and/or local partner requirements (see **Table 1**).<sup>184</sup>

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<sup>178</sup> World Bank, *World Development Indicators/Foreign Direct Investment, Net Inflows (Balance of Payments, Current \$US)*, (World Bank, available at <http://databank.worldbank.org/data/reports.aspx?source=2&series=BX.KLT.DINV.CD.WD&country=CHN>, accessed September 11, 2017).

<sup>179</sup> *Ibid.*

<sup>180</sup> AmCham China, *American Business in China White Paper* (2017), 12. U.S. Department of State Bureau of Economic and Business Affairs, *China: 2017 Investment Climate Statements* (2017).

<sup>181</sup> WTO, *Trade Policy Review Body Trade Policy Review: China, Minutes of the Meeting*, WT/TPR/M/342, (September 26, 2016).

<sup>182</sup> European Commission, *Impact Assessment Report on the EU-China Investment Relations*, Commission Staff Working Document SWD(2013) 185 final (May 23, 2013), 12-14. See also European Chamber of Commerce and Roland Berger Strategy Consultants, *European Business in China: Business Confidence Survey 2016* (2016); and Office of the U.S. Trade Representative, *2016 Report to Congress on China's WTO Compliance* (January 2017), 103-104, 141, 146, 149, 154, 157.

<sup>183</sup> *Ibid.*

<sup>184</sup> See the 2017 *Foreign Investment Catalogue* for a complete list of "restricted" and "prohibited" industries provided therein.

**Table 1: Equity Restrictions and Local Partner Requirements in China’s Foreign Investment Regime**

Sector	Summary of Requirements
Selection and cultivation of new varieties of crops and production of seeds	Chinese party must be the controlling shareholder
Printing of publications	Chinese party must be the controlling shareholder
Manufacturing of whole automobiles	Chinese party’s investment cannot be lower than 50%, and the same foreign investor may establish no more than two joint ventures in China for the same kind of automobiles
Value-added Telecommunications Services	Foreign investment cannot exceed 50%, excluding e-commerce
Basic telecommunications services	Chinese party must be the controlling shareholder
Banks	Foreign financial institution investment cannot exceed 20% or 25% depending on how the investment is structured
Insurance companies	For life insurance companies, foreign investment cannot exceed 50%
Medical institutions	Limited to CJV or EJV
Production of radio and television programs and movies	Limited to CJV

Source: *Foreign Investment Catalogue (2017 Amendment)*.

The Chinese government’s restrictions on foreign investment are often highly targeted and detail specific sub-sectors that are consistent with its industrial policy objectives, such as encouraging foreign investment in key components, equipment and technologies that the government deems to be critical to the development of China’s domestic industry and its industrial capabilities. For example, the *Foreign Investment Catalogue* encourages foreign investment in civil aircraft and aircraft components, but restricts foreign investment in the final aircraft product market to joint ventures with a non-controlling interest.<sup>185</sup> These foreign investment policies serve to further the Chinese government’s industrial policy objective of developing a “national champion” in the final aircraft market with the assistance of foreign technology and expertise.<sup>186</sup>

In some cases, the Chinese government first encourages and then restricts investment after the technology gap has narrowed. For example, since 2015, foreign investments in automobile manufacturing have been designated as “restricted” and require the Chinese partner to hold at least 50% of the equity in the joint venture,<sup>187</sup> in order to encourage the development of Chinese-

<sup>185</sup> *Ibid.*

<sup>186</sup> Keith Crane et al., *The Effectiveness of China’s Industrial Policies in Commercial Aviation Manufacturing* (Rand Corporation, 2014).

<sup>187</sup> See *Catalogue of Industries for Guiding Foreign Investment (2015 Amendment)* (NDRC and MOFCOM, Order No. 22, issued March 10, 2015, effective April 10, 2015).

owned and branded vehicles. Prior to 2015, automobile manufacturing was a “permitted” industry for foreign investment, and prior to 2011, it was designated an “encouraged” industry in the *Foreign Investment Catalogue*.<sup>188</sup> Moreover, the Chinese government is now prioritizing the development of new energy vehicles (NEVs) and has encouraged investment in the manufacture of key components for NEVs, including components with specific technical requirements, such as battery separators with a thickness of 15-40µm and porosity of 40-60%.<sup>189</sup> At the same time, foreign investment in automobile manufacturing can avoid the restrictions described above if the foreign investor merges its automobile manufacturing investments in China into a joint venture that manufactures NEVs jointly with the Chinese partner.<sup>190</sup>

The *Foreign Investment Catalogue* is merely the starting point for determining what equity restrictions or local partnership requirements may exist. There are thousands of other regulations, rules, and regulatory documents related to foreign investment that are issued by central government authorities, as well as a myriad of local government regulations and restrictions that may contradict central government measures that may also need to be consulted.<sup>191</sup> For example, the 2015 *Foreign Investment Catalogue* shifted foreign investment in high-grade hotels, office buildings, and international exhibition centers from the restricted category to the permitted category, but did not remove significant domestic law restrictions that continue to exist for foreign investment in real estate.<sup>192</sup>

To the extent there is any inconsistency between the *Foreign Investment Catalogue* and any of the Chinese government’s industrial policies, the industrial policies may prevail.<sup>193</sup> In addition to

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<sup>188</sup> See *Catalogue of Industries for Guiding Foreign Investment (2007 Amendment)* (NDRC and MOFCOM, Order No. 57, issued October 31, 2007, effective December 1, 2007); *Catalogue of Industries for Guiding Foreign Investment (2011 Amendment)* (NDRC and MOFCOM, Order No. 12, issued December 24, 2011, effective January 30, 2012); *Catalogue of Industries for Guiding Foreign Investment (2015 Amendment)* (NDRC and MOFCOM, Order No. 22, issued March 10, 2015, effective April 10, 2015).

<sup>189</sup> *Catalogue of Industries for Guiding Foreign Investment (2017 Amendment)* (NDRC and MOFCOM, Order No. 4, issued June 28, 2017), “Catalogue of Encouraged Industries”- para. 209.

<sup>190</sup> *Ibid.*, “Catalogue of Restricted Industries”- para. 7.

<sup>191</sup> See Covington & Burling LLP, *Measures and Practices Restraining Foreign Investment in China*, prepared for the European Commission Directorate-General for Trade (August 2014), 55. This study looks at 39 central government agencies that promulgated 137,328 measures affecting foreign investment that were in effect at the time of the survey. *Ibid.*, 5.

<sup>192</sup> *Thomson Reuters Practical Law*, “China Releases New Foreign Investment Catalogue,” March 16, 2015.

<sup>193</sup> A provision in the notes section of the 2011 *Foreign Investment Catalogue* states that State Council special provisions or industrial policies shall prevail over the catalogue. This provision was removed from the 2015 *Foreign Investment Catalogue*. See *Catalogue of Industries for Guiding Foreign Investment (2011 Amendment)* (NDRC and MOFCOM, Order No. 12, issued December 24, 2011, effective January 30, 2012) and the *Catalogue of Industries for Guiding Foreign Investment (2015 Amendment)* (NDRC and MOFCOM, Order No. 22, issued March 10, 2015, effective April 10, 2015). See also U.S. Chamber of Commerce, *China’s Approval Process for Inbound Foreign Investment: Impact on Market Access, National Treatment and Transparency* (November 2012), 9.



outright investment restrictions, foreign investment faces other restraints, such as licensing limitations. For example, in addition to the equity limits in telecommunications sectors, FIEs are also prohibited from receiving licenses to engage in certain telecommunications services.<sup>194</sup> As a result, even if a foreign investor were able to establish an FIE in this industry in China, it would be unable to receive the license needed to conduct this business.

In January 2017, the State Council issued a notice calling for expanded market access for foreign investors in traditionally sensitive sectors such as financial services, securities and banking, insurance institutions, and telecommunications, through revisions to the *Foreign Investment Catalogue*.<sup>195</sup> However, in the 2017 *Foreign Investment Catalogue*, these sectors were listed in the “restricted” section with only minor changes,<sup>196</sup> and thus, it remains unclear whether and when new industries may be liberalized for foreign investment. Foreign investors remain skeptical that the Chinese government will implement a comprehensive and transparent liberalization of its foreign investment regime and continue to urge the Chinese government to adopt a comprehensive, single negative list for the administration of foreign investment, with only very limited, narrow, and transparent exceptions.

Recent surveys of foreign investors in China illustrate that foreign investors are not expecting the foreign investment regime to improve, despite the Chinese government’s announced intentions to institute changes.<sup>197</sup> In the American Chamber of Commerce in China’s (AmCham China) 2016 Business Climate Survey, over 60% of respondents have little or no confidence that the Chinese government is committed to opening China’s markets further in the next three years, and 81% feel less welcome than before.<sup>198</sup> In addition, AmCham China’s 2017 *American Business in China White Paper* states:

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<sup>194</sup> Covington & Burling LLP, *Measures and Practices Restraining Foreign Investment in China*, prepared for the European Commission Directorate-General for Trade (August 2014), 29.

<sup>195</sup> *Notice on Increasing Openness to Foreign Investment and Active Use of Foreign Investment*, Section 1 (State Council, Guo Fa [2017] No. 5, issued January 12, 2017).

<sup>196</sup> *Catalogue of Industries for Guiding Foreign Investment (2017 Amendment)* (NDRC and MOFCOM, Order No. 4, issued June 28, 2017).

<sup>197</sup> See e.g., European Chamber of Commerce and Roland Berger Strategy Consultants, *European Business in China: Business Confidence Survey 2016* (2016), 36. (“More than two years after promises of market reforms and equal treatment were made at the Third Plenum, which European business had welcomed as a potential breakthrough, European companies are still treated unfairly. When compared to domestic Chinese companies, 57% of respondents report that FIEs tend to be subjected to unfair treatment. As the Decision was a reform package that the Chinese authorities chose to publicly announce of their own free will, the lack of follow through has been particularly disappointing.”) See also AmCham China, *American Business in China White Paper*, (2017), Section II. (“One trend that is missing is reform of the Chinese economy. Long promised, meaningful reform has failed to materialize and is becoming increasingly difficult to enact.”)

<sup>198</sup> AmCham China, *American Business in China White Paper*, (2017), 8-10. (“More than 60 percent of Business Climate Survey respondents have little or no confidence that the government is committed to opening China’s markets further in the next three years. According to survey data, 31 percent of AmCham China member companies say that the investment environment is deteriorating, while only 24 percent believe that it is improving. This is the most pessimistic response we have received for this question since we began asking it in 2011. More than half of

Despite recent rhetoric regarding opening and globalization, investment barriers in China remain high 15 years after China's accession to the World Trade Organization (WTO)... [T]he pace has been slow and uneven; following the 2008 world financial crisis, China even appears to be moving in the opposite direction in some regards.<sup>199</sup>

Similarly, according to a 2016 survey conducted by the European Chamber of Commerce, 70% of European companies surveyed feel less welcome in China than they did 10 years ago and only 22% of respondents are convinced of the government's commitment to foreign investment reform, representing a 10% decrease from the previous year.<sup>200</sup>

### 3. *Investment Approval and Regulatory Process*

Foreign investors have consistently raised concerns that the approval process is time-consuming, complicated, and expensive, often involving multiple government agencies.<sup>201</sup> As a result of overlapping and often conflicting rules and regulations, foreign investment in China can be excessively complicated, to the point where it deters investment as foreign investors must consult a wide range of documents and industry regulators to understand what restrictions may be applicable to their businesses. Given the multiple agencies that must review and approve foreign investment in China, the approval process presents many opportunities for government authorities to make decisions that favor domestic industry over foreign investors. Foreign investors have expressed concerns about the Chinese government increasingly using the investment review process as an instrument to shield selected Chinese domestic enterprises,

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members (55 percent) believe foreign companies are treated unfairly compared to local companies, and 81 percent feel less welcome than before.”)

<sup>199</sup> *Ibid.*, 4.

<sup>200</sup> European Chamber of Commerce and Roland Berger Strategy Consultants, *European Business in China: Business Confidence Survey 2016* (2016), 8. (“Although pronouncements made in the Decision committing to a market economy, and gradualist reform efforts such as the once-hailed pilot free trade zones initially piqued great interest among European companies, the absence of concrete developments has deepened their disillusionment in China's reform agenda, the extent of which can be seen from the following figures: 56% of respondents are of the view that doing business in China has become more difficult, a five-point increase from 2015; 57% report that foreign companies tend to receive unfavourable treatment compared to domestic Chinese companies; 57% of respondents believe that environmental regulations are strongly enforced against foreign companies, while only 14% think that they are strongly enforced against Chinese state-owned enterprises and only 12% think that this is the case with privately-owned Chinese companies; 58% of respondents state that the recent tightening of Internet controls and access restrictions has a negative impact on their business, a 17-point jump from 2015; 40% of respondents feel that foreign companies are being discriminated against through recently promulgated national-security-related legislation; 70% of respondents feel less welcome in China than they did 10 years ago.”)

<sup>201</sup> See e.g., U.S. Chamber of Commerce, *China's Approval Process for Inbound Foreign Investment: Impact on Market Access, National Treatment and Transparency* (November 2012); Covington & Burling LLP, *Measures and Practices Restraining Foreign Investment in China*, prepared for the European Commission Directorate-General for Trade (August 2014); James Zimmerman, *China Law Deskbook, A Legal Guide for Foreign-Invested Enterprises, 4th edition* (Chicago: American Bar Association, 2014), 145.

including inefficient or monopolistic enterprises, from foreign competition.<sup>202</sup> Foreign investor concerns about unfair treatment in the approval process have typically focused on investment approval by MOFCOM, project approval by NDRC or its local branch, regulatory approval by the relevant industry regulator, and AML review by MOFCOM in the case of concentration transactions.<sup>203</sup> Foreign investors have mainly raised the following concerns about the foreign investment approval process in China.

First, foreign investors are often expressly subject to more onerous investment approval requirements than domestic investors. As noted above, inbound foreign investments often require the approval of several different government agencies. When approval is needed for domestic investments, the domestic process is “often less onerous than the process for foreign investment in the same industry.”<sup>204</sup> Notably, many foreign investors believe that discrimination against foreign companies has been increasing in recent years and that the situation is likely to worsen in the future.<sup>205</sup>

Second, foreign investors often face broadly drafted regulations that provide government approval authorities the discretion to restrict or unreasonably delay approval. For example, if MOFCOM approval is required to establish a WFOE, MOFCOM will consider whether the investment meets the “requirements of the development of China’s national economy.”<sup>206</sup> Similarly, as noted above, in order for an EJV to receive project approval, NDRC will consider whether a foreign investment “is in line with development plans, industrial policies and access standards” and “has no material adverse effects on public interest.”<sup>207</sup> Vaguely worded provisions such as these provide government authorities wide discretion to restrict investments in order to protect domestic competitors or otherwise act in furtherance of industrial policy objectives.

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<sup>202</sup> See European Commission, *Impact Assessment Report on the EU-China Investment Relations*, Commission Staff Working Document SWD(2013) 185 final (May 23, 2013), 90. See also Office of the U.S. Trade Representative, *2016 Report to Congress on China’s WTO Compliance* (January 2017), 103-105.

<sup>203</sup> U.S. Chamber of Commerce, *China’s Approval Process for Inbound Foreign Investment: Impact on Market Access, National Treatment and Transparency* (November 2012), 36-37.

<sup>204</sup> *Ibid.*, 33.

<sup>205</sup> *Ibid.*, 39.

<sup>206</sup> *Ibid.*, 17.

<sup>207</sup> *Administrative Measures for the Confirmation and Recordation of Foreign-Funded Projects*, Articles 16(2) and 16(5) (NDRC, Order No. 12, issued May 17, 2014). See also U.S. Chamber of Commerce, *China’s Approval Process for Inbound Foreign Investment: Impact on Market Access, National Treatment and Transparency* (November 2012), 37.

Third, foreign companies have consistently reported that Chinese government officials have imposed *de facto* requirements beyond what is expressly set forth in Chinese laws and regulations.<sup>208</sup> AmCham China's 2017 *American Business in China White Paper* states:

Despite the enormous economic benefits that China has reaped from FDI, there is an increasing perception of animosity toward foreign business that belies its contribution to China's development. As noted above, Chinese companies are expanding overseas into areas restricted to foreign companies in China. This imbalance is seen not just in market entry restrictions, but also in many unofficial practices that disadvantage FIEs already established in China.<sup>209</sup>

Foreign companies have reported that Chinese government authorities in charge of foreign investment approvals will use the approval process to advance its policy objectives, including restricting or unreasonably delaying market entry for foreign companies, requiring the foreign company to work with a Chinese partner, or extracting valuable, deal-specific commercial concessions as a price for market entry.<sup>210</sup> In addition, industry associations have noted that if a proposed FIE project includes terms that are perceived to be unfair to the Chinese party, or if the foreign party is from a country with a strained relationship with the Chinese government, government authorities are "likely to look on the proposal with disfavor."<sup>211</sup>

Although the Chinese government has recently introduced changes that would allow foreign investors to file with MOFCOM, rather than seek its approval, there are still several other Chinese government authorities from which approval may be needed. As result, multiple opportunities remain for the Chinese government to use the approval process to extract concessions from foreign investors. As noted above, most foreign investor concerns about the investment approval process have focused not only on the MOFCOM investment approval process, but have also included NDRC project approval and the AML approval processes.<sup>212</sup>

The lack of transparency in the approval process and the broad discretion granted to approval authorities create an environment in which it is possible for government authorities to impose requirements beyond what is written in the law.<sup>213</sup> This problem has been able to persist partly

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<sup>208</sup> U.S. Chamber of Commerce, *China's Approval Process for Inbound Foreign Investment: Impact on Market Access, National Treatment and Transparency* (November 2012), 36-37. See also Ken Davies, *International Investment – China Investment Policy: An Update*, OECD Working Papers on International Investment 2013/01 (OECD, 2013).

<sup>209</sup> AmCham China, *American Business in China White Paper* (2017), 8-10.

<sup>210</sup> U.S. Chamber of Commerce, *China's Approval Process for Inbound Foreign Investment: Impact on Market Access, National Treatment and Transparency* (November 2012), 36-38.

<sup>211</sup> James Zimmerman, *China Law Deskbook, A Legal Guide for Foreign-Invested Enterprises, 4th edition* (Chicago: American Bar Association, 2014), 148.

<sup>212</sup> U.S. Chamber of Commerce, *China's Approval Process for Inbound Foreign Investment: Impact on Market Access, National Treatment and Transparency* (November 2012), 36-38.

<sup>213</sup> European Commission, *Impact Assessment Report on the EU-China Investment Relations*, Commission Staff Working Document SWD(2013) 185 final (May 23, 2013), 12-14. (Respondents to the EC survey "stressed that the

due to the lack of meaningful administrative or judicial review of Chinese regulatory actions, which enables government officials to take unilateral action without fear of legal challenge, as discussed in more detail in Factor 6.<sup>214</sup> While an appeals process exists in theory, the situation is exacerbated by that fact that foreign investors rarely invoke such processes given the low likelihood of success in prevailing on such claims and the potential for retaliation from Chinese government approval authorities that have considerable power to affect their business prospects in China.<sup>215</sup>

#### 4. *Technology Transfer and Localization Requirements*

Foreign investors have raised longstanding concerns that they have been required to transfer advanced technologies to Chinese entities as a condition of entering the Chinese market.<sup>216</sup> Confidential accounts from foreign investors indicate that Chinese government officials, acting without the potential for legal challenge, sometimes require foreign enterprises to transfer technology, conduct research and development in China, or satisfy performance requirements relating to exportation or the use of local content as a condition for securing investment approvals.<sup>217</sup> One mechanism by which this practice occurs is the requirement that a foreign investor transfer technology to a joint venture that must be controlled by the Chinese party in order to gain market access. For example, some foreign automobile manufacturers have been informed that they will not be granted approval to manufacture electric vehicles in China unless they transfer core technology to a joint venture in which they can hold only a minority stake (even though the *Foreign Investment Catalogue* permits foreign investment up to 50%).<sup>218</sup>

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legal decision process was subject to political pressure, both from the local SOEs and from the administrative agencies at central, provincial and municipal level, which have a strong discretionary power to decide on foreign investments.”) See also U.S. Chamber of Commerce, *China’s Approval Process for Inbound Foreign Investment: Impact on Market Access, National Treatment and Transparency* (November 2012), 36-38.

<sup>214</sup> *Ibid.* (“[I]nvestors feel that recourse to judicial remedies in China is not sufficient... 80% of the respondents who expressed an opinion on the Chinese legal system said that they did not have confidence in it to protect their rights as investors. They explained that the Chinese legal system lacked transparency and consistency, both in the decisions and in the judicial process itself.”) See also Office of the U.S. Trade Representative, *2016 Report to Congress on China’s WTO Compliance* (January 2017), 103.

<sup>215</sup> U.S. Chamber of Commerce, *China’s Approval Process for Inbound Foreign Investment: Impact on Market Access, National Treatment and Transparency* (November 2012), 40; Office of the U.S. Trade Representative, *2016 Report to Congress on China’s WTO Compliance* (January 2017), 103.

<sup>216</sup> Covington & Burling LLP, *Measures and Practices Restraining Foreign Investment in China*, prepared for the European Commission Directorate-General for Trade (August 2014), 31-32.

<sup>217</sup> Office of the U.S. Trade Representative, *2016 Report to Congress on China’s WTO Compliance* (January 2017), 3-4.

<sup>218</sup> *Catalogue of Industries for Guiding Foreign Investment (2017 Amendment)*, Part I, “Catalogue of Restricted Industries for Foreign Investment,” Article 7 (which states that for the manufacture of whole automobiles and special use cars, the proportion of shares of the Chinese party shall not be lower than 50%) (NDRC and MOFCOM, Order No. 4, issued June 28, 2017). See also U.S. Chamber of Commerce, *China’s Approval Process for Inbound Foreign Investment: Impact on Market Access, National Treatment and Transparency* (November 2012), 38.

In addition, foreign investors have also raised concerns about the Chinese government linking procurement preferences to technology localization measures designed to pressure foreign investors into transferring technology to Chinese parties.<sup>219</sup> For example, a potential foreign investor in a joint venture was told that “the Chinese government would purchase its products through public tenders.”<sup>220</sup> However, foreign investment in this sector was subject to a requirement that foreign investors must hold a non-controlling interest. As a result, the foreign investor was forced to choose between transferring its intellectual property rights to a joint venture that it would not control or risk losing significant market share and revenue.<sup>221</sup> The Chinese government also provides incentives and regulatory preferences to foreign investors in certain high-tech industries if they locate R&D facilities or manufacturing facilities in China. For example, the Chinese government recently issued a measure that provides for expedited regulatory review for innovative new drugs where the applicant’s manufacturing capacity has been moved to China,<sup>222</sup> which as noted above, would result in a foreign investor transferring its intellectual property rights to a joint venture that is controlled by a local partner.

Technology transfer concerns often arise in sectors and technologies that align with the Chinese government’s industrial policy objectives. For example, there is a noticeable relationship between China’s foreign investment restrictions and the priority industries that have been listed in the Chinese government’s Made in China 2025 (“MiC2025”) initiative, which is discussed in more detail in Factor 5.<sup>223</sup> The U.S. Chamber of Commerce in a report on MiC2025 notes that foreign investment restrictions impact half of the MiC2025 industries, and it concludes that “[t]hese restrictions either block opportunities for foreign companies to operate in the market, or, in some cases, create a de facto technology transfer requirement to the Chinese partner as a precondition for market access.”<sup>224</sup> For certain MiC2025 industries in which foreign investment is encouraged, the U.S. Chamber has raised concerns that once China’s economy has achieved self-sufficiency and closed the technology gap, it may impose additional requirements on foreign investors in these industries.<sup>225</sup>

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<sup>219</sup> Covington & Burling LLP, *Measures and Practices Restraining Foreign Investment in China*, prepared for the European Commission Directorate-General for Trade (August 2014), 6, 37-38.

<sup>220</sup> U.S. Chamber of Commerce, *China’s Approval Process for Inbound Foreign Investment: Impact on Market Access, National Treatment and Transparency* (November 2012), 39-40.

<sup>221</sup> *Ibid.*, 40.

<sup>222</sup> Office of the U.S. Trade Representative, *2016 Report to Congress on China’s WTO Compliance* (January 2017), 10, 12, 132.

<sup>223</sup> U.S. Chamber of Commerce, *Made in China 2025: Global Ambitions Built on Local Protections* (2017), 26.

<sup>224</sup> *Ibid.*

<sup>225</sup> *Ibid.*, 27.



### 5. *Anti-Monopoly Law Enforcement and National Security Reviews*

Foreign investors have expressed concerns that the *AML* may be used in some cases to protect the Chinese domestic market from foreign competition and encourage the development of national champions and indigenous innovation.<sup>226</sup> The *AML*'s stated purpose is to create a competition framework "which accord with the socialist market economy."<sup>227</sup> The *AML* by its terms requires MOFCOM, in conducting its review of concentration transactions, to take into consideration the effect on the development of the national economy, rather than limiting its review strictly to competitiveness concerns.<sup>228</sup> Such broad provisions along with increased enforcement activity in recent years have fueled concerns among foreign investors.<sup>229</sup> While both domestic companies and foreign companies have been targets of *AML* investigations, foreign companies have expressed concern that they appear to be the target of increased scrutiny by the Chinese government's enforcement agencies.<sup>230</sup> In addition, foreign investors have expressed concerns about "insufficient predictability, fairness and transparency" in the investigative processes, including Chinese government "pressure to cooperate in the face of unspecified allegations or face steep fines."<sup>231</sup>

The Chinese government's national security review mechanism also serves as a potential barrier to foreign investment. Certain transactions involving foreign investors may be subject to a national security review, however, the scope of the Chinese government's national security

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<sup>226</sup> U.S. China Business Council, *Competition Policy and Enforcement in China* (September 2014), 11. According to a 2014 U.S. China Business Council survey, 86% of U.S. companies surveyed were somewhat concerned about China's competition enforcement activities. See also AmCham China, *American Business in China White Paper* (2017), 36.

<sup>227</sup> *AML*, Article 4.

<sup>228</sup> *AML*, Article 27(5). See also U.S. Chamber of Commerce, *China's Approval Process for Inbound Foreign Investment: Impact on Market Access, National Treatment and Transparency* (November 2012), 37.

<sup>229</sup> U.S. China Business Council, *Competition Policy and Enforcement in China* (September 2014), 7-8. Between 2008 and 2012, NDRC conducted approximately 20 price-related investigations. In 2013 alone, NDRC investigated more than 80 companies under the *AML* across a range of sectors, including pharmaceuticals, infant formula, liquor, and telecoms. *Ibid.*

<sup>230</sup> *Ibid.* See also Laurie Burkitt and Colum Murphy, "China Using Antimonopoly Law to Pressure Foreign Businesses," *Wall Street Journal*, August 4, 2014. ("Once targeted, industries and companies have little choice but to comply. Unlike in other markets, foreign companies can't expect much recourse from the courts, which are controlled by the Communist party. 'Despite all of the reform and progress to date, China is still a command economy driven by a political agenda that seeks to first and foremost legitimize the party in power,' said James Zimmerman, former chairman of the American Chamber of Commerce China and managing partner of law firm Sheppard Mullin Richter & Hampton LLP's Beijing office.")

<sup>231</sup> Office of the U.S. Trade Representative, *2016 Report to Congress on China's WTO Compliance* (January 2017), 171. See also AmCham China, *American Business in China White Paper* (2017), 42. ("While the NDRC maintains that it enforces anti-monopoly pricing laws without discrimination based on ownership against both domestic and foreign firms, the latter have been subject to disproportionately large fines. In 2016, approximately 94 percent of the NDRC's fines were imposed on foreign firms.")

review remains unclear.<sup>232</sup> The *National Security Law of the People's Republic of China* (“*National Security Law*”) sets forth an expansive definition of national security, which considers economic security, political security, cultural security, and societal security,<sup>233</sup> and the national security system must “adhere to the leadership of the Communist Party of China.”<sup>234</sup> The Chinese government’s national security review regime protects interests that fall outside the widely accepted scope of essential national security concerns and international norms governing investment reviews.<sup>235</sup> In 2015, the State Council announced that government authorities should consider national security as a factor when enacting a new negative list system and use an expansive definition of national security, which includes “economic security.”<sup>236</sup> In addition, the draft *Foreign Investment Law* contemplates a national security review for any foreign investment in China, regardless of whether it meets any threshold level of investment, and would allow for domestic industry to petition authorities to review a foreign investment for national security reasons.<sup>237</sup> Even if the Chinese government were to implement other liberalizing changes to its foreign investment regime, a sweeping national security review could undermine any progress and deter foreign investment.

According to recent surveys, foreign investors believe they have been targeted and discriminated against through national security-related legislation, such as the *National Security Law*, the *Counter-terrorism Law* and the *Cyber Security Law*. For example, according to one survey of

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<sup>232</sup> *AML*, Article 21. See also *Notice of the General Office of the State Council on Launching the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors*, Section 1 (State Council, Order No. 6, issued February 3, 2011, effective March 3, 2011).

<sup>233</sup> *National Security Law of the People's Republic of China*, Articles 2 and 3 (adopted by NPC on February 22, 1993, amended August 27, 2009, further amended July 1, 2015).

<sup>234</sup> *National Security Law*, Article 4.

<sup>235</sup> According to the *OECD Guidelines for Recipient Countries Investment Policies Relating to National Security*, a national security review process should carefully circumscribe the scope of the review process, including by identifying precisely the transactions that are subject to review and the national security-based criteria on which determinations will be made. See OECD, *OECD Guidelines for Recipient Country Investment Policies Relating to National Security*, Investment Committee Report on Recipient Country Policies and SWFs (April 4, 2008). See also AmCham China, *China's Investment Environment: Overcoming Impediments to the US-China BIT* (October 2015), 12.

<sup>236</sup> *Opinions on the Implementation of the Market Access Negative List System*, Section III.9 (State Council, Guo Fa [2015] No. 55, issued October 19, 2015, effective from December 1, 2015 to December 31, 2017). The measure states: “While drawing up and implementing a negative list for market access, we should maintain a holistic view of national security and follow laws and regulations safeguarding national security as well as the national systems concerning security in various fields. With a focus on safeguarding economic security, we should maintain the national basic economic system and the socialist market economic order, improve the institutional mechanism to prevent and dissolve the economic security risks, guarantee key sectors and areas that are the lifeblood of the economy, key industries, major infrastructure and major construction projects, and ensure the security of other significant economic benefits.”

<sup>237</sup> *Notice on Seeking Comments to the “Foreign Investment Law of the People's Republic of China” (Draft for Public Comment)* (MOFCOM, issued January 19, 2015).

European investors in China, 40% of respondents reported that foreign investors are being discriminated against through recently promulgated national-security-related legislation.<sup>238</sup>

### C. Assessment of Factor

The Chinese government's foreign investment regime remains one of the most complex and restrictive in the world. Despite some government efforts to streamline investment procedures, China's foreign investment regime remains subordinate to industrial policy. The Chinese government is able to channel foreign investment into the producers, products, technologies, and industries it seeks to support, while limiting foreign investment in those sectors that it finds strategically important to develop. The Chinese government continues to impose significant barriers to foreign investment, including equity limits and local partner requirements, opaque approval and regulatory procedures, technology transfer and localization requirements, and anti-monopoly enforcement and national security reviews. Foreign investors remain skeptical that Chinese government pronouncements about liberalizing the foreign investment regime will lead to significant improvements in the foreign investment environment.

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<sup>238</sup> European Chamber of Commerce and Roland Berger Strategy Consultants, *European Business in China: Business Confidence Survey 2016* (2016), 38.

## **Factor Four: The extent of government ownership or control of the means of production.**

Excessive government ownership or control of the means of production undermines the functioning of a market economy. If economic actors cannot make market-based decisions based on supply and demand, then prices and costs become distorted, and non-market conditions prevail. Part A of this section assesses the role of SIEs in China's economy. Part B assesses the extent to which government policies intervene in land markets through the ownership of land and the regulation of land-use rights.

### **A. State-Invested Enterprise (SIE) Sector**

Part A analyzes the role of SIEs in China's economy. It begins by describing the Chinese government's legal mandate to "maintain a leading role for the state sector," which is codified in its constitutional documents as well as in economic legislation. It then examines key features of the SIE sector, including state-owned asset management; interrelationships between SIEs, the state, and the CCP; and sectoral policies designed to maintain SIEs in industries deemed strategic by the government and the CCP.

Part A then analyzes the prevalence of SIEs in China's economy. This analysis includes a statistical comparison of the SIE sector and the private sector; statistics on the persistence of SIEs in China's economy, across industries, and at the central and local levels; a comparison of SIEs in China and other economies; and a discussion of the definitional issues concerning official data on enterprises.

Finally, Part A also examines the bankruptcy system, the growth and concentration of SIEs through consolidations, and the emergence of state enterprise groups. The analysis concludes by reviewing recent government efforts to modify policies governing SIEs.

#### *1. Legal and Institutional Framework*

##### 1.1. Legal Mandate to Preserve a Leading Role for the SIE sector

The Chinese government has a constitutional mandate, echoed in China's broader legal framework, to maintain and uphold the "socialist market economy," which includes "maintaining a leading role for the state sector" in the economy. The guiding principles for government ownership and control are set forth in the *PRC Constitution*<sup>239</sup> and the *Constitution of the Chinese Communist Party* ("CCP Constitution").<sup>240</sup>

<sup>239</sup> The *PRC Constitution* is not legally enforceable in Chinese courts. However, it is considered relevant as a document that expresses core views. See Keith J. Hand, "Resolving Constitutional Disputes in Contemporary China," *University of Pennsylvania East Asia Law Review* 7 (2011): 59-60.

<sup>240</sup> *Constitution of the Communist Party of China* (adopted by CCPC on October 18, 1992, amended October 21, 2007, further amended November 14, 2012).

The *PRC Constitution* provides a clear mandate for government ownership and control over the economy:

- The preamble provides that “China will be in the primary stage of socialism for a long time to come.”<sup>241</sup> Article 6 provides that “[i]n the primary stage of socialism, the State upholds the basic economic system in which public ownership is dominant and diverse forms of ownership develop side by side [...]”<sup>242</sup>
- Article 7 provides that “[t]he state-owned economy, that is, the socialist economy with ownership by the whole people, is the leading force in the national economy. The state ensures the consolidation and growth of the state-owned economy.”<sup>243</sup>
- Article 11 provides that “[t]he state *encourages, supports, and guides* the development of the non-public sectors of the economy [...]” (emphasis added) In other words, the state reserves for itself an affirmative role in developing the private sector, as distinct from strictly granting lawful protections to the private sector.<sup>244</sup>
- Article 11 also provides that “[t]he state permits the private sector of the economy to exist and develop within the limits prescribed by law. The private sector of the economy is a complement to the socialist public economy.” In other words, the nature and very existence of the private sector is explicitly limited and circumscribed in the *PRC Constitution* and is subordinate to the SIE sector.<sup>245</sup>
- The preamble, Article 11, and Article 15 provide that China is governed as a “*socialist market economy*,” not strictly as a “market economy.”<sup>246</sup> (emphasis added)

Furthermore, the *PRC Constitution* sets out a leading role for the CCP to ensure a certain outcome with respect to the overall structure and direction of the economy. In view of this leading role, the *CCP Constitution* states: “[T]he Party must uphold and improve the basic economic system, with public ownership playing a dominant role and different economic sectors developing side by side [...]”<sup>247</sup> (emphasis added)

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<sup>241</sup> *PRC Constitution*, Paragraph 9.

<sup>242</sup> *Ibid.*, Article 6.

<sup>243</sup> *Ibid.*, Article 7.

<sup>244</sup> *Ibid.*, Article 11.

<sup>245</sup> *Ibid.*

<sup>246</sup> *Ibid.*, preamble and Articles 11 and 15.

<sup>247</sup> *CCP Constitution*, Preamble.

The core principles established by the *PRC Constitution* reflect that the government's role in China's economy is not solely that of a neutral market regulator but the predominant actor seeking to ensure certain structural economic outcomes. Wide-reaching economic legislation provides further evidence to this effect. For example:

- Article 1 of the *Property Law of the People's Republic of China* (“*Property Law*”) makes clear that the law's purpose includes “safeguarding the basic economic system of the state,” and “maintaining the socialist market order.”<sup>248</sup> Article 3 of the *Property Law* states that:

In the primary stage of socialism, the state upholds the basic economic system under which the public (state) ownership shall play a dominant role and diversified forms of ownership may develop side by side. The state consolidates and develops the public (state) economy, and encourages, supports and guides the development of the nonpublic economy.<sup>249</sup>

- Article 1 of the *Company Law of the People's Republic of China* (“*Company Law*”), similar to Article 1 of the *Property Law*, states that the law is enacted for the purposes of, among other reasons, “maintaining the socialist economic order” and “promoting the development of the socialist market economy.”<sup>250</sup>
- The *Law of the People's Republic of China on the State-Owned Assets of Enterprises*, which applies to all enterprises with any level of state investment, affirms the role of the state as the overseer, participant, and ultimate decision-maker in preserving the leading role of the state sector.<sup>251</sup>

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<sup>248</sup> *Property Law of the People's Republic of China*, Article 1 (adopted by NPC on March 16, 2007, Order No. 62, promulgated March 16, 2007).

<sup>249</sup> *Ibid.*, Article 3.

<sup>250</sup> *Company Law of the People's Republic of China*, Articles 1 and 146 (adopted by NPC on December 29, 1993, amended December 25, 1999, further amended August 28, 2004 and October 27, 2005 and December 28, 2013).

<sup>251</sup> *Law of the People's Republic of China on the State-Owned Assets of Enterprises* (adopted by NPC on October 28, 2008, Order No. 5, effective May 1, 2009), Article 5, provides: “The term “state-invested enterprise” as mentioned in this Law refers to a wholly state-owned enterprise or company with the state being the sole investor, or a company in which the state has a stake, whether controlling or non-controlling.” Article 1 states that the law was formulated “for the purposes of safeguarding the basic economic system of China, *consolidating and developing the state-owned economy, strengthening the protection of state-owned assets, giving play to the leading role of the state-owned economy in the national economy*, and promoting the development of the socialist market economy.” (emphasis added) Article 7 of the same law states that “[t]he *state shall take measures* to promote the centralization of state-owned capital to the important industries and key fields that have bearings on the national economic lifeline and state security, optimize the layout and structure of the state-owned economy, promote the reform and development of state-invested enterprises, improve the overall quality of the state-owned economy, and *strengthen the control force and influence of the state-owned economy*.” (emphasis added)



- Article 1 of the *Interim Regulation on the Supervision and Administration of State-owned Assets of Enterprises* provides:

The present measures are enacted in order to establish a supervision and administration system of state-owned assets that meets the demand of the socialist market economy, to further activate the state-invested enterprises, to promote the strategic adjustment of the layout and structure of the state-owned economy, to *develop and strengthen the state-owned economy, and maintain and increase the value of state-owned assets*.<sup>252</sup> (emphasis added)

These laws and related measures affect the entire economy either directly, through the regulation of the SIE sector, or indirectly, by establishing the context for the private sector's relationship with the SIE sector. They set forth the government's legal authority to secure a leading a role for the SIE sector.

### 1.2. Institutions Exercising Government Ownership and Control

The State-owned Assets Supervision and Administration Commission (SASAC) was established in 2003. Classified as a government agency under the State Council, SASAC is the state's representative owner of state-owned assets as well as the supervisory organ of non-financial central SIEs, which as of 2017 comprise 102 enterprises and their subsidiaries.<sup>253</sup> In addition to the centrally controlled SASAC, there are also sub-national SASACs (Local SASAC), which perform the same role as SASAC for assets owned by sub-national government authorities.<sup>254</sup>

SASAC and Local SASACs play an active role in the management of SIEs, including investment decisions, personnel appointments, and share transactions.<sup>255</sup> SASAC's stated objective, as set forth in its founding document, is not to privatize state-owned assets, but to preserve and

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<sup>252</sup> *Interim Regulation on the Supervision and Administration of State-owned Assets of Enterprises*, Article 1 (State Council, Order [2003] No. 26, issued May 27, 2003, amended January 8, 2011). The basic principles described in a 2006 State Council notice on the adjustment of state-owned capital and SIE reorganization include a requirement to "uphold the basic economic system under which the public ownership plays a dominant role and diverse forms of ownership develop side by side," "firmly consolidate and develop public ownership economy," and "enhance the state-owned economy's controlling power, influence, driving force, bring[ing] the leading role of the state-owned economy into play." *Notice of the General Office of the State Council on Forwarding the Guiding Opinion of the SASAC about Promoting the Adjustment of State-Owned Capital and the Reorganization of State-owned Enterprises*, Section 1.1 (State Council, Guo Ban Fa [2006] No. 97, issued December 5, 2006). (emphasis added)

<sup>253</sup> *List of Central State-owned Enterprises* (State Asset Supervision and Administration Commission website, available at <http://www.sasac.gov.cn/n86114/n86137/index.html>, accessed July 14, 2017).

<sup>254</sup> A 2013 study estimates that there are approximately 300 SASACs in China. Andrew Szamosszegi and Cole Kyle, *An Analysis of State-owned Enterprises and State Capitalism in China*, prepared for the U.S.-China Economic and Security Review Commission (Washington, DC: Capital Trade, Incorporated, October 26, 2011), 6.

<sup>255</sup> Barry Naughton, "Claiming Profit for the State: SASAC and the Capital Management Budget," *China Leadership Monitor* 18 (June 7, 2006): 3. See also Barry Naughton, "Top-Down Control: SASAC and the Persistence of State Ownership in China," Paper presented at the conference on "China and the World Economy," Leverhulme Centre for Research on Globalisation and Economic Policy (GEP), University of Nottingham, June 23, 2006, 6.

enhance their value.<sup>256</sup> Although SASAC has supported the privatization of some state-owned assets, primarily through public listings,<sup>257</sup> the government generally retains majority ownership.<sup>258</sup> By increasing the value of a minority of publicly listed shares, partial privatization effectively increases the value of enterprises that remain under government ownership and control.

There are also SIEs owned and supervised by other government authorities. For example, for the largest SOCBs in the financial sector, government ownership is exercised through Central Huijin Investment, a subsidiary of China's sovereign wealth fund, China Investment Corp., which in turn is supervised by MOF.<sup>259</sup>

### 1.3. State Control Mandated in Certain Sectors

The Chinese government has retained government ownership and control throughout China's economy. The *Notice of the General Office of the State Council on Forwarding the Guiding Opinions of the SASAC about Promoting the Adjustment of State-owned Capital and the Reorganization of State-owned Enterprises*,<sup>260</sup> issued by the State Council in 2006, defines the

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<sup>256</sup> The *Interim Regulation on the Supervision and Administration of State-owned Assets of Enterprises*, which formally establish SASAC, provide at Article 14 that one of SASAC's six chief obligations is to "...promote the preservation of and increase in the value of State-owned assets of enterprises, and prevent the loss of State-owned assets of enterprises." *Interim Regulation on the Supervision and Administration of State-owned Assets of Enterprises* (State Council, Order [2003] No. 26, issued May 27, 2003, amended January 8, 2011). See also Barry Naughton, "Claiming Profit for the State: SASAC and the Capital Management Budget," *China Leadership Monitor* 18 (June 7, 2006): 3. A 2006 State Council notice likewise provides that one of the basic principles for adjusting state-owned capital and reorganizing SOEs is to prevent the loss of state-owned assets, so as to guarantee that the value of state-owned assets is retained and increased. *Notice of the General Office of the State Council on Forwarding the Guiding Opinion of the SASAC about Promoting the Adjustment of State-Owned Capital and the Reorganization of State-owned Enterprises*, Section 1.1 (State Council, Guo Ban Fa [2006] No. 97, issued December 5, 2006), (emphasis added).

<sup>257</sup> In its five-year retrospective, published in 2009, SASAC listed its principal achievement as helping central SOEs achieve public listings: Between 2003 and year-end 2007, SASAC approved a total of 52 subsidiary enterprises to issue their initial public share offering in- and outside the territory of China, with 12 newly listed companies in 2003, eight in 2004, seven in 2005, 13 in 2006, and 12 in 2007. Currently there are approximately 279 listed companies for which central SIEs act as the actual controlling shareholder. Over five years, through the issuance of shares, central SIEs have raised a large amount of capital. Capital raised totaled RMB 25.3 billion in 2003; RMB 64.2 billion in 2004; RMB 76.8 billion in 2005; RMB 133.9 billion in 2006; and RMB 317.8 billion in 2007. SASAC, *Central State-owned Enterprise Reform Work Five-Year Retrospective* (2008).

<sup>258</sup> A 2015 report states that the free float of SIE stocks typically accounts for less than 20% of total issuances. Jianguang Shen and Michael Luk, "Beware the New Direction of SOE Reform," (Mizuho Securities Asia Ltd. Economics Research, November 24, 2015), 2.

<sup>259</sup> Carl Walter and Fraser J.T. Howie, *Red Capitalism: The Fragile Financial Foundation of China's Extraordinary Rise* (Singapore: John Wiley & Sons (Asia) Pte. Ltd., 2011), 191-193, 218.

<sup>260</sup> *Notice of the General Office of the State Council on Forwarding the Guiding Opinion of the SASAC about Promoting the Adjustment of State-Owned Capital and the Reorganization of State-owned Enterprises* (State Council, Guo Ban Fa [2006] No. 97, issued December 5, 2006).

objective of “[p]romoting the concentration of state-owned capital on major industries and key fields, enhancing the controlling power of state-owned economy, and bringing its leading role into play.”<sup>261</sup> SASAC in 2006 also formulated a policy (“*SASAC Document*”)<sup>262</sup> that divides economic sectors into three categories and related sub-categories, according to the perceived necessity for government control, namely: (1) strategic industries, which “affect national security and the lifeblood of the economy, in which the state must “maintain absolute controlling power”; (2) “basic and pillar industries” in which the state must “maintain relatively strong controlling power”; or (3) other industries in which the state must “maintain influence:”

(1) *Absolute controlling power*: This category comprises seven industries, namely: (i) defense, (ii) electricity grid and electricity production, (iii) petroleum and, (iv) telecommunications, (v) coal, (vi) civil aviation, and (vii) shipping. The *SASAC Document* states that these seven industries (as of 2006), comprising 40 SIEs under central SASAC control (“central SIEs”), accounted for 75% of the total value of central SIE assets, 82% of state-owned assets, and 79% of total central SIE profits. For central SIEs in these industries, the state should “increase the total amount of state-owned capital and optimize structures.”<sup>263</sup>

(2) *Relatively strong controlling power*: This category comprises nine industries: (i) machinery equipment, (ii) automotive, (iii) information technology, (iv) construction, (v) steel, (vi) nonferrous metals, (vii) chemicals, (viii) mineral surveying design, and (ix) science and technology. The *SASAC Document* states that these nine industries (as of 2006) comprised 70 central SIEs, accounted for 17% of the total value of central SIE assets, 17% of state-owned assets, and 15% of total central SIE profits.<sup>264</sup>

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<sup>261</sup> *Notice of the General Office of the State Council on Forwarding the Guiding Opinion of the SASAC about Promoting the Adjustment of State-Owned Capital and the Reorganization of State-owned Enterprises*, Chapter 2, “Main Policies and Measures,” Article 3 (State Council, Guo Ban Fa [2006] No. 97, issued December 5, 2006). It lists some key sectors: “Major industries and key fields mainly include: industries concerning national security, major infrastructure and important mineral resources, industries that provide essential public goods and services, as well as the key enterprises in pillar industries and high-tech industries.”

<sup>262</sup> *Xinhua News Agency*, “SASAC: State-owned Economy Should Maintain Absolute Controlling Power over Seven Industries,” December 18, 2006.

<sup>263</sup> *Ibid.* Within this category of seven industries, the *SASAC Document* provides the following sub-categories: (a) The state should maintain sole investment or majority shareholdings for central SIEs in core infrastructure sectors including defense, oil and gas and other important natural resource development industries, as well as the electricity grid and telecoms. (b) The state should maintain majority shareholdings for the subsidiary enterprises of the sectors listed in sub-category (a), as well as for the central SIEs in civil aviation and shipping sectors. (c) The state should intensify reform and restructuring, introduce the non-public economy and foreign capital, and promote the diversification of investment entities and shareholding rights in downstream petrochemical operations and value-added services in the telecoms sector.

<sup>264</sup> *Ibid.* Within this category of nine industries, the *SASAC Document* provides the following sub-categories: (a) The state should maintain majority shareholdings or conditional relative shareholdings for central SIEs in the machinery equipment, automotive, IT, construction, steel, and nonferrous metals industries that will become important backbone enterprises and industry-leading enterprises. (b) The state should maintain shareholdings for scientific research and design-type central SIEs that bear important obligations including the conversion of industry-wide generic technology and of scientific research achievements. (c) The state should maintain fairly strong

- (3) Influence: This category comprises, *inter alia*, (i) commercial logistics, (ii) investment, (iii) pharmaceuticals, (iv) construction materials, (v) agriculture, and (vi) geological surveying. The *SASAC Document* states that these industries (as of 2006), comprising over 50 central SIEs, and accounted for 8% of the total value of central SIE assets, 6% of state-owned assets, and 6% of total central SIE profits.<sup>265</sup>

As the foregoing demonstrates, the Chinese government accords great importance to government control in a wide range of sectors. In addition, for the first two categories of industries, in which the state must maintain an absolute or relatively strong controlling power, the *SASAC Document* also emphasizes the importance of establishing a group of “backbone enterprises” that are global leaders.<sup>266</sup>

To implement this policy, the Chinese government draws marked distinctions between sectors when devising policies and regulations. A key consequence of this policy has been the concentration of large SIEs in certain sectors and the formation of monopolistic or oligopolistic market structures.<sup>267</sup> This issue is discussed in more detail below.

## 2. *The Prevalence of SIEs in China’s Economy*

### 2.1. Government Policy and SIEs

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controlling power for important backbone enterprises in all nine of the basic and pillar industries. In particular, the state should maintain majority shareholdings or conditional relative shareholdings for important backbone enterprises that have fairly strong influence and are driving forces within an industry, (d) Aside from the above, state-owned capital will be lowered as appropriate for the basic and pillar industries, albeit with a view toward strengthening the influence and driving force of the state-owned economy.

<sup>265</sup> *Ibid.*

<sup>266</sup> *Ibid.* The SASAC Document sets a general goal of having, by 2010, a group of important backbone enterprises with fairly strong influence and driving force for the development of an industry, which entails establishing a strong foundation for important backbone enterprises in the petrochemical, telecoms, electricity, shipping, and construction industries to develop and become *globally first-rate enterprises*, and for important backbone enterprises in the automotive, machinery, and IT industries to become globally first-rate enterprises. For those industries listed in Category (1), the state should also maintain sole investment or majority shareholdings for important backbone enterprises that will become *globally first-rate enterprises*.

<sup>267</sup> Barry Naughton, “The Transformation of the SIE sector: SASAC, the Market Economy, and the New National Champions,” in *State Capitalism, Institutional Adaptation, and the Chinese Miracle*, eds. Barry Naughton and Kellee S. Tsai, (New York: Cambridge UP, 2015), 52. (“A key feature of China’s state firm strategy coming out of the 1990s was the creation of protected markets with limited competition. While these firms are sometimes criticized for their monopoly privileges, they are not, strictly speaking, monopolies. Instead, two or three incumbent central government firms compete in each market. The three oil firms have different specialties and concentrations but also compete as potentially integrated firms; three telecom companies now compete in providing mobile phone services [...] While the SASAC firms do not have absolute monopolies, they have substantial market power, and there are virtually insurmountable barriers to new firm entry in most cases [...] SASAC profitability therefore is significantly due to the protected markets in which these firms operate.”)

The legal mandate to ensure a leading role for the SIE sector in China's economy is not simply a formality. Rather, as the World Bank has noted, it is a guiding principle and policy objective of the Chinese government that has a systemic impact on private firms in China's economy. Research reports published by various international institutions have recognized the distinct effect that Chinese government policy has had on SIE market dominance.

- World Bank. A 2013 report finds that “[a]lthough formal barriers to entry may be low in these industries, informal entry barriers convey the clear policy message—competition from private firms is not welcome.”<sup>268</sup> The report also argues that many government departments favor SIE investments “instead of achieving the same ends through incentives, market forces, and private sector initiatives.”<sup>269</sup>
- WTO. The Trade Policy Review for 2016 concludes:  

China continues to maintain a basic economic system in which public ownership is kept as the mainstay of the economy while allowing diverse forms of ownership to develop side by side. As a result, the private sector is dominant in industries such as clothing, food, and assembly for export, while sectors of strategic importance (*e.g.* energy; utilities; and transport, financial, telecom, education, and health care services) remain only partially open to private investment. These sectors are often dominated by large SOEs.<sup>270</sup>
- OECD. According to a 2010 OECD report, the Chinese government policy of sectoral classification “marked a shift in policy away from encouraging private-sector involvement in all competitive sectors of the economy to one of private[z]ing smaller SOEs in non-strategic sectors while increasing government ownership in enterprises deemed to be strategic.”<sup>271</sup>

## 2.2. The SIE Sector in China Compared with Other Economies

Several major economies have state-owned sectors, but China's state-owned sector is uniquely large as compared to other major economies. A 2013 report comparing “state-owned enterprises” in the BRIICS countries (Brazil, Russia, India, Indonesia, China and South Africa) determined that the assets of listed Chinese “state-owned enterprises” are equivalent to 145% of China's Gross National Income (GNI), while the corresponding figures for the other BRIICS countries are considerably lower, ranging from just 3% to 75%. The report also finds that the sales revenue of listed “state-owned enterprises” in China is equivalent to 26% of China's GNI, compared to a

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<sup>268</sup> World Bank, *China 2030: Building a Modern, Harmonious, and Creative Society*, Report No. 96299 (March 2013), 26. See also *Ibid.*, 26-28, 106, 111.

<sup>269</sup> *Ibid.*

<sup>270</sup> WTO, *Trade Policy Review – Report by the Secretariat – China*, WT/TPR/S/342 (June 15, 2016), 95.

<sup>271</sup> OECD, *OECD Economic Surveys: China*, (Paris: OECD Publishing, 2010), 114.

much lower proportion, ranging from 2% to 16%, in the other BRIICS countries.<sup>272</sup> In addition, according to the OECD, China was the only country among the OECD members and 11 non-OECD members included in its study in 2013 to have SIEs in all 30 sectors included in the study.<sup>273</sup>

In addition, SIE assets as a percentage of Gross Domestic Product (GDP) are multiples larger in China than in France, a market economy country with a relatively high degree of government ownership. MOF reported that non-financial “state-owned enterprise” assets in China totaled RMB 104 trillion in 2013, approximately 180% of China’s total GDP for the same period.<sup>274</sup> By comparison, in France, non-financial SIE assets totaled €829 million, just under 40% of France’s GDP that year.<sup>275</sup>

### 2.3. SIEs as Leading Enterprises in Key Sectors

Although government-controlled shareholding groups are not unique to China, SASAC is distinctive because the SIEs that it oversees are dominant in many sectors, particularly in critical sectors relating to infrastructure, transport, communications, energy, and capital-intensive manufacturing.<sup>276</sup>

Nearly every leading firm in a critical industry in China is under SASAC control. The vast majority of the 115 Chinese companies on the Global Fortune 500 are state-owned,<sup>277</sup> and of these 115, 48 are controlled by central SASAC.<sup>278</sup> The ten largest SIEs in 2015 reported

<sup>272</sup> Przemyslaw Kowalski et al., *State-Owned Enterprises: Trade Effects and Policy Implications*, Trade Policy Papers 147 (OECD, 2013), 21.

<sup>273</sup> OECD, *The 2013 Update of the OECD’s Database on Product Market Regulation: Policy Insights for OECD and Non-OECD Countries*, Economics Department Working Papers, No. 1200 (2015), 37. The OECD has published indicators of product market regulation that include a sub-indicator measuring the “scope of state-invested enterprises.” This sub-indicator tracks whether SIEs are present in 30 different sectors that cover a large swath of the economy.

<sup>274</sup> MOF, *Ministry of Finance Discloses State-owned Enterprise Accumulated Property: for the First Time: 155,000 Firms with Total Assets of Over 100 Trillion* (August 1, 2014). (The report refers to state-owned and state-controlled enterprises, including centrally-managed enterprises, enterprises under central departments and affiliated subsidiaries, and state-owned and state-controlled enterprises of the 36 provinces (as well as autonomous regions, directly administered municipalities, and municipalities with independent planning status). State-owned financial institutions are not included.)

<sup>275</sup> Agence des participations de l'Etat, 2014-15, *The Government as Shareholder*, 2015.

<sup>276</sup> Jason Dean, Andrew Browne, and Shai Oster, “China’s ‘State Capitalism’ Sparks a Global Backlash,” *Wall Street Journal*, November 16, 2010.

<sup>277</sup> Celine Ge, “Alibaba, Tencent included in Fortune Global 500 for the First Time,” *South China Morning Post*, July 21, 2017.

<sup>278</sup> SASAC Press Release (SASAC, available at <http://www.sasac.gov.cn/n2588025/n2588119/c7419470/content.html>, accessed on July 21, 2017).



revenues that were nearly four times as large as the revenue reported by the ten largest private companies in China.<sup>279</sup> Also according to *Fortune China*, in 2015, 19 out of China's 20 largest listed companies by revenue were SIEs.<sup>280</sup>

As noted above, China seeks to maintain control, to varying degrees, across a wide range of sectors. With respect to market concentration in individual sectors, examples of SIE dominance include:

- *Banking and Finance.* The “Big Five” commercial banks in China – Bank of China (BoC), Industrial and Commercial Bank of China (ICBC), China Construction Bank Corporation (CCBC), Agriculture Bank of China (ABC), and Bank of Communications (BCM) – all operate large branch networks on a nationwide basis. These are truly large banks, with combined assets of over RMB 78 trillion in 2015.<sup>281</sup> The Chinese government is also the largest shareholder of the top-four insurance companies, which together accounted for over half of China's life and non-life insurance markets in 2013.<sup>282</sup>
- *Energy.* In the oil and gas sector, three enterprises administered by SASAC – China National Offshore Oil Corp., China National Petroleum Corp. and Sinopec – accounted for 94% of domestic oil production and 99% of domestic gas production in 2015.<sup>283</sup> In the electricity sector, five power generation enterprises administered by SASAC account for just under half of installed capacity, and two power distribution enterprises administered by SASAC hold a quasi-monopoly over power distribution.<sup>284</sup>

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<sup>279</sup> *Fortune China*, “China's Top 500 List,” July 8, 2015, and *Exclusive Debut: China's Top 500 Private Enterprises 2015 List*, [presentation] Chinese People's Political Consultative Conference, August 25, 2015.

<sup>280</sup> *Fortune China*, “China's Top 500 List,” July 8, 2015.

<sup>281</sup> All information in paragraph taken from *China Banking Regulatory Commission 2015 Annual Report* (PRC, CBRC, 2015), 26.

<sup>282</sup> The firms China Life, Ping'an Life, and New China Life accounted for 53.7% of China's life insurance market in 2013. The firms PICC, Ping'an, and China Pacific accounted for 64.8% of China's non-life insurance market in 2013. Dagong Europe Credit Rating, *China's Insurance Market Overview: Characteristics, Trends, Challenges and Opportunities for Foreign Insurers* (June 24, 2014), 7-9.

<sup>283</sup> Lei Wang, [presentation] the Colorado School of Mines at the Oil & Gas Conference, Denver, Colorado, August 17, 2016.

<sup>284</sup> A 2011 report in the business publication *Forbes* states: “Of the more than 4,300 power generation companies in China that have capacity of 6,000 kilowatts and above, approximately 90 percent are state-owned, or companies with a majority of their shares controlled by the state. Among them, five corporations directly under the central government account for approximately 45 percent of China's installed capacity. *The big five are: China Huaneng Group; China Datang Corporation; China Guodian Corporation; China Huadian Corporation; and China Power Investment Corporation.* [...] In order to transmit electricity around the country, there are 38 power transmission companies at the central government and provincial levels. [...] The State Grid Corporation of China covers 25 provinces, municipalities and autonomous regions, while the China Southern Power Grid Co., Ltd. covers five. Provincial level power transmission companies, such as Inner Mongolia Power Company, operate locally and independently.” Jack Perkowski, “Cracking China's Power Sector,” *Forbes*, January 12, 2011. (emphasis added)

- *Telecommunications.* Two enterprises administered by SASAC – China Mobile and China Telecom – together with a third state-invested enterprise – China Unicom – account for practically the entire sector. In 2015 these three telecom firms agreed to sell and transfer assets worth a combined RMB 214 billion to an infrastructure-sharing joint venture, China Tower Corp.<sup>285</sup>
- *Aerospace.* The Commercial Aircraft Corporation of China, Ltd. (COMAC), managed by SASAC, is the only major firm dedicated to producing commercial jets.<sup>286</sup> In the airline sector, the majority of market share is accounted for by Air China Ltd., China Eastern Airlines Corp. and China Southern Airlines Co., all enterprises administered by SASAC.<sup>287</sup>
- *Automotive.* The market leaders in domestic vehicle sales are joint ventures between foreign automakers and the three SIEs: Shanghai Automotive Industry Corp., First Automotive Works, and Dongfeng Motor Corporation.<sup>288</sup> According to the National Bureau of Statistics of China (NBS), “state-owned enterprises” accounted for 47% of assets in the automotive sector in 2014.<sup>289</sup>

The market dominance of large SIEs is also indicated by their share of China’s stock market. As of May 2017, the top ten firms listed on the Shanghai Stock Exchange account for approximately one-quarter of total market capitalization.<sup>290</sup> These firms include three SOCBs – Industrial and Commercial Bank of China, Bank of China, and Agricultural Bank of China – and two of the three oil companies administered by central SASAC – Petrochina and Sinopec.<sup>291</sup>

#### 2.4. SIEs at the National and Sub-National Level

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<sup>285</sup> Bien Perez, “China’s ‘Big Three’ Network Operators Inject 214 Billion Yuan Assets into Telecoms Tower Venture,” *South China Morning Post*, October 15, 2015.

<sup>286</sup> Keith Crane et al., *The Effectiveness of China’s Industrial Policies in Commercial Aviation Manufacturing* (Washington, DC: RAND Corp., 2014), 25. See also *About Us* (Commercial Aircraft Corporation of China, Ltd. website, available at <http://english.comac.cc/aboutus/>).

<sup>287</sup> *Bloomberg News*, “China’s Carriers Set for Biggest Profit Since 2010 on Expansion,” March 29, 2017.

<sup>288</sup> *China Daily*, “Top 10 Chinese Automotive Firms by Revenue in 2015,” June 6, 2016.

<sup>289</sup> NBS, *China Statistical Yearbook – 2015* (Beijing: China Statistics Press, 2015), “13-2 Main Indicators of Industrial Enterprises above Designated Size by Industrial Sector (2014)” and “13-5 Main Indicators of State-owned and State-holding Industrial Enterprises by Industrial Sector (2014).” Calculations performed by the Department.

<sup>290</sup> “Shanghai Stock Exchange,” available at <http://www.sse.com.cn/market/stockdata/marketvalue/>, accessed July 12, 2017.

<sup>291</sup> *Ibid.*

The Chinese government introduced SIE restructuring policies in the late 1990s, and the total number of SIEs and the workforce employed by SIEs declined significantly in the 1998-2007 period.<sup>292</sup> However, official statistics published by MOF in 2015 show that approximately 155,000 SIEs continue to be registered with the government at different levels, with 37.9 million employees and RMB 104.1 trillion in assets.<sup>293</sup>

In the late 1990s, the Chinese government implemented a policy to “grasp the large, let go of the small,” which, in essence, called for the closure or sale of smaller SIEs – particularly in sectors of less strategic value – and the development of larger SIEs into industrial conglomerates – particularly in sectors of greater strategic value.<sup>294</sup> However, this policy did not result in the elimination of smaller SIEs. In terms of the number of enterprises, MOF statistics for “state-owned enterprises” (as defined by MOF) show that only 52,000 (33.5%) out of 155,000 are owned at the central level; the remaining 103,000 (66.5%) are owned at the sub-central level, divided among provincial (27.1%), municipal (10.3%), and county-level (29%) governments.<sup>295</sup> MOF statistics also indicate that “state-owned enterprises” at the sub-central level account for approximately half of total SIE assets and equity.<sup>296</sup>

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<sup>292</sup> OECD, *State Owned Enterprises in China: Reviewing the Evidence*, Working Group on Privatization and Corporate Governance of State Owned Assets (January 26, 2009), Section 4.2. According to statistics published by MOF and NBS, which define as SOEs strictly those under full government ownership, the total number of SOEs decreased from 262,000 in 1997 to 116,000 in 2006, and the number of workers employed by SOEs decreased from 71 million to 25 million over the same period. Moreover, the proportion of industrial SOEs declined relative to private and foreign-invested firms in the 1998-2006 period: in 1998, for every 100 SOEs, there were only 40.8 foreign-invested enterprises and 16.5 private-owned enterprises; by 2006, the proportions had increased to 243.9 foreign-invested enterprises and 600 private-owned enterprises. *See also* WTO, *Trade Policy Review – Report by the Secretariat – China*, WT/TPR/S/199 (April 16, 2008), 92-93. (“Since the previous Review of China [...] the number of SOEs fell from 929,152 (12.08% of all enterprises in China) in 2004, to 730,121 (8.46%) in 2006. SOEs held total assets of Y 29 trillion, and provided employment to 39 million people in 2006 (Y 18 trillion and 42.3 million people in 2003).”)

<sup>293</sup> Jianguang Shen, “SOE Reform (I): Improving Corporate Governance,” *Economics Weekly* (24) (Mizuho Securities Asia Ltd. Economics Research, May 29, 2015), 3; OECD, *OECD Economic Surveys: China*, (Paris: OECD Publishing, 2017), 44.

<sup>294</sup> Chang-Tai Hsieh and and Zheng Michael Song, *Grasp the Large, Let Go of the Small: The Transformation of the SIE sector in China*, No. w21006 (National Bureau of Economic Research, 2015), 7-15; Andrew Batson, *Fixing China’s SIE sector*, Paulson Policy Memorandum (Paulson Institute, January 2014), 7. *See also* Tony Saich, *Governance and Politics of China*, Third Edition (New York: Palgrave MacMillan, 2011), 285.

<sup>295</sup> Jianguang Shen, “SOE Reform (I): Improving Corporate Governance,” *Economics Weekly* (24) (Mizuho Securities Asia Ltd. Economics Research, May 29, 2015), 1. Calculations performed by the Department.

<sup>296</sup> A 2015 report by Mizuho Securities Asia Ltd., using MOF data, cites the followings figures for what it defines as “state-owned enterprises.” (1) Assets: RMB 48.6 trillion at central level; RMB 9.8 trillion at municipal level; RMB 22.2 trillion at county level; and RMB 22.6 trillion at province level. (2) Equity: RMB 16.6 trillion at central level; RMB 7.5 trillion at province level; RMB 8.9 trillion at county level; RMB 4 trillion at municipal level. Jianguang Shen, “SOE Reform (I): Improving Corporate Governance,” *Economics Weekly* (24) (Mizuho Securities Asia Ltd. Economics Research, May 29, 2015), 3. *See also* Andrew Batson, *Fixing China’s SIE Sector*, Paulson Policy Memorandum (Paulson Institute, January 2014), 3.

## 2.5. China's Official Statistics on the SIE Sector Compared to the Private Sector

Using official statistics to determine the economic significance of the SIE sector in China is inherently difficult, and economists have reached varying conclusions about the size of the SIE sector relative to China's overall economy.<sup>297</sup> Nevertheless, NBS data for 2015 allow for a comparison of “state-owned and state-holding industrial enterprises”<sup>298</sup> and “private enterprises” in the industrial sector (as defined by NBS).<sup>299</sup> The data show that in 2015 on average state-owned and state-holding industrial enterprises were approximately 20 times as large as private enterprises when measured in terms of total assets, seven times as large in terms of revenue from principal business, five times as large in terms of total profits, and five times as large in terms of employees.<sup>300</sup> This significant size differential between state-owned and state-holding industrial enterprises over private enterprises has persisted over time. Using NBS data from 2005-2015, state-owned and state-holding industrial enterprises were, on average, 23 times as large as private enterprises in terms of total assets, 10 times as large in terms of revenue from principal business, 11 times as large in terms of total profits, and six times as large in terms of employees.<sup>301</sup> In addition, NBS statistics indicate that state-owned and state-holding industrial

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<sup>297</sup> See e.g., Andrew Batson, *The State of The State Sector*. [presentation] Gavekal/Dragonomics, March 2017; Paul Hubbard, *Reconciling China's Official Statistics on State and Control*, East Asian Bureau of Economic Research (Working Paper, Paper No. 120 (May 19, 2015)); Derek Scissors, “China's SOE sector is bigger than some would have us think,” East Asia Forum, (May 17, 2016); Nicholas Lardy, “Private not state firms are China's growth engine,” East Asia Forum (November 30, 2014).

<sup>298</sup> Note that in the *China Statistical Yearbook – 2016* (concerning data for 2015), state-owned and state-holding industrial enterprises were all grouped under the heading “State-holding Industrial Enterprises” rather than “State-owned and State-holding Industrial Enterprises,” which NBS used in previous years. See *Explanatory Notes on Main Statistical Indicators* after Table 13-15 for a detailed explanation: “State-holding enterprises cover the original state-owned enterprises and state-holding enterprises.”

<sup>299</sup> NBS, *China Statistical Yearbook – 2016* (Beijing: China Statistics Press, 2016), “Explanatory Notes on Main Statistical Indicators” (after section 13-15). See Section 2.6 for further information on the NBS definition of “state-holding enterprises” and “private enterprises.” NBS alternatively uses the term “private enterprise” and “private-holding enterprise.” For simplicity, the term “private enterprise” is used herein.

<sup>300</sup> Private enterprise in China in 2015 on average had RMB 105.7 million in total assets, RMB 54.8 million in liabilities, RMB 178.4 million in revenues, RMB 11.2 million in profit, and 160 employees. By contrast, in 2015 industrial state-holding enterprises in China had on average RMB 2.06 billion in total assets, RMB 1.27 billion in liabilities, RMB 1.25 billion in revenue, RMB 59.2 billion in profits, and 922 employees. All data in this paragraph is derived from NBS, *China Statistical Yearbook – 2016* (Beijing: China Statistics Press, 2016), “13-6 Main Indicators of Private Enterprises by Industrial Sector (2015)” and “13-4 Main Indicators of State-holding Industrial Enterprises by Industrial Sector (2015),” and calculations performed by the Department.

<sup>301</sup> Data derived from NBS, *China Statistical Yearbook* for the years 2006-2016 (Beijing: China Statistics Press, 2006-2016), using tables titled “Main Indicators of Private Enterprises by Industrial Sector” and “Main Indicators of State-owned and State-holding Industrial Enterprises by Industrial Sector.” See Footnote 299 for explanation of category title change from “State-owned and State-holding” to “State-holding.”

enterprises tend to be larger in both capital- and labor-intensive industrial sectors.<sup>302</sup> As discussed in more detail below, these statistics may underestimate the size of the SIE sector.

Moreover, NBS statistics indicate that the number of state-owned and state-holding industrial enterprises in China fell by 30% from 2005 to 2015, but the total assets under the control of these enterprises grew by 240%, resulting in an almost four-fold increase in average assets per state-owned and state-holding industrial enterprise.<sup>303</sup> At the same time, NBS statistics suggest that over the past decade, the share of total assets of private enterprises has risen, as have revenue and profit.<sup>304</sup> Yet, as of December 2016, state-owned and state-holding industrial enterprises made up 44.8% of total assets, far in excess of the share of state-owned and state-holding industrial enterprises in total industrial enterprises (5.7%). This is also far in excess of the figure for total assets of private industrial enterprises (22.4%).<sup>305</sup>

In certain sectors, NBS statistics show that private enterprises account for a greater share of Fixed Asset Investment (FAI) than state-owned and state-holding industrial enterprises. For example, “private enterprises” account for more than 80% of FAI in textile, clothing and furniture manufacturing and also maintain a strong presence in retail and wholesaling in 2015.<sup>306</sup> Conversely, private enterprises account for only a small share of FAI in the healthcare, education, construction, and financial sectors. Rail, road, and air transportation all had state-holding enterprise shares in FAI in excess of 80% in 2015. In telecommunications, the state-owned and state-holding industrial enterprise share in FAI was 77%.<sup>307</sup> Overall, the NBS data estimates private enterprises accounted for around half of FAI in China [in 2015].<sup>308</sup>

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<sup>302</sup> For example, in petroleum extraction and automotive manufacturing, two capital-intensive industries, the total assets of state-owned and state-holding industrial enterprises are on average 63 and 29 times larger, respectively, than of private enterprises. In textiles and food, two labor-intensive industries, the total assets of state-owned and state-holding industrial enterprises are on average seven and four times larger, respectively, than of the average private enterprise. See NBS, *China Statistical Yearbook – 2016* (Beijing: China Statistics Press, 2016), “13-6 Main Indicators of Private Enterprises by Industrial Sector (2015)” and “13-4 Main Indicators of State-holding Industrial Enterprises by Industrial Sector (2015).” Calculations performed by the Department.

<sup>303</sup> *Ibid.* Calculations performed by the Department.

<sup>304</sup> *Ibid.* Calculations performed by the Department.

<sup>305</sup> NBS, *Industry, National Data* (Monthly), available at <http://data.stats.gov.cn/english/easyquery.htm?cn=A01>, accessed June 1, 2017. As of December 2016, industrial firms in China totaled 379,142, of which 214,514 were defined as “private enterprises” and 21,579 as “state-owned industrial enterprises” or “state-holding industrial enterprises,” with the sizeable remainder falling into other categories. Calculations performed by the Department.

<sup>306</sup> NBS, *China Statistical Yearbook – 2016* (Beijing: China Statistics Press, 2016), Table 10-11 “Investment in Fixed Assets (Excluding Rural Households) By Sector, Jurisdiction of Management, Registration Status and Holding Type.” Calculations performed by the Department.

<sup>307</sup> *Ibid.* Calculations performed by the Department.

<sup>308</sup> *Ibid.* Rail, road, and air transportation all had SIE shares in FAI in excess of 80% in 2015. Investment in telecommunications was 77% SIE and only 6% private, Table 10-11 “Investment in Fixed Assets (Excluding Rural Households).” Calculations performed by the Department.



Statistics on the size of SIEs relative to private enterprises are striking, especially when considering that the SIEs in China generally perform worse than private enterprises. A 2015 study by economists affiliated with the National Bureau of Economic Research finds that SIEs allocate capital less efficiently than private enterprises. Sampling 230 state business groups (of which 82 are managed by SASAC and 148 controlled by a local equivalent) and 91 private business groups between 2004 and 2013, the study attributes the differences in allocative efficiency largely to the degree of government influence over SIE business decisions.<sup>309</sup> MOF statistics indicate that the performance of “state-owned enterprises” improved in the years 1998-2007, during the period of large-scale restructuring of the SIE sector, but declined markedly after 2007.<sup>310</sup> In any case, size measurements do not fully account for the disproportionate share of factor inputs consumed by the SIE sector relative to its share of output. This is particularly true for capital. The IMF reports that the “SOE share in credit stock” was 55.6% in 2014.<sup>311</sup> Given that SIEs generally use capital less efficiently than the rest of the economy, their capital intensity of production is correspondingly higher.<sup>312</sup> It attributes this trend to the fact that SOEs have “soft budget constraints” and act “partly as a conduit for policy-driven investment.”<sup>313</sup> A 2013 report by the World Bank notes the inherent tension between the poor performance of the SIE sector and its access to credit:

The weighted average return on assets of SOEs is [...] significantly lower than that of other firms [...] On the other hand, the average debt to equity ratio of SOEs is substantially higher, exceeding 230[%] (Liu and Zhao 2009). If the financial system is liberalized, many highly leveraged SOEs would face difficulties in financing

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<sup>309</sup> See Alexander Ljungqvist et al., *State Capitalism vs. Private Enterprise*, Working Paper 20930 (National Bureau of Economic Research, February 2015), Abstract and 7-8.

<sup>310</sup> See Andrew Batson, *Fixing China's State Sector*, Paulson Policy Memorandum (Paulson Institute, January 2014), 7. SIE statistics cited by Batson include: overall return on assets stood at 0.2% in 1998, increased to 5.0% in 2007, and declined to 3.1% in 2012; overall return on equity stood at 0.4% in 1998, increased to 12.1% in 2007, and declined to 9.0% in 2011; overall profit margin stood at 0.3% in 1998, increased to 9.0% in 2007, and declined to 5.6% in 2012.

<sup>311</sup> See Kang et al., *People's Republic of China: Selected Issues*, IMF Country Report No. 16/271 (International Monetary Fund, July 2016), 9. See Table 1: Rebalancing Scorecard.

<sup>312</sup> See e.g., Yasheng Huang, *State Capitalism in China*. [presentation] The Annual Proceedings of the Wealth and Well-Being of Nations, Beloit College, Beloit, Wisconsin, 2016, 27. (“Private firms are more efficient than SOEs and therefore they generate more value-added per unit of inputs—labor and/or capital—deployed”); Andrew Batson, *The State of The State Sector*. [presentation] Gavekal/Dragonomics, March 2017.

<sup>313</sup> See Wojciech Maliszewski et al., *Resolving China's Corporate Debt Problem*, Working Paper WP/16/203 (IMF, October 2016), 7. (“SOEs have been more leveraged and less profitable than private enterprises. SOEs have been the bulwark of government industrial policy, used to reach development and strategic goals. They have been the key policy instrument used by the central and local governments in the post-GFC response to mitigate growth slowdown [...] Acting partly as a conduit for policy-driven investment, mostly in resources-intensive industries, they have reported higher and rising leverage compared to the private enterprises, and significantly weaker profitability [...] Inefficiency has been linked to soft budget constraints. The policy role of SOEs is enhanced by preferential access to financing. [...] The privileged access has been underpinned by substantial land endowment (that can be used as collateral) and implicit government guarantees.”)



their investment or debt at low cost, resulting in deteriorating their financial situation and possibly leading to insolvency.<sup>314</sup>

The legal mandate to ensure a leading role for the SIE sector in China's economy has a systemic impact on private firms in China's economy, by discouraging new private sector entrants and reducing innovation and competition.<sup>315</sup>

## 2.6. Issues Concerning Official Data on Enterprises

As noted above, determining the economic significance of the SIE sector in China is inherently difficult, as China does not publish a single figure on the size of the entire SIE sector. In addition, economists have questioned the extent to which Chinese official statistics published by NBS can render a consistent and accurate picture of the state sector.<sup>316</sup> NBS reports some statistics based on China's formal enterprise registration system, and others using a concept of control as defined by NBS. However, neither of these reporting methods covers all of the complex mixed ownership structures that exists in China, and as a result, official statistics may underestimate the extent of government ownership and control in the economy.

First, NBS uses China's formal enterprise registration categories to report official statistics, but it is difficult to determine based on an enterprise's registration alone the extent of state involvement or control in that enterprise.<sup>317</sup> All enterprises in China must be registered under one of 18 categories pursuant to the *Provisions for the Classification of Enterprise Registration Types*. For domestically invested enterprises, there are eight possible enterprise registration

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<sup>314</sup> World Bank, *China 2030: Building a Modern, Harmonious, and Creative Society*, Report No. 96299 (March 2013), 125.

<sup>315</sup> *Ibid.*, 25-28, 106, 111. ("State enterprises have close connections with the Chinese government. State enterprises are more likely to enjoy preferential access to bank finance and other important inputs, privileged access to business opportunities, and even protection against competition (Li and others 2008). This discourages new private sector entrants and reduces competition and innovation. Some state enterprises operate outside their mandated area (many invest in real estate and the shadow banking system), because they can keep their earnings and invest them with limited external control or oversight. A new issue needing attention is the recent rapid expansion of some state enterprises owned by sub-central governments; their growth will likely further crowd out private sector activity, dampen competition, and conflict with efforts to build sound foundations for a market-based economy...") *Ibid.*, 26.

<sup>316</sup> See e.g., Loren Brandt, Johannes Van Biesebroeck, and Yifan Zhang, "Challenges of Working with the Chinese NBS Firm-Level Data," *China Economic Review* (May 2, 2014), 339-52; Chang-Tai Hsieh and Zheng Michael Song, *Grasp the Large, Let Go of the Small: The Transformation of the SIE sector in China*, No. w21006 (National Bureau of Economic Research, 2015), 7-15; Andrew Batson, *Fixing China's State Sector*, Paulson Policy Memorandum (Paulson Institute, January 2014), 7; Paul Hubbard, *Reconciling China's Official Statistics on State and Control*, East Asian Bureau of Economic Research (Working Paper, Paper No. 120 (May 19, 2015)), Derek Scissors, "China's SOE sector is bigger than some would have us think," East Asia Forum, (May 17, 2016).

<sup>317</sup> Chang-Tai Hsieh and Zheng Michael Song, *Grasp the Large, Let Go of the Small: The Transformation of the SIE sector in China*, No. 21006 (National Bureau of Economic Research, 2015), 7-15; Nicholas Lardy, *Markets Over Mao: The Rise of Private Business in China*, (Washington, DC: Peterson Institute for International Economics, 2014), 62-68; Curtis J. Milhaupt and Wentong Zheng, "Beyond Ownership: State Capitalism and the Chinese Firm," *The Georgetown Law Journal* 103:665 (2015): 671-676.

categories, including “state-owned enterprise.”<sup>318</sup> According to the NBS definition, “state-owned enterprise” for registration purposes is limited in scope to “non-corporate economic units where the entire assets are owned by the State.”<sup>319</sup> It does not include enterprises that are registered under any of the other categories but nevertheless may be subject to state involvement or control. For example, a publicly traded company that is registered as a “company limited by shares” may be controlled by the state, but it would not be included in NBS statistics as a “state-owned enterprise.”<sup>320</sup> Conversely, NBS registration statistics for “company limited by shares” and “private enterprise” do not indicate the extent to which these enterprises may in fact be subject to state involvement or control. In addition, an entity registered as a sino-foreign equity joint venture would be reflected in NBS registration statistics as a foreign-invested enterprise even if the joint venture were subject to significant state involvement or control. Therefore, a review of NBS statistics based on registration type alone can understate the extent of state involvement or control in the enterprise sector.

Second, as noted above, NBS also reports statistics using a concept of control based on six different categories,<sup>321</sup> which includes “state-holding enterprise” (which could alternatively be translated as “state-controlled enterprise”) and “privately-controlled enterprise.” “State-controlled enterprises” include not only “state-owned entities” as defined above but also include enterprises in which the state is the largest shareholder or exercises control over the enterprise by virtue of an agreement.<sup>322</sup> However, the concept of state-controlled enterprise used by NBS for

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<sup>318</sup> The eight domestically-invested enterprise registration types are: 1) “state-owned enterprise”; (2) collective enterprise (3) share cooperative; (4) joint venture; (5) limited-liability company; (6) company limited by shares; (7) “private enterprises”; and (8) other enterprises.

<sup>319</sup> NBS, *China Statistical Yearbook – 2016* (Beijing: China Statistics Press, 2016), “Explanatory Notes on Main Statistical Indicators” (after section 1-8). (“State-owned Enterprises refer to non-corporation economic units where the entire assets are owned by the State and which have been registered in accordance with the *Regulation of the People’s Republic of China on the Management of Registration of Corporate Enterprises*. Not included from this category are solely State-funded corporations in the limited liability corporations.”)

<sup>320</sup> Chang-Tai Hsieh and Zheng Michael Song, *Grasp the Large, Let Go of the Small: The Transformation of the SIE sector in China*, No. 21006 (National Bureau of Economic Research, 2015), 9. (“[M]any state-owned firms, particularly after 1998, are registered as limited-liability or publicly traded companies, albeit with the controlling stake held by a state-controlled holding company. The Baoshan steel company and Shanghai’s SAIC Group’s stand-alone car company (SAIC)[...] are examples of publicly listed companies (and, thus, registered as share-holding companies) but with a controlling stake held by a holding company owned by the Chinese state (the Central government in the case of Baoshan and the local Shanghai government in the case of SAIC).”)

<sup>321</sup> These categories are: (1) state controlled enterprise (which NBS translates as “state-owned or state-holding enterprise), (2) privately-controlled enterprise (which NBS translates as “private-holding,” (3) collective-controlled enterprise, (4) Hong Kong, Macao, Taiwan controlled enterprise, (5) foreign-controlled enterprise, and (6) others.

<sup>322</sup> NBS, *China Statistical Yearbook – 2016* (Beijing: China Statistics Press, 2016), “Explanatory Notes on Main Statistical Indicators” (after section 13-15). (“State-holding enterprises cover the original state-owned enterprises and state-holding enterprises. They are classified according to the actual investment made by the contributor [*sic*] of state-owned part in the paid-in capital of the enterprises, or the degree of control or dominance of the contributor on the assets of the enterprises. The following cases are regarded as state holding: (1) Absolute state-holding in which the contributors [*sic*] of state-owned parts possess more than 50% of all the paid-in capital (stocks) of the enterprise; (2) Relative state holding in which the contributors [*sic*] of state-owned parts possess no more than 50% of the paid-in

statistical purposes still understates the extent of state involvement for at least two reasons. First, an enterprise in which the state holds a significant but non-controlling stake would be considered a private enterprise. Second, the concept of state-holding as defined by NBS does not capture all of the complex corporate structures that exist in China in which the state effectively controls the enterprise. For example, the NBS definition does not aggregate state involvement at different levels of the corporate structure or among different shareholders, such that an enterprise may be considered privately controlled even if the state has actual control over the enterprise.<sup>323</sup> Conversely, NBS statistics may overstate the extent of private control over industrial enterprises for the same reason.<sup>324</sup>

### 3. *Bankruptcy, Consolidations and State Enterprise Groups*

#### 3.1. The Bankruptcy System

The incidence of bankruptcy cases in China is relatively limited given the size of China's economy and population, according to the IMF and other experts.<sup>325</sup> Statistics provided by the Supreme People's Court show that Chinese courts accepted 5,665 bankruptcy cases in 2016.<sup>326</sup> This figure pales in comparison to the United States, where the number of bankruptcy filings totaled 794,492 for the filing year ending March 31, 2017.<sup>327</sup> One reason for the disparity is that

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capital (stocks) of the enterprises, but more than that of any other contributors; or Agreed state holding in which the contributors [*sic*] of state-owned parts possess no more than other contributors but have actual control over the enterprises according to agreements; (3) In the case both contributors possess 50% and it is not clear which one is in absolute holding position, the enterprise is regarded as state-holding enterprise if one of the contributor has state-owned elements.”)

<sup>323</sup> Paul Hubbard, *Reconciling China's Official Statistics on State and Control*, East Asian Bureau of Economic Research (Working Paper, Paper No. 120 (May 19, 2015), 10. (“The definition of ‘state-owned and state controlled’ is also non-cumulative – for example, company A might be 49 per cent state-owned and 51 per cent owned by a private shareholder, in which case it is classified as private controlled. Suppose they create a new company, company B in which company A holds a 51 per cent stake, with the remaining 49 per cent owned by wholly state-owned enterprise B. In this case, company C is not ‘state controlled’ because its controlling parent is not state-controlled. Nevertheless, the state would remain the ultimate beneficial owner of almost three quarters of company C.”)

<sup>324</sup> *Ibid.* See also Derek Scissors, “China’s SOE sector is bigger than some would have us think,” East Asia Forum, (May 17, 2016).

<sup>325</sup> Wojciech Maliszewski et al., *Resolving China's Corporate Debt Problem*, Working Paper WP/16/203 (IMF, October 2016), 16. See also Markus Taube and Christian Schmidkonz, *Assessment of the Normative and Policy Framework Governing the Chinese Economy and Its Impact on International Competition*, Final Extended Report for AEGIS Europe (Think!Desk China Research & Consulting, August 13, 2015), 236.

<sup>326</sup> *Bloomberg News*, “Chinese Leaders Back Bankruptcies for Unwanted Zombie Firms,” March 13, 2017.

<sup>327</sup> United States Courts, *March 2017 Bankruptcy Filings Down 4.7 Percent* (April 19, 2017).

Chinese law does not provide for the bankruptcy of private individuals.<sup>328</sup> Nevertheless, of the bankruptcies filed in the United States, 23,591 were “business” bankruptcies, which is more than four times the number of bankruptcy cases accepted in China.<sup>329</sup>

In addition, the incidence of bankruptcy filings is low given the speed at which the country is transforming.<sup>330</sup> The low incidence of bankruptcy cases is not the result of a dearth of business exit in China. The IMF estimates that for each insolvency case accepted by China’s courts, another 100 to 250 enterprises go out of business, many of them through deregistration and business license cancellation.<sup>331</sup> Studies suggest that such business exit disproportionately affects firms in the non-SIE sector that have less access to credit.<sup>332</sup> Business exit through means other than bankruptcy can have a detrimental impact on the financial health of a company’s employees, management, shareholders, and creditors, in addition to discouraging future risk-taking among entrepreneurs in the economy as a whole.

As described below, a principal problem with China’s bankruptcy system is the uneven manner in which the Chinese government has developed and administered bankruptcy regulations, as well as the discretion the Chinese government exercises in managing the business exit of enterprises under government ownership and control.

The adoption of a new *Enterprise Bankruptcy Law of the People’s Republic of China* (“EBL”)<sup>333</sup> in 2006 marked an important step forward. The EBL covers bankruptcy not only of SIEs, but also

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<sup>328</sup> Bankruptcy of private individuals is not expressly forbidden, but it is not covered in the EBL or any other bankruptcy legislation. See also CCP Central Committee United Front Work Department, *Recommendations on Establishing a Bankruptcy System for Individuals* (April 18, 2017).

<sup>329</sup> United States Courts, *March 2017 Bankruptcy Filings Down 4.7 Percent* (April 19, 2017).

<sup>330</sup> Markus Taube and Christian Schmidkonz, *Assessment of the Normative and Policy Framework Governing the Chinese Economy and Its Impact on International Competition*, Final Extended Report for AEGIS Europe (Think!Desk China Research & Consulting, August 13, 2015), 18.

<sup>331</sup> Wojciech Maliszewski et al., *Resolving China’s Corporate Debt Problem*, Working Paper WP/16/203 (IMF, October 2016), 16. See also Changyin Han, “The Practice of Reorganization in China,” *Arizona Journal of International & Comparative Law* 33(1) (2016): 277. The paper states that in the period 2006-2013, the annual number of “revoked enterprises” – i.e., enterprises that exited the economy – ranged between 672,000 and 871,400; during the same period, the annual number of “bankruptcy cases” continually declined, from a high of 4,253 in 2006 to a low of 1,998 in 2013.

<sup>332</sup> Wojciech Maliszewski et al., *Resolving China’s Corporate Debt Problem*, Working Paper WP/16/203 (IMF, October 2016), 7. For studies of firm survival in China, See also Jia Liu and Dong Pang, “Financial Factors and Company Investment Decisions in Transitional China,” *Managerial and Decision Economics* 30:2 (March 2009): 95; Chang-Tai Hsieh and Zheng Michael Song, *Grasp the Large, Let Go of the Small: The Transformation of the SIE sector in China*, No. w21006 (National Bureau of Economic Research, 2015), Table 1; David Audretsch et al., “Ownership, Productivity and Firm Survival in China,” *Economia E Politica Industriale* 43(1) (2016): 67-83.

<sup>333</sup> *Enterprise Bankruptcy Law of the People’s Republic of China* (adopted by NPC on August 27, 2006, Order No. 54, effective June 1, 2007).

of private enterprises, foreign enterprises, and Sino-foreign joint ventures.<sup>334</sup> The Chinese government also formally ended the system of “policy-led” bankruptcies, with all SIE bankruptcy cases henceforth to be conducted pursuant to the *EBL*.<sup>335</sup> In a departure from the “policy-led” bankruptcy model, the *EBL* rearranges the order in which claims are ranked, such that creditors are placed ahead of workers.<sup>336</sup>

While the *EBL* made certain improvements,<sup>337</sup> bankruptcy in China still faces several institutional issues. The foremost problem is the government’s *ad hoc* approach to the business exit of SIEs. In spite of the poor performance of the SIE sector and the proliferation of “zombie” enterprises, bankruptcies of SIEs since the enactment of the *EBL* are few. Moreover, China’s State Council has acknowledged the serious problem of economically unviable “zombie” enterprises.<sup>338</sup> International institutions have also taken note of this issue in assessments of China’s economy.<sup>339</sup> According to one study, the existence of “zombie” enterprises in a province is correlated with the extent of SOCB operations in that province, one of several indications that banks under government influence act to support “zombie” enterprises.<sup>340</sup> By contrast, studies find that the private sector has faced harder budget constraints in the wake of the global financial crisis, as manifested in less secure lines of credit and higher factor input costs.<sup>341</sup>

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<sup>334</sup> Markus Taube and Christian Schmidkonz, *Assessment of the Normative and Policy Framework Governing the Chinese Economy and Its Impact on International Competition*, Final Extended Report for AEGIS Europe (Think!Desk China Research & Consulting, August 13, 2015), 18.

<sup>335</sup> A report filed by the National People’s Congress on August 27, 2006 confirmed the impending elimination of policy-led bankruptcies in conjunction with the *EBL*, so as to eliminate the special treatment of SOEs. In February 2007, six months after the adoption of the *EBL*, MOF then issued a measure asking local financial authorities to submit reports by mid-year 2007 on outstanding cases to be resolved. See the *Notice on Pragmatically Strengthening the Administrative Work for the Policy-Led Closure and Bankruptcy of State-Owned Enterprises* (MOF, Cai Qi [2007] No. 30, issued February 25, 2007); NPC, *Enterprise Bankruptcy Law Amendment and the Enterprise Bankruptcy System* (August 28, 2006).

<sup>336</sup> *EBL*, Article 43, provides that liquidation and bankruptcy fees are ranked ahead of public interest debts. Article 42 defines “public interest debts” to include worker compensation and social welfare fees.

<sup>337</sup> The *EBL* contains provisions on the handling of restructuring plans and debt disposition. The law places the onus upon the debtor or the administrator to submit a restructuring plan to the court within six months of the date the court decides such a plan is needed, while also stipulating favorable conditions for restructuring solutions that would allow a company to emerge from insolvency. *EBL*, Chapter 8.

<sup>338</sup> IMF, *The People’s Republic of China: Selected Issues*, IMF Country Report No. 16/271 (July 2016), 8.

<sup>339</sup> IMF, *2015 Article IV Consultation – Press Release: Staff Report; and Statement by the Executive Director for the People’s Republic of China*, IMF Country Report No. 15/234 (IMF, August 2015), 17. OECD, *OECD Economic Surveys: China*, (Paris: OECD Publishing, 2017), 41.

<sup>340</sup> Yuyan Tan, Yiping Huang, Wing Thye Woo, “Zombie Firms and the Crowding-Out of Private Investment in China,” *Asian Economic Papers* 15(3) (2016): 32-55.

<sup>341</sup> Douglas J. Elliott and Yu Qiao, *Reforming Shadow Banking in China* (The Brookings Institution, May 2015), 2, 6-7.



In exercising discretion over SIE business exit, Chinese government authorities, particularly at the local level, often act on imminent concerns relating to financial stability and unemployment.<sup>342</sup> A survey of four high-profile cases of SIE restructuring between 2014 and 2015 illustrates that indebted SIEs in heavy industries such as steel, shipbuilding, and coal frequently resort to worker layoffs and other restructuring measures, but rarely file for bankruptcy.<sup>343</sup> Defaults remain isolated incidents in spite of the high level of corporate debt in the SIE sector.<sup>344</sup> A 2016 study by a Chinese legal expert identifies the “negative attitude” of local governments as a key factor affecting the practice of enterprise reorganization in China. The study finds that local governments often act on concerns that bankruptcies will result in a decline in the number of publicly listed enterprises in their jurisdiction, or will increase the burden of resettling laid off workers. Consequently, local governments often intervene to preempt bankruptcy cases altogether, or alternatively, attempt to affect the outcome of bankruptcy proceedings by appointing government officials as trustees for insolvent enterprises.<sup>345</sup>

The lack of business exit and default among SIEs reflects the Chinese government’s unwillingness to let SIEs fail, which in turn gives rise to an implicit government guarantee on credit provided to SIEs. Implicit government guarantees result in borrowing costs that are not commensurate with risks and returns, distorting the allocation of resources and promoting inefficiency in the SIE sector and the economy as a whole.<sup>346</sup> It also gives rise to a vicious cycle of continual borrowing and debt accumulation that distorts the financial sector in favor of SIEs.

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<sup>342</sup> Loss-making SOEs may still drive growth in a given jurisdiction and contribute to the local tax base (also indirectly by stimulating demand in corollary sectors and raising the value of land transactions). Maintaining SOEs is also a means to guard against large-scale layoffs; preserve the stability of the banking system; and avoid a drawn-out and uncertain bankruptcy process involving multiple stakeholders. Jianguang Shen, “Dealing with Zombie Companies and Overcapacity in China,” *Economics Weekly* (47) (Mizuho Securities Asia Ltd. Economics Research, November 20, 2015), 3.

<sup>343</sup> *Ibid.*, 5.

<sup>344</sup> In April 2015, Cloud Live Tech Group (002306 CN) announced it would default on a RMB 480 million bond, marking the first time a bond in the Chinese market failed to meet its principal payment. Previously, the only bond default was in March 2014, when Shanghai Chaori Solar Energy Science & Technology failed to meet its principal payment. Jianguang Shen, “First Case of Principal Default in the Bond Market,” *Economics Weekly* (18) (Mizuho Securities Asia Ltd. Economics Research, April 10, 2015), 3. The October 2016 initiation of bankruptcy proceedings for Dongbei Special Steel, an SIE backed by the Liaoning provincial government, attracted widespread attention because of the rare nature of a Chinese state-owned enterprise declaring bankruptcy. The bankruptcy proceedings were only initiated after extensive efforts by the Chinese government authorities to rescue the firm through debt-to-equity swaps. Sidney Leng, “Major Chinese State Steel Maker Starts Bankruptcy Process after Failed Debt-to-Equity Attempt,” *South China Morning Post*, October 13, 2016.

<sup>345</sup> Changyin Han, “The Practice of Reorganization in China,” *Arizona Journal of International & Comparative Law* 33(1) (2016): 280-281.

<sup>346</sup> IMF, *The People’s Republic of China: Selected Issues*, IMF Country Report No. 16/271 (July 2016), 33, 34, and 40.



Both the IMF and the World Bank have found implicit government guarantees to be a significant impediment to efficient business exit in China's economy.<sup>347</sup>

It is noteworthy that China's bankruptcy system does not adequately provide for the insolvency of financial institutions. The OECD has remarked that China's "[f]inancial institutions are still not covered by bankruptcy legislation and their insolvency process follows *ad hoc* rules."<sup>348</sup> Article 134 of the *EBL* appears to preclude financial institutions from self-filing for bankruptcy, leaving this option to the discretion of the regulatory authority.<sup>349</sup> Moreover, the law does not specify which or what type of "corresponding measures" the State Council should formulate when a financial institution is in bankruptcy. Similar to the OECD, the World Bank has found that "[f]inancial market infrastructure is improving but remains challenged: bankruptcy procedures are not widely understood [...]"<sup>350</sup> According to a 2016 research paper by the Shanghai branch of the China Banking Regulatory Commission (CBRC), only four Chinese banks have undergone bankruptcy proceedings, of which three were initiated between 1997 and 1999 and one was initiated in 2005.<sup>351</sup> By comparison, the Federal Deposit Insurance

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<sup>347</sup> See IMF, *2015 Article IV Consultation – Press Release: Staff Report; and Statement by the Executive Director for the People's Republic of China*, IMF Country Report No. 15/234 (August 2015), 16. ("Implicit guarantees are prevalent throughout the financial system, leading to mispricing of risk and misallocation of resources. Breaking this web will introduce greater uncertainty into the financial system and cannot be done overnight. At the same time, the process must start and will involve greater acceptance of defaults, credit events, and bankruptcies. This applies, in particular, to state-owned enterprises (SIEs), which benefit from preferential access to financing supported by a perceived state backing of their liabilities. Such perceptions create an uneven playing field that distorts the allocation of financing toward SIEs, crowds out the private sector, and lowers productivity growth." (emphasis added) See also World Bank, *China 2030: Building a Modern, Harmonious, and Creative Society*, Report No. 96299 (March 2013), 401. "The policies required to establish the renminbi as an international currency will have important implications for China and the world. [...] State-owned enterprises would have to face hard budget constraints, that is, those that become insolvent would have to be allowed to go bankrupt, so that creditors would not be tempted to lend in the expectation that their loans enjoyed an implicit government guarantee." (emphasis added)

<sup>348</sup> OECD, *OECD Economic Surveys: China*, (Paris: OECD Publishing, 2017), 41.

<sup>349</sup> *EBL*, Article 134. ("If any commercial bank, securities firm, insurance company or other financial institutions falls under any of the circumstances set forth in Article 2 of this Law, the financial regulatory authority of the State Council apply for reorganization or bankruptcy liquidation of such financial institution with the People's Court. When adopting such measures as takeover and custody with the financial institutions that have incurred material operational risks, the financial regulatory authority of the State Council may apply to the People's Court for suspending the civil proceedings or execution proceedings where such financial institutions are the plaintiff or the parties against which execution is performed. Where the financial institutions implement bankruptcy, the State Council may formulate implementing measures according to the provisions of this Law and other relevant laws.")

<sup>350</sup> World Bank, *China 2030: Building a Modern, Harmonious, and Creative Society*, Report No. 96299 (March 2013), 396.

<sup>351</sup> Shanghai Banking Regulatory Office Legal Affairs Department Task Group, "Research on the Allocation of Rights for Commercial Bank Bankruptcy Risk Disposal," *Jinrong Jianxue Yanjiu* 10 (2016): 80-81. Available at <http://www.cbrc.gov.cn/chinese/files/2017/B2CAAC5EC34C4780B4D514F75D4848D0.pdf>.

Corporation (FDIC) has recorded over 500 failed banks in the United States since October 2000.<sup>352</sup>

Discretion accorded to the government in the administration of bankruptcy proceedings provides the government with another instrument to influence business exit outcomes of both SIEs and privately-owned enterprises. First, the *EBL* affords courts the discretion to choose which bankruptcy cases to accept.<sup>353</sup> One Chinese legal expert notes that courts in China often lack an incentive to take on bankruptcy cases because “[t]he court’s internal performance evaluation has not formed an encouraging mechanism for bankruptcy hearings.”<sup>354</sup> In addition, the *EBL* contains no regulations governing insolvency of private individuals or sole proprietorships.<sup>355</sup> This gap effectively precludes bankruptcy proceedings for many small businesses, making it more difficult for them to deal with accumulated debts.<sup>356</sup>

For the cases accepted by the courts, the *EBL* also provides that the appointment of bankruptcy administrators be conducted at the court’s discretion.<sup>357</sup> It appears that many bankruptcy trustees lack experience and the system may also not provide rational incentives in establishing trustee remuneration.<sup>358</sup>

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<sup>352</sup> *Failed Bank List*, (Federal Deposit Insurance Corporation, available at <https://www.fdic.gov/bank/individual/failed/banklist.html>).

<sup>353</sup> *EBL*, Article 10.

<sup>354</sup> Changyin Han, “The Practice of Reorganization in China,” *Arizona Journal of International & Comparative Law* 33(1) (2016): 282.

<sup>355</sup> Markus Taube and Christian Schmidkonz, *Assessment of the Normative and Policy Framework Governing the Chinese Economy and Its Impact on International Competition*, Final Extended Report for AEGIS Europe (Think!Desk China Research & Consulting, August 13, 2015), 239.

<sup>356</sup> A 2017 CCP document acknowledges this issue. See CCP Central Committee United Front Work Department, *Recommendations on Establishing a Bankruptcy System for Individuals* (April 18, 2017). (The document acknowledges that China does not have a bankruptcy system for individuals and that entrepreneurs are often asked to assume joint responsibility for the company’s debt liability, and as a result, a large number of entrepreneurs shoulder heavy debts from which they are unable to separate themselves, which seriously impedes the process of self-correction between enterprises and the market. The document concludes that it has become increasingly urgent to implement a bankruptcy system for private individuals.)

<sup>357</sup> *EBL*, Article 22. See also Filip Moerman, Marc Grey, and George A. Bongartz, *The New Chinese Bankruptcy Law, Restructuring Newsletter* (Cleary Gottlieb Steen & Hamilton LLP, Spring 2007), sequential page 2 [source not paginated]. (“Another important feature of the [*EBL*] is that once the court has accepted the bankruptcy filing, the court will appoint an administrator to take over the debtor’s property and manage its affairs. While there is no provision for a debtor-in-possession, a debtor may request the court to permit it to continue to manage the debtor’s property under the supervision of the administrator. The [*EBL*], however, does not specify whether management returns once the debtor has reorganized. The [*EBL*] does not itself specify who will be eligible to serve as administrator. It only provides that the Chinese Supreme Court will determine eligibility as well as compensation at a later point.”)

<sup>358</sup> Changyin Han, “The Practice of Reorganization in China,” *Arizona Journal of International & Comparative Law* 33(1) (2016): 282.

According to the OECD's 2017 review of China's economy, "[a] major obstacle to getting rid of public zombie enterprises is the obstruction of the insolvency process by the insolvency manager for fear of state asset embezzlement."<sup>359</sup> The OECD further states:

Asset disposal has made little progress between 2012 and 2015, with central SOEs controlled by SASAC shedding assets worth RMB 108 billion, equivalent to only 1.6% of the total. Stripping off assets is quite complicated as the suspicion of State asset embezzlement always looms large. The target of 345 zombie firms to be closed by SASAC in the coming three years appears rather modest given that it controls around 40 000 firms and that most zombies are SOEs. As SOEs expand internationally, destination countries place increased scrutiny on transactions involving SOEs to assess the potential anti-competitive effects in their markets.<sup>360</sup>

In addition to the institutional problems discussed above, the lack of efficiency of China's bankruptcy administration in China also effectively undermines the protection available to creditors. OECD statistics, using the World Bank *Doing Business* database, show that insolvency procedures in China lag behind major OECD economies.<sup>361</sup> A key impediment is inadequate staffing of local courts.<sup>362</sup> As the OECD has noted, one consequence of lengthy and uncertain insolvency procedures is that creditors are hesitant to participate in the reorganization of debtor enterprises, even if this approach would be conducive to recouping outstanding debts.<sup>363</sup>

At its Central Economic Work Conference in December 2015, the CCP decided to accelerate the business exit of "zombie" companies.<sup>364</sup> Beginning in 2016, the Chinese government took steps to implement this decision and facilitate more bankruptcy proceedings. In August 2016, the Supreme People's Court also set up a website for the first time to allow creditors to register bankruptcy applications and for courts to release information on pending bankruptcy cases. Statistics show a 54% year-on-year increase in accepted bankruptcy cases between 2015 and

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<sup>359</sup> OECD, *OECD Economic Surveys: China*, (Paris: OECD Publishing, 2017), 41.

<sup>360</sup> *Ibid.*, 46.

<sup>361</sup> In a score that reflects the time, cost and outcome of insolvency proceedings involving domestic entities as well as the strength of the legal framework governing judicial liquidation and reorganization, China scores just above 50 out of 100, well behind other major economies such as Russia, France, the United Kingdom, the United States, South Korea, Germany, and Japan. OECD, *OECD Economic Surveys: China*, (Paris: OECD Publishing, 2017), 42.

<sup>362</sup> The OECD stated in 2017: "The ongoing reform aiming at specialization of the industry by establishing bankruptcy divisions in intermediate courts in provincial capitals and No. 2 cities in provinces will likely increase the efficiency of case handling. Shenzhen has been a pilot and by July 2016 15 provinces had introduced this new system with nationwide coverage expected by end-year. A simplified procedure for micro- or small enterprises would also work in the same direction." OECD, *OECD Economic Surveys: China*, (Paris: OECD Publishing, 2017), 41-42.

<sup>363</sup> *Ibid.*

<sup>364</sup> *Xinhua Finance Agency*, "Eight Key Words Interpreting China's Central Economic Work Conference," December 22, 2015.

2016, but this growth spurt is not representative of long-term trends.<sup>365</sup> The number of accepted bankruptcy cases declined by more than half between 2005 and 2014, from over 4,000 to approximately 2,000.<sup>366</sup> As discussed in the next section, the increase in bankruptcy proceedings has coincided with an increase in the rate of consolidations among SIEs.

### 3.2. Consolidations of SIEs

Consolidation of state-owned assets through mergers and acquisitions (M&A) has facilitated the expansion of large SIEs and shaped the distribution of SIEs across different sectors. Government policies, as well as government intervention on a case-by-case basis, has guided this consolidation activity. In 1980, the State Council issued a decision to encourage horizontal mergers, which gave rise to the first generation of enterprise groups.<sup>367</sup> The Chinese government-led industry consolidation policies also played a major role in SIE restructuring in the 1990s.<sup>368</sup>

Over the past decade, the Chinese government has issued additional measures that solidify its SIE consolidation policy. The *SASAC Adjustment Opinion* of 2006 contemplates alliances among “powerful state-owned enterprises.”<sup>369</sup> In August 2010, the State Council issued the *Opinions of the State Council on Promoting Enterprise Merger and Restructuring*,<sup>370</sup> which promotes consolidation of enterprises in six industries, most of which are dominated by SIEs, namely the automobile, steel, cement, aluminum, rare earths, and machinery manufacturing industries.<sup>371</sup> A principal objective for M&A set forth in this measure is to:

<sup>365</sup> *Bloomberg News*, “Chinese Leaders Back Bankruptcies for Unwanted Zombie Firms,” March 13, 2017; *Supreme People’s Court Monitor*, “Ramping up China’s Bankruptcy Courts, the Latest Data,” May 18, 2016.

<sup>366</sup> *Bloomberg News*, “Chinese Leaders Back Bankruptcies for Unwanted Zombie Firms,” March 13, 2017; *Supreme People’s Court Monitor*, “Ramping Up China’s Bankruptcy Courts, the Latest Data,” May 18, 2016.

<sup>367</sup> Yong Zhang, *Large Chinese State-Owned Enterprises* (New York: Palgrave MacMillan, 2008), 42-43.

<sup>368</sup> See Chang-Tai Hsieh, and Zheng Michael Song, *Grasp the Large, Let Go of the Small: The Transformation of the SIE sector in China*, No. w21006 (National Bureau of Economic Research, 2015), 7. (“In the steel sector, for example, five large industrial groups were created in the late 1990s and early 2000s, and ownership of the state-owned steel manufacturers was transferred to these groups. Three of these groups are owned by the Chinese central government (the BaoSteel Group, the WuSteel Group, and the AnSteel Group) and two by provincial governments (the Hebei Steel Group and the Shandong Steel Group). In the automobile industry, state-owned automobile companies were consolidated into six state-owned conglomerates, the largest of which is the Shanghai Automobile Industrial Group (SAIC) owned by the municipal government of Shanghai.”)

<sup>369</sup> *Notice of the General Office of the State Council on Forwarding the Guiding Opinion of the SASAC about Promoting the Adjustment of State-Owned Capital and the Reorganization of State-owned Enterprises*, Chapter 2, “Main Policies and Measures,” Article 8 (State Council, Guo Ban Fa [2006] No. 97, issued December 5, 2006).

<sup>370</sup> *Opinions of the State Council on Promoting Enterprise Merger and Restructuring* (State Council, Guo Fa [2010] No. 27, issued August 28, 2010).

<sup>371</sup> The *Opinions of the State Council on Promoting Enterprise Merger and Restructuring* was issued concurrent numerous other structural adjustment policies including, *inter alia*: *State Council Decision on Implementing the “Interim Provisions on Promoting the Structural Adjustment of Industry* (State Council, Guo Fa [2005] No. 40, issued December 2, 2005); *Nonferrous Metals Industry Adjustment and Revitalization Plan* (State Council,

...[P]romote the union, trans-regional merger and restructuring, overseas M&A and investment cooperation among competitive enterprises by focusing on such industries as automobile, steel, cement, machinery manufacturing, electrolytic aluminum and rare earth, so as to improve industrial centralization, promote large-scale and intensive operation, accelerate the development of key enterprises with independent intellectual property rights and famous brands, cultivate a large number of large enterprise groups with international competitiveness, and promote the optimization and upgrading of industrial structure.<sup>372</sup>

The CCPC and State Council's *Guiding Opinion on Deepening Reform of State-owned Enterprises* ("SOE Reform Opinion")<sup>373</sup> of 2015, discussed in more detail below, also calls for accelerated consolidation of enterprises through M&A. Pursuant to the *SOE Reform Opinion*, SASAC in February 2016 stated that it will promote consolidation through additional M&A transactions among central government SIEs on a pilot basis.<sup>374</sup>

Experts have noted the significant extent to which the Chinese government has influenced M&A transactions among large SIEs. In its 2008 *Trade Policy Review* of China, the WTO attributed the steady reduction in SIEs managed by SASAC "mainly" to M&A transactions rather than privatization or other forms of market exit.<sup>375</sup> There was an uptick in SIE M&A activity during the 18th Party Congress – one study identifies at least 16 major "mergers" of central SIEs between 2012 and 2016, of which six were transacted in 2015 and five in 2016 (see **Table 2** below).<sup>376</sup>

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published May 11, 2009); *Steel Industry Adjustment and Revitalization Plan* (State Council, Guo Fa [2009] No. 6, March 20, 2009).

<sup>372</sup> *Opinions of the State Council on Promoting Enterprise Merger and Restructuring*, Section 2.1 (State Council, Guo Fa [2010] No. 27, issued August 28, 2010).

<sup>373</sup> *Guiding Opinion on Deepening Reform of State-owned Enterprises* (CCP Central Committee and State Council, Guo Fa [2015] No. 22, issued August 24, 2015).

<sup>374</sup> Se Yan and Shuang Ding, *China – A Gradual Step Forward for SOE Reform* (Standard Chartered Global Research, February 26, 2016), 2.

<sup>375</sup> WTO, *Trade Policy Review – Report by the Secretariat – China*, WT/TPR/S/199 (April 16, 2008), 93.

<sup>376</sup> Wendy Leutert, *State-owned Enterprise Mergers: Will Less Be More?*, ECFR/197 (European Council on Foreign Relations, November 2016), 5. According to the financial publication Bloomberg News, in the 20 months leading up to September 2016, "the government has announced SIE deals involving 6.9 trillion yuan (\$1 trillion) of assets in what's shaping up to be the biggest overhaul of state-owned companies since the 1990s." *Bloomberg News*, "Why China's \$1 Trillion Merger Makeover Could Fail," September 7, 2016.

**Table 2: Mergers of Central State-owned Enterprises in China, 2012-2016**

Year	Industry	Central state-owned enterprise	Merged into/became
2012	Printing	China Printing Group Corporation	China Reform Holdings Corporation Ltd
2013	Electronics	Caihong Group Corporation	China Electronics Corporation
2013	Grain production and distribution	China Grain & Logistics Corporation	China National Cereals, Oils and Foodstuffs Corporation (COFCO)
2014	Machinery equipment	China National Erzhong Group Corporation	China National Machinery Industry Corporation (Sinomach)
2014	Food production and distribution	China Huafu Trade & Development Corporation	China National Cereals, Oils and Foodstuffs Corporation (COFCO)
2015	Rail equipment	- CNR Corporation - CSR Corporation	China Railway Rolling Stock Corporation (CRRC)
2015	Energy (Production)	- China Power Investment Corporation (CPI) - State Nuclear Power Technology Corporation (SNPTC)	State Power Investment Corporation
2015	Shipping	- China Ocean Shipping Group Corporation (COSCO) - China Shipping Group Company	China COSCO Shipping Corporation Ltd
2015	Metals	China Metallurgical Group Corporation	China Minmetals Corporation
2015	Energy (Logistics)	Zhuhai Zhenrong Company	Nam Kwong (Group) Company Ltd
2015	Energy (Logistics)	Sinotrans & CSC Holdings Company Ltd	China Merchants Group Company Ltd
2016	Textiles	Chinatex Corporation	China National Cereals, Oils and Foodstuffs Corporation (COFCO)
2016	Travel Services	China International Travel Services Group	China National Travel Service (HK) Group
2016	Metals	Wuhan Iron and Steel Corporation	Shanghai Baosteel Group Corporation
2016	Construction materials	- China National Building Materials Group Corporation (CNBM) - China National Materials Group Corporation Ltd (Sinoma)	China Construction Materials Group
2016	Cotton production and distribution	China National Cotton Reserves Corporation	Sinograin

Source: Adapted from Wendy Leutert, *State-owned Enterprise Mergers: Will Less Be More?* ECFR/197 (European Council on Foreign Relations, November 2016), 5.

Scholars have suggested that the government at times pressures enterprises to participate in M&A transactions. A 2013 legal study notes an “evolving dynamic” by which national, state-owned business groups purchase smaller SIEs at the province- and sub-province-level, subject to pressures exerted by the Chinese government.<sup>377</sup> As part of *Article IV Consultations* in 2016, the

<sup>377</sup> See Liwen Lin and Curtis Milhaupt, “We are the (National) Champions: Understanding the Mechanisms of State Capitalism in China,” *Stanford Law Review* 65(4) (May 2013): 725-726. (“Initially, local governments sought investment from the national groups to rescue moribund local SOEs. As the national groups expanded, local governments began to view them as competitive threats to local businesses. Local protectionism increased, and a push was made to create “provincial champions.” The relationship between national and local groups appears to be in flux again because of the global financial crisis, which prompted renewed central-local cooperation. The local governments now view the national champions as sources of support for small and midsize enterprises, which suffered when they lost the backing of foreign and private companies. For the national groups, which are under pressure from their governmental supervisors to grow, tie-ups with local groups are an avenue of expansion.”)



IMF recommended that mechanisms for enterprise restructuring in China be “market-based, rather than relying on *forced mergers* between weak and strong firms” (emphasis added).<sup>378</sup> The broader regulatory framework governing M&A in China also illustrates how such transactions serve high-level policy objectives, such as promoting structural adjustment and shedding excess capacity. (See Factor 5.A. for further discussion.)

### 3.3. State Enterprise Groups

As part of its management of SIEs, the Chinese government has pursued an objective to create “national champions.” These often take the form of large enterprise groups under government ownership and control (“state enterprise groups,” or SEGs).<sup>379</sup> The State Council has stated that by developing large SEGs, China “can reap economies of scale, invest heavily in research and development, undertake overseas investment, and ultimately compete internationally as modern transnational corporations.”<sup>380</sup> The use of control pyramids allows SEGs to meet these government policy directives by quickly growing in scale through increased reliance on private capital without diluting government control.<sup>381</sup>

Many of the central SIEs managed by SASAC constitute SEGs. When SASAC was established in 2003, it took charge of roughly 200 of the most important non-financial SIEs.<sup>382</sup> Subsequently, the number of SIEs managed by SASAC has declined, to 102 as of 2017.<sup>383</sup> These remaining SIEs are now among the largest enterprises in their sectors, both in China and worldwide.

Government policy has played an important role in fostering the emergence of large SEGs. SEGs are organized under the *Circular of the State Administration for Industry and Commerce on Printing and Issuing the Interim Regulations for Administration of Registration for Enterprise Groups* (“*Enterprise Group Rules*”),<sup>384</sup> which were issued by the State Administration of

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<sup>378</sup> IMF, *2016 Article IV Consultation – Press Release: Staff Report; and Statement by the Executive Director for the People’s Republic of China*, IMF Country Report No. 16/270 (August 2016), 20.

<sup>379</sup> Wendy Leutert, “Challenges Ahead in China’s Reform of State-owned Enterprises,” *Asia Policy* 21 (January 2016), 85.

<sup>380</sup> Dylan Sutherland and Lutao Ning, “The Emergence and Evolution of Chinese Business Groups: Are Pyramidal Groups Forming?” in *State Capitalism, Institutional Adaptation, and the Chinese Miracle*, eds. Barry Naughton and Kellee S. Tsai (New York: Cambridge University Press, 2015), 141.

<sup>381</sup> *Ibid.*, 151.

<sup>382</sup> Sarah Y. Tong, “Corporate Governance of China’s SOEs and CAEs,” in *China into the Hu-Wen Era: Policy Initiatives and Challenges*, eds. John Wong and Hongyi Lai (Hackensack: World Scientific Publishing, 2006), 270.

<sup>383</sup> *List of Central State-owned Enterprises* (SASAC website, available at <http://www.sasac.gov.cn/n86114/n86137/index.html>, accessed July 14, 2017).

<sup>384</sup> *Circular of the State Administration for Industry and Commerce on Printing and Issuing the Interim Regulations for Administration of Registration for Enterprise Groups* (SAIC, Gong Shang Qi Zi [1998] No. 59, issued April 6,

Industry and Commerce in 1998 concurrent with government policies to restructure the SIE sector. Under the *Enterprise Group Rules*, business groups shall have at least two layers: a parent company (the first layer) and at least five controlled subsidiaries (the second layer), with required registered capital of RMB 50 million for the parent company and exceeding RMB 100 million for the parent company and controlled subsidiaries combined.<sup>385</sup> Proper registration requires an “Articles of Grouping” that specifies the business group’s boundaries and internal governance rules.<sup>386</sup> According to one legal review study, such standard Articles of Grouping would contain directives for the business to undertake important functions requested by the Chinese government, such as implementing national industrial policies, advising the government in the development of such policies, and implementing national standards.<sup>387</sup> Moreover, business groups qualify for unique benefits such as the eligibility to establish financial subsidiaries and research institutes.<sup>388</sup>

SEGs have far-reaching influence over the means of production in China’s economy. For example, China Guodian Corporation (CGDC) is one of the top-five enterprises in China’s power generation sector.<sup>389</sup> With over 100,000 employees, it owns 16 regional and provincial branch companies, 13 large subsidiaries, two research and development institutes, and 200 power companies spread over 31 provinces.<sup>390</sup> Its subsidiaries include five publicly listed companies. Like many other SEGs, CGDC has operations outside of its core business. For example, CGDC is the majority shareholder for city commercial banks in the Ningxia and Hebei provinces; founded an insurance company; and has investments in securities, trust, and asset management businesses.<sup>391</sup>

The Chinese government is effectively able to exert control over the broader economy with less capital than would otherwise be required for complete government ownership through these

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1998). See also Liwen Lin and Curtis Milhaupt, “We are the (National) Champions: Understanding the Mechanisms of State Capitalism in China,” *Stanford Law Review*, Volume 65(4) (May 2013): 715.

<sup>385</sup> *Circular of the State Administration for Industry and Commerce on Printing and Issuing the Interim Regulations for Administration of Registration for Enterprise Groups*, Article 5 (SAIC, Gong Shang Qi Zi [1998] No. 59, issued April 6, 1998).

<sup>386</sup> *Ibid.*, Article 6.

<sup>387</sup> Liwen Lin and Curtis Milhaupt, “We are the (National) Champions: Understanding the Mechanisms of State Capitalism in China,” *Stanford Law Review* 65(4) (May 2013): 730.

<sup>388</sup> *Ibid.*, 717-718.

<sup>389</sup> Todd J. Edwards, “China’s Power Sector Restructuring and Electricity Price Reforms,” *Asia Papers* 6(2) (Brussels Institute of Contemporary China Studies, January 18, 2012): 17-20.

<sup>390</sup> See CGDC website, available at [www.cgdc.com.cn/](http://www.cgdc.com.cn/), accessed September 13, 2017.

<sup>391</sup> Nicholas Lardy, *Markets Over Mao: The Rise of Private Business in China*, (Washington, DC: Peterson Institute for International Economics, 2014), 51.

“control pyramids,”<sup>392</sup> in which SASAC controls a group of enterprises, each of which in turn controls its own subsidiaries.<sup>393</sup> While control pyramids exist in other economies,<sup>394</sup> they are especially prevalent in China’s economy, where the control pyramids managed by SASAC operate in many of the major industries.<sup>395</sup> As discussed in more detail below, given the relationship between the CCP, the state and state-owned assets in China, the result is that these corporate structures allow the Chinese government and the CCP to exert control over large segments of China’s economy, influencing economy-wide resource allocation, rates of innovation, and economic growth.<sup>396</sup>

Control pyramids permit the Chinese government to diversify SIE ownership and to profit from public listings of SIEs, without relinquishing meaningful control over SIE decision-making. The Chinese government maintains a controlling stake in listed firms, while minority shareholders have only limited influence.<sup>397</sup> In addition to control pyramids, contractual and equity linkages among SIEs serve as a means for the Chinese government to influence not only the decisions of individual SIEs, but also the manner in which various SIEs interact in China’s economy.<sup>398</sup>

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<sup>392</sup> Dylan Sutherland and Lutao Ning, “The Emergence and Evolution of Chinese Business Groups: Are Pyramidal Groups Forming?” in *State Capitalism, Institutional Adaptation, and the Chinese Miracle*, eds. Barry Naughton and Kellee S. Tsai (New York: Cambridge University Press, 2015), 103-106. For example, a first-tier enterprise is 49% financed by outside shareholders and 51% by a single controlling shareholder. In lower tiers, a similar relationship holds, so as we move down the tiers of the control pyramid, at each new tier new firms will be increasingly financed by outside shareholders, while control still lies at the apex firm. So, in the second tier, 74% of the firms are financed by outside shareholders and in the third this rises to 85.25%. If lower ownership shares are required to lock in control, which could be as low as 10%, external shareholders can rapidly be responsible for financing the business group’s expansion. For a generally discussion of pyramid groups, see Liwen Lin and Curtis Milhaupt, “We are the (National) Champions: Understanding the Mechanisms of State Capitalism in China,” *Stanford Law Review* 65(4) (May 2013), 717.

<sup>393</sup> Dylan Sutherland and Lutao Ning, “The Emergence and Evolution of Chinese Business Groups: Are Pyramidal Groups Forming?” in *State Capitalism, Institutional Adaptation, and the Chinese Miracle*, eds. Barry Naughton and Kellee S. Tsai (New York: Cambridge University Press, 2015), 103-106.

<sup>394</sup> Rafael La Porta et al., “Corporate Ownership around the World,” *Journal of Finance* 54(2) (1999): 497.

<sup>395</sup> Dylan Sutherland and Lutao Ning, “The Emergence and Evolution of Chinese Business Groups: Are Pyramidal Groups Forming?” in *State Capitalism, Institutional Adaptation, and the Chinese Miracle*, eds. Barry Naughton and Kellee S. Tsai (New York: Cambridge University Press, 2015), 104.

<sup>396</sup> Randall Morck, Daniel Wolfenzon, and Bernard Yeung, “Corporate Governance, Economic Entrenchment, and Growth,” *Journal of Economic Literature* 43 (2005): 655-720.

<sup>397</sup> Dylan Sutherland and Lutao Ning, “The Emergence and Evolution of Chinese Business Groups: Are Pyramidal Groups Forming?” in *State Capitalism, Institutional Adaptation, and the Chinese Miracle*, eds. Barry Naughton and Kellee S. Tsai (New York: Cambridge University Press, 2015), 139-140. (Pyramidal ownership “provide[s] an ingenious solution for group insiders wishing to socialize the risk of their business group expansion plans.”)

<sup>398</sup> See Liwen Lin and Curtis Milhaupt, “We are the (National) Champions: Understanding the Mechanisms of State Capitalism in China,” *Stanford Law Review* 65(4) (May 2013): 723-724. (“While groups in the same industry do sometimes compete domestically, SASAC has encouraged the national groups to collaborate in overseas projects to increase their global competitiveness. These linkages, often among groups in complementary industries, are designed to facilitate technological development and a host of other objectives, such as information sharing,

#### 4. Government and CCP Influence over the Behavior of SIEs

The Department previously concluded that the constitutional, legal and *de facto* source of authority for governance in China lies with the CCP.<sup>399</sup> There are “eight nominally independent small parties ultimately controlled by the CCP,” such that “no substantial political opposition groups exist” in China.<sup>400</sup> As such, the relatively unique characteristics of the Chinese system of governance require an examination of the CCP’s extensive influence on SIE corporate governance.

##### 4.1. CCP Influence over SIEs

The CCP exercises significant influence over the SIE sector. One form of influence is through the Organization Department under the CCP Secretariat, which appoints individuals to leading positions in the CCP, the government, and the military, as well as in SIEs and other institutions.<sup>401</sup> Scholars have emphasized the institutional continuity between the Organization Department’s work and the *nomenklatura* system that originated in the Soviet Union. Under this system, the CCP maintains a list of individuals whom it may appoint, dismiss, or hold in reserve for important leadership positions, in accordance with an intricate ranking system.<sup>402</sup> An economist notes that, while there are regulations that specify appointment powers for SASAC:

...in practice, this is an extremely sensitive and complex issue. The Communist Party of China in fact exercises nearly complete control over personnel decisions throughout the SIE sector. The system, copied from the Soviet Union but still fully in use in China today, requires Communist Party committees to make

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marketing, and pooling of capital for capital-intensive projects. [...] [T]hese linkages typically take two forms: equity joint ventures and contractual alliances. In most economies, these forms of collaboration would raise obvious antitrust concerns. China enacted an Antitrust Law in 2008 that, as a formal matter, would appear to subject these alliances (along with mergers and other combinations between SOEs) to antitrust scrutiny. In practice, however, the national enterprises under SASAC supervision have thus far been virtually exempt from antitrust enforcement.”)

<sup>399</sup> Shauna Biby, Christopher Cassel, and Timothy Hruby, *The relevance of the Chinese Communist Party for the limited purpose of determining whether particular enterprises should be considered to be "public bodies" within the context of a countervailing duty investigation*, Memorandum of Proceedings (U.S. Department of Commerce, 2012), 3.

<sup>400</sup> *World Factbook: China* (U.S. Central Intelligence Agency, available at <http://bit.ly/1ivGnuD>, last updated on May 7, 2017, accessed on May 24, 2017).

<sup>401</sup> Richard McGregor, *The Party: The Secret World of China’s Communist Rulers* (New York: HarperCollins, 2010), 49-50 (stating that “the CCP has remained unyielding on a number of fronts. Its control over personnel appointments has been inviolate.”).

<sup>402</sup> See Zheng Yongnian, *The Chinese Communist Party as Organizational Emperor: Culture, Reproduction, and Transformation* (London: Routledge, 2010), 103-104. (“The CCP’s most powerful instrument in structuring its domination over the state is a system called the ‘Party management of cadres’ (*dangguan ganbu*), or more commonly known in the West as the *nomenklatura* system. The *nomenklatura* system ‘consists of lists of leading positions, over which Party units exercise the power to make appointments and dismissals; lists of reserves or candidates for these positions; and institutions and processes for making the appropriate personnel changes.’”)

appointments to a name list, or *nomenklatura* of professional and managerial positions. It is not an exaggeration to say that the political power of the Communist Party is based on its control of job appointments.<sup>403</sup>

The CCP Organization Department can function to discipline and control leaders in both government and business.<sup>404</sup> In so doing, it can blur the line between the state and the private sector, and influence executives in SIEs.<sup>405</sup>

Pursuant to the *Interim Regulation on the Supervision and Administration of State-owned Assets of Enterprises*, SASAC as the managing entity of state-owned assets has the power to appoint SIE managers, board members and Supervisory Board members.<sup>406</sup> In fact, this power is either shared with or superseded by the CCP.<sup>407</sup> Within the *nomenklatura* system, there is a formal division of appointment power between SASAC and the CCP, particularly insofar as the Organization Department has the power to appoint the executives of 53 central SIEs.<sup>408</sup> In turn,

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<sup>403</sup> Barry Naughton, “Top-Down Control: SASAC and the Persistence of State Ownership in China,” Paper presented at the conference on “China and the World Economy,” Leverhulme Centre for Research on Globalisation and Economic Policy (GEP), University of Nottingham, June 23, 2006, 4.

<sup>404</sup> Tony Saich, *Governance and Politics of China* (New York: Palgrave MacMillan, 2011), 123. (“[T]he Central Organization Department and its affiliates play a crucial role in maintaining discipline and adherence to the CCP through their control over member’s personal files, their evaluation of performance and recommendation for promotion. Basically, the Department oversees the CCP’s *nomenklatura* appointments; these cover all senior ministry appointments, senior judicial appointees, heads of major state-owned enterprises, top university presidents, the editor of key party publications and other media, provincial leaders and directors of think tanks.”)

<sup>405</sup> See Carl Walter and Fraser J.T. Howie, *Red Capitalism: The Fragile Financial Foundation of China’s Extraordinary Rise* (Singapore: John Wiley & Sons (Asia) Pte. Ltd., 2011), 24. (“The huge state corporations have adopted the financial techniques of their international competitors and raised billions of dollars in capital, growing to an economic scale never before seen in all of Chinese history. But these companies are not autonomous corporations; they can hardly be said to be corporations at all. Their senior management and, indeed, the fate of the corporation itself, are completely dependent on their political patrons.”). See also Richard McGregor, *The Party: The Secret World of China’s Communist Rulers* (New York: Harper, 2010), 68. (“[W]ith the need to be profitable and compete globally, top executives of state enterprises these days have relative freedom to run their businesses inconceivable a decade ago. But throughout the reform of the sector, the CCP has retained its influence by maintaining power over all senior appointments. Through personnel, they can in turn direct corporate policy.”)

<sup>406</sup> *Interim Regulation on the Supervision and Administration of State-owned Assets of Enterprises*, Article 13 (State Council 2003 Order No. 26, issued May 27, 2003, amended January 8, 2011).

<sup>407</sup> Richard McGregor, *The Party: The Secret World of China’s Communist Rulers* (New York: HarperCollins, 2010), 49-50. (“[T]he CCP has remained unyielding on a number of fronts. Its control over personnel appointments has been inviolate.”)

<sup>408</sup> See Liwen Lin and Curtis Milhaupt, “We are the (National) Champions: Understanding the Mechanisms of State Capitalism in China,” *Stanford Law Review* 65(4) (May 2013): 737-738. (“Party and corporate leadership appointments take place in a highly institutionalized sharing arrangement between the CCP and SASAC. In fifty-three central enterprises, the occupants of top positions, including board chairmen, CEOs, and party secretaries, are appointed and evaluated by the Organization Department of the CCP’s Central Committee. This is a legacy of the appointment practice prior to the establishment of SASAC. Some of these positions hold ministerial rank equivalent to provincial governors and members of the State Council; others hold vice-ministerial rank... While the



CCP influence over SASAC is reinforced by a Party Committee within SASAC.<sup>409</sup> Furthermore, the Local SASACs have express instructions to defer to the CCP in all specific personnel decisions.<sup>410</sup> In general, though, SASAC and Organization Department authorities at the local level jointly appoint the senior executives of local SIEs.<sup>411</sup> For example, the Shanghai SASAC supervises the personnel management of the automotive manufacturer SAIC, and as such, formally appoints SAIC's top executives. Yet, nominees are first recommended by the Shanghai municipal CCP and inspected by the Shanghai CCP Organization Department.<sup>412</sup> SAIC's CEO, President, and Chairman of the trade union are current CCP officials.<sup>413</sup>

One manifestation of the CCP's appointment power is the manner in which high-profile individuals are "shuffled" through postings in business and government. "Shuffling" has two distinct characteristics that underscore how SIE leadership is subject to government direction. First, SIE management can cycle between SIEs and government bodies. For example, the chairman of China National Offshore Oil Corporation was appointed Governor of Hainan Province; the head of China Construction Bank was transferred from the State Administration of Foreign Exchange; and the head of Sinopec came from a senior political post in northeast China.<sup>414</sup> Second, top executives at different SIEs in the same sector may be required to switch positions. Examples of this "executive reshuffling" can be seen in the telecommunications,

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appointments power formally resides with SASAC, appointments are made with input from various party organs and ministries supervising relevant business operations, and are subject to approval by the State Council.")

<sup>409</sup> Barry Naughton, "Top-Down Control: SASAC and the Persistence of State Ownership in China," Paper presented at the conference on "China and the World Economy," Leverhulme Centre for Research on Globalisation and Economic Policy (GEP), University of Nottingham, June 23, 2006, 5.

<sup>410</sup> *State Council General Office Notice on Reissuing the State Council State-owned Asset Supervision and Administration Commission Guiding Opinion on Establishing Municipal (Local) Level People's Government State-owned Asset Supervision and Administration Organizations*, Article 3 (State Council, Guo Ban Fa [2004] No. 84, issued November 26, 2004). See also Article 7. (The notice states that the establishment of municipal (local) level People's Government state-owned asset supervision and administration entities will be administered by Party Committees of provinces, autonomous regions, and municipalities directly under the central government, in accordance with the provisions of relevant central government documents.)

<sup>411</sup> Liu, Fend and Zhang, Linlin, "Executive Turnover in China's state-owned enterprises: Government-oriented or market-oriented?" *China Journal of Accounting Research* (2017), 4. See also Margaret Pearson, "State-Owned Business and Party-State Regulation in China's Modern Political Economy," in *State Capitalism, Institutional Adaptation, and the Chinese Miracle*, eds. Barry Naughton and Kellee S. Tsai (New York: Cambridge University Press, 2015), 40-41.

<sup>412</sup> Yeo, Yukyung and Pearson, Margaret, "Regulating Decentralized State Industries: China's Auto Industry," *The China Review* (8) 2 (2008): 248.

<sup>413</sup> SAIC website, available at [http://www.saicmotor.com/english/company\\_profile/board\\_of\\_directors/index.shtml](http://www.saicmotor.com/english/company_profile/board_of_directors/index.shtml), accessed August 8, 2017.

<sup>414</sup> *China's Emerging Financial Markets Challenges and Global Impact*, eds. Min Zhu, Jinqing Cai, and Martha Avery (Singapore: John Wiley & Sons (Asia) Pte. Ltd., 2009), 149.



airlines, and oil and gas sectors.<sup>415</sup> As one scholar describes: “[M]ore disorienting is the frequent interchange of senior figures in the *nomenklatura* between even competing firms in the same industry, a kind of musical chairs played not just at the very highest level, but at the operational level as well.”<sup>416</sup> *The Economist* notes that these reshufflings serve as a reminder to the managers of the SIE sector that the government is ultimately in charge, noting that “[e]ven the most successful top executives of China’s SOEs are cadres first and company men second. They care more about pleasing their party bosses than about the global market.”<sup>417</sup>

Additionally, vice-CEO positions are to be appointed through the central SASAC’s Party Committee.<sup>418</sup> Senior positions in other enterprises are supposed to be appointed by the SASAC’s personnel bureau, though in reality these appointments are also not free from CCP influence.<sup>419</sup> Similarly, SASACs at the municipal level have been instructed to defer to the CCP in all specific personnel decisions.<sup>420</sup>

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<sup>415</sup> See Erica Downs and Michael Meidan, “Business and Politics in China: The Oil Executive Reshuffle of 2011,” *China Security* 19 (2011): 3. See also Richard McGregor, *The Party: The Secret World of China’s Communist Rulers* (New York: HarperCollins, 2010), 84-89. (“During the first week of April 2011, the [CCP] reshuffled top executives of China’s three major national oil companies (NOCs): China National Offshore Oil Corporation (CNOOC), China National Petroleum Corporation (CNPC) and China Petrochemical Corporation (Sinopec) [...] The oil executive reshuffle was a blatant reminder of the CCP’s control over China’s flagship firms. Unlike the CEOs of companies like ExxonMobil and Shell, the leaders of China’s NOCs are not selected by their boards of directors, outgoing CEOs and other senior managers. Instead, they are nominated by the Organization Department, the secretive human resources division of the CCP, and ultimately approved by the Politburo.”) (emphasis added)

<sup>416</sup> Nicholas Calcina Howson, “China’s Restructured Commercial Banks: Nomenklatura Accountability Serving Corporate Governance Reform?” in *China’s Emerging Financial Markets Challenges and Global Impact*, eds. Min Zhu, Jinqing Cai, and Martha Avery (Singapore: John Wiley & Sons (Asia) Pte. Ltd., 2009), 144.

<sup>417</sup> *The Economist*, “State Capitalism is Not All the Same,” January 2012. (The article states further that “...nobody would apply the term ‘paper tiger’ to the Organization Department. Created by Chairman Mao in 1924, it has become the world’s mightiest human-resources department. It appoints all the senior figures in China Inc. In 2004 it reshuffled the heads of the three biggest telecoms companies. In 2009 it rotated the bosses of the three biggest airlines. In 2010, it did the same to the chiefs of the three biggest oil companies, each of which is a Fortune 500 company.”)

<sup>418</sup> Barry Naughton, “Top-Down Control: SASAC and the Persistence of State Ownership in China,” Paper presented at the conference on “China and the World Economy,” Leverhulme Centre for Research on Globalisation and Economic Policy (GEP), University of Nottingham, June 23, 2006, 5.

<sup>419</sup> *Ibid.*

<sup>420</sup> *Ibid.*, 5-6, citing *Guiding Opinions on Setting up State Asset Supervision and Management Organs at the Level of the Municipal (prefectural) Peoples Government* (stating that municipal SASACs shall uphold the principle that the CCP manages cadres (*i.e.*, managers), perfect the cadre management system, and guarantee that the local party committee strengthens its management of the responsible personnel at important key point SOEs in the locality).

The CCP's appointment power appears to influence SIE operations. As one source explains, the CCP "can intervene for any reason, changing CEOs, investing in new projects or ordering mergers," regardless of the laws that are in place.<sup>421</sup>

A 2017 OECD report highlights the corporate governance problems created by this appointment system:

"[a] major link between business and politics is the appointment system and the intertwined career paths in the public administration and the SOE system, where progress has so far been modest... Sometimes SOE managers appear to fare worse than their private peers in profit maximisation or raising the market value of the firm but those may not be their primary goals, which include public policy objectives."<sup>422</sup>

Party influence is reinforced by the existence of Party Committees that exercise a stronger influence over enterprise decisions. According to the *Company Law*, an organization of the CCP may be set up in all enterprises, regardless of whether it is a state, private, domestic or foreign-invested enterprise, to carry out activities of the Chinese Communist Party.<sup>423</sup> Party committees in SIEs, are subsequently subject to party discipline and control.<sup>424</sup> The *CCP Constitution* states that in SIEs, the CCP committee (referred to as the CCP "primary party organization"):

guarantees and oversees the implementation of the principles and policies of the Party and the state in its own enterprise and backs the meeting of shareholders, board of directors, board of supervisors and manager (factory director) in the exercise of their functions and powers according to law... and participates in making final decisions on major questions in the enterprise.<sup>425</sup>

While there is a lack of transparency regarding the precise role Party Committees play in enterprise decision-making, studies have found their influence to be substantial, particularly in SIEs. A 2010 OECD report notes that Party committees in SIEs "often play an active role in

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<sup>421</sup> Carl Walter and Fraser J.T. Howie, *Red Capitalism: The Fragile Financial Foundation of China's Extraordinary Rise* (Singapore: John Wiley & Sons (Asia) Pte. Ltd., 2011), 24.

<sup>422</sup> OECD, *OECD Economic Surveys: China*, (Paris: OECD Publishing, 2017), 44.

<sup>423</sup> *Company Law*, Article 19. (The article states that the Chinese Communist Party may, according to the Constitution of the Chinese Communist Party, establish its branches in companies to carry out activities of the Chinese Communist Party and that the company shall provide necessary conditions to facilitate the activities of the CCP.)

<sup>424</sup> Nicholas Calcina Howson, "China's Restructured Commercial Banks: Nomenclatura Accountability Serving Corporate Governance Reform?" in *China's Emerging Financial Markets Challenges and Global Impact*, eds. Min Zhu, Jinqing Cai, and Martha Avery (Singapore: John Wiley & Sons (Asia) Pte. Ltd., 2009), 142. ("The CCP Committee in any bank or other SOE is in turn subject to control by the CCP system (as contrasted with the state and military), with appointments to enterprise-level Party committees governed by Party personnel appointments.")

<sup>425</sup> *CCP Constitution*, Article 32.

human resources and the strategic decision making of the enterprise.”<sup>426</sup> Other survey evidence confirms the active role of party committees in many SIEs.<sup>427</sup>

The formal parallel structure within SIEs, wherein corporate and CCP leaders operate side-by-side affects the independence of corporate board decisions. As one recent examination states:

In particular, the widespread joint appointment of board chairman and party secretary undermines outside investors’ confidence in boards of directors. Specifically, it implies that the board’s independent decision-making authority may be subject to influence by the CCP committee, suggests the possibility of political priorities trumping profit maximization, and underscores the state’s predominant authority to shareholders already wary about protection of their interests.<sup>428</sup>

The role of Party Committees also extends to private enterprises. Cheng Li, a leading scholar on the CCP based at the Brookings Institution, notes that the linkages between the private sector and the CCP became tighter as a consequence of the “Three Represents” policy, which combines an official acceptance of private entrepreneurs with active efforts to recruit them into the CCP.<sup>429</sup> According to China’s official Xinhua News Agency, 51.8% of all non-state firms had in-house CCP cells in 2015.<sup>430</sup> At least one observer has noted that there has been a concerted effort to establish Party committees in private enterprises, with occasional cash incentives for those CCP

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<sup>426</sup> OECD, *OECD Economic Surveys: China 2010* (Paris: OECD Publishing, 2010), 116.

<sup>427</sup> Victor Nee and Sonja Opper, “On Politicized Capitalism,” in *On Capitalism*, eds. Victor Nee and Richard Swedberg (Stanford: Stanford UP, 2007), 120. (“An in-depth study of state involvement of listed corporations finds persisting party interference in almost all domains of the firms’ activity, with party committees exercising an even stronger influence in the firm than government bureaus. Local party committees exert the most control in personnel decisions, especially the selection of managers of departments, branches, and subsidiaries, and the selection and dismissal of vice chief executive officers. In essence, party involvement concentrates on personnel issues, which have been a central focus of the *nomenklatura* system for decades of socialist planning. The fact that local party units tend to have a high level of involvement in decisions assigned de jure to the enterprise manager suggests that they may use the manager’s office as their venue for interventionist activities. Party influence with the firm may be even stronger if the CEO is actively involved in the CCP and holds a party office. Particularly in large- and medium-sized firms, management positions are often filled by politically active members of the CCP.”)

<sup>428</sup> Wendy Leutert, “Challenges Ahead in China’s Reform of State-Owned Enterprises,” *Asia Policy* 21 (January 2016), 95.

<sup>429</sup> See Cheng Li, “China’s Communist Party State: The Structure and Dynamics of Power,” in *Politics in China: An Introduction*, ed. William A. Joseph (Oxford: Oxford University Press, 2010), 205. (“[F]or the last decade or so, the CCP has actively sought to recruit members from groups that only came into existence with the market reforms, the so-called new social strata, which includes, among others, private entrepreneurs (‘Red Capitalists’), technical personnel and managers in private firms and foreign-funded enterprises [...]”) See also 209. (“The rise of private entrepreneurs in terms of political influence can be traced to July 2001, when then-CCP General Secretary Jiang Zemin gave an important speech on the anniversary of the CCP’s founding. [...] Jiang’s so-called “Theory of the Three Represents” was an ideological justification for the priority given to the private sector in China’s economic development and for allowing entrepreneurs to be members of the [CCP].”)

<sup>430</sup> *Xinhua News Agency*, “Authorized Announcement: 2015 Annual Chinese Communist Party Statistics Report,” June 30, 2016.

members who achieve this.<sup>431</sup> The presence of Party Committees can constrain overall decision-making of private firms.<sup>432</sup> According to one study, “membership in the CCP is often regarded as a minimum requirement for a career as professional managers – particularly in SOEs, and *in private firms that exceed a certain size and influence.*” (emphasis added)<sup>433</sup> According to recent reports, the CCP is also writing itself into the articles of association of large enterprises.<sup>434</sup>

#### 4.2. SIEs as Instruments of State Industrial and Macro-Stabilization Policies

SIEs are recipients of policy preferences, but in turn must carry out a wide range of policy objectives.<sup>435</sup> As noted above, SIEs have a legal mandate to preserve a leading role for the SIE sector in China’s economy, and as such, respond to social, economic, and political objectives set by the state. As a manager of one of China’s largest SIEs has acknowledged:

As a unique kind of economic organization, SOEs are different from the CCP or administrative departments, in that they have to create material wealth and compete in the market place. They are also

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<sup>431</sup> Richard McGregor, *The Party: The Secret World of China’s Communist Rulers* (New York: HarperCollins, 2010), 32. (“When the allure of the elite network is not enough, the CCP tosses money into the mix. To attract private entrepreneurs into the club, the CCP offers cash incentives for business leaders and workers who sign up new members.”) See also Jun Du and Sourafel Girma, *Red Capitalists: Political Connections and the Growth and Survival of Start-up Companies in China*, University of Nottingham Research Paper Series – China and the World Economy, Research Paper 2007/40 (2007), 4-5.

<sup>432</sup> Regina M. Abrami, William C. Kirby, and F. Warren McFarlan, “Why China Can’t Innovate,” *Harvard Business Review* (March 2014). Based on discussions with private business owners, Richard McGregor notes that the stated purpose of the CCP Committee in a private enterprise can range from a formality, to the formation of a study group, to providing “ethical” and “spiritual” guidance. However, McGregor notes that “left unstated by all the entrepreneurs was the fundamental reason for the CCP’s interest in the private sector. The CCP’s presence [...] was more than just a monitoring device. It was a kind of political insurance policy [...] to be activated in a crisis.” Richard McGregor, *The Party: The Secret World of China’s Communist Rulers* (New York: HarperCollins, 2010), 216-217.

<sup>433</sup> Victor Nee and Sonja Opper, “On Politicized Capitalism,” in *On Capitalism*, eds. Victor Nee and Richard Swedberg (Stanford: Stanford University Press, 2007), 109.

<sup>434</sup> See Jennifer Hughes, “China’s Communist Party Writes Itself into Company Law,” *Financial Times*, August 15, 2017. (“More than 30 Hong Kong-listed state-owned enterprises, representing more than \$1tn in market capitalisation, have this year added lines to their central documents that place the CCP, rather than the Chinese state, at the heart of each group. New phrases injected into the articles of association in recent months include describing the CCP as playing a core role in ‘an organised, institutionalised and concrete way’ and ‘providing direction [and] managing the overall situation’. [...] Companies acknowledging the role of the CCP range from state oil group Sinopec and ICBC, the world’s largest bank by assets, to steel and energy groups as well as leading brokers including Haitong Securities. The articles of association for China Railway Group, one of the country’s biggest construction groups, now state that ‘when the board of directors decides on material issues, it shall first listen to the opinions of the CCP committee of the company’.”)

<sup>435</sup> World Bank, *China 2030: Building a Modern, Harmonious, and Creative Society*, Report No. 96299 (March 2013), 26. (State enterprise management and government officials usually support each other - management often accepts informal guidance from government officials and, in return, “state enterprises are more likely to enjoy preferential access to bank finance and other important inputs, privileged access to business opportunities, and even protection against competition.”)

different from enterprises under other forms of ownership, for they assume not only basic economic responsibilities, but also important political and social responsibilities. SOEs are considered a potent mechanism for the government to implement national policies while being the reliable instrument for the country to cope with major economic risks.<sup>436</sup>

Beyond their role of carrying out industrial policy objectives, SIEs in recent years have also been used to implement the government's macro-stabilization policies, by driving investment and maintaining economic growth.<sup>437</sup> This macro-stabilization role has required substantial low-return investments that have increased the debt burden and financial strain on SIEs.<sup>438</sup>

Although the CCP outlined in its *Third Plenum Decision* measures to implement its objective of comprehensively deepening reforms, primarily SIE reforms, the CCP has increasingly made clear that it has prioritized short-term stability and growth via economic stimulus, at the expense of fundamental reform and change. The government pursuing the route of stimulating the economy beyond its underlying growth potential necessarily is at odds with the Chinese government and the CCP's stated objectives of reforming the SIE sector to allow the market to play a more decisive role.<sup>439</sup>

The "leading role" for the SIE sector in China is reflected in the disproportionate allocation of resources that SIEs receive relative to other types of enterprises. Many sources, including the IMF and the OECD, have concluded that China's SIEs receive preferential access to financing from state-owned commercial banks.<sup>440</sup> SIEs also receive preferential access to important inputs

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<sup>436</sup> Zhou Xinmin, *Core Capability of Leaders, Exploration and Practice of China's State-Owned Enterprises* (East West Discovery Press, 2007), 7.

<sup>437</sup> Batson, Andrew, "Villains or Victims? The Role of SOEs in China's Economy," *China Economic Quarterly*, June 2016, 7.

<sup>438</sup> *Ibid.*

<sup>439</sup> Naughton, Barry, "Supply-Side Structural Reform: Policy-Makers Look for a Way Out," *China Leadership Monitor*, March 2016, 2.

<sup>440</sup> See, e.g., IMF, *People's Republic of China Sustainability Report 2011* (November 23, 2011), 10 ("With interest rates being held below market levels, loan demand has long been high and banks have been forced to ration credit. In these circumstances, banks have preferred to lend to SOEs that benefit from implicit state guarantees."); The Economist Intelligence Unit, *Country Finance: China* (July 1, 2010), 55 ("The five large state-owned commercial banks continue to dominate the lending market, with a combined market share of over 50%. Despite official orders to transform themselves into truly commercial banks, they continue to lend much of their portfolios to the state-owned enterprises (SOEs)."); OECD, *OECD Economic Surveys: China*, (Paris: OECD Publishing, 2010), see also 54, 56. ("Even so, as discussed in Chapter 3, commercial banks are not yet generally pricing loan risk efficiently and lending remains biased towards SOE. This highlights another important difficulty with using quantity-based tools to implement monetary policy. Because SOEs still have preferential access to bank finance, a reduction in credit growth, for example, typically falls disproportionately on private-sector firms which, as a group, have been the most productive in China (Chapter 4).") and ("As discussed in detail in Conway et al. (2010), the macro-based evidence of a significant negative relationship between changes in interest rates and capital formation in China is not particularly compelling. The most common and obvious explanation is that state-owned commercial banks are obliged to lend to SOEs that enjoy soft budget constraints, often have their debts forgiven and are therefore insensitive to changes in the price of credit.")

(e.g., land and raw materials) and enjoy other competitive advantages unavailable to private firms.<sup>441</sup>

SIEs also enjoy indirect preferences by constraining private and foreign enterprises that might otherwise present significant competition to SIEs in state-favored industry sectors. A World Bank report confirms that China's economic policies discriminate in favor of larger, state-owned firms, resulting in "over abundant resource flows to (often less efficient SOEs)" and encouraging "Chinese firms to expand simply as a means of gaining policy support." Indeed, China issues official lists which grant SIEs an exclusive or privileged role in certain sectors.<sup>442</sup> This effectively holds back small- and medium-sized enterprises from developing.<sup>443</sup>

#### 4.3. Proposals to "Reform" SIEs

During the 18th Party Congress (2012-2017), the CCP issued policies with the aim of modifying various aspects of government ownership in the economy. The Chinese government has proposed several policies under what it terms "reform" of SIEs.<sup>444</sup> Key guidance for these policies is set forth in the *Third Plenum Decision*.<sup>445</sup> The *Third Plenum Decision* calls for the market to play a "decisive" role in resource allocation.<sup>446</sup> Among the most prominent policies put forward is to "[v]igorously develop... a mixed economy," through, among other means, "allow[ing] more state-owned enterprises (SOEs) and enterprises of other types of ownership to

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<sup>441</sup> World Bank, *China 2030: Building a Modern, Harmonious, and Creative Society*, Report No. 96299 (March 2013), 25.

<sup>442</sup> *Ibid.*, 113.

<sup>443</sup> *Ibid.*, 109. See also Carl Walter and Fraser J.T. Howie, *Red Capitalism: The Fragile Financial Foundation of China's Extraordinary Rise* (Singapore: John Wiley & Sons (Asia) Pte. Ltd., 2011), 8-10. ("... the foreign and non-SIE sectors will be supported only as long as they are critical as a source of jobs (and hence, the all-important household savings), technology and foreign exchange... [today's non-state commercial sector] is there to be used tactically by the CCP and is not allowed to play a dominant role.")

<sup>444</sup> Proposed policies include, *inter alia*, diversifying the ownership of SIEs, the creation of asset management companies, a formal separation between "commercial" and "public welfare" SIEs, improved hiring and compensation mechanisms for corporate executives, greater public disclosure of company information, increased consolidation through mergers and acquisitions, and further securitization of SOE shares. Some of these initiatives are discussed in more detail below. See Wendy Leutert, "Challenges Ahead in China's Reform of State-Owned Enterprises," *Asia Policy* 21 (January 2016): 83-99; Wendy Leutert, *State-owned Enterprise Mergers: Will Less Be More?*, ECFR/197 (European Council on Foreign Relations, November 2016), 3-4; Se Yan and Shuang Ding, *China – A Gradual Step Forward for SOE Reform* (Standard Chartered Global Research, February 26, 2016); Se Yan and Shuang Ding, *China – A Cautious Step Forward for SOE Reform* (Standard Chartered Global Research, October 8, 2015).

<sup>445</sup> *CCP Central Committee Decision on Several Major Issues for Comprehensively Deepening Reform* (adopted by CCPCC at the Third Plenary Session of the 18th National Congress of the CCP on November 12, 2013).

<sup>446</sup> *Third Plenum Decision*.



develop into mixed enterprises.”<sup>447</sup> The *Third Plenum Decision* calls for mixed-ownership to be introduced even at the level of centrally owned enterprises, which are still wholly and directly owned by the state.<sup>448</sup>

#### 4.3.1. Mixed Ownership Proposals

Pursuant to the CCP’s *Third Plenum Decision*, the CCPCC and State Council in 2015 jointly issued the *Guiding Opinion on Deepening Reform of State-owned Enterprises* (“*SOE Reform Opinion*”). It includes more detailed proposals with respect to mixed ownership, including: the reduction in the percentage of state-owned shares (Article 7); in select cases, the conversion of state-owned shares into preferred shares, and establishment of “a national special management share system in a few special fields” (similar to the “golden share” that gives the state veto power in crucial sectors) (Article 7); the distribution of company shares to employees and management (Article 19); and the distribution of state-owned shares to private investors through capital injection, share acquisition, debt-for-equity swaps, and other means (Article 17).<sup>449</sup> The document affords some discretion to sub-central government authorities in implementing these policies.<sup>450</sup>

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<sup>447</sup> *Third Plenum Decision*, Article 6. Pursuant to the *Third Plenum Decision*, the CCP Central Committee and State Council in 2015 jointly issued the *Guiding Opinion on Deepening Reform of State-owned Enterprises* (“*SOE Reform Opinion*”). *Guiding Opinion on Deepening Reform of State-owned Enterprises*, Articles 7, 17, and 19 (CCP Central Committee and State Council, Guo Fa [2015] No. 22, issued August 24, 2015). The Chinese government established corresponding pilot programs in certain sectors and enterprises in 2016. See also Se Yan and Shuang Ding, *China – A Gradual Step Forward for SOE Reform* (Standard Chartered Global Research, February 26, 2016), 2. (“To advance ‘mixed ownership’ reform, SASAC announced in February 2016 that it will advance mixed ownership in the electricity, petroleum, natural gas, railroad, civil aviation, telecommunications and military sectors, introducing multiple diversified investors. SASAC will also experiment with employee shareholding systems for mixed-ownership enterprises.”)

<sup>448</sup> *Ibid.*

<sup>449</sup> *Guiding Opinion on Deepening Reform of State-owned Enterprises*, Article 7, 17, and 19 (CCP Central Committee and State Council, Guo Fa [2015] No. 22, issued August 24, 2015). To advance “mixed ownership” reform, SASAC announced in February 2016 that it will advance mixed ownership in the electricity, petroleum, natural gas, railroad, civil aviation, telecommunications and military sectors, introducing multiple diversified investors. SASAC will also experiment with employee shareholding systems for mixed-ownership enterprises. See Yan and Shuang Ding, *China – A Gradual Step Forward for SOE Reform* (Standard Chartered Global Research, February 26, 2016), 2.

<sup>450</sup> *SOE Reform Opinion*, Article 4, provides that the institution that performs the duties of capital contributor [*i.e.*, SASACs at different levels of government] is responsible for formulating plans to define the functional definition and classification scheme of the enterprises it funds, to be approved by the government authority at its level [*i.e.*, central, province, or sub-province level]. In each region in China, in turn, local authorities of the Chinese government may delineate and dynamically adjust the state-owned enterprise functional types, taking into account actual circumstances. Province-level plans illustrate the degree of variation in province-level. According to government website reports, from December 2013 to November 2014, province-level SASACs in 19 provinces issued roadmaps for state-owned assets and state-owned enterprise reform. Of these documents, some were “opinions on deepening state-owned and state-owned asset reform,” whereas others were “official plans.” Only around one-half of the plans specify timetables and objectives with respect to reform of the mixed ownership system, and specific targets are not uniform. See Xiamen Municipality, *19 Province-Level SASACs State-Owned Asset Reform Roadmaps Concentrate Capital in Strategic and Emerging Industries* (November 12, 2014); Shandong

Analysts have pointed out that mixed-ownership reform is not likely to lead to fundamental changes in the operations or role of SIEs in China's economy unless the CCP is willing to cede control.<sup>451</sup> Mixed ownership may allow for the transfer of productive capital to state-owned firms, but it has not introduced market mechanisms into firms still controlled by the government.<sup>452</sup>

The *Third Plenum Decision* prefaces the mixed ownership proposal by stating that China “must unswervingly consolidate and develop the public economy, persist in the dominant position of public ownership, *give full play to the leading role of the state-owned sector, and continuously increase its vitality, controlling force and influence.*”<sup>453</sup> (emphasis added) The *Third Plenum Decision* also emphasizes that an economy with mixed ownership “improv[es] the amplification function of state-owned capital.”<sup>454</sup> State Council guidelines issued in 2015 to promote mixed ownership reaffirm that state capital should have “the absolute controlling position.”<sup>455</sup>

In addition, the *SOE Reform Opinion* does not appear to mean that SIEs will be privatized. Indeed, as Article 18 of the *SOE Reform Opinion* makes clear, “mixed ownership” also refers to an expansion of government ownership through encouraging state-owned capital to acquire equity in non-public enterprises through various means, including those enterprises in “high-tech industries” and “strategic industries” characterized by “great development potential and strong growth.”<sup>456</sup>

Moreover, diversifying SIE ownership structures is not a new feature of China's economic policy. Enterprises with diverse ownership structures already exist, particularly among the subsidiaries of SIEs managed by SASAC and Local SASACs.<sup>457</sup> Within these entities, the extent

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Province, *16 Provinces Including Jiangsu, Shanghai, Guangdong, and Shandong Unveil Province-Level State-Owned Asset and State-Owned Enterprise Reform Plans* (September 2014).

<sup>451</sup> Curtis J. Milhaupt and Wentong Zheng, *Why Mixed-Ownership Reforms Cannot Fix China's State Sector*, Paulson Policy Memorandum (January 2016), 19-20.

<sup>452</sup> Marshall W. Meyer and Changqi Wu, *Making Ownership Matter: Prospects for China's Mixed Ownership Economy*, Paulson Policy Brief (September 2014), 2.

<sup>453</sup> *Third Plenum Decision*, Chapter 2, Preamble. (emphasis added)

<sup>454</sup> *Ibid.*, Chapter 2, Paragraph 6.

<sup>455</sup> *Xinhua News Agency*, “China Urges SOE Modernization Through Mixed Ownership Reform,” September 24, 2015.

<sup>456</sup> *SOE Reform Opinion*, Article 18.

<sup>457</sup> Furthermore, as implemented, mixed-ownership reforms have often entailed shares being sold to other state-invested enterprises or government-backed funds. For example, in 2015, the provincial state-invested enterprise Jiangxi Salt sold a 47% stake to four outside investors, all four of which were SIEs. David Keohane, “SOE You Think You Can Reform? Mixed-ownership Edition,” *Financial Times*, September 28, 2015.

of government ownership can be difficult to ascertain owing to the manner in which corporate owners in China are classified.<sup>458</sup>

Finally, during the period when the specifics of “mixed ownership” policies were being formulated, the CCP’s senior leadership made a decision to tie compensation of enterprise managers to that of government officials of the same bureaucratic rank. This decision marks a clear step backward in the corporatization and marketization of SIEs.<sup>459</sup> Thus, while the Chinese government has emphasized “separating ownership from control” through asset management companies and other means, the government continues to influence the incentives of corporate managers.<sup>460</sup>

#### 4.3.2. *State-Invested Enterprise Classification Reform*

In addition, under the rubric of “reforming” SIEs, the Chinese government is pursuing a policy to divide SIEs into either “commercial” or “public interest” enterprises.<sup>461</sup> “Commercial” SIEs will be opened to various forms of ownership (with the state variably exercising majority, conditional, or minority shareholdings), operate in “fully competitive” industries, and be evaluated according to competitiveness and profitability.<sup>462</sup> “Public interest” SIEs, on the other hand, will remain under sole ownership of the state, operate predominately in non-competitive industries, and be evaluated according to their ability to deliver quality goods and services reliably and cost-effectively.<sup>463</sup>

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<sup>458</sup> For example, owners classified as “legal persons” may be state entities. See further discussion on enterprise classification below. Marshall W. Meyer and Changqi Wu, *Making Ownership Matter: Prospects for China’s Mixed Ownership Economy*, Paulson Policy Brief (September 2014), 2.

<sup>459</sup> Barry Naughton, “Two Trains Running: Supply-Side Reform, SOE Reform and the Authoritative Personage,” *China Leadership Monitor* 50 (April 2016): 8.

<sup>460</sup> See Donald Clarke, “Central Committee and State Council Issue Document on State-owned Enterprise Reform,” *Chinese Law Professor Blog*, September 21, 2015. (“[O]wnership and control necessarily are now, have always been, and always will be, separated in SOEs. If SOEs are not performing properly, it is not because ownership and control are insufficiently separate. It is because management does not have the right set of incentives that align their interests with those of the state owner.”)

<sup>461</sup> *SOE Reform Opinion*, Article 4.

<sup>462</sup> *SOE Reform Opinion*, Article 5. See also Se Yan and Shuang Ding, *Global Research, China – A Cautious Step Forward for SOE Reform* (Standard Chartered Global Research, October 8, 2015), 6-7. (“The guidelines also call for profit-oriented SOEs to introduce corporate and shareholding systems and make full use of public listings. Market-oriented companies should have an open equity structure, and each company should outline its own strategy.”)

<sup>463</sup> *SOE Reform Opinion*, Article 6. Subsequently, in December 2015, SASAC, MOF and NDRC issued the *Guiding Opinion on the Functional Definition and Classification of State-owned Enterprises (SOE Classification Opinion)*. Consistent with the *SOE Reform Opinion*, which provides that “commercial” SIEs and “public interest” SIEs are independent market entities, and therefore their business operation mechanisms must meet the requirements of the market economy. *Guiding Opinion on the Functional Definition and Classification of State-owned Enterprises*, Section 1, Paragraph 4 (SASAC, MOF, NDRC, issued December 30, 2015). SASAC and Ministry of Finance released a corresponding *Implementation Plan for Optimizing the Function Classification and Evaluation of Central State-owned Enterprises (SOE Classification Plan)* for central-level SIEs in August 2016. See also *Notice on Issuing*

In December 2015, SASAC, MOF, and NDRC issued the *Guiding Opinions on the Functional Definition and Classification of State-owned Enterprises* (“2015 SOE Classification Opinion”), which accords “commercial” and “public welfare” SIEs a degree of independence consistent with a “market economy.” However, immediately following this provision it states that “commercial SOEs and SOEs in public welfare nature shall conscientiously serve national strategies and take the initiative to fulfill social responsibilities.”<sup>464</sup> In other words, both types of SIEs, even commercial SIEs nominally designated for competitive, market-driven sectors, are required to fulfill national objectives set by the government. There is not yet a clear indication that the “commercial” versus “public welfare” classification system is a basis for full divestiture of state share-holdings. Rather, the *2015 SOE Classification Opinion* aims to make state-invested enterprises in non-strategic commercial sectors “market players that are full of vigor and vitality.”<sup>465</sup>

## B. Land and Land-Use Rights

Part B of this section examines land and land-use rights. It begins by detailing China’s system of public land ownership and the various restrictions the Chinese government places on tenure and scope of land-use rights. It then considers the manner in which the government compensates parties whose rural land-use rights have been revoked. Part B concludes with a discussion of the major barriers to efficient allocation of land resources, including the segmentation of rural and urban land markets; government allocation of land resources and state industrial policy;

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*the Implementation Plan for Optimizing the Function Classification and Evaluation of Central State-owned Enterprises* (SASAC, MOF, Guo Zi Fa Zong He [2016] No. 252, issued August 24, 2016).

<sup>464</sup> *Notice on Issuing the Implementation Plan for Optimizing the Function Classification and Evaluation of Central State-owned Enterprises*, Section 1, Paragraph 4. (SASAC, MOF, Guo Zi Fa Zong He [2016] No. 252, issued August 24, 2016). Documents published by Local SASACs further demonstrate the link between so-called “SOE reform” policies and government efforts to maintain control over sectors it deems strategic. A report published on a municipal government website in November 2014 states that 19 provinces issued “roadmaps for state-owned assets and state-owned enterprise reform” between 2013 and 2014. Of these, nearly all set targets for retaining some level of state-owned capital in “strategic and emerging industries,” *i.e.*, industries selected by the government for priority support under state-sponsored science and technology programs. Xiamen Municipality, *19 Province-Level SASACs State-Owned Asset Reform Roadmaps Concentrate Capital in Strategic and Emerging Industries* (November 12, 2014).

<sup>465</sup> *Notice on Issuing the Implementation Plan for Optimizing the Function Classification and Evaluation of Central State-owned Enterprises*, Section 2.1 (SASAC, MOF, Guo Zi Fa Zong He [2016] No. 252, issued August 24, 2016). See also Barry Naughton, “Two Trains Running: Supply-Side Reform, SOE Reform and the Authoritative Personage,” *China Leadership Monitor* 50 (April 2016): 7-8. (“What has emerged instead is a mandate for the creation of multiple investment funds with developmental objectives. That is, these funds are expected to foster the creation of big, competitive firms, develop emerging industries, to intervene in markets precisely in order to shape specific developments. If it is true, as the Third Plenum document states, that government is to withdraw from microeconomic interventions in the economy, these investment funds suggest that the government withdrawal would be accomplished simply by delegating the government’s objectives to these investment funds, which would be partially market-oriented operators. On the ground, though, it doesn’t represent much improvement at all, and in the reform context, it is a step backward.”)

misaligned incentives of local government actors; and the inadequate documentation of land-use rights in rural areas.

The Department finds that, owing in large part to the Chinese government’s regulatory framework for land ownership and land use, land prices are distorted and land resources are not efficiently allocated. Fiscal imbalances incentivize local governments to maximize revenues from land transactions, which further skews the allocation of land resources. Although the government has taken some steps to improve land markets, such as developing secondary transfer markets and better modes of land compensation, these developments do not fully address the existing distortions in the land market.

## 1. *Legal and Institutional Framework*

### 1.1. Public Ownership and the Separation of Ownership and Use Rights

Private land ownership is prohibited in China. All land is owned by some level of government, the distinction being between rural land owned by the local government or “collective” at the township or village level (referred to as “collectively owned”), and urban land owned by the national government (referred to as “state-owned”).<sup>466</sup> Public land ownership is consistent with the objective, set forth in the *PRC Constitution*, of “uphold[ing] the basic economic system under which the public (state) ownership shall play a dominant role” in the economy “[i]n the primary stage of socialism.”<sup>467</sup> Chinese laws governing land administration further codify this system of public land ownership. The *Land Administration Law of the People’s Republic of China* (“LAL”) provides for a system of “socialist public ownership.”<sup>468</sup> The *Property Law* classifies land in China as either “collectively owned” or “state-owned.”<sup>469</sup>

Prior to 1978, individuals and non-state entities in China did not possess land-use rights.<sup>470</sup> After 1978, the Chinese government separated land ownership from the right to use land, in an attempt to introduce productivity incentives.<sup>471</sup> The *LAL*, adopted in 1986, codifies the ownership of

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<sup>466</sup> *PRC Constitution*, Articles 9 and 10. See also Chengri Ding and Yan Song, *Emerging Land & Housing Markets in China* (Cambridge: Lincoln Institute of Land Policy, 2005), 14.

<sup>467</sup> *Property Law*, Article 3.

<sup>468</sup> *Land Administration Law of the People’s Republic of China*, Article 2 (adopted by NPC on June 25, 1986, Order No. 8, effective January 1, 1999).

<sup>469</sup> *Property Law*, Articles 45-48 (promulgated March 16, 2007). See also OECD, *OECD Investment Policy Reviews: China 2008: Encouraging Responsible Business Conduct* (Paris: OECD Publishing, 2008), 23-25.

<sup>470</sup> The principal legislation during this period was the *Land Reform Law of the People’s Republic of China* (“*Land Reform Law*”), promulgated in June 1950 in the context of large-scale land expropriation and redistribution by the CCP. See Tony Saich, *Governance and Politics of China, Third Edition* (New York: Palgrave MacMillan, 2011), 42.

<sup>471</sup> For state-owned land in urban areas, the separation of ownership from use rights was first instituted in the early 1980s in special economic zones (SEZs) to attract foreign investment. In rural areas, the “household responsibility system” of 1978 introduced the contracting of collectively owned land to individual households for private farming



land-use rights and, in certain circumstances, their transfer. The *PRC Constitution* was correspondingly amended in 1988 to allow for the transfer of land-use rights.<sup>472</sup> In response to the rapid development of urban land markets in the 1990s, the Chinese government formalized urban land-use rights through new laws and regulations; notably, the *Interim Regulations of the People's Republic of China Concerning the Assignment and Transfer of the Right to the Use of the State-owned Land in Urban Areas* (“*State-owned Land Regulations*”) and the *Law of the People's Republic of China on Administration of Urban Real Estate* (“*UREL*”).<sup>473</sup> The *Rural Land Contracting Law of the People's Republic of China* (“*RLCL*”),<sup>474</sup> adopted in 2002, permits certain forms of rural land-use rights transfers.<sup>475</sup> The *Property Law*, adopted in 2007, codifies general provisions for land contracting rights, construction land-use rights, residential land-use rights, and easement rights, with respect to both urban and rural land.<sup>476</sup>

Although the Chinese government has established a legal framework for land-use rights, significant restrictions remain with respect to the scope, tenure, and security of such rights. These restrictions are discussed in more detail below.

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in conjunction with a policy that allowed farmers to sell above-quota agricultural output at decontrolled prices. By 1983, use rights for virtually all arable land had been allocated to rural households in this manner. Chengri Ding and Yan Song, *Emerging Land & Housing Markets in China* (Cambridge: Lincoln Institute of Land Policy, 2005), 14; World Bank and State Council DRC, World Bank, *China 2030: Building a Modern, Harmonious, and Creative Society*, Report No. 76299 (March 23, 2013), 129. See also Barry Naughton, *China's Economy: Transitions and Growth* (Cambridge: MIT Press, 2007), 241. (“Instead of allocating work points for inputs (for labor days, reputation, or effort), some collectives began allocating work points for output, linking the remuneration of a given work group or household to the output of a specific plot of land. Some went even further and simply contracted pieces of collective land to individual households to cultivate. [...] By 1981-1982 a nationally defined program of contracting land to households, known as ‘household contracting’ or the ‘household responsibility system’ emerged as the clearly preferred organizational system [...] By the end of 1982 more than 90% of China’s agricultural households had returned to some form of household farming.”)

<sup>472</sup> Chengri Ding and Yan Song, *Emerging Land & Housing Markets in China* (Cambridge: Lincoln Institute of Land Policy, 2005), 14, 39.

<sup>473</sup> *Interim Regulations of the People's Republic of China Concerning the Assignment and Transfer of the Right to the Use of the State-owned Land in Urban Areas* (State Council, Order [1990] No. 55, issued May 19, 1990). See also *Law of the People's Republic of China on Administration of Urban Real Estate* (adopted by NPC on July 5, 1994, amended August 30, 2007, further amended August 27, 2009).

<sup>474</sup> *Rural Land Contracting Law of the People's Republic of China* (adopted by NPC on August 29, 2002, Order [2002] No. 73, effective March 1, 2003, amended August 27, 2009).

<sup>475</sup> See, *China's Political System*, ed. Sebastian Heilmann (CITY: Rowman & Littlefield Publishers, 2017), 256. (“Following the 2002 and 2003 changes in party and state leadership, a change in policy with respect to rural development was introduced. The focus of the political agenda of the Hu Jintao and Wen Jiabao leadership was to improve rural livelihoods. In March 2003 new legal regulations on land-leasing contracts and land-use rights entered into effect. Under the new regulations, China’s rural population is allowed to sell future land-use rights on a voluntary and legal basis, and farmers are to receive adequate compensation for transfers of land-use rights.”)

<sup>476</sup> *Property Law*, Chapters 11-14.



## 1.2. Scope of Land-Use Rights

### ***1.2.1. Rural Land***

The Chinese government imposes onerous restrictions on the scope of land-use rights in rural areas. These restrictions are evident in several respects. Foremost, individual holders of rural land-use rights – also referred to as “contracting rights” – cannot convert collectively owned rural land into state-owned urban land. Collectively owned land may only be “leas[ed] out to land users with due compensation” once that land has been “requisitioned and turned into state-owned land.”<sup>477</sup>

Second, there are restrictions on rural land-use for non-farming purposes. The law distinguishes between (1) rural agricultural land and (2) rural construction land for commercial and non-commercial purposes,<sup>478</sup> and places limits on the transfer of agricultural land to construction land.<sup>479</sup> The *LAL* provides that contracting of collectively owned land is for farming purposes only, and individuals contracting the land “ha[ve] the obligation to protect the land and rationally use it in conformity with the purposes of use provided for in the [land-use rights] contract.”<sup>480</sup> The *RLCL* provides that the contracted rural land shall not be used for non-agricultural construction without lawful approval.<sup>481</sup> The government will administer “administrative sanctions” to those who unlawfully use their contracted land for construction not related to farming.<sup>482</sup>

Third, within the category of rural construction land, there are limits on how such land may be used for housing (*i.e.*, residential land). The *LAL* provides that each rural village household “shall only have one house site, the area of which may not exceed the limits fixed by provinces, autonomous regions and municipalities directly under the Central Government.”<sup>483</sup> The law further requires “examination and verification by the township (town) people's government and

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<sup>477</sup> *UREL*, Article 9.

<sup>478</sup> *LAL*, Article 4.

<sup>479</sup> *Property Law*, Article 43; *LAL*, Article 4.

<sup>480</sup> *LAL*, Articles 14 and 15.

<sup>481</sup> *RLCL*, Articles 8 and 60. *See also* World Bank and State Council DRC, “Urban China: Toward Efficient, Inclusive, and Sustainable Urbanization,” *Natural Resources Forum* 39(2) (2014), 41. (“In line with plans and regulations of land use, collective organizations can use land for collective nonagricultural industrial and commercial activities, but under the current law, they cannot lease collective construction land to non-collective entities for commercial or industrial development. Furthermore, the rights to rural homestead land are limited: with strong emphasis on collective membership, farmers only have the right to occupy and use land, but not the right to profit from it.”)

<sup>482</sup> *RLCL*, Articles 8 and 60.

<sup>483</sup> *LAL*, Article 62.

approval by the county people's government.”<sup>484</sup> If farmers choose to sell or rent out their residences, the law mandates that their application to construct another residence will not be approved.<sup>485</sup> This provision makes it difficult for rural residents to lawfully earn non-farm revenue from residential property. At the same time, because rural residential land is not subject to the stringent use restrictions that exist for farmland, it is especially prone to conversion into state-owned urban land by local governments.<sup>486</sup>

Fourth, the Chinese government generally does not allow rural land-use rights to serve as collateral for credit. The *Property Law* expressly forbids the mortgaging of use rights for collectively owned land, including arable land, residential land, land set aside for farmers to cultivate for their private use, and hilly land allotted for private use, unless it is otherwise prescribed by law.<sup>487</sup> Recent pilot programs have been introduced to relax this prohibition, but have yet to result in a meaningful change to nationwide practices.<sup>488</sup> According to a 2015 OECD report, the inability of farmers to use rural land use rights as collateral constrains their access to financing. Rural commercial banks and credit cooperatives have expanded financing for agricultural projects, but the OECD finds that lending by these institutions is “currently biased toward larger, usually state-owned, enterprises that have significant collateral and guarantees.”<sup>489</sup>

Furthermore, the Chinese government has established a complex legal framework governing the transfer of use rights for farming purposes. The *RLCL* provides that contracting rights for farmland may be sub-contracted, leased, exchanged, or swapped to third parties (including for monetary compensation) by individual contracting rights holders, a practice collectively referred

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<sup>484</sup> *Ibid.*

<sup>485</sup> *Ibid.*

<sup>486</sup> Neither the *LAL* nor the *Property Law* contain express provisions regarding the conversion of rural residential land for other uses.

<sup>487</sup> *Property Law*, Article 184.

<sup>488</sup> In March 2016, PBOC, CBRC, China Insurance Regulation Commission (CIRC), and other central government authorities launched a pilot program in over 200 counties across China that grants loan collateral to rural land-use rights holders. It applies to both holders of household contracting rights as well as to holders of operating rights in the secondary market. It is premature to assess whether the new pilot program can improve financing for farmers. The land-use rights that banks would obtain if farmers fail to repay the loans may not be valuable in practice, considering the numerous restrictions placed on selling land-use rights and the relatively low value of farmland in general. Moreover, due to underdeveloped land titling and registration systems (discussed in more detail below), it is questionable to what extent farmers are able to meet the basic requirements established by the Chinese government, which include, *inter alia*, documentation that proves ownership of contracting or operating rights, and the absence of any disputes over contracting or operating rights. See e.g., The Economist Intelligence Unit, *Trial Scheme to Allow Farmers to Mortgage Their Land* (March 29, 2016). See also Notice of the People's Bank of China, the China Banking Regulatory Commission, the China Insurance Regulatory Commission and Other Departments on Issuing the Interim Measures for the Pilot Program of the Loans Secured against the Management Right of Contracted Rural Land (PBOC, CBRC, CIRC, Yin Fa [2016] No. 79, issued March 15, 2016).

<sup>489</sup> Ben Westmore, *Agricultural Reforms and Bridging the Gap for Rural China*, ECO/WKP(2015)36 (OECD, May 22, 2015), 17-18.

to as “circulation.” “Circulation”<sup>490</sup> is subject to the condition that the third party to whom the land is transferred must not alter the nature of the ownership of the contracted land nor its use for agriculture and must have the operational capability to engage in agricultural activity.<sup>491</sup> Third parties may acquire contracting rights through one of three means: negotiation, tender, or auction. The third parties may further “circulate” their rights through transfer, leasing, shareholding, mortgaging, and other means.<sup>492</sup>

Studies show that across China, agricultural land-use transfer policies remain at an experimental stage. A 2015 OECD study identifies five main types of land transfer arrangements that have been applied to varying degrees in different localities: (1) exchange of land-use rights; (2) leasing of operation rights; (3) outright transfer of contract rights; (4) land joint-stock cooperatives; and (5) land circulation trusts.<sup>493</sup> The Chinese government has also established Land Transfer Centers (LTCs) in rural regions to facilitate transactions, particularly the bundling and transfer of small land holdings to larger commercial farming operations.<sup>494</sup> Another program to facilitate land transactions, initiated in Sichuan province, involves the creation of a unified platform for conducting land-bidding transactions aimed at improving price discovery for land.<sup>495</sup> A 2016 policy change, moreover, allows foreign companies to rent or lease farmland.<sup>496</sup>

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<sup>490</sup> *RLCL*, Chapter II, Section 5.

<sup>491</sup> *Ibid.*, Article 33.

<sup>492</sup> *Ibid.*, Article 49.

<sup>493</sup> Ben Westmore, *Agricultural Reforms and Bridging the Gap for Rural China*, ECO/WKP(2015)36 (OECD, May 22, 2015), 13-14. (“i. Exchange of land-use rights – Within the same collective, two farmers may want to exchange operation rights for their respective land. This may aid consolidation for farmers who have a number of non-contiguous plots. ii. Leasing of operation rights – In such an arrangement, farmers rent out the right to cultivate their land to another entity within or outside the rural collective (however, under equal conditions, members from the collective are given priority). Despite renting out the operation rights, the farmers retain the contract right to the farmland. iii. Outright transfer of contract rights – Conditional on the lessor having built a stable livelihood outside the agricultural sector, the outright transfer of contract rights is allowed. At this point, the contract between the household transferring out the land and the village is terminated. iv. Land joint-stock cooperatives – Farmers may jointly pool their operation rights to engage in cooperative agricultural production. They are then given a share of the joint-stock cooperative and are generally paid a dividend proportionate to their share. [...] v. *Land circulation trusts* – Farmers entrust their operation rights to a trust company, which is responsible for finding tenants, land development, procuring funds and organising construction activities [...]. Some of these functions, such as land development and recruitment of tenants, are undertaken by an operating company contracted by the trust. The first such trust was CITIC Trust Co., Ltd. which was established in 2013 in Yongqiao district, Suzhou, Anhui province.” (emphasis added))

<sup>494</sup> Yanling Peng et al., *How Farmland Mortgages Could Stimulate Rural Entrepreneurship in China* (Paulson Institute, February 14, 2017), 8.

<sup>495</sup> Land was transferred to larger, more efficient farming operations, and there was a shift in production toward more profitable crops. The Chengdu experiment is considered one of the most successful agricultural land reform programs in China. Klaus Deininger et al., *Impact of Property Rights Reform to Support China’s Rural-Urban Integration*, Policy Research Working Paper WPS7388 (World Bank, August 11, 2015), 6, 14.

<sup>496</sup> This policy change followed a government announcement about its intent to relocate 100 million farmers, about 12% of the rural population, into smaller cities. See *Opinions of the General Office of the CCP and the General*

Analyses published by the World Bank and OECD find that the Chinese government has achieved only limited success in developing secondary markets for farmland in China.<sup>497</sup> Rented land as a share of total farmland increased from 3% to 24% between 1996 and 2013, but remains lower than in many OECD countries.<sup>498</sup> Large farming enterprises only make up a small share of the secondary market.<sup>499</sup> Pilot programs designed to increase the scope of land-use rights transfers have varied widely by province, with gains in land consolidation concentrated in North and Northeast China.<sup>500</sup> The OECD has identified a number of problems that constrain land rental markets in China's agriculture sector, including: poorly defined contract rights; a perceived lack of contract enforcement by independent courts; corruption among local officials; and the difficulty of valuing operating rights due to a lack of transparency and a uniform valuation method. Surveys indicate significant mismatches in price expectations between those wishing to rent in and those wishing to rent out.<sup>501</sup>

### 1.2.2. Urban Land

The Chinese government also imposes significant restrictions on the scope of land-use rights in urban areas. The *LAL* provides that any entity or individual seeking land for construction must apply for approval from the government, the formal owner of state-owned land.<sup>502</sup> As with rural land, the government draws a legal distinction between different categories of urban land, which is divided into industrial, commercial, and residential land.<sup>503</sup> Within this system, there are restrictions on transferring land from one category to another, and some regulations are not uniform across categories (*e.g.*, with respect to the tenure of use rights.)<sup>504</sup>

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*Office of the State Council on Improving the Measures for Separating Rural Land Ownership from Contracting Management Right* (CCPCC and State Council, Order, issued October 30, 2016). See also Saibal Dasgupta, "China Embraces Corporate Farming," *VAO News*, November 2, 2016; Lucy Hornby, "China Land Reform Opens Door to Corporate Farming," *Financial Times*, November 3, 2016.

<sup>497</sup> World Bank and State Council DRC, *Urban China: Toward Efficient, Inclusive, and Sustainable Urbanization* (2014), 10-11. See also Ben Westmore, *Agricultural Reforms and Bridging the Gap for Rural China*, ECO/WKP(2015)36 (OECD, May 22, 2015), 6.

<sup>498</sup> OECD, *OECD Economic Surveys: China* (Paris: OECD Publishing, 2015), 107 (see Figure 2.5).

<sup>499</sup> The Chinese government has taken actions to increase private investment in large-scale farming, but the effects of the reforms have also varied widely by province – a recent study found that only 20% of land in China is cultivated by farms larger than 5 acres and only 4% of land is now operated by corporate farms. Xianqing Ji, et al., "Are China's Farms Growing?" *China & World Economy* 24(1) (2016): 59.

<sup>500</sup> OECD, *OECD Economic Surveys: China* (Paris: OECD Publishing, 2015), 107.

<sup>501</sup> Ben Westmore, *Agricultural Reforms and Bridging the Gap for Rural China*, ECO/WKP(2015)36 (OECD, May 22, 2015), 14.

<sup>502</sup> *LAL*, Article 21.

<sup>503</sup> *Property Law*, Chapters 11-14.

<sup>504</sup> *Ibid.*

The Chinese government classifies land-use rights for state-owned urban land as either “granted” or “allocated,” depending on how the government confers the use rights.<sup>505</sup> When use rights are “granted,” they are effectively leased by the government in return for a payment.<sup>506</sup> In addition to paying the government for the right to use the land, the party receiving the urban land-use right is required to use the land in accordance with the terms and use purposes set forth in a contract signed with the relevant municipal- or county-level government department in charge of land administration.<sup>507</sup>

The government has discretion to “grant” use rights via one of three means – negotiation, tender, or auction – each of which constitutes a different form of use rights transaction.<sup>508</sup> An Asian Development Bank Institute (ADBI) study for the period 2003-2008 finds that “small, expensive land parcels were generally leased by auction, whereas large, inexpensive lots were leased by listing.” For land leased by listing, the total area was much larger, and the average transaction price much lower, than for land leased by auction. The report further notes that “local governments use agreement and tender for most industrial land leasing transactions, whereas auctions are used for commercial and residential land leasing to ensure that the highest tenderer acquires the land and that there is no price cap.”<sup>509</sup> An economist emphasizes the informal nature of many land-use rights transactions in China:

The method of transfer is occasionally open auction, but far more often such transfers are arranged in private negotiations between the local government official and the company desiring a lease. The situation is fraught with conflicts of interest, and the result is often corruption, sometimes on a grand scale.<sup>510</sup>

As an alternative to “granting” use rights, government authorities above the county level may “allocate” use rights to an entity or individual.<sup>511</sup> In this arrangement, the party receiving the land-use right does not pay the government. The *UREL* defines the “allocation” of land-use rights as either the conveyance of land to a land-user subsequent to that land-user’s payment of compensation, resettlement, and other fees to rural collectives (*i.e.*, when agricultural land is

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<sup>505</sup> *Ibid.*, Article 137.

<sup>506</sup> *State-owned Land Regulations*, Articles 8-14; LAL, Article 4. Li Zhang and Xianxiang Xu, *Land Policy and Urbanization in the People’s Republic of China*, ADBI Working Paper Series No. 614 (Asian Development Bank Institute, November 11, 2016), 5.

<sup>507</sup> *Ibid.*

<sup>508</sup> *Ibid.*

<sup>509</sup> *Ibid.*

<sup>510</sup> Dwight Perkins, “China’s Land System: Past, Present, and Future” in *Property Rights and Land Policies*, eds. Gregory K. Ingram and Yu-Hung Hong (Cambridge, Ma: Lincoln Institute of Land Policy, 2009), 88-89.

<sup>511</sup> *UREL*, Article 22.

converted for urban use), or simply as land-use rights conveyed for no fee at all.<sup>512</sup> In contrast to the limited tenure of “granted” land-use rights, “allocated” land-use rights are indefinite.<sup>513</sup>

Since the late 1990s, Chinese law has limited the “allocation” of land to certain specified uses.<sup>514</sup> Construction on “allocated” land is generally not permitted unless it is for purposes of a government or military installation, urban basic infrastructure and public services, energy, transport, and irrigation projects, or other uses set forth in law.<sup>515</sup> Nonetheless, the existence of a category that allows for the conveyance of state-owned land at no cost creates the potential for abuse by local government authorities.

### 1.3. Tenure of Land-Use Rights

The Chinese government generally does not grant land-use rights for an indefinite period. For collectively owned rural land, the Chinese government has extended the tenure of contracting rights in small increments over time. A 1998 amendment to the *LAL* for the first time codified a 30-year tenure period.<sup>516</sup> The CCP put forward recommendations in 2008 and 2013 to grant indefinite tenure to rural contracting rights holders.<sup>517</sup> To date, however, the *LAL* has not been further amended to codify these recommendations.<sup>518</sup> A 2013 World Bank report identifies indefinite use rights as an important item for reforming China’s economy in rural areas, and

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<sup>512</sup> *Ibid.*, Article 23.

<sup>513</sup> *Ibid.*, Article 22.

<sup>514</sup> See Li Zhang and Xianxiang Xu, *Land Policy and Urbanization in the People’s Republic of China*, ADBI Working Paper Series No. 614 (Asian Development Bank Institute, November 11, 2016), 5. (“In 1999, the revised *LAL* established new regulations. With the exception of the four types of construction land (military use; municipal infrastructure; energy and power industries; and schools, hospitals, and other public facilities) that can be transferred through allotment, construction units are permitted to use state-owned land only by means of a paid transfer (Article 54 of Chapter V).”) See also *Land Allocation Catalogue* (MLR, Order [2001] No. 9, issued October 22, 2001). The Catalogue provides that “allocated” land will be strictly limited to 19 categories, which primarily comprise military and governmental purposes, public infrastructure and utilities, and other public interest, social and cultural purposes. Moreover, allocated land-use rights may not be used by an FIE, even if the FIE is a joint venture that is majority owned by a domestic firm.

<sup>515</sup> *Ibid.*, Article 23; *LAL*, Article 54.

<sup>516</sup> Samuel Ho and George Lin, “Emerging Land Markets in Rural and Urban China: Policies and Practices,” *The China Quarterly* 175 (2003): 689-690; *LAL*, Article 14 (August 29, 1998).

<sup>517</sup> See *Decision of the Central Committee of the Communist Party of China on Several Big Issues on Promoting the Reform and Development of Rural Areas* (CCPCC, Zhong Fa [2008] No. 16, issued October 15, 2008) for recommendation to grant indefinite land-use contracting rights. The *Third Plenum Decision* of 2013 reiterates this recommendation.

<sup>518</sup> The *LAL* was last amended in 2004.



states that “[i]t is important that the Communist Party’s [2008 policy decision] regarding this issue be enshrined in law soon.”<sup>519</sup>

Chinese law grants longer tenure periods for state-owned urban land. The *UREL* provides that when the government chooses to “allocate” land-use rights, there are no tenure limits.<sup>520</sup> In the more common scenario, however, urban land-use rights are “granted” in which case tenure periods are limited:

- 70 years for residential land-use;
- 50 years for industrial production land-use;
- 50 years for educational, healthcare and scientific and technological research land-use;
- 40 years for commercial land-use; and
- 50 years for all other land-use purposes.<sup>521</sup>

Chinese law is not entirely clear with respect to whether and how land-use rights may be extended. The *Property Law* states that once the 30-year tenure period on rural land contracting rights expires, the contracting rights holder can continue to contract in accordance with relevant national regulations.<sup>522</sup> Yet, the law does not specify which national regulations or administrative procedures apply.

With respect to urban land-use rights, the *State-owned Land Regulations* provide that when the land-use rights tenure expires, the land-use rights holder may apply for an extension, subject to signature of a new contract with the relevant government authority. If not extended, the rights revert to the state, and any buildings on the land or improvements made to the land then become property of the state.<sup>523</sup> The *LAL* likewise provides that government departments in charge of land administration are authorized to take back land-use rights for state-owned urban land if the land-user has not applied for an extension or the application for an extension has not been approved.<sup>524</sup>

The *Property Law*, in turn, draws an important distinction regarding renewal of use rights for different categories of urban land. Rights for *residential* construction land may be “automatically renewed” upon expiration, whereas *non-residential* construction land extensions will be processed according to provisions of the law. The statute, however, neither specifies what

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<sup>519</sup> World Bank, *China 2030: Building a Modern, Harmonious, and Creative Society*, Report No. 76299 (March 23, 2013), 129.

<sup>520</sup> *UREL*, Article 23.

<sup>521</sup> *State-owned Land Regulations*, Article 12.

<sup>522</sup> *Property Law*, Article 126.

<sup>523</sup> *State-owned Land Regulations*, Articles 8-11 and 39-41.

<sup>524</sup> *LAL*, Article 58.

“automatically” means nor what provisions of the law apply with respect to non-automatic renewals.<sup>525</sup>

#### 1.4. Compensation for Expropriated Land-Use Rights in Rural Areas

In principle, rural land-use rights holders in China receive compensation when their use rights are revoked. In both a legal and practical sense, however, the level of compensation is inadequate. The *LAL* provides for a per capita resettlement subsidy and arable land compensation payment for individuals whose agricultural land has been requisitioned; yet, this payment is calculated based on the value of farm crops, rather than on the higher value of the land once it has been converted into urban land.<sup>526</sup> A 2015 academic study finds numerous other deficiencies in the legal framework governing monetary compensation for rural land. For example, compensation is generally paid as a one-time lump-sum payment, rather than in increments over time,<sup>527</sup> and compensation for demolished rural housing is insufficient.<sup>528</sup>

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<sup>525</sup> *Property Law*, Article 149. See also Donald Clarke, “Full Private Land Ownership Returns to China’s Cities,” *Chinese Law Prof Blog*, April 15, 2017. (“In 2007, the authorities granted a teaser: the Property Law was promulgated, and it stated that residential LURs would, at the end of their term, be renewed ‘automatically.’ But it didn’t say what ‘automatically’ meant. As Professor Wang Liming, a member of the drafting team, later admitted, this lack of clarity was no accident; the drafters had deliberately opted for ambiguity.”) In March 2017, Chinese Premier Li Keqiang stated that residential construction land-use rights “can be renewed, and no application or pre-set conditions needs to be filed or met.” These and other government policy statements elaborate on the meaning of a provision codified in the Property Law, but they do not meaningfully clarify the rules governing tenure of urban land-use rights more generally. Ministry of Foreign Affairs, *Transcript of Premier Li Keqiang’s Meeting with the Press at the Fifth Session of the 12th National People’s Congress* (March 16, 2017); Donald Clarke, “The Paradox at the Heart of China’s Property Regime,” *Foreign Policy*, January 19, 2017.

<sup>526</sup> Article 47 of the *LAL* provides: (1) the resettlement subsidy amount will be based on the value of the three-year average annual crop yield of the requisitioned land, at a minimum of four to six times that value and a maximum of 15 times that value; (2) the arable land compensation payment is set at six to ten times the value of the three-year average annual crop yield of the requisitioned land.

<sup>527</sup> Zhu Qian, “Land Acquisition Compensation in Post-Reform China: Evolution, Structure, and Challenges in Hangzhou,” *Land Use Policy* 46 (2015): 252-253. (“[T]he land acquisition compensation is one-time lump sum compensation. The living expenses for land-lost villagers are of ongoing and long-term nature that requires a sustained income to support. Moreover, these expenses often increase significantly over the following years. The compensation rate initially set by local authorities may seem sufficient to rural villagers and subsequently secure villagers’ acquiescence. After a few years, when living expenses increase, the feeling of disfranchisement after land acquisition would become strong among villagers.”)

<sup>528</sup> *Ibid.*, 252-253. (“[The *LAL*] specifies rural land acquisition compensation but does not regulate rural housing demolition compensation, which is the burden of local municipalities. [...] It is not uncommon for housing demolition executors to disobey municipal regulations and implement their own policies and incentives for quick rural villager relocation. During the process, township administration often gives acquiescence to rural village’s own, unofficial or illegal, policy and thus amplifies rural collective’s power in housing demolition and compensation. Alternatives to municipal policies are often used to overcome housing demolition and villager relocation barriers in practice. The compensation difference in housing demolition and villager relocation can be huge. The highest incentive for timely demolition and relocation was 70,000 RMB yuan in a village in Yuhang District, Hangzhou and the lowest was only 5,000 RMB yuan in another village in the same district.”)

A fundamental problem is that collectively owned rural land, as a category of land ownership, is ambiguous. An ADBI study notes that, in fact, a “three-class system of collective ownership exists in [China’s] rural regions,” comprising “natural villages,” “administrative villages,” and “towns.”<sup>529</sup> The *LAL* provides that monetary compensation for requisitioned land be paid out through collectives rather than directly to individuals.<sup>530</sup> This arrangement facilitates corruption and embezzlement at the local level, reducing the likelihood that individuals will receive the compensation they are due.<sup>531</sup>

Several studies indicate that, in practice, compensation provided for expropriated land-use rights in China is inadequate.

- A 2011 survey by the Landesa Rural Development Institute, covering 1,791 farmers across 17 provinces, finds that one in every four farmers does not receive any compensation at all. For those who do, the mean value received is only a fraction of the commercial value of the land.<sup>532</sup> The survey also finds that farmers are often pressured by collectives to lease their small plots of land to outside companies, and that such companies may put the land to illegal non-farming uses or acquire leases that exceed the land-use rights contracting period of the farmer.<sup>533</sup>

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<sup>529</sup> See Li Zhang and Xianxiang Xu, *Land Policy and Urbanization in the People’s Republic of China*, ADBI Working Paper Series No. 614 (Asian Development Bank Institute, November 11, 2016), 1-2. (“A three-class system of collective ownership exists in the PRC’s rural regions and includes (i) natural villages—peasant collective ownership of farms in villages; (ii) administrative villages—peasant collective ownership of more than two rural collective economic organizations in villages; and (iii) towns—peasant collective ownership in townships. This three-class system makes property rights over rural collective-owned land difficult to discern. The term “collective” is not clearly defined, nor is the relationship between the collective and the farmers. This leads to ambiguous property rights and makes it difficult for rural land to enter the market.”)

<sup>530</sup> *LAL*, Articles 25-30.

<sup>531</sup> Zhu Qian, “Land Acquisition Compensation in Post-Reform China: Evolution, Structure, and Challenges in Hangzhou,” *Land Use Policy* 46 (2015): 252-253.

<sup>532</sup> Landesa Rural Development Institute, *Summary of 2011 17-Province Survey’s Findings* (April 26, 2012), 2. (“The survey finds that affected farmers received some compensation in 77.5% of all cases, were promised but did not receive compensation in 9.8% of cases, and were neither promised, nor received compensation in 12.7% of cases. [...] The mean compensation paid to affected farmers was 18,739 yuan per mu (app. \$17,850 per acre), a fraction of the mean price authorities themselves received for the land (778,000 yuan per mu or \$740,000 per acre, mostly in cases of commercial projects).”)

<sup>533</sup> *Ibid.*, 4. (“About a third (32.6%) of the surveyed villages reported some extent of farmland leasing to outside bosses or companies. [...] The median amount of farmland that these bosses or companies hold right now is about 100 mu, and the mean amount is 560 mu. In 69.5% of all cases this is assembled as one large, continuous tract of land, a strong indication of pressure being applied to farmers who typically hold very small parcels. [...] The lease terms tend to be long. Some are so long that they are illegal as they run past the farmer’s own contract for the land. [...] The farmland leased out is used for a variety of purposes, some illegal, such as: 10.2% for apartment buildings or tourism, and 20.7% used at least partially for factories or commercial development. [...] Violation of farmers’ consent is widespread. Surveyed farmers indicated that in 11.4% of these cases, local officials said that the land transfer was an order from the government above, and farmers had no choice but to comply. In another 14.0% of the cases, local officials came to persuade or pressure the affected farmers, and farmers eventually agreed. Besides, in another 41.7% of cases, officials and bosses came together to “negotiate” a deal with farmers.”)

- A 2015 World Bank study finds that “[w]hile farmers receive compensation for their agricultural land based on the value of land for agricultural production, land acquired in this way can be transferred by local governments at prices a hundred times or more what was paid in compensation.”<sup>534</sup>
- A 2012 World Bank study finds that “the current practice of expropriating the entire difference between the agricultural value of the land and its urban market value is equivalent to a 100% capital gains tax.”<sup>535</sup> A separate World Bank report also states that “[i]n reality, large amounts of collective construction land have also entered the urban market illegally, particularly in China’s eastern coastal areas and large cities.”<sup>536</sup>

In certain instances, rural land-use rights holders have received various forms of compensation, including non-monetary compensation.<sup>537</sup> However, these compensation methods have yet to be instituted on a systemic, nationwide basis. Indeed, land expropriation and compensation is one of the primary sources of social discontent in China. Protests over land expropriation and compensation have become regular occurrences, with 60,000 protests in 2013 alone.<sup>538</sup>

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<sup>534</sup> Klaus Deininger et al., *Impact of Property Rights Reform to Support China’s Rural-Urban Integration*, Policy Research Working Paper WPS7388 (World Bank, August 11, 2015), 4. *See also* Dwight Perkins, “China’s Land System: Past, Present, and Future,” in *Property Rights and Land Policies*, eds. Gregory K. Ingram and Yu-Hung Hong (Cambridge, Ma: Lincoln Institute of Land Policy, 2009), 88. (“The potential for abuse is enormous. It is not just that local officials often do not pay attention to the national laws and procedures, but that in many cases the transfer of the land involves a corrupt arrangement between the local official, who receives a payment, and the purchasing unit, which gets the land at a favorable price. In some cases, local governments collude with developers to simply expand the boundaries of what is considered urban and thereby convert land from collective to government ownership, thus confiscating rural land without compensation. [...] The method of transfer is occasionally open auction, but far more often such transfers are arranged in private negotiations between the local government official and the company desiring a lease. The situation is fraught with conflicts of interest, and the result is often corruption, sometimes on a grand scale.”)

<sup>535</sup> World Bank, *China 2030: Building a Modern, Harmonious, and Creative Society*, Report No. 76299 (March 23, 2013), 32.

<sup>536</sup> World Bank and State Council DRC, “Urban China: Toward Efficient, Inclusive, and Sustainable Urbanization,” *Natural Resources Forum* 39(2) (2014), 41.

<sup>537</sup> Novel compensation methods include, *inter alia*, providing social security assistance and employment alternatives as part of a compensation package; granting localities permission to retain a portion of requisitioned land for non-farming commercial and residential use; and the establishment of shareholding cooperatives, under which the local government either acquires land owned by township and village enterprises (“TVEs”) and allows those TVEs to retain their use rights, or TVEs retain their rural collective land ownership and lease their land or invest it as stock in joint ventures for capital returns and interests. Zhu Qian, “Land Acquisition Compensation in Post-Reform China: Evolution, Structure, and Challenges in Hangzhou,” *Land Use Policy* 46 (2015): 254-255.

<sup>538</sup> Sarah Hsu, “China Is Finally Improving Property Rights Protections,” *Forbes*, November 30, 2016. *See also* Wei Xiao, *The Compensation for Land Expropriation in Rural China Under the Constitution in People’s Republic of China* (Hong Kong: The University of Hong Kong, 2014), 1.

According to an OECD estimate, 65% of social conflicts in China's rural areas involve disputes over land.<sup>539</sup>

In Chongqing and Chengdu municipalities, the Chinese government has recently piloted a *dipiao*, or land voucher, program involving rural residential land. Rural residents can offer residential land for conversion into farmland, which entitles them to a *dipiao* eligible for sale on a property exchange. A land developer wishing to build on what currently is a tract of farmland, but who at the same time must show no net reduction in farmland will result from the project, has the option to buy a *dipiao* at the exchange to offset the reduction.<sup>540</sup> The land developer negotiates prices directly with the individual selling the *dipiao*, as opposed to indirect negotiation with a representative from a rural collective. In theory, the price the developer pays for the land-use rights should reflect the construction-use value of the land, rather than the lower farmland-use value. The farmer is promised 85% of the proceeds with the remainder going to the local government.<sup>541</sup>

The *dipiao* program indicates a new policy approach, but it does not markedly improve the status of land-use rights in China. First, the program has not been adopted on a nationwide basis. Second, to the extent it has been implemented, it has given rise to corrupt practices, as some farmers have claimed that they have been forced out of their homes or did not receive compensation for the sale of their *dipiao* from the property exchange.<sup>542</sup> Studies also show that the reclaimed farmland is not always as fertile as the agricultural land lost to development.<sup>543</sup>

## 2. *Barriers to the Efficient Allocation of Land Resources*

### 2.1. Segmentation of the Land Market between Rural and Urban Areas

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<sup>539</sup> Ben Westmore, *Agricultural Reforms and Bridging the Gap for Rural China*, ECO/WKP(2015)36 (OECD, May 22, 2015), 15.

<sup>540</sup> Samson Yuen, "China's New Rural Land Reform? Assessment and Prospects," *China Perspectives* 2014/1 (2014): 63-64. See also Jianguang Shen, "Benefits of Offering Urban Hukou to Migrant Workers," *Economics Weekly* (56) (Mizuho Securities Asia Ltd., January 29, 2016), 6. ("In recent years, another new utility of rural residential land is to swap it with urban construction land. The Ministry of Land and Resources allows local governments in selected areas to buy residential land from farmers and turn it into arable land. Then, these local governments could have new quota (in addition to allocated quota) to turn arable land around the cities into new urban construction land.")

<sup>541</sup> Samson Yuen, "China's New Rural Land Reform? Assessment and Prospects," *China Perspectives* 2014/1 (2014): 63-64.

<sup>542</sup> Ben Westmore, *Agricultural Reforms and Bridging the Gap for Rural China*, ECO/WKP(2015)36 (OECD, May 22, 2015), 15.

<sup>543</sup> The Economist Intelligence Unit, *China Economy: Thinking Big: Modernizing Agriculture* (May 24, 2013).

Owing largely to the legal and institutional framework discussed above, China does not have a nationally unified land market. Land administration is bifurcated between collectively owned rural land and state-owned urban land. Within each category of ownership, moreover, there are restrictions on the use of land for different purposes, such as the transfer of farmland to construct residences in rural areas. An ADBI report concludes that local governments “have monopsony power in the rural land market and monopoly power in the urban land market,” and “serve as a single-plank bridge between the urban and rural land markets[...].”<sup>544</sup> An economist observes:

Formally, rural land [China] is collectively owned by the local village or township, and urban land is owned by the state. In both cases, local officials play the primary role in deciding whether a piece of land under their jurisdiction can be leased for commercial uses.<sup>545</sup>

Land market segmentation distorts land prices, particularly by driving a wedge between prices in rural and urban areas.<sup>546</sup> Segmented land markets also distort the broader allocation of resources in China’s economy. As the OECD has noted, economic development should force certain changes in the use of a country’s productive inputs. Populations transition from working in agriculture to working in industrial sectors. The rural population, and in particular the rural population employed in agriculture, consequently declines. Farms consolidate, economies of scale are realized, and the farmers that remain become more efficient and productive. Urban areas generally grow, and workers achieve a higher marginal product outside the farm sector. In China, however, government ownership and control over land impedes this process.<sup>547</sup>

China’s farm sector remains inefficient. The average size of farm plots in China is under 2 acres,<sup>548</sup> only a fraction of the average in the U.S., which is about 445 acres.<sup>549</sup> Although the United States has one of the most consolidated agriculture industries, the order-of-magnitude difference illustrates the degree of farm plot fragmentation in China. Because farm plots are small, farmers generally lack the incentive to invest in technology and make other capital investments because they cannot recover their investment in the timeframe their contract

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<sup>544</sup> Li Zhang and Xianxiang Xu, *Land Policy and Urbanization in the People’s Republic of China*, ADBI Working Paper Series No. 614 (Asian Development Bank Institute, November 11, 2016), 7.

<sup>545</sup> Dwight Perkins, “China’s Land System: Past, Present, and Future,” in *Property Rights and Land Policies*, (eds.) Gregory K. Ingram and Yu-Hung Hong (Cambridge, Ma: Lincoln Institute of Land Policy, 2009), 89.

<sup>546</sup> Yanling Peng et al., *How Farmland Mortgages Could Stimulate Rural Entrepreneurship in China* (Paulson Institute, February 14, 2017), 7.

<sup>547</sup> Ben Westmore, *Agricultural Reforms and Bridging the Gap for Rural China*, ECO/WKP(2015)36 (OECD, May 22, 2015), 5-6.

<sup>548</sup> According to the OECD, in 2010 the average size of farm plots was 0.6 hectares. OECD, *OECD Economic Survey: China* (Paris: OECD Publishing, 2015), 106.

<sup>549</sup> The Economist Intelligence Unit, *China Economy: Thinking Big: Modernizing Agriculture* (May 24, 2013).



spans.<sup>550</sup> According to NBS data, almost 30% of the employed population still works in agriculture,<sup>551</sup> but agriculture makes up only about 9% of GDP.<sup>552</sup>

The CCP's *Third Plenum Decision* pledges to “form a unified construction land market for both urban and rural construction areas.”<sup>553</sup> This objective, short of permitting the free conversion of collectively owned agricultural land into state-owned urban land, implies a relaxation of the strict controls on the transfer of collectively owned rural construction land. The Chinese government has not passed any subsequent laws, however, to codify this policy of market unification.<sup>554</sup> Moreover, the proposed reform is constrained by the government's arable land conservation mandate. The *Third Plenum Decision* states that farmers may only transfer, rent out, and mortgage their rights to rural construction land on the condition that the overall scale of farmland remains unchanged.<sup>555</sup>

## 2.2. Government Allocation of Land Resources and State Industrial Policy

The Chinese government's systemic, nationwide management of land resource allocations further exacerbates distortions in China's land market. In 1997, the State Council issued the *Notice on Further Regulation of Land Management and Protection of Arable Land*,<sup>556</sup> which

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<sup>550</sup> See e.g., World Bank and State Council DRC, *Urban China: Toward Efficient, Inclusive, and Sustainable Urbanization*, Natural Resources Forum 39(2) (2014), 348. See also Ben Westmore, *Agricultural Reforms and Bridging the Gap for Rural China*, ECO/WKP(2015)36 (OECD, May 22, 2015), 6. In 2016, the Agricultural Development Bank of China (ADBC), a fully government-owned policy bank, agreed to lend \$450 billion by 2020 to facilitate the modernization of agriculture. However, as a policy bank, ADBC is responsible for funding state development projects rather than individual farmers and small businesses. Douglas Elliott and Kai Yan, *The Chinese Financial System: An Introduction and Overview* (The Brookings Institution, July 1, 2013), 13; Fred Gale and Robert Collender, *New Directions in China's Agricultural Lending*, WRS-06-01 (United States Department of Agriculture, January 2006), 6; *Reuters*, “China to Invest \$450 Billion Modernizing Agriculture by 2020,” September 18, 2016.

<sup>551</sup> According to NBS, there are 800 million employed people in China, of which 219 million are classified under “primary industry,” which comprises agriculture, forestry, animal husbandry and fishery. NBS, *China Statistical Yearbook - 2016* (Beijing: China Statistics Press, 2016). See Table 4-1 “Employment.” Calculations performed by the Department.

<sup>552</sup> Lucy Hornby, “China Migration: Dying for Land,” *Financial Times*, August 6, 2015.

<sup>553</sup> *Third Plenum Decision*, Article III(11).

<sup>554</sup> Samson Yuen, *China's New Rural Land Reform? Assessment and Prospects*, China Perspectives 2014/1 (2014), 61. (“[...] while the Third Plenum reforms point in the direction of reducing state monopoly on rural land transfer and restoring land-use rights to farmers, they are nothing very new. More importantly, these reforms cannot enjoy much success unless more drastic reforms are undertaken. Such reforms include reconfiguring the power relations between local governments and farmers in a way that owners of collective land will truly secure their land-use rights, as well as a thorough fiscal and tax reform that reduces the reliance of local government on land sales.”)

<sup>555</sup> *Ibid.*

<sup>556</sup> *Notice on Further Regulation of Land Management and Protection of Arable Land* (Bureau of Land Management, Guo Tu Ban Zi [1997] No. 58, issued April 16, 1997, invalid since February 20, 2003).

elevated preservation of arable land to an important national strategy.<sup>557</sup> The *LAL* was subsequently amended in 1998 to incorporate arable land protection provisions.<sup>558</sup> Beginning with the 11th five-year planning period in 2006, the Chinese government has incorporated arable land conservation into five-year plans as one of a small number of binding targets (*i.e.*, targets that government officials are obligated to meet).<sup>559</sup> In 2008, the State Council issued the *Outline of the National Overall Planning on Land Use (2006-2020)*,<sup>560</sup> which sets forth a target to preserve 120 million hectares of arable land (*i.e.*, the “Red Line”), including 104 million hectares of basic agricultural land, and limits the conversion of arable land to construction land to 3 million hectares in total by 2020.<sup>561</sup>

In order to achieve these targets, the central government sets an annual national quota for the conversion of arable land for construction and distributes the quota to each province. Whenever arable land is used for construction purposes, an equal amount must be provided somewhere else to ensure the overall arable land area of the province is not reduced.<sup>562</sup> To ensure effective local implementation of this policy, the *Criminal Law of the People’s Republic of China* was amended in 1998 to make it a criminal offence for local officials to grant approval for the conversion of arable land for development if the terms of the 1997 *Land Protection Notice* are not met.<sup>563</sup> This policy of quota allocation has given the central government significant influence over how and where to convert rural land for urban use.<sup>564</sup>

These land planning policies ostensibly support arable land conservation. In reality, however, there is a severe mismatch between supply and demand in China’s land markets, and large swathes of urban land are underutilized. “Ghost towns” have sprung up in peripheral areas around many cities as local governments, competing for economic activity and investment,

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<sup>557</sup> Siu Wai Wong, “Land Requisitions and State-Village Power Restructuring,” *The China Quarterly* 224 (December 2015): 901.

<sup>558</sup> Zhu Qian, “Land Acquisition Compensation in Post-Reform China: Evolution, Structure, and Challenges in Hangzhou,” *Land Use Policy* 46 (2015): 251.

<sup>559</sup> See *e.g.*, *12th Five-Year Plan for Economic and Social Development*, discussed further in Factor 5.A.

<sup>560</sup> *Outline of the National Overall Planning on Land Use (2006-2020)* (State Council, Guo Fa [2008] No. 33, issued October 6, 2008).

<sup>561</sup> *Outline of the National Overall Planning on Land Use (2006-2020)* (State Council, Guo Fa [2008] No. 33, issued October 6, 2008). See also World Bank and State Council DRC, *Urban China: Toward Efficient, Inclusive, and Sustainable Urbanization*, Natural Resources Forum 39(2) (2014), 268.

<sup>562</sup> Siu Wai Wong, “Land Requisitions and State-Village Power Restructuring,” *The China Quarterly* 224 (December 2015): 901.

<sup>563</sup> *Ibid.*

<sup>564</sup> See Yuan Xiao and Jinhua Zhao, *Fixing China’s Distorted Urban Land Quota System*, Paulson Policy Memorandum (Paulson Institute, March 2015).

transact land at very low prices.<sup>565</sup> A 2014 World Bank report estimates that average population density in China's cities has declined by over 25% over the past decade.<sup>566</sup> Land designated for industrial use is also underutilized; a nationwide survey suggests that 70% of the total land within China's 6,866 Development Zones is unused.<sup>567</sup> An ADBI report summarizes the problem:

With its monopoly on land expropriation and transaction, local governments have held down land expropriation prices to acquire large amounts of rural land and turned them into urban lands, which directly led to the excessive expansion of urban land area, as in the massive construction of development zones and new towns. As the *hukou* system hinders rural–urban migration, it can be predicted that land urbanization will outpace population urbanization, with decreasing density of urban population and low efficiency of land use.<sup>568</sup>

Contrary to the objective of carefully conserving arable land, the Chinese government has also used its ownership and control over land to support state industrial policies. A 2013 World Bank study finds that one of the defining characteristics of industrial policies in China is to institute “direct administrative interventions” to shift resources, including land, from prohibited to preferred sectors.<sup>569</sup> The central government's ability to assign construction quotas by province is a particularly powerful tool in this regard, as it allows planners to influence the distribution and growth of industry across the country.<sup>570</sup>

Central government measures to influence the distribution of industrial assets expressly reference land. For example, the 2005 *State Council Decision on Implementing the Interim Provisions on Promoting the Structural Adjustment of Industry*, discussed in more detail under Factor 5,

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<sup>565</sup> World Bank and State Council DRC, *Urban China: Toward Efficient, Inclusive, and Sustainable Urbanization*, Natural Resources Forum 39(2) (2014), 9, 34; Wade Shepard, “China's Ghost Cities Are Now Resorting To Coupons To Fill Vacant Homes,” *Forbes*, November 18, 2016; Sarah Jacobs, “12 Eerie Photos of Enormous Chinese Cities Completely Empty of People,” *Business Insider*, October 3, 2017; Steve Chao, “Inside China's Ghost Towns: ‘Developers Run Out of Money,’” *Al Jazeera*, September 21, 2016; Lucy Hornby, “China Migration: Dying for Land,” *Financial Times*, August 6, 2015.

<sup>566</sup> World Bank and State Council DRC, *Urban China: Toward Efficient, Inclusive, and Sustainable Urbanization*, Natural Resources Forum 39(2) (2014), 10. See also Yasheng Huang, *Urbanization, Hukou System and Government Land Ownership: Effects on Rural Migrant Works and on Rural and Urban Hukou Residents* (OECD Development Center, March 2010).

<sup>567</sup> Jinfeng Du and Richard Peiser, “Land Supply, Pricing and Local Governments' Land Hoarding in China,” *Regional Science and Urban Economics* 48 (2014): 183. See also Klaus Deininger et al., *Impact of Property Rights Reform to Support China's Rural-Urban Integration*, Policy Research Working Paper WPS7388 (World Bank, August 11, 2015), 5.

<sup>568</sup> Li Zhang and Xianxiang Xu, *Land Policy and Urbanization in the People's Republic of China*, ADBI Working Paper Series No. 614 (Asian Development Bank Institute, November 11, 2016), 7.

<sup>569</sup> World Bank and State Council DRC, *China 2030: Building a Modern, Harmonious, and Creative Society*, No. 76299 (March 23, 2013), 142.

<sup>570</sup> See Yuan Xiao and Jinhua Zhao, *Fixing China's Distorted Urban Land Quota System*, Paulson Policy Memorandum (Paulson Institute, March 2015).

provide that Chinese authorities “shall speed up the formulation and amendment of policies on...land...[to] intensify the coordination and cooperation with industrial policies, and further improve and promote the policy system on industrial structure adjustment.”<sup>571</sup> Similarly, the *Guiding Opinions of the State Council on Central and Western Regions' Undertaking of Industrial Transfer* provides that the annual construction quotas allocated to central and western regions are to be increased, with “preferential allocation of construction land quotas for industrial parks.”<sup>572</sup>

### 2.3. Misaligned Incentives of Local Government Actors

In a well-functioning market, economic actors are incentivized to put land to its most productive use, taking into account factors such as land quality and location. When the government exercises ownership and control over land, however, the dynamics of the land market are different. Government authorities take many administrative factors into account when deciding how to use land, such as revenue from land sales; future tax revenues from the opening of profitable businesses on the land; and the need to meet economic growth targets and implement industrial policy directives set by the government.<sup>573</sup>

Fiscal imbalances are a particularly important factor influencing land-use decisions in China. Local governments account for a greater share of total government expenditure than government revenue,<sup>574</sup> largely because they bear primary responsibility for financing public services such as policing, schools, hospitals, and roads.<sup>575</sup> At the same time, local governments are constrained in their revenue-raising activities. Pursuant to tax reforms introduced in 1994, the central government collects the majority of fiscal revenue from the two largest tax items – the value-added tax and the corporate income tax<sup>576</sup> – and power to pass tax legislation rests at the central

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<sup>571</sup> *State Council Decision on Implementing the “Interim Provisions on Promoting the Structural Adjustment of Industry* (State Council, Guo Fa [2005] No. 40, issued December 2, 2005).

<sup>572</sup> *Guiding Opinions of the State Council on Central and Western Regions' Undertaking of Industrial Transfer*, Article 28 (State Council, Guo Fa [2010] No. 28, issued August 31, 2010).

<sup>573</sup> World Bank and State Council DRC, *Urban China: Toward Efficient, Inclusive, and Sustainable Urbanization*, Natural Resources Forum 39(2) (2014), 269.

<sup>574</sup> For the year 2015, local governments accounted for 85.5% of fiscal outlays, versus 50.2% of tax revenue. WTO, *Trade Policy Review – Report by the Secretariat – China*, WT/TPR/S/342 (June 15, 2016), 19.

<sup>575</sup> See Athar Hussain and Nicholas Stern, “Public Finances, the Role of the State, and Economic Transformation, 1978-2020,” in *Public Finance in China: Reform and Growth for a Harmonious Society*, (eds.) Jiwei Lou and Shuilin Wang (Washington, DC: World Bank, 2008), 13-38.

<sup>576</sup> As a share of China’s national tax revenue in 2015, the domestic value-added tax accounted for 24.9% and the corporate income tax for 21.7%. The next-largest tax items were the business tax (15.5% share) and the VAT and consumption tax from imports (10.0% share, offset by a commensurate rebate on exports). WTO, *Trade Policy Review – Report by the Secretariat – China*, WT/TPR/S/342 (June 15, 2016), 19. See also budget revenue statistics for the year 2015 (Ministry of Finance website, available at <http://yss.mof.gov.cn/2015js/>, accessed September 11, 2017.)

level. Authorities at the sub-province level lack the ability to raise capital through bond issuances.<sup>577</sup> Central government fiscal transfers are designed to plug funding gaps at the local level, but in practice, they do not suffice.<sup>578</sup>

Consequently, local governments sell land-use rights in order to meet their fiscal needs, typically following the conversion of collectively owned rural land into state-owned urban land.<sup>579</sup> Revenues from land sales are a primary source of local government revenue.<sup>580</sup> Revenue from land sales as a share of total government revenue fluctuates from year-to-year but was approximately 45% in 2013 after reaching a peak of nearly 70% in 2010.<sup>581</sup> Land concession income, which is the income local governments receive from leasing the land-use rights, grew from an estimated RMB 588 billion in 2006 to RMB 3.3 trillion in 2013.<sup>582</sup>

Property taxes could reduce local governments' reliance on land concession income as a major revenue source, and in so doing, mitigate land expropriation and increase the security of rural land-use rights. However, to date, property taxes have only been piloted in select regions, such as Shanghai and Chongqing municipalities, at low effective rates of taxation. An important reason is that individuals do not have the right to own the land.<sup>583</sup>

#### 2.4. Land Titling and Registration

Rural land-use rights in China are poorly documented. A 2013 report by the World Bank states that in “the near to medium term, supplemental reforms will have to tackle the poor quality of current documentation on collective land ownership and individual use rights.”<sup>584</sup> It also finds

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<sup>577</sup> A revised budget law passed in 2014 permits province-level authorities to issue bonds, but this authority does not extend to the sub-province level. Sandra Heep, “Public Finance,” in *China's Political System*, (ed.) Sebastian Heilmann (New York: Rowman & Littlefield, 2017), 109.

<sup>578</sup> Christine Wong, “Fiscal Reform: Paying for the Harmonious Society,” *China Economic Quarterly* 14(2) (2010): 20-25.

<sup>579</sup> W. Raphael Lam and Philippe Wingender, *China: How Can Revenue Reforms Contribute to Inclusive and Sustainable Growth?*, IMF Working Paper WP/15/66 (IMF, March 2015), 21-22. See also Zhu Qian, “Land Acquisition Compensation in Post-Reform China: Evolution, Structure, and Challenges in Hangzhou,” *Land Use Policy* 46 (2015): 251.

<sup>580</sup> World Bank and State Council DRC, *Urban China: Toward Efficient, Inclusive, and Sustainable Urbanization*, Natural Resources Forum 39(2) (2014), 267.

<sup>581</sup> *Ibid.*, 278.

<sup>582</sup> *Ibid.*, 275. An important basis for this trend is the 1994 tax reform, which reclassified land concession income as local government income. Unlike other major tax items, land concession income does not need to be shared with the central government.

<sup>583</sup> *Ibid.*, 165.

<sup>584</sup> World Bank and State Council DRC, *China 2030: Building a Modern, Harmonious, and Creative Society*, No. 76299 (March 23, 2013), 131.

that land contract and certificate documentation has “not been sufficiently harmonized across the rural and urban spheres,” and that China lacks a “reliable complete national inventory of land parcels.”<sup>585</sup>

In lieu of comprehensive national statistics, experts rely on survey data to measure the extent of such documentation. A 2011 survey by the Landesa Rural Development Institute<sup>586</sup> found that only half of respondents possessed contracts and land-use rights certificates, and only a small share of the documents issued contained all the relevant legal information.<sup>587</sup> A separate survey, conducted between 2009 and 2010, records significant differences across provinces, with only 30% of households in Jiangxi province holding a land certificate versus 95% in Gansu province.<sup>588</sup>

Inadequate documentation affects the economic behavior of farmers. The Landesa survey, for example, identifies a statistical correlation between inadequate documentation and low levels of investment in farmland.<sup>589</sup> Similarly, an OECD report finds that poorly defined contract rights, combined with poor enforcement of those rights, often prevent farmers from renting out their land to more productive uses and seeking employment outside the farm sector.<sup>590</sup>

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<sup>585</sup> *Ibid.* (“While the full establishment of a national land inventory may not be feasible in the short or medium term, effective implementation of land rights will require some degree of clarity about the location and extent of the land to which the rights apply. More reliable, precise, and accessible records concerning the location of individual land parcels and who has what rights to a given parcel will help strengthen the trust and sense of security of contract owners, help reduce land disputes, and facilitate the more efficient implementation of land-related laws.”)

<sup>586</sup> Landesa Rural Development Institute, *Summary of 2011 17-Province Survey’s Findings* (April 26, 2012), 1. (“The survey is the sixth in a series by Landesa, in cooperation with China Renmin University and Michigan State University. Conducted in mid-2011, the survey covered 1,791 households in 17 provinces that together contain an estimated three quarters of China’s rural population (Anhui, Fujian, Guangxi, Guizhou, Hebei, Heilongjiang, Henan, Hubei, Hunan, Jiangsu, Jiangxi, Jilin, Shaanxi, Shandong, Sichuan, Yunnan, and Zhejiang). The previous surveys were done in 1999, 2001, 2005, 2008, and 2010. The findings are accurate within  $\pm 2.3$  percent (at the 95 percent confidence level) for the entire rural population of these 17 provinces.”)

<sup>587</sup> *Ibid.* (“Two documents are supposed to record farmers’ land rights and afford farmers some measure of protection: contracts (which 56.8% of the respondents have been issued) and land-rights certificates (which 57.0% of farm households have been issued). Overall, 77.1% of all households have at least one land document, and 36.7% have both documents as required by law and policy. However, only 20.9% of issued contracts and 40.3% of issued certificates contain all the legally required information and can be considered strictly law-compliant, reducing the contribution of documentation to the security of land rights.”)

<sup>588</sup> Ma, X., N. Heerink, S. Feng, X. Shi, “Farmland Tenure in China: Comparing Legal, Actual and Perceived Security,” *Land Use Policy* 42 (2015): 293-306.

<sup>589</sup> Landesa Rural Development Institute, *Summary of 2011 17-Province Survey’s Findings* (April 26, 2012), 2. (“Preliminary data analysis shows that the quality of land certificates is highly correlated to farmers’ decision in making investments. Surveyed farmers are 76.5% more likely to have made investments when they have law-compliant land certificates compared to noncompliant certificates. In addition, of all the investments made, 84.5% were made in or after the year of contract issuance, 78.2% made in or after the year of certificate issuance, and 81.3% made in the year of or following the issuance of both documents.”)

<sup>590</sup> Ben Westmore, *Agricultural Reforms and Bridging the Gap for Rural China*, ECO/WKP(2015)36 (OECD, May 22, 2015), 12.



The Chinese government has adopted some initiatives to improve rural land-use rights documentation. A guiding document, *Communist Party of China Central Committee and State Council Several Opinions on Accelerating Development of Modern Agriculture and Further Increasing Rural Development Dynamism*, calls for completing registration of farmers' land rights throughout the country within five years.<sup>591</sup> Further, in November 2014, the State Council issued *the Interim Regulations on Real Estate Registration*, which requires that all collectively owned rural land be registered in a centralized registry.<sup>592</sup> Although the development of a national land registry marks an important step forward, reports suggest that the public will not have access to it, which may limit its utility in improving price discovery and developing land markets.<sup>593</sup>

### C. Assessment of Factor

Under Factor 4, the Department finds that the Chinese government continues to exert significant ownership and control over the means of production, as demonstrated by the role and prevalence of SIEs throughout the enterprise sector and the system of land ownership and land-use rights. The average size of SIEs remains large when compared with private companies, and the relative “economic weight” of SIEs in China’s economy is substantial in comparison with relevant sectors in other major economies. In fact, formal indicia of government investment in Chinese enterprises likely understate the actual extent of government ownership and control. The Chinese government allocates resources to SIEs in what it deems strategically important sectors, such that SIEs are not strictly disciplined by market principles of supply and demand. At the same time, however, the government requires that SIEs undertake large-scale investments to help stabilize China’s macro-economy. The government also intervenes extensively in the enterprise sector to shield SIEs from the consequences of economic failure, facilitates mergers and acquisitions to achieve government, not enterprise, objectives, and enables the rise of large enterprise groups under government ownership and control.

Although the government has adopted policies to restructure and corporatize SIEs, it continues to fulfill its legal mandate to “maintain a leading role for the state sector.” As a consequence, SIEs in China operate in sectors and industries beyond those that typically raise natural monopoly or public goods or services policy considerations. An important enabling factor for government control over firm decision-making is the manner in which the CCP reserves the right to make personnel appointments and participate in corporate decision-making through Party Committees

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<sup>591</sup> World Bank and State Council DRC, *Urban China: Toward Efficient, Inclusive, and Sustainable Urbanization*, Natural Resources Forum 39(2) (2014), 39.

<sup>592</sup> *Interim Regulations on Real Estate Registration*, Articles 2 and 5 (State Council, Order [2014] No. 656, issued November 24, 2014). MLR issued pursuant implementing rules in January 2016, which contain detailed provisions on what types of documentation shall be submitted to the land registry by rural collectives. *See Implementing Rules for the Interim Regulations on Real Estate Registration* (MLR, Order [2016] No. 63, issued January 1, 2016), Chapter 3, Section 2.

<sup>593</sup> The Economist Intelligence Unit, *China Economy: China Hand: Land and Property* (July 29, 2015).

and other channels. Recent efforts to promote “mixed ownership” and the separation of “commercial” from “public interest” SIEs do not fundamentally alter this fact.

The Chinese government exercises significant control over land, another key means of production. There is no private land ownership, rural and urban land markets are segmented, and the government remains the final arbiter on how land is used (through extensive planning) and valued. Individuals, firms, and other entities may own land-use rights, but there are limits on the scope and tenure of these rights in both rural and urban areas. The result of these dynamics is an inefficient land market in which large swathes of land are misallocated either to small farm plots or to underutilized urban infrastructure.

In rural areas, the scope of individual use rights for agricultural land is limited, *inter alia*, by restrictions on non-agricultural use, conditions imposed on use-rights transfers, and inadequate land titling systems. Crucially, individual holders of agricultural land-use rights are not authorized to convert their land into state-owned urban land, and conversely, are not adequately compensated when the government requisitions their land for urban use. Rural residents remain effectively constrained in terms of how they use the land and the extent to which they can transfer their land-use rights or fully monetize their value. As a result, agricultural production in China remains inefficient due to small plots and underdeveloped leasing markets.

In urban areas, the government “allocates” use rights indefinitely for certain uses, or, as is more often the case, “grants” use rights – through auction, tender, or listing – for varying lengths of time to industrial, commercial, and residential users. On the basis of arable land preservation mandates, the Chinese government tightly manages the use of urban land through nationwide construction quotas and a complex system of land-use planning. A combination of fiscal imbalances and decentralized authority exacerbates non-market land-use policies at the local level. In practice, the government uses its discretion to make large amounts of land available for industrial uses, particularly in the central and western regions of the country, while limiting the supply of land available for residential and commercial uses, a practice that segments land markets and distorts prices.

## **Factor Five: The extent of government control over the allocation of resources and over the price and output decisions of enterprises.**

Excessive government control over the allocation of resources and over the price and output decisions of enterprises undermines the functioning of a market economy. If resources are severely misallocated or the government unduly influences or constrains the price and output decisions of individual market actors, then prices and costs become distorted and non-market conditions prevail. Part A of this section assesses the Chinese government’s industrial policies, including the formulation and execution of state plans; the tools used to implement industrial policies; key examples of industrial policies; and “supply-side structural reform” initiatives. Part B of this section assesses the Chinese government’s regulation of prices, including the prevalence of price distortions; the status of formal price controls; and certain informal price controls. Part C of this section assesses the financial sector, including the formal banking sector, interbank markets, bond markets, and “shadow banking.”

The Department discusses, in each of these areas, the Chinese government’s direct and indirect control over the allocation of resources, which in turn distort price and output decisions of enterprises. In sum, the Department finds that the extent of government control is significant and far-reaching.

### **A. Industrial Policies**

Part A of this section analyzes the Chinese government’s industrial policies. It first examines the relevant legal and institutional framework, including the extent to which the Chinese government’s system of state planning mobilizes government authorities, the CCP, and SIEs. It then assesses the mechanisms by which the Chinese government implements industrial policies, including the use of investment restrictions and approval procedures; access conditions and other industry standards; guidance catalogues; financial supports; and quantitative restrictions. Part A also examines how these mechanisms function in priority areas for industrial policy – industrial restructuring and upgrading, the geographic distribution of industry, and science and technology development. Part A concludes by analyzing excess capacity and excessive corporate debt issues in the context of the Chinese government’s “supply-side structural reform” initiatives, in order to illustrate how recent developments in industrial policymaking have reinforced the government’s role in managing the economy.

The analysis presented below is informed, in part, by the Department’s 2012 analysis of public bodies in China (“*Public Bodies Analysis*”),<sup>594</sup> which identifies “[t]he development and dissemination of industrial policies” as “one of the formal means by which [the Chinese] government communicates its plans to uphold the socialist market economy.” The planning process and the resulting documents are “the means (and roadmap) by which the government

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<sup>594</sup> U.S. Department of Commerce, *Section 129 Determination of the Countervailing Duty Investigation of Circular Welded Carbon Quality Steel Pipe; Light-Walled Rectangular Pipe and Tube; Laminated Woven Sacks; and Off-the-Road Tires from the People’s Republic of China: An Analysis of Public Bodies in the People’s Republic of China in Accordance with the WTO Appellate Body’s Findings in WTO DS379* (May 18, 2012), 9.

seeks to fulfill its legal mandate to maintain the predominance of the state sector.”<sup>595</sup> The *Public Bodies Analysis* is informed by the World Bank and State Council DRC report, *China 2030*, which observed that the Chinese government’s extensive industrial policy interventions are “designed to affect the allocation of resources among economic activities (across or within sectors) to achieve a different outcome from what otherwise would have occurred.”<sup>596</sup> *China 2030* describes several features of the Chinese government’s industrial policies, including their implementation across all levels of government; the range of instruments that the Chinese government uses to achieve multiple, sometimes conflicting, objectives; and the focus on increasing scale, with a preference for larger enterprises with higher market concentration and favoring SIEs over private firms.<sup>597</sup>

While many countries may have some form of industrial policy, the Chinese government’s system and implementation is distinctive in terms of its complexity and pervasiveness, as well as its reliance on direct administrative interventions to allocate resources to different sectors of China’s economy. The objective of the Chinese government and the CCP is to uphold the “socialist market economy” in which the Party-state directs and channels economic actors to meet the targets of state planning, not for economic outcomes that reflect predominantly market forces acting independent of the Party-state. In China’s economic framework, state planning through industrial policies conveys instructions regarding sector-specific economic objectives, particularly for those sectors deemed strategic and fundamental.

### 1. Framework of State Planning and Industrial Policymaking

#### 1.1. The Preservation of State Planning after the “Planned Economy”

In China’s command economy prior to 1978, the Chinese government established input-use and output-production targets for industry and agriculture by unit and locality with great specificity. A core objective of this system was to prioritize the allocation of resources to heavy industries such as steel.<sup>598</sup> Since 1978, the Chinese government has modified the system of state planning. The first phase in this process was the “dual track system” introduced in the 1980s, under which a traditional plan and market channel were permitted to coexist.<sup>599</sup> Subsequently, the 1993

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<sup>595</sup> *Public Bodies Analysis*, 9.

<sup>596</sup> World Bank, *China 2030: Building a Modern, Harmonious, and Creative Society*, Report No. 96299 (March 2013), 107-108.

<sup>597</sup> *Ibid.*, 107-109, 141-142.

<sup>598</sup> Tony Saich, *Governance and Politics of China, Third Edition* (New York: Palgrave MacMillan, 2011), 45-53.

<sup>599</sup> Barry Naughton, *The Chinese Economy: Transitions and Growth* (Cambridge: MIT Press, 2007), 91-92. (“Perhaps the most characteristic feature of China’s initial departure from the planned economy was the dual-track system. The Chinese term *shuangguizhi* refers to the coexistence of a traditional plan and a market channel for the allocation of a given good. Rather than dismantling the plan, reformers acquiesced to a continuing role for the plan in order to ensure stability and guarantee the attainment of some key government priorities (in the Chinese case, primarily investment in energy and infrastructure). The dual track implied a two-tier pricing system for most goods: a single commodity had both a (typically low) state-set planned price and a (typically higher) market price.”)

revision to the 1982 *PRC Constitution* introduced the concept of the “socialist market economy” to replace the “planned economy,”<sup>600</sup> which reflected this shift. Industrial policymaking became more complex, combining state planning with some ostensibly market-oriented instruments.<sup>601</sup>

Industrial policies in China today continue to be extensive. A core organizing principle of these policies remains the five-year planning period, first instituted in 1953-1957 based on the practice of the Soviet Union. At the apex of the five-year planning system is the *Five-Year Plan for Economic and Social Development* (“FYP”).<sup>602</sup> The *13th Five-Year Plan for Economic and Social Development (2016-2020)* (“13<sup>th</sup> FYP”), issued in March 2016, is divided into twenty chapters, which unify plans for the national development of agriculture, industry, infrastructure and communications, regional economic zones, and foreign trade and investment; health, education, and welfare; the CCP-led political system; and national defense.<sup>603</sup> Each sub-national government authority issues its own *FYP*, pursuant to the central government document.<sup>604</sup>

The Chinese government has not only maintained the planning system, but also further formalized it. The State Council’s *Several Opinions on Strengthening Drafting Work for the*

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<sup>600</sup> *PRC Constitution*, Article 15.

<sup>601</sup> Sebastian Heilmann and Oliver Melton, “The Reinvention of Development Planning in China, 1993-2012,” *Modern China* 39(6) (2013): 584.

<sup>602</sup> The *PRC Constitution* expressly states that various government authorities are responsible for formulating and executing *FYPs*. In particular, Article 89, Paragraph 5 of the *PRC Constitution* provides that “to draw up and implement the plan for national economic and social development” is one of the “functions and powers” exercised by the State Council, China’s “highest administrative organ.” Article 62, Paragraph 9 of the *PRC Constitution* provides that “to examine and approve the plan for national economic and social development and the report on its implementation” is one of the “functions and powers” exercised by NPC.

<sup>603</sup> Chapter I of the *13th FYP* presents “guiding thoughts,” “principal targets,” and “developmental concepts.” Chapters II and III present the principal themes set by the Chinese government for the 13th FYP period: “innovation to spur development” and “establishing a new model for development.” The ensuing nine chapters present plans for various aspects of economic development, including: agricultural modernization (Chapter IV); structural optimization of the industrial sector (Chapter V); expansion of the Internet economy (Chapter VI); buildout of basic infrastructure networks (Chapter VII); promotion of new forms of urbanization and regional economic zones (Chapters VIII and IX); the development of environmentally sustainable industries (Chapter X); and the promotion of the “One Belt, One Road” initiative and other policies to expand foreign trade and investment (Chapters XI and XII).

<sup>604</sup> Sebastian Heilmann and Oliver Melton, “The Reinvention of Development Planning in China, 1993-2012,” *Modern China* 39(6) (2013): 586. (“The five-year plan begins with brief, fairly general guidelines approved by the [CCPCC] in the fall of the year before the start of the plan period, and with a more detailed – but still fairly broad – outline approved by the National People’s Congress the following March. Collectively, they set national priorities and outline how they will be met, but these documents—which are commonly referred to as the five-year plan—are only *executed through a network of thousands of sub-plans* that evolve into detailed execution instructions for all levels of government. This web of plans evolves over the entire five-year period, and is better thought of as a planning coordination and evaluation cycle rather than a cohesive, unified blueprint. The planning system’s layered and nested programs can be found in almost every single policy domain in China and across three core levels of government: the center, provincial-level jurisdictions, and cities or counties.”)

*National Economic and Social Development Plan*, issued in 2005, provide for a “three-by-three” system according to which economic and social development plans are divided vertically into (1) national, (2) provincial, and (3) municipal/county level plans, and, by function, into (1) comprehensive plans, (2) macro-regional plans, and (3) specialized plans.<sup>605</sup> Macro-regional plans serve as a means for the Chinese government to coordinate various government authorities across sub-regions and sectors, particularly with respect to infrastructure and industrial investment.<sup>606</sup>

Specialized plans, in turn, translate industrial policy elements into sector-specific five-year plans drafted by government authorities under the State Council. For the 13th five-year planning period, there are over 100 such plans, including, *inter alia*, for energy, raw material, and farm sectors; technology- and capital-intensive industries; and important facets of economic regulation, such as intellectual property and fair competition.<sup>607</sup> As part of reinvigorating the planning system, the Chinese government has also formulated an increasing number of specialized plans for periods exceeding five years. In the high-tech sector, for example, China has issued the *Medium- and Long-Term Plan for Science and Technology (2006-2020)* (“S&T MLP”)<sup>608</sup> and the *Decision on Issuing “China Manufacturing 2025”* (“*Made in China 2025 Decision*”).<sup>609</sup>

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<sup>605</sup> *Several Opinions on Strengthening Drafting Work for the National Economic and Social Development Plan*, Section 1.1 (State Council, Guo Fa [2005] No. 33, issued October 22, 2005).

<sup>606</sup> Sebastian Heilmann and Oliver Melton, “The Reinvention of Development Planning in China, 1993-2012,” *Modern China* 39(6) (2013): 591-594. Important macro-regions include the Western and Central region, the Northeast region, the Pearl River delta, and the Yangtze River delta.

<sup>607</sup> For the 11th FYP period, Heilmann and Melton identify “roughly 160 national-level special plans.” Sebastian Heilmann and Oliver Melton, “The Reinvention of Development Planning in China, 1993-2012,” *Modern China* 39(6) (2013): 595.

<sup>608</sup> *Notice on Issuing the National Medium- and Long-Term Plan for Science and Technology (2006-2020)* (State Council, Guo Fa [2005] No. 44, issued December 26, 2005).

<sup>609</sup> *Decision on Issuing “China Manufacturing 2025”* (State Council, Guo Fa [2015] No. 28, issued May 8, 2015).



Targets remain numerous throughout China's state plans.<sup>610</sup> A subset of targets is formalized into a dual system of “binding targets” and “indicative targets.”<sup>611</sup> For example, the *12th Five-Year Plan for Economic and Social Development (2011-2015)* (“12th FYP”) contains a series of “binding targets” pertaining, *inter alia*, to arable land supply, energy intensity, pollution emissions, and welfare provision. It also contains a series of “indicative targets” pertaining, *inter alia*, to per capita income growth, the unemployment rate, the services sector share of GDP, the urbanization rate, grain comprehensive production capacity, R&D spending as a share of GDP, and patent ownership per 10,000 people.<sup>612</sup> Another example is the *National Mineral Resource Plan (2016-2020)*, which provides “indicative targets” for the level of production of one set of resources (including oil, gas, coal, iron ore, and various nonferrous metals) and “binding targets” for the level of production of tungsten and rare earths.<sup>613</sup> A 2017 policy document issued by the Ministry of Science and Technology, moreover, instructs officials to prescribe both “binding targets” and “indicative targets” when drafting science and technology development plans for the “2030 Sustainable Development Initiative Innovation Demonstration Zones.”<sup>614</sup>

Studies indicate that the Chinese government uses a variety of methods to ensure implementation of planning targets. Fulfillment of “binding targets,” in particular, is a formal component of evaluating the performance of government officials,<sup>615</sup> and also entails direct allocation of

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<sup>610</sup> See e.g., the *Decision on Issuing “China Manufacturing 2025”* (State Council, Guo Fa [2015] No. 28, issued May 8, 2015), which contains a table that lists year 2020 and year 2025 targets for R&D spending and patents in large manufacturing industries, measured in relation to operating revenue. A related objective is to form a group of advantageous industries and backbone enterprises that possess global competitiveness. See also *State Council Notice on Issuing the Medium and Long-Term Development Plan for the Logistics Industry (2014-2020)*, Sections 4 and 5 (State Council, Guo Fa [2014] No. 42, issued September 12, 2014). Among the targets set forth in the plan are: for the logistics sector to achieve an annualized rate of growth of approximately 8% through the year 2020; for the logistics sector to achieve an approximately 7.5% share of China's GDP by 2020; and for total spending on logistics, as a share of GDP, to decrease from 18% to 16%; and for the formation of a “group of backbone logistics enterprises that possess relative strong goods transportation capacity.”

<sup>611</sup> Sebastian Heilmann and Oliver Melton, “The Reinvention of Development Planning in China, 1993-2012,” *Modern China* 39(6) (2013): 609-611; Sebastian Heilmann, “Economic Governance: Authoritarian Upgrading and Innovative Potential,” in *China Today, China Tomorrow: Domestic Politics, Economy, and Society*, ed. Joseph Fewsmith (Lanham: Rowman & Littlefield, 2010), 116-118.

<sup>612</sup> See e.g., *12th Five-Year Plan for Economic and Social Development* (adopted by NPC on March 14, 2011). See also Sebastian Heilmann and Oliver Melton, “The Reinvention of Development Planning in China, 1993-2012,” *Modern China* 39(6) (2013): 587-589.

<sup>613</sup> *National Mineral Resources Plan (2016-2020)* (MLR, issued November 2016); *State Council Approval of the National Mineral Resources Plan (2016-2020)* (State Council, Guo Han [2016] No. 178, issued November 2, 2016), Chapter II(3).

<sup>614</sup> *Ministry of Science and Technology Notice on Issuing the “Guidance for Applying to National Sustainable Development Initiative Innovation Demonstration Zones,”* Part IV(2)(3) (MOST, Guo Ke Ban She [2017] No. 24, issued April 14, 2017).

<sup>615</sup> Sebastian Heilmann and Oliver Melton, “The Reinvention of Development Planning in China, 1993-2012,” *Modern China* 39(6) (2013): 609. (“In China, the linkage between plan targets and cadre assessments was loose and unsystematic until the early 1990s. From the early 1990s on, as a result of a thorough overhaul of the party's personnel system, cadre evaluations became more systematic and started to include more economic and social

funding and stringent administrative oversight.<sup>616</sup> To fulfill “indicative targets,” the government uses methods such as policy signaling (e.g., announcements about changes to fiscal policy) and indirect incentives (e.g., improved access to bank loans) to inform the behavior of government officials and economic actors.<sup>617</sup> The Chinese government enters into contracts – concluded between central and sub-central government authorities, or between government departments and major enterprises that take part in implementing state plans – that contain planning targets for items such as road construction, technology zones, and energy production.<sup>618</sup>

Another prominent feature of the current generation of planning documents is its specificity with respect to sub-sectors, products, materials, processes, and technologies for further development. Sector-specific plans frequently detail such items in textboxes and appendices. One example is the appendix to the *12th Five-Year Development Plan for New Materials*, which pinpoints industrial materials that Chinese industry should prioritize for the development of a wide range of high-technology applications.<sup>619</sup> As is further discussed below, these enumerative planning documents act in conjunction with various types of guidance catalogues in which the Chinese government lists specific items it encourages, discourages, restricts, or prohibits for investment or other market activity. As such catalogues are made public, they signal the government’s preferences not only to government officials, but also to economic actors in individual sectors.

To ensure the implementation of state plans, the Chinese government maintains a formal system for assigning tasks and reviewing their execution. Tasking documents, which cascade from the level of the State Council and its subordinate ministries down to the local level, integrate a variety of government departments into the process of implementation. For the purposes of implementing the *11th Five-Year Plan for Economic and Social Development (2006-2010)* (“*11th FYP*”), for example, the State Council issued the *Notice on Principal Objectives and the Division of Work Tasks to Fulfill the Outline of the PRC 11th Five-Year Plan for Economic and Social Development*,<sup>620</sup> and a similar document was issued for the *12th FYP*.<sup>621</sup> These documents

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indicators than just GDP growth or unemployment in each leading cadre’s jurisdiction. [...] A breakthrough for systemically linking a more complex set of economic and noneconomic plan targets with cadre appraisals resulted from the re-institution of a “binding target” category in national, provincial- and local-level planning from 2006.”)

<sup>616</sup> *Ibid.*, 610-611; Sebastian Heilmann, “Economic Governance: Authoritarian Upgrading and Innovative Potential,” in *China Today, China Tomorrow: Domestic Politics, Economy, and Society*, ed. Joseph Fewsmith (Lanham: Rowman & Littlefield, 2010), 116-117.

<sup>617</sup> *Ibid.*

<sup>618</sup> *Ibid.*

<sup>619</sup> *12th Five-Year Development Plan for New Materials* (MIIT, issued January 4, 2012). See also the *Four Ministries Notice on Issuing the New Materials Industry Development Guide* (MIIT, NDRC, MOST, MOF, Gong Xin Bu Lin Gui [2016] No. 454, issued December 30, 2016).

<sup>620</sup> *Notice on Principal Objectives and the Division of Work Tasks to Fulfill the Outline of the PRC 11th Five-Year Plan for Economic and Social Development* (State Council, Guo Fa [2006] No. 29, issued August 24, 2006).

<sup>621</sup> *Notice on Principal Objectives and the Division of Work Tasks to Fulfill the “Outline of the PRC 12th Five-Year Plan for Economic and Social Development* (State Council, Guo Fa [2011] No. 34, issued October 11, 2011).

list which government department will be responsible for, or lead, the implementation of each item of the *FYP*.

In conjunction with tasking documents, China's institutional framework comprises a formal review process, formalized in 2005 through the State Council's *Several Opinions on Strengthening Drafting Work for the National Economic and Social Development Plan*.<sup>622</sup> One component of this review process is a mid-term evaluation of each *FYP*. The *Notice on Launching the Mid-Term Evaluation of "12th Five-Year Plan" Outline*,<sup>623</sup> issued by NDRC pursuant to the aforementioned State Council tasking document for the *12th FYP*, sets forth an intricate point-tallying system to evaluate implementation of each aspect of the *12th FYP*. Another component, carried out primarily within NDRC using market analysis tools, is an annual review of the previous year's performance and the setting of targets for the coming year, presented by NDRC each March at NPC's annual meeting. The most recent such presentation is contained in the *Decision of the 12th National People's Congress Fifth Meeting on the Status of Executing the 2016 National Plan for Economic and Social Development and on the 2017 National Plan for Economic and Social Development*.<sup>624</sup>

## 1.2. Institutional Framework for Industrial Policies

### 1.2.1. Planning Agencies with Broad Regulatory Authority

In China's system of government, the central government agencies that bear prime responsibility for state planning also have broad legislative and regulatory authority. In 2003, the Chinese government consolidated disparate authorities, including the former State Planning Commission,

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<sup>622</sup> *Several Opinions on Strengthening Drafting Work for the National Economic and Social Development Plan* (State Council, Guo Fa [2005] No. 33, issued October 22, 2005). Section 5 provides for establishing an evaluation and adjustment mechanism for plans. Article 12 provides: Implement a plan evaluation system. In the course of plan implementation, plan drafting departments are required to organize and carry out in a timely manner evaluations of the implementation status, promptly discover problems, earnestly analyze the causes of the problems, and provide recommendations for targeted counter-measures. The regions and departments concerned are also required to closely track and analyze the implementation status of the plan, and promptly provide feedback to the plan drafting departments. Article 13 further provides: Adjust and amend plans in a timely manner. If through evaluation or due to other reasons it becomes necessary to amend a plan, the plan drafting departments shall provide a plan revision program [fang'an]. Each region and each department is required to take full into account the realities of its region or department in earnestly and properly handling the implementation of this work. They shall constantly summarize experiences and lessons, reform the planning administration system, innovation plan drafting methods, and regularize plan drafting processes, so as to make plan drafting work better meets the demands of the socialist market economy system and the needs of economic and social development.

<sup>623</sup> *Notice on Launching the Mid-Term Evaluation of "12th Five-Year Plan" Outline* (NDRC, Fai Gai Gui Hua [2013] No. 328, issued October 11, 2011).

<sup>624</sup> The most recent such presentation is contained in the *Decision of the 12th National People's Congress Fifth Meeting on the Status of Executing the 2016 National Plan for Economic and Social Development and on the 2017 National Plan for Economic and Social Development*, [presentation] NPC, March 15, 2017.

to establish NDRC.<sup>625</sup> One of NDRC's key functions is to formulate the *FYP* through a complex process of inter-ministerial planning and coordination.<sup>626</sup> Other functions of NDRC also include planning components, such as promoting innovation and industrial restructuring, coordinating development of macro-regions, and balancing supply and demand of important commodities.<sup>627</sup>

At the same time, NDRC enjoys broad legislative and regulatory authority. One of its stated functions is to “draft relevant laws and regulations concerning national economic and social development, economic system restructuring and opening up to the outside world and formulate regulations; to guide and coordinate tendering in accordance with regulations.”<sup>628</sup> As discussed further in Factor 5.B. below, NDRC also comprises a pricing department that formally guides and sets national prices for energy and other important factor inputs that influence prices and costs throughout the economy. NDRC also wields authority over the approval of large domestic and foreign investment projects, administration of import tariff-rate quotas, and the procurement and storage of raw materials.<sup>629</sup>

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<sup>625</sup> Tony Saich, *Governance and Politics of China* (New York: Palgrave MacMillan, 2011), 96; Sebastian Heilmann and Leah Shih, “The Central Government,” in *China's Political System*, ed. Sebastian Heilmann (New York: Rowman & Littlefield, 2017), 77-78.

<sup>626</sup> NDRC divides its “main functions” into 15 categories, of which the first category applies to high-level state planning. *Main Functions of NDRC* (NDRC, available at <http://en.ndrc.gov.cn/mfndrc/>, accessed on May 22, 2017). (“To formulate and implement strategies of national economic and social development, annual plans, medium and long-term development plans; to coordinate economic and social development; to carry out research and analysis on domestic and international economic situation; to put forward targets and policies concerning the development of the national economy, the regulation of the overall price level and the optimization of major economic structures, and to make recommendations on the employment of various economic instruments and policies; to submit the plan for national economic and social development to the National People's Congress on behalf of the State Council.”) See also Sebastian Heilmann and Oliver Melton, “The Reinvention of Development Planning in China, 1993-2012,” *Modern China* 39(6) (2013): 600. (“Top Party leaders and the State Council, and their affiliated research arms, sit at the apex of the planning process, but NDRC's various offices are the locus of many drafting and planning functions: they approve and oversee regional strategic plans down to the city level, manage major regional investment projects, and are deeply involved in virtually every macro-economic issue. The same is true at the local level, where province- and city-level Development and Reform Commissions enjoy an analogous leadership role [...]”)

<sup>627</sup> *Ibid.* (“[P]ush forward strategic economic restructuring,” functions of which include, *inter alia*, to “balance and coordinate industrial development with relevant plans, major policies and plans for the national economic and social development”; “formulate strategies and plans for modern logistics development”; “formulate strategies, plans and major policies for the development of high-tech industries and advance of industrial technologies.”[...] To “formulate strategies, plans and major policies for promoting the coordinated development of regional economy, development of western region, revitalization of northeastern region and other old industrial bases, and rise of central region of China.” [...] To “maintain the aggregate balance and overall control of important commodities,” functions of which include, *inter alia*, to “formulate plans for the overall volume of import and export of important agricultural products, industrial products and raw materials, supervise the implementation of these plans and adjust them in accordance with the performance of the national economy” and “formulate plans for the state reserve of strategic materials and carry out collection, utilization, rotation and management of these materials.”)

<sup>628</sup> *Ibid.*

<sup>629</sup> NDRC lists on its website 33 subordinate units. The Department of Development Planning, Department of National Economy, and Department of Economic System Reform are the units principally in charge of state planning. The Department of Price and the Bureau of Price Supervision and Anti-Monopoly administer pricing regulation. The Department of Fixed Asset Investment and Department of Foreign Capital and Overseas Investment

Another central government agency that combines planning with legislative and regulatory functions is the Ministry of Industry and Information Technology (MIIT). Established in 2008, MIIT has formulated dozens of state plans for specific sectors of China's economy, especially those pertaining to technology-intensive industries.<sup>630</sup> At the same time, MIIT houses over 20 departments responsible for regulating diverse economic activities; notably, science and technology research, telecommunications, the Internet, the production of electronic and information goods, and primary raw materials.<sup>631</sup>

### 1.2.2. Mobilizing Capacity through the Government and the CCP

The Chinese government has the capacity to mobilize a large number of government authorities to execute state industrial policies. These authorities comprise nearly all ministries and agencies across the government hierarchy, including, *inter alia*, over 80 different authorities under the State Council, comprising ministry-level departments, organizations, special organizations, administrative offices, institutions, and sub-ministerial state administrations and bureaus; and thousands of sub-central government authorities.<sup>632</sup>

The CCP also plays a leading role in implementing industrial policies. The CCPCC has formal power to approve each *FYP*, in conjunction with the State Council. Importantly, *13th FYP* also appears to contain more forceful language than previous *FYPs* regarding the CCP's role in overseeing implementation of the *FYP*.<sup>633</sup> This modification in the *FYP* has coincided with reports of increased CCP control over administrative and economic activity in China. CCP

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administer investment regulation. The State Bureau of Material Reserve, State Grain Administration, and National Energy Administration administer important facets of mining, grain, and energy regulation. See NDRC website, available at <http://en.ndrc.gov.cn/>.

<sup>630</sup> See also World Bank, *China 2030: Building a Modern, Harmonious, and Creative Society*, Report No. 96299 (March 2013), 108. ("Such [industrial] interventions are implemented by three broad classes of actors [...] The first are high-level national bodies. The second are central government departments, including the *National Development and Reform Commission (NDRC)*, the *Ministry of Industry and Information Technology (MIIT)*, and others. The third are sub-central governments and their departments. While such governments are expected to help execute national policy, their extensive responsibilities also give them the means to influence industrial development, such as industrial planning, fiscal policy, access to land, and ownership of local SOEs." (emphasis added))

<sup>631</sup> MIIT website, available at <http://www.miit.gov.cn/>.

<sup>632</sup> For a list of counties, see NBS website, available at [http://www.stats.gov.cn/tjsj/tjbz/xzqhdm/201703/t20170310\\_1471429.html](http://www.stats.gov.cn/tjsj/tjbz/xzqhdm/201703/t20170310_1471429.html). For a list of State Council authorities, see State Council website, available at <http://www.gov.cn/guowuyuan/zuzhi.htm>.

<sup>633</sup> *13th Five-Year Plan for Economic and Social Development (2016-2020)* (adopted by NPC at the Fourth Session of the 12th Congress on March 16, 2013). Chapter XX(1) states: "We will see that the Party exercises overall leadership and coordinates all aspects of work and that Party committees and leading Party members' groups at all levels serve as the core leadership and exercise more effective leadership so as to provide a firm guarantee for the realization of this plan."



members at all levels are now subject to multiple new and wide-ranging disciplinary measures, which seek in part to ensure implementation of central government and CCP policies.<sup>634</sup>

The CCP's leading role in industrial policymaking is also evident in its institutional makeup.<sup>635</sup> At the central government level, the CCPCC comprises Departments,<sup>636</sup> Commissions,<sup>637</sup> and Central Leading Small Groups,<sup>638</sup> several of which participate in industrial policymaking. For example, at the policy formulation stage, the Central Finance and Economy Leading Small Group coordinates closely with NDRC.<sup>639</sup> The newly established Central Leading Small Group for Comprehensively Deepening Reforms, established at the Third Plenary Session of the 18th National Congress of the CCP and expected to run through the year 2020, also influences the current planning work of NDRC and other government departments.<sup>640</sup>

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<sup>634</sup> Jude Blanchette, *Back to Basics: The CCP at 95*, (The Conference Board, September 2016), 1-4.

<sup>635</sup> The Department previously concluded that “the constitutional, legal and de facto source of authority for governance in China lies with the CCP.” See Shauna Biby, Christopher Cassel, and Timothy Hruby, *The Relevance of the Chinese Communist Party for the Limited Purpose of Determining Whether Particular Enterprises Should Be Considered to Be “Public Bodies” within the Context of a Countervailing Duty Investigation. Memorandum of Proceedings* (U.S. Department of Commerce, 2012), 3.

<sup>636</sup> CCP Departments comprise: (1) Organization Department responsible for cadre and organization policy), (2) the Central Party School that functions as a forum for CCP members to exchange ideas and as a think tank for administrative reforms; (3) the CCP Propaganda Department in charge of propaganda work and information policy; and the (4) International Liaison Department; (5) United Front Work Department responsible for maintain contacts with non CCP forces (including entrepreneurs and the All-China Federation of Industry and Commerce). Sebastian Heilmann and Leah Shih, “The Chinese Communist Party,” in *China's Political System*, ed. Sebastian Heilmann (New York: Rowman & Littlefield, 2017), 68-72.

<sup>637</sup> CCP Commissions comprise: (1) Central National Security Commission that consolidates all the relevant security institutions under the leadership of the CCP Secretary; (2) Political and Legal Affairs Commission, represented at the central, province, and sub-province level, that is responsible for overseeing the police and the judiciary; (3) Central Institutional Organization Commission, responsible for organizational planning and administrative reform at the various CCP and government levels; (4) Central Commission for Discipline Inspection. Sebastian Heilmann and Leah Shih, “The Chinese Communist Party,” in *China's Political System*, ed. Sebastian Heilmann (New York: Rowman & Littlefield, 2017), 68-72.

<sup>638</sup> CCP Leading Small Groups comprise: (1) Central Foreign Affairs Work Leading Small Group and Central Taiwan Work Leading Small Group are inter-ministerial coordination and decision-making bodies with CCP headquarters; (2) Central Finance and Economy Leading Small Group, responsible for developing guidelines for economic planning and economic structural reforms, drawing on the expertise of a large number of government bodies and research institutes; (3) Central Leading Small Group for Rural Work, responsible for rural economic and social policy; (4) Central Leading Small Group for Comprehensively Deepening Reforms was set up specifically to implement the institutional and economic restructuring program established in 2013 to be completed by 2020.

<sup>639</sup> Sebastian Heilmann and Leah Shih, “The Chinese Communist Party,” in *China's Political System*, ed. Sebastian Heilmann (New York: Rowman & Littlefield, 2017), 77-78.

<sup>640</sup> *Ibid.*



As discussed above in Factor 4, a particularly powerful CCP organ is the Organization Department, which operates the *nomenklatura* system that governs personnel appointments.<sup>641</sup> It also uses a cadre evaluation system in which the performance of government officials is calculated according to a weighted points system.<sup>642</sup> One scholar notes:

The CCP's most powerful instrument in structuring its domination over the state is a system called the "Party management of cadres" (*dangguan ganbu*), or more commonly known in the West as the *nomenklatura* system. The *nomenklatura* system 'consists of lists of leading positions, over which Party units exercise the power to make appointments and dismissals; lists of reserves or candidates for these positions; and institutions and processes for making the appropriate personnel changes.' The system established was based on the Soviet model, and changes occurred from time to time, albeit not drastic ones. [...] The CCP selects all government officials; almost all government officials and all top officials are themselves Party members; and in each government agency, Party members are organized under a Party committee that is subordinate to the Party committee at the higher administrative level.<sup>643</sup>

In addition to the *nomenklatura* system, Chinese law contains provisions that mandate the compliance of officials at all levels of government with the CCP. Article 4 of the *Law of the People's Republic of China on Civil Servants*, adopted in 2005, provides:

The basic route of the preliminary stage of socialism and the [CCP] cadre routes, as well as the guidelines of the CCP, shall be carried out in the civil servant system. The principle that the CCP assumes the administration of cadres shall be insisted."<sup>644</sup>

### 1.2.3. *The Formal Role of SIEs in Industrial Policymaking*

As discussed in Factor 4, government ownership and control over enterprises in China's economy is extensive, particularly in industries the government deems essential or strategic. Government influence over SIE decision-making is thus a powerful tool for the implementation of state industrial policies. Indeed, through various laws and other measures, the Chinese government has formalized the participation of SIEs in industrial policymaking. First, the 2008

<sup>641</sup> Tony Saich, *Governance and Politics of China, Third Edition* (New York: Palgrave MacMillan, 2011), 123. ("Basically, the [Organization] Department oversees the CCP's *nomenklatura* appointments, the cover all senior ministry appointments, senior judicial nominees, heads of major state-owned enterprises, top university presidents...the editors of key party publications and other media, provincial leaders and the directors of think tanks.")

<sup>642</sup> For a discussion of cadre evaluation systems, see Susan Whiting, "The Cadre Evaluation System at the Grass Roots: The Paradox of Party Rule," in  *Holding China Together: Diversity and National Integration in the Post-Deng Era*, ed. Barry Naughton and Dali Yang (New York: Cambridge University Press, 2004), 101-119; Victor Shih, Christopher Adolph, and Liu Mingxing, "Getting Ahead in the Communist Party: Explaining the Advancement of Central Committee Members in China," *American Political Science Review* 106(1) (2012): 1166-1187.

<sup>643</sup> Zheng Yongnian, *The Chinese Communist Party as Organizational Emperor: Culture, Reproduction, and Transformation* (London: Routledge, 2010), 103-104.

<sup>644</sup> *Law of the People's Republic of China on Civil Servants*, Article 4 (adopted by NPC on April 27, 2005, effective January 1, 2006).

*Law of the People's Republic of China on the State-Owned Assets of Enterprises*, which applies to all enterprises with any level of state investment, provides that the investments of state-invested enterprises shall *conform to state industrial policies*.<sup>645</sup> (emphasis added)

With respect to the over 100 SIEs administered by SASAC at the national level, the Chinese government has issued various policies to mandate compliance with industrial policies:

- The 2003 *Interim Regulation on the Supervision and Administration of State-owned Assets of Enterprises* provides that SASAC shall perform its responsibilities as an investor with respect to major investment and financing decisions “in accordance with the *state development planning and industrial policies*.”<sup>646</sup> (emphasis added)
- The 2004 *Measures for the Administration of Central State-owned Enterprise Development Strategies and Plans (Trial)* provides that the principal criteria SASAC shall use when examining and approving SIEs’ development plans and targets are “whether [they] conform to state development plans and industrial policies” and “whether [they] comply with the strategic adjustment of the layout and structure of the state-owned economy.”<sup>647</sup>
- The 2006 *Guiding Opinions of the SASAC about Promoting the Adjustment of State-Owned Capital and the Reorganization of State-owned Enterprises* encourages alliances between strong central state-owned enterprises that conform to state industrial policies in order to foster a group of especially large enterprise groups that possess global competitiveness.<sup>648</sup>

SASAC evaluates the SIEs it manages according to a points system. According to the 2006 *Implementing Rules for Central State-owned Enterprise Comprehensive Achievements Evaluation*, central SIEs will be rewarded for major science and technology innovation so as to incentivize enterprises to strengthen science and technology innovation. The same provision provides that enterprises that undertake major state S&T-related projects and achieve breakthroughs will be assessed an additional three to five points; when they undertake research for a major science and technology issue listed in the Catalogue of National Science and Technology Development Plan Outline, even if they do not achieve breakthroughs but have

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<sup>645</sup> *Law of the People's Republic of China on the State-Owned Assets of Enterprises*, Article 36 (adopted by NPC on October 28, 2008).

<sup>646</sup> *Interim Regulation on the Supervision and Administration of State-owned Assets of Enterprises*, Article 31 (State Council 2003 Order No. 26, issued May 27, 2003, amended January 8, 2011).

<sup>647</sup> *Measures for the Administration of Central State-owned Enterprise Development Strategies and Plans (Trial)*, Articles 3 and 13(2) (SASAC, Order [2004] No. 10, issued November 26, 2004, effective January 1, 2005).

<sup>648</sup> *Notice of the General Office of the State Council on Forwarding the Guiding Opinions of SASAC about Promoting the Adjustment of State-Owned Capital and the Reorganization of State-owned Enterprises*, Articles 8 and 17 (State Council, Guo Ban Fa [2006] No. 97, issued December 5, 2006).

made fairly large investments, they will be assessed an additional one to two points.<sup>649</sup> The 2017 *Measures for the Supervision and Administration of Central State-Owned Enterprise Investment*<sup>650</sup> provide that the orientation of investments of central SIEs shall be guided by national development strategies and central state-owned enterprise five-year development plan outlines. Moreover, central SIE investments shall serve national development strategies and embody the wishes of its investor [...] and foster and develop strategic and emerging industries.<sup>651</sup>

With respect to state planning specifically, the 2017 *Measures for the Supervision and Administration of Central State-Owned Enterprise Investment* provide that central SIEs are required to be “guided by the central SIEs’ five-year plans.”<sup>652</sup> Examples of SIE five-year plans include:

- In a report published on its website on July 5, 2010, Baosteel, China’s second-largest steel producer, stated that in the middle of 2010, many entities, from enterprises to the government, were all busy with one thing – drafting the *2011-2015 Development Plan*. Baosteel, it reported, had taken the lead by announcing its *2010-2015 Development Outline* on June 25. Reportedly, Baosteel’s plan calls for shedding capacity at the firm level so as to support the government’s objective to reduce excess capacity in the steel industry.<sup>653</sup>
- A report published December 3, 2014 on the website of CNOOC, one of China’s three major oil and gas companies, stated that the enterprise had initiated ‘13th Five-Year’ Plan Drafting, and was conducting research to set oil and gas output volume plans for that period.<sup>654</sup>
- In a report published on the SASAC website on April 26, 2016, China National Petroleum Corp. announced it had formulated its *13th Five-Year Development Plan* after two years of drafting work. In so doing, it had fully carried out the spirit of the 18th National Congress of the CCP and the Third, Fourth, and Fifth Plenary Sessions of the 18th National Congress of the CCP, and profoundly carried out the spirit of the speeches

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<sup>649</sup> *Implementing Rules for Central State-owned Enterprise Comprehensive Achievements Evaluation*, Article 32 (SASAC, Guo Zi Fa Ping Jian [2006] No. 157, issued September 12, 2006).

<sup>650</sup> *Measures for the Supervision and Administration of Central State-Owned Enterprise Investment* (SASAC, Order [2017] No. 34, issued January 7, 2017).

<sup>651</sup> *Ibid.*, Articles 3 and 5. As discussed further in Section C, strategic and emerging industries are an important component of technology-related industrial policies.

<sup>652</sup> *Ibid.*, Article 3.

<sup>653</sup> *Zhong Jingying Bao*, “Baosteel Plan Five-Year Target for 30% Cut in Output, Plans for ‘Non-Steel,’” July 5, 2010.

<sup>654</sup> *China Offshore Oil News*, “CNOOC Launches ‘13th Five-Year Plan’ Drafting,” December 3, 2014.

of Secretary Deng Xiaoping and respectively adhered to the strategic thinking of the ‘Four Comprehensives’<sup>655</sup> strategic constellation and the energy revolution.<sup>656</sup>

- In a report published on the SASAC website on March 22, 2016, COFCO announced it had formulated its *13th Five-Year Development Plan*, based on “earnestly studying the spirit of the CCPCC Economic Work Conference and the requirements of supply-side structural reform,” *i.e.*, the reforms proposed by the CCP leadership in 2015.<sup>657</sup>

A book authored in 2008 by Zhou Xinmin, Deputy Director of Human Resources of the petroleum and gas SIE Sinopec, further demonstrates the manner in which large SIEs fulfill government mandates. Zhou states that “we must accurately comprehend the special positioning of SOEs in the economic society of China and master the development trend of SOEs under that grand objective of developing a Socialist market economy.”<sup>658</sup> Further,

As a unique kind of economic organization, SOEs are different from the Party or administrative departments, in that they have to create material wealth and compete in the market place. They are also different from enterprises under other forms of ownership, for they assume not only basic economic responsibilities, but also important political and social responsibilities. SOEs are considered a potent mechanism for the government to implement national policies while being the reliable instrument for the country to cope with major economic risks.<sup>659</sup>

As noted under Factor 4, the CCP also uses the *nomenklatura* system as a means to reward compliance or punish non-compliance of corporate executives with industrial policies.

Industry associations are another set of entities through which the government seeks to implement industrial policies. Many of China’s largest industrial associations were not formed through private sector initiatives, but rather, were created to replace and assume the regulatory functions of national government bureaus abolished in 2003.<sup>660</sup> Such associations are often

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<sup>655</sup> Four Comprehensives, or the Four-pronged Comprehensive Strategy is a list of political goals for China, put forward by CCP General Secretary Xi Jinping: (1) Comprehensively build a moderately prosperous society; (2) Comprehensively deepen reform; (3) Comprehensively govern the nation according to law; (4) Comprehensively strictly govern the Party.” Chris Buckley, “Xi Jinping’s ‘Four Comprehensives’ Give Shape to a Crowded Agenda,” *New York Times*, March 1, 2015; John Fei, *To Understand China’s Economic Signals, Start With the ‘Four Comprehensives’*, The Council on Foreign Relations, March 11, 2016.

<sup>656</sup> *CNPC*, “CNPC Announces ‘13th Five-Year’ Development Plan,” April 26, 2016.

<sup>657</sup> *COFCO*, “COFCO Group Formulates ‘13th Five-Year’ Development Plan,” March 22, 2016.

<sup>658</sup> Xinmin Zhou, *Core Capability of Leaders, Exploration and Practice of China’s State-Owned Enterprises* (Manhattan Beach: East West Discovery Press, 2008), 8.

<sup>659</sup> *Ibid.*, 7.

<sup>660</sup> These industrial associations include: China Iron and Steel Association, China Machinery Industry Federation, China Petroleum and Chemical Industry Federation, China Light Industry Federation, China Textile Industry Association, China Coal Industry Association, China Federation of Logistics and Purchasing, and China Non-Ferrous Metals Industry Association. In addition, a number of chambers of commerce were established in the import and export sector. These chambers of commerce include: China Chamber of Commerce for Import and Export of

“staffed by former government officials from the defunct ministries and have the same organizational structures and functions as those ministries. The industrial associations actively supervise the operations of firms in their respective industries and have retained much, if not all, of the power exercised by their state predecessors.”<sup>661</sup>

## 2. *Implementation Mechanisms for Industrial Policies*

The Chinese government uses a diverse set of instruments to intervene in the economy in order to achieve industrial policy objectives. In its 2008 *Trade Policy Review* of China, the WTO has noted the growing complexity of these instruments as China’s economic policymaking evolves:

Direct intervention in the economy remains the main approach of industrial policy. Nonetheless, there has been a shift towards the use of various other policy tools to channel resources into certain activities that the Government believes are important for China’s continued growth and development. In addition to tariffs and other border tax measures, tax incentives, and subsidies, these tools include ‘guided credit,’ various ‘catalogues’ identifying sectors eligible for incentives, as well as restricted or prohibited activities, various forms of ‘guidance’ including section-specific ‘industrial development policies’ (e.g. for steel, automobiles, and cement), and price controls.<sup>662</sup>

The World Bank has emphasized direct interventions:

Industrial policies have relied heavily on direct administrative intervention to shift resources from prohibited to preferred sectors. While market mechanisms also play a role, the authorities often use very direct means to “close down, suspend operation, merge and shift” resources. These have included market access controls, project examination and approval, land supply approval, loan approval, industrial guidance catalogue, and compulsory elimination of outdated production capacity.<sup>663</sup>

Provided below is a list of the wide variety of mechanisms that China deploys to implement its industrial policy objectives, namely (1) investment restrictions and the approval process, (2) access conditions and other industry standards, (3) guidance catalogues, (4) financial supports, and (5) quantitative restrictions.

### 2.1. Investment Restrictions and Approval Process

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Textiles, China Chamber of Commerce for Import and Export of Light Industrial Products and Arts-Crafts, China Chamber of Commerce of Metals, Minerals and Chemicals Importers and Exporters, China Chamber of Commerce for Import and Export of Foodstuffs, Native Produce and Animal By-Products, China Chamber of Commerce for Import and Export of Machinery and Electronic Products, and China Chamber of Commerce for Import and Export of Medicines and Health Products. Curtis J. Milhaupt and Wentong Zheng, “Beyond Ownership: State Capitalism and the Chinese Firm,” *The Georgetown Law Journal* 103:665 (2015): 686, note 107.

<sup>661</sup> *Ibid.*, 686-687.

<sup>662</sup> WTO, *Trade Policy Review – Report by the Secretariat – China*, WT/TPR/S/199 (April 16, 2008), 89.

<sup>663</sup> World Bank, *China 2030: Building a Modern, Harmonious, and Creative Society*, Report No. 96299 (March 2013), 142.

The Chinese government's framework for granting or denying access for a market entry of an entity, product, or activity serves important industrial policy objectives. First, in many cases, the Chinese investment regime reserves the right for the government to review and approve domestic and foreign investments. The *State Council Notice on Announcing the Catalogue of Government Approved Investment Projects (2016 Edition)* ("2016 Investment Catalogue")<sup>664</sup> stipulates that government approvals are necessary for certain investments in 12 categories: (1) agricultural irrigation; (2) energy; (3) transport infrastructure; (4) telecommunications infrastructure; (5) primary materials, including rare earths, iron ore, and nonferrous metals mining, petrochemicals, coal processing, rare earths processing, and gold processing; (6) automotive sector manufacturing; (7) tobacco processing; (8) civil aviation manufacturing; (9) urban infrastructure; (10) public goods; (11) foreign investment; and (12) outbound investments.

Large investments often require approval at the central or sub-central level by NDRC, the same agency responsible for formulating industrial policy.<sup>665</sup> Investment approvals can assume the character of industrial policy when they are carried out or denied in a coordinated manner so as to achieve a desired objective. This is the case, for example, in the 2006 *Opinion on Strengthening Adjustment and Control of Investment in Fixed Assets and Strictly Controlling Newly Started Projects*,<sup>666</sup> issued by NDRC in conjunction with MLR and the CBRC. This document constitutes a macro-economic tool to slow down rapid investment growth, calling for stricter approvals of new investment projects in tandem with tighter regulation of land allocations and stricter controls on lending to new infrastructure projects.<sup>667</sup>

To achieve its industrial policy objectives, the government regulates investment flows from both foreign and domestic sources, to favored and disfavored firms, products, technologies, and industries. Accordingly, China's domestic and foreign investment regimes have parallel structures, defining certain sectors as encouraged, restricted, or prohibited for investment. (See Factor 3 for more detail.) Notably, various industrial policy measures, including the *State Council Decision on Implementing the Interim Provisions on Promoting the Structural Adjustment of Industry* (discussed in more detail below), expressly state that an FDI catalogue and related measures should be formulated in accordance with these industrial policies. For example, the government encourages FDI in industries in upstream inputs, rather than downstream products, particularly in key components, equipment, and technologies that the

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<sup>664</sup> *State Council Notice on Announcing the Catalogue of Government Approved Investment Projects (2016 Edition)* (State Council, Guo Fa [2016] No. 72, issued December 20, 2016).

<sup>665</sup> *State Council Notice on Announcing the Catalogue of Government Approved Investment Projects (2016 Edition)* (State Council, Guo Fa [2016] No. 72, issued December 20, 2016). Article 7 states that projects for which State Council approval is stipulated will be reported to the State Council for approval following preliminary screening by the National Development and Reform Commission.

<sup>666</sup> *State Council Notice on Issuing NDRC Opinion on Strengthening Adjustment and Control of Investment in Fixed Assets and Strictly Controlling Newly Started Projects* (State Council, Guo Ban Fa [2006] No. 44, issued June 13, 2006, expired November 27, 2015).

<sup>667</sup> *Ibid.*, Sections 2, 3, and 4.



government deems critical to the development of each industry as well as to China's industrial capabilities as a whole.<sup>668</sup>

## 2.2. Access Conditions and Other Industry Standards

“Access conditions” are used by the Chinese government to achieve multiple objectives, including, *inter alia*, encouraging the adoption of new technologies, restricting market access, and shedding capacity in heavy industry sectors. Enterprises that meet industry access conditions may be entitled to certain benefits while enterprises that fail to meet the conditions may face closure or restrictions on expansion. Industry access conditions are used in a wide variety of industries. For example, with respect to NEVs, the Chinese government has issued access rules for manufacturers, such that conformity with the rules serves as a precondition for receiving government subsidies.<sup>669</sup>

With respect to excess capacity industries, there are several access conditions that set standards for the industry.<sup>670</sup> For example in the steel industry, the *Iron and Steel Industry Standard Conditions* were issued in 2010, 2012, and 2015.<sup>671</sup> According to its terms, the standards serve as the fundamental condition for the production and operation of the steelmaking industry.<sup>672</sup> In addition to setting environmental and safety standards, the standard conditions cover a wide range of topics that relate to basic operational and business decisions, including product quality, production method and equipment, and energy consumption and resource usage, and include

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<sup>668</sup> See *Catalogue for the Guidance of Foreign Investment Industries (2015 Amendment)* (NDRC and MOFCOM Order No. 22, issued March 10, 2015, effective April 10, 2015).

<sup>669</sup> NDRC first issued *Rules on the Administration of Access for New Energy Vehicle Manufacturing* in 2007. These access rules essentially consist of detailed technical and other criteria for NEV manufacturers and products, respectively; the requisite application materials to be submitted for approval, respectively; details on administrative procedures, including how regulators will verify, and entrust third-party specialists to verify, the information submitted; periodic reporting requirements for those who have qualified, together with other obligations, such as after-sales services; and penalties for violations. Those who meet the access rules are listed in a catalogue published by MIIT, which determines the NEV manufacturers and products eligible to receive subsidies under a purchase subsidy program. See *Rules on the Administration of Access for New Energy Vehicle Manufacturing* (NDRC 2007 Public Notice No. 72, issued October 17, 2007); *Rules on the Administration of Access for New Energy Vehicle Manufacturers and Products* (MIIT, Gong Chan Ye [2009] No. 44, issued June 17, 2009); *Provisions on the Administration of Access for New Energy Vehicle Manufacturers and Products* (MIIT 2017 Order No. 39, issued January 7, 2017).

<sup>670</sup> See e.g., *2009 Nonferrous Metals Industry Adjustment and Revitalization Plan* (State Council, issued May 11, 2009), *Steel Industry Adjustment and Revitalization Plan* (State Council, Guo Fa [2009] No. 6, issued March 20, 2009), *Shipbuilding Industry Structural Adjustment and Transformation and Upgrade Action Plan (2016-2020)* (MIIT, NDRC, MOF, PBOC, CBRC, issued January 12, 2017). See also *Overcapacity in China: An Impediment to the Party's Reform Agenda* (European Chamber of Commerce in China & Roland Berger, 2016), 20-22.

<sup>671</sup> *Announcement on the Standard Conditions for the Iron and Steel Industry* (Revised 2015) and the *Measures for the Administration of Standards for Enterprises in the Iron and Steel Industry* (MIIT Order [2015] No. 35, issued May 19, 2015).

<sup>672</sup> *Ibid.*, Article 1(3).

detailed specifications for each. For example, according to the 2015 standard conditions, under the production method and equipment category, for existing steelmaking enterprises, blast furnaces must have a capacity of at least 400 cubic meters and electric furnaces must have a capacity of at least 30 metric tons.<sup>673</sup>

These industry conditions offer incentives for compliance and disincentives for non-compliance. Enterprises that do not meet the standards may be forced to restructure, and local governments are directed to adopt legal, economic, and market measures to restructure these enterprises and phase out unqualified enterprises.<sup>674</sup> In April 2013, MIIT released a list of 45 steel enterprises that met the requirements of the 2012 steel standard conditions, which qualified these enterprises for various support policies.<sup>675</sup> The announcement also stated that MIIT will use differential electricity pricing, financial awards, accountability systems, and other economic, legal, and administrative processes to gradually consolidate the industry by forcing the non-qualifying enterprises out of the market thereby resolving excess capacity.<sup>676</sup> The standard conditions are intended to have a significant impact on the entire industry, with the 2013 notice setting a target of 80% of enterprises meeting the standards before the end of the 12th five-year planning period (2011-2015).<sup>677</sup>

### 2.3. Guidance Catalogues

China issues different catalogues that provide guidance on the implementation of its industrial policies that set forth, *inter alia*, sectors entitled to preferential treatment; sectors in which investment is “encouraged,” “permitted,” or “prohibited”; and products that are subject to licenses or export taxes.<sup>678</sup> As the WTO found in its *Trade Policy Review of China*, five-year plans will often provide the overarching industrial policy objective, while a detailed and often extensive guidance catalogue will provide the implementation details. The *Trade Policy Review of China* includes the following table of selected catalogues that have been issued by the Chinese government:<sup>679</sup>

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<sup>673</sup> *Ibid.*, Article 2(2)(ii).

<sup>674</sup> According to the 2012 standards conditions for steel, enterprises that meet the conditions of this standard will become the fundamental basis for relevant policy support; enterprises that do not meet these standard conditions should carry out rectification. If after rectification, the enterprise is still unable to meet the requirements of these standard conditions, all localities should comprehensively use laws and regulations, economic and market means to push forward the enterprises’ exit or transformation and development. *Ibid.*, Article 1(4).

<sup>675</sup> *MIIT Public Announcement on the First Batch of Enterprises that Fulfill the Steel and Iron Industry Normative Conditions* (MIIT, published on MIIT website, April 2, 2013). According to the notice, these 45 enterprises together accounted for 300 million MT of steel capacity in 2012, representing 41.4 % of total crude steel capacity that year.

<sup>676</sup> *Ibid.*

<sup>677</sup> *Ibid.*

<sup>678</sup> WTO, *Trade Policy Review, The People’s Republic of China*, WT/TPR/S/342 (June 15, 2016), 35.

<sup>679</sup> *Ibid.*, 82. NDRC and MIIT maintain and regularly update a series of guidance catalogues. In 2017, for example, NDRC issued updated versions of the *Foreign Investment Catalogue, the Catalogue of Priority Industries for*

**Table 3: Chinese Government Guidance Catalogues as Reported by WTO**

	Remarks
Catalogue of Public Infrastructure Projects Eligible for Preferential Enterprise Income Tax Treatment (2008)	"Ministry of Finance, State Administration of Taxation announced the National Development and Reform Commission Catalogue of Public Infrastructure Projects Eligible for Preferential Corporate Income Tax Treatment (2008 edition), Notice" (Cai Shui [2008] No. 116). Viewed at: <a href="http://www.chinatax.gov.cn/n810341/n810755/c1225570/content.html">http://www.chinatax.gov.cn/n810341/n810755/c1225570/content.html</a>
Catalogue of Priority Industries for Foreign Investment in the Central-Western Regions (2013)	Decree No. 1 of 2013, NDRC and the Ministry of Commerce. Viewed at: <a href="http://www.sdpc.gov.cn/zcfb/zcfbl/201305/t20130516_541505.html">http://www.sdpc.gov.cn/zcfb/zcfbl/201305/t20130516_541505.html</a>
Catalogue of Encouraged Technology and Product Imports	Jointly issued by NDRC, Ministry of Finance, and Ministry of Commerce on 6 July 2015. Viewed at:
Catalogue of Comprehensive Use of Resources for Preferential Enterprise Income Tax Treatment	"Ministry of Finance, State Administration of Taxation, the State Development and Reform Commission on Comprehensive Utilization of Resources announced the Corporate Income Tax Catalogue (2008 edition) Notice" (Cai Shui [2008] No. 117). Viewed at: <a href="http://www.mof.gov.cn/mofhome/gp/shuizhengsi/200809/t20080924_77975.html">http://www.mof.gov.cn/mofhome/gp/shuizhengsi/200809/t20080924_77975.html</a>
Catalogue of Chinese High-Tech Products for Export (2006)	On the issuance of Chinese High-Tech Products Catalogue 2009 "Notice" No. 61 of 2009 by the Ministry of Science. Viewed at: <a href="http://www.most.gov.cn/tztg/200910/t20091009_73551.htm">http://www.most.gov.cn/tztg/200910/t20091009_73551.htm</a>
Catalogue for the Guidance of Foreign Investment Industries	Directory (2015 Amendment) Foreign Investment Industrial Guidance, National Development and Reform Commission and MOFCOM, Order No. 22, 10 March 2015. Viewed at: <a href="http://www.sdpc.gov.cn/zcfb/zcfbl/201503/t20150313_667332.html">http://www.sdpc.gov.cn/zcfb/zcfbl/201503/t20150313_667332.html</a>
Catalogue of Imported Products not subject to Tax Exemption under Foreign Investment Projects	Customs Notice No. 65 of 2008 (regarding adjustments to Catalogue of Non-Duty-Free Products under Foreign Investment Projects and other merchandise tariffs) of 5 September 2008. Viewed at:
Catalogue of Imported Major Technical Equipment and Products not Eligible for Tax Exemption	Cai Guan Shui [2014] No. 2. Viewed at <a href="http://www.gov.cn/gzdt/2014-02/28/content_2625354.htm">http://www.gov.cn/gzdt/2014-02/28/content_2625354.htm</a> (in Chinese only)
Category of Non-Tax- Exempted Imported Items under Domestically Funded Projects	Ministry of Finance, Notice No. 83 of 2012. Viewed at: <a href="http://gss.mof.gov.cn/zhengwuxinxi/zhengcefabu/201212/t20121231_723618.html">http://gss.mof.gov.cn/zhengwuxinxi/zhengcefabu/201212/t20121231_723618.html</a>

*Foreign Investment in Central and Western China, the National Catalogue for Promoting Key Energy-efficient and Low-carbon Technologies, and the Strategic Emerging Industries Key Products and Services Catalogue. Also in 2017, MIIT issued the Catalogue of New Energy Vehicle Models Exempted from the Vehicle Purchase Tax, the Military-to-Civil Technology Promotion Catalogue, the Notice of the two departments on the recommendation of the "People's Army Technology and Product Recommendation Catalog (2017)", and the Catalogue of Building Materials Industry Technologies and Products to Encourage the Popularization and Application (2016-2017).*

Source: WTO, *Trade Policy Review, The People's Republic of China*, WT/TPR/S/342 (June 15, 2016), 82.

Various government authorities also issue catalogues in accordance with a national program. For example, to implement the *12th FYP* goals for “strategic and emerging industry” (SEI) development, various central and sub-central government authorities have issued catalogues concerning SEIs, which provide details regarding the sub-sectors and specific products that qualify as SEIs. Sectors and products covered by these catalogues may be entitled to various forms of financial support, including preferred access to credit, grants, tax incentives, investments, and other preferential treatment.<sup>680</sup>

#### 2.4. Financial Supports

Government control over the financial sector, as well as fiscal resources and fiscal policy tools, allows the Chinese government to provide a wide range of direct and indirect financial support in furtherance of industrial policy objectives. In its 2016 *Trade Policy Review* of China, the WTO concluded that China continues to provide various incentives to different sectors or industries, for the purpose of, *inter alia*, “upgrading production methods in industries that use obsolete technologies; promoting development in remote areas and narrowing the income gap between regions; and attracting FDI.”<sup>681</sup> A 2015 report commissioned by AEGIS Europe and the Cross-sector Alliance Representing European Manufacturing, moreover, identifies government subsidies reported in the public filings of hundreds of listed Chinese companies, most of which are state-owned. The report finds that important objectives behind these subsidies are to promote domestic technology upgrading and high-tech sectors; promote strategic emerging industries; and fund revitalization and technological renovation in key industries.<sup>682</sup> Two in-depth studies of the steel and nonferrous metals sectors, respectively, list a broad set of financial supports offered by sub-central governments, including, *inter alia*, tax incentives, financial grants, “export subsidies,” and “energy subsidies.” In many cases, these supports are offered in a coordinated manner to support specific government initiatives. For example, “subsidies” related to technology renovation in key industries; in support of trademark and patent registration; as

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<sup>680</sup> See Markus Taube, *Analysis of Market Distortions in the Chinese Non-Ferrous Metals Industry* (Berlin: Think!Desk China Research and Consulting, April 24, 2017), 88-93. See also WTO, *Trade Policy Review, The People's Republic of China*, WT/TPR/S/342 (June 15, 2016), 80-81. (“[T]he 12th Five-Year Plan (2011-2015) called for the transformation and upgrading of key existing industries to increase the competitiveness of China’s industrial core, and for the development of strategic emerging industries (SEIs). [...] [S]upport policies, such as those for SEIs, are stated by the Central and provincial governments in legal documents, usually an administrative regulation or a local government rule. Thereafter, the governments at the city or county levels may promulgate more detailed rules to implement the measures.”)

<sup>681</sup> WTO, *Trade Policy Review, The People's Republic of China*, WT/TPR/S/342 (June 15, 2016), 80.

<sup>682</sup> Markus Taube and Christian Schmidkronz, *Assessment of the Normative and Policy Framework Governing the Chinese Economy and Its Impact on International*, Final Extended Report for AEGIS Europe (Think!Desk China Research & Consulting, August 13, 2015), 72-127.

compensation for R&D expenses; and in direct support of enterprises classified as high and new technology enterprises.<sup>683</sup>

International institutions have also taken note of financial supports provided by the Chinese government. The WTO has found that the Chinese government generally provides “tax preferences, direct transfers, and access to credit.”<sup>684</sup> The OECD similarly concluded that the “widespread misallocation of resources” in China has been “exacerbated by local authorities’ growth-seeking behaviour as they competed to offer low-cost or free land, cheap credit, tax concessions and other subsidies to attract investment.”<sup>685</sup>

Some examples of such support programs have included: significant payments and other benefits offered to qualifying Chinese companies’ exports under the “Famous Export Brand” and “World Top Brand” programs; import-substituting support provided by the Chinese government to promote the production of wind turbine systems in China; support provided by the central government and various sub-central governments in China to automobile and automobile-parts enterprises located in regions in China known as “export bases”; and export-contingent supports provided by central government and sub-central government to manufacturers and producers across seven industries located in designated clusters of enterprises called “Demonstration Bases.”<sup>686</sup>

China has established various funds for the express purpose of supporting a long-term S&T policy. For example, for the SEI policy introduced in 2010, several provinces established dedicated technology funds.<sup>687</sup> For the MiC2025, the Chinese government established two funds worth over \$20 billion to fund advanced manufacturing and national integrated circuit R&D

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<sup>683</sup> See Markus Taube and Peter in der Heiden, *China Steel Inc. – State-owned and State-run? An Investigation of State-Business Interaction in the World’s Largest Steel Industry*, vol. 8 of *Economic Studies on Asia* (Marburg: Metropolis, 2010), 129-145; Markus Taube, *Analysis of Market Distortions in the Chinese Non-Ferrous Metals Industry* (Berlin: Think!Desk China Research and Consulting, April 24, 2017), 53-93.

<sup>684</sup> WTO, *Trade Policy Review, The People’s Republic of China*, WT/TPR/S/342 (June 15, 2016), 80.

<sup>685</sup> OECD, *OECD Economic Surveys: China* (Paris: OECD Publishing, 2015), 31.

<sup>686</sup> 2016 USTR Report to Congress on China’s WTO Compliance (Washington, DC: Office of the U.S. Trade Representative, January 2017), 64-65.

<sup>687</sup> U.S.-China Business Council, *China’s Strategic Emerging Industries: Policy, Implementation, Challenges, & Recommendations* (March 2013), 17-21. The report finds that, as part of SEI policies and actions, select provinces and cities in China have offered large funding amounts, including: Beijing (\$6.4 billion); Fujian (\$80.4 million); Hunan (\$80.4 million); Jiangsu (\$61.1 million); Jiangxi (\$64.3 million); Shandong (\$160.7 million); Shanxi (\$80.4 million); Sichuan \$321.5 million); and Zhejiang \$80.4 million). See also list of measures counter-notified by the United States to the WTO Committee on Subsidies and Countervailing Measures in WTO, *Request from the United States to China Pursuant to Article 25.10 of the Agreement G/SCM/Q2/CHN/53* (October 19, 2015). (“As we noted previously, in 2010, China’s State Council announced its decision to support the development of SEIs through a wide range of support policies. Subsequently, China’s central and sub-central authorities have issued dozens, if not hundreds of measures, for the 12th Five-Year planning period that target the development of the SEI sectors. The United States notes that the list below is merely illustrative of the universe of SEI measures in China.”)



projects.<sup>688</sup> In recent years, the Chinese government has also diversified such financial support through new types of government-run financing entities.<sup>689</sup>

Under its approach to modifying the SIE system, the Chinese government is establishing asset management companies, also referred to as SCIOs, which are designed to play an active role in promoting the government's industrial policies, in conjunction with the aforementioned government-run investment funds. An important mission of SCIOs is to promote innovation and high technology enterprises during the *13th FYP*.<sup>690</sup> As a result, according to Barry Naughton, "every local government will be under a certain amount of pressure to show they are contributing to the technology effort by establishing an SCIO company and having it be actively engaged in concentrating state capital in key sectors."<sup>691</sup>

Investment funds and SCIOs thus have preferential access to capital and pursue state or local government industrial policy objectives. This trend exacerbates a pattern in which the state plays the preeminent role in directly allocating research and development funds. According to the OECD, Chinese GERD increased from 1.22% of GDP in 2004 to 2.05% of GDP in 2014; although the Chinese business sector accounts for 75% of China's GERD, the domestic private enterprise sector accounts for less than a third of this share.<sup>692</sup>

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<sup>688</sup> Jost Wubbeke et al., *Made in China 2025: The Making of a High-Tech Superpower and Consequences for Industrial Countries*, Papers on China No. 2 (Berlin: MERICS, December 2016), 7. ("In order to achieve these goals, government entities at all levels funnel large amounts of money into China's industrial future. The recently established Advanced Manufacturing Fund alone amounts to 20 billion CNY (2.7 billion EUR). The National Integrated Circuit Fund even received 139 billion CNY (19 billion EUR). These national level funds are complemented by a plethora of provincial level financing vehicles. The financial resources are enormous compared to, for instance, the 200 million EUR of federal funding that the German government has provided for research on Industry 4.0 technologies so far.")

<sup>689</sup> For example, in order to implement the *Notice on Issuing the National Medium- and Long-Term Plan for Science and Technology (2006-2020)* (State Council, Guo Fa [2005] No. 44, issued December 26, 2005), the Chinese government established the NFFTTC in 2011 under the auspices of the MOST and the MOF. In 2015 and 2016, nine different government venture capital funds were established as subsidiaries of the NFFTTC. See NFFTTC, "Major Historical Events of the Fund" and "Introduction to the Fund," available at <http://www.nfttc.gov.cn/www/nfttc/212/index.html> and <http://www.nfttc.gov.cn/www/nfttc/209/index.html>. The funds were established pursuant to the *Provisional Measures on Administering Government Investment Funds* (MOF, Cai Yu [2015] No. 2010, issued November 12, 2015).

<sup>690</sup> Barry Naughton, "Restructuring and Reform: China 2016," in *Reserve Bank of Australia Annual Conference 2016, Structural Change in China: Implications for Australia and the World* (2016), 67. ("The reforms introduce a new – and newly important – layer of management into the state enterprise sector, the state capital investment and/or operations companies (SCIOs) (State Council 2015). When this type of investment company was first suggested in the Third Plenum document, there was speculation that it would refer to a relatively passive, investment-return-oriented entity like a sovereign wealth fund. The explicit incorporation of the word 'operation' in their titles, however, shows that these investment companies are expected to take on an activist role, rather than a passive investment-oriented role.")

<sup>691</sup> *Ibid.*

<sup>692</sup> OECD, *Policies for Sound and Effective Investment in China*, (Paris: OECD Publishing, 2016), 21.



The government has reportedly budgeted RMB 500 billion to spend on *13th FYP* projects in 2016,<sup>693</sup> but a large share of the financing is likely to be provided by state-controlled banks and investment funds. At the end of 2015, there were 780 state-linked investment funds holding RMB 2.18 trillion in capital, and almost 300 of these funds holding RMB 1.5 trillion were established in 2015 alone.<sup>694</sup>

## 2.5. Export Restraints and Quantitative Restrictions

Export restraints and quantitative restrictions are another mechanism the Chinese government uses to implement industrial policies, particularly with respect to raw materials. The WTO, in its *Trade Policy Review*, has noted the manner in which the Chinese government has taken trade policy measures, such as taxes and reduced VAT rebates in respect of exports, that “discourage exports and increase the domestic supply of products concerned, and thus result in lower domestic prices of these products than otherwise.”<sup>695</sup> The WTO’s 2014 *Trade Policy Review* finds:

Export restraints are an important feature of China's trade regime. China imposes export taxes on certain products, and quotas or even bans on others. The list of goods subject to "statutory" and interim export taxes is issued every year. Exports that are subject to interim taxes may also be subject to special export duties, which are applied seasonally and may be substantially higher than interim duty rates. In 2013 the special export duty rate was 75%, while interim duty rates varied from 5% to 35%. Export taxes were applied to some 4.2% of all tariff lines at the HS 8-digit level in 2013; as China is the leading world exporter of certain products subject to export taxes, their application may have an *impact on the world price of these products*. (emphasis added)<sup>696</sup>

Chinese law also authorizes the Chinese government to designate state trading enterprises (STEs) to import and export key commodities. Rules governing STEs are set out, *inter alia*, in the 2002 *Regulation of the People’s Republic of China on the Administration of the Import and Export of Goods*<sup>697</sup> and the 2004 *Foreign Trade Law of the People’s Republic of China*.<sup>698</sup> China’s WTO

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<sup>693</sup> Center for Strategic and International Studies, *Perfecting China Inc.* (May 2016), 27 (citing to Li Keqiang, “Report on the Work of the Government,” delivered at the Fourth Session of the 12th National People’s Congress of the People’s Republic of China, March 5, 2016).

<sup>694</sup> *Ibid.*

<sup>695</sup> WTO, *Trade Policy Review – Report by the Secretariat – China*, WT/TPR/S/199 (April 16, 2008), x.

<sup>696</sup> WTO, *Trade Policy Review, The People’s Republic of China*, WT/TPR/S/300 (May 27, 2014), 12.

<sup>697</sup> *Regulation of the People’s Republic of China on the Administration of the Import and Export of Goods (State Council)*, Chapter IV (adopted at the 46th executive meeting of the State Council on October 31, 2001, Order [2001] No. 332, effective January 1, 2002).

<sup>698</sup> *Foreign Trade Law of the People’s Republic of China*, Article 11 (adopted at the 7th Meeting of the Standing Committee of the Eighth NPC on May 12, 1994, revised at the 8th Meeting of the Standing Committee of the Tenth NPC, Order [2004] No. 15 of the President of the People’s Republic of China on April 6, 2004, effective July 1, 2004). (The State may implement state trading on certain goods. The import and export of the goods subject to state trading will be operated only by the authorized enterprises unless the state allows the import and export of certain quantities of the goods subject to state trading to be operated by the enterprises without authorization. The lists of the goods subject to state trading and the authorized enterprises will be determined, adjusted and made public by the

Accession Protocol lists products subject to importation through STEs to include grain, vegetable oil, sugar, tobacco, crude oil and processed oil, chemical fertilizer, and cotton.<sup>699</sup> In an October 2015 notification to the WTO STE Committee, the Chinese government states that STEs determine import and export levels by, *inter alia*, “taking into account the domestic supply and the prices of both domestic and international markets among other factors.”<sup>700</sup> (emphasis added)

Furthermore, China has imposed quotas on the export and production of raw materials for extended periods.<sup>701</sup> Several of the raw materials at issue play an important role as material inputs for downstream products used in electronics and other industries.<sup>702</sup> China also imposes restrictions on the domestic production and processing of certain minerals and metals. These include, *inter alia*, extraction quotas on rare earths and tungsten minerals<sup>703</sup> and quotas on the (post-extraction) production of rare earths, fluorspar, and certain rare metals.<sup>704</sup> As aforementioned, long-term “binding targets” and “indicative targets” for minerals and metals production are also set forth in province-level mineral resource plans, pursuant to the MLR

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authority responsible for foreign trade under the State Council in conjunction with other relevant authorities under the State Council. In the event of importation of the goods subject to state trading without authorization in violation of paragraph 1 of this Article, the Customs will not grant release.)

<sup>699</sup> WTO, *Protocol on the Accession of the People’s Republic of China*, WT/L/432 (November 10, 2001), Annex 2A1 and 2A2.

<sup>700</sup> WTO, *State Trading: New and Full Notification Pursuant to Article VII:4(A) of the GATT 1994 and Paragraph 1 of the Understanding on the Interpretation of Article VII*, G/STR/N/10/CHN-G/STR/N/15/CHN (October 19, 2015), 9. (emphasis added)

<sup>701</sup> See WTO dispute settlement cases DS394 *China — Measures Related to the Exportation of Various Raw Materials*, DS431 *China — Measures Related to the Exportation of Rare Earths, Tungsten and Molybdenum*, and DS508 *China — Export Duties on Certain Raw Materials*.

<sup>702</sup> See e.g., Ann Norman, Xinyuan Zou, and Joe Barnett, *Critical Minerals: Rare Earths and the U.S. Economy*, Backgrounder No. 175 (Washington, DC: National Center for Policy Analysis, September 2014); Marc Humphries, *Rare Earth Elements: The Global Supply China* (Washington, DC: Congressional Research Service, July 28, 2010).

<sup>703</sup> *Notice on 2017 Total Extraction Quotas for Rare Earths and Tungsten Minerals* (MLR, Guo Tu Zi Fa [2017] No. 67, issued June 30, 2017); *Notice on 2016 Total Extraction Quotas for Rare Earths and Tungsten Minerals* (MLR, Guo Tu Zi Fa [2016] No. 316, issued June 22, 2016); *Notice on 2015 Total Extraction Quotas for Rare Earths and Tungsten Minerals* (MLR, Guo Tu Zi Fa [2015] No. 263, issued May 8, 2015); *Notice on 2014 Total Extraction Quotas for Rare Earths and Tungsten Minerals* (MLR, Guo Tu Zi Fa [2014] No. 65, issued June 5, 2014).

<sup>704</sup> See e.g., *Circular on Passing Down the 2016 Fluorspar Total Output Control Plan* (Jiangxi Province MIIT Commission, Gang Gong Xin Jian Cai Zi [2016] No. 213, issued May 13, 2016); *Circular on Passing Down 2016 Batch 1 Rare Earths Total Output Control Plan* (MIIT, issued March 25, 2016); *Notice Passing Down 2015 Province-Wide Tungsten Total Production Quantity Control* (Jiangxi Province MIIT Commission, Gan Gong Xin You Se Zi [2015] No. 229, issued June 1, 2015); *Circular on Passing Down 2014 Rare Metals Total Production Quantity Control Indices* (Tibet Autonomous Region People’s Government, issued October 8, 2014); *Circular on Passing Down 2014 Rare Metals Total Production Quantity Control Indices* (Jiangxi Province MIIT Commission, Gan Gong Xin You Se Zi [2014] No. 356, issued July 29, 2014).

*Mineral Resource Plan*.<sup>705</sup> These mineral resource plans outline administrative methods, such as mine zoning and mining licensing, to achieve these targets.<sup>706</sup>

### 3. Examples of Industrial Policy Implementation

The implementation mechanisms discussed above are widely applied throughout China's economy. This section focuses on three areas in which industrial policies have a particularly significant effect on the allocation of resources: (1) industrial restructuring; (2) the transfer of industrial assets to inland regions; and (3) the promotion of science and technology development and indigenous innovation.

#### 3.1. Industrial Restructuring and Upgrading

“Industrial restructuring” is a focal point of China's industrial policies and is one mechanism by which the government influences the allocation of industrial assets within and among industries, as well as between regions. An important element of these policies is the *State Council Decision on Implementing the Interim Provisions on Promoting the Structural Adjustment of Industry* (State Council, Guo Fa [2005] No. 40, issued December 2, 2005) (“*No. 40 Document*”), which was issued by the State Council in 2005 and remains in effect.<sup>707</sup> The *No. 40 Document* details the government's long-term economic and industrial policy objectives for China, including, *inter alia*:<sup>708</sup>

- Redistribution of industrial assets from more developed to less developed regions;
- Technological upgrading and modernization of basic industries such as power, transport, steel, chemicals and cement;
- Indigenous innovation and Chinese-origin intellectual property;
- Localization of important manufacturing equipment;
- Development of advanced manufacturing capabilities;
- Development of high-tech and service industries that will drive China's future economy including information technology, computers, integrated circuits and computer software, new energy, aerospace, new materials, biomedical, petrochemicals, telecom, finance,

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<sup>705</sup> *National Mineral Resources Plan (2016-2020)* (MLR, issued November 2016); *State Council Approval of the National Mineral Resources Plan (2016-2020)* (State Council, Guo Han [2016] No. 178, issued November 2, 2016); *Notice on Issuance of the National Mineral Resources Plan (2008-2015)* (MLR, Guo Tu Zi Fa [2008] No. 309, issued December 31, 2008).

<sup>706</sup> *Ibid.*

<sup>707</sup> *State Council Decision on Implementing the “Interim Provisions on Promoting the Structural Adjustment of Industry* (State Council, Guo Fa [2005] No. 40, issued December 2, 2005).

<sup>708</sup> *Ibid.*, Articles 3, 6, 7, 8 and 10.

insurance, logistics and accounting,<sup>709</sup> and larger firms and higher industry concentration levels, and;

- Development of large enterprises and large enterprise groups with independent intellectual property rights and strong core competitive strengths.

The *No. 40 Document* covers the entire economy, from agriculture to manufacturing to service sectors and all sub-sectors included therein. In addition, the *No. 40 Document* explicitly directs all provincial governments to formulate specific measures to guide investment with supporting policies including those regarding land, credit, taxation, import and export.<sup>710</sup> To implement the *No. 40 Document*, NDRC issued the *Guidance Catalogue for the Structural Adjustment of Industry* (“*Structural Adjustment Catalogue*”) in 2005, which was subsequently amended in 2011 and 2013.<sup>711</sup> The *Structural Adjustment Catalogue* divides industry segments into “encouraged,” “limited,” and “prohibited” for investors,<sup>712</sup> based on whether the Chinese government seeks to reduce or increase that segment’s share of the industrial sector.<sup>713</sup>

By categorizing an industry as limited or prohibited, the *Structural Adjustment Catalogue* signals that the government may pursue restrictive policies, such as withholding approval for new projects, expanding existing projects, or eliminating existing facilities to facilitate industry consolidation and restructuring. On the other hand, the *No. 40 Document* accords priority to “encouraged” investments that are needed for the technological upgrading of industry, or to develop indigenous innovation and advanced manufacturing capabilities.<sup>714</sup> The sheer number and specificity of items listed in the *Structural Adjustment Catalogue* indicate the degree of government guidance and control of intra- and inter-industry investment allocations. In total, the *Structural Adjustment Catalogue* lists 761 “encouraged,” 220 “restricted,” and 424 “prohibited” investments.

In addition, the listed investments are remarkably detailed and are generally specified at the product, project, or technology level. For example, the *Structural Adjustment Catalogue* lists in the encouraged category of investments: energy-type drive battery packs, with energy density  $\geq$

<sup>709</sup> These industries overlap considerably with the “(economic) life-line,” “backbone,” “pillar” or (government-deemed) strategically important industries in which high-level government policy documents reiterate that the state sector must have a leading or dominant role, consistent with relevant PRC constitutional mandates.

<sup>710</sup> See *No. 40 Document*, Articles 12-19.

<sup>711</sup> The first edition is the *Guidance Catalogue for the Structural Adjustment of Industry (2005 Edition)* (NDRC, Order [2005] No. 40, issued December 2, 2005). The most recent edition is the *Guidance Catalogue for the Structural Adjustment of Industry (2011 Edition) (2013 Revision)* (NDRC, Order [2013] No. 21, issued February 16, 2013).

<sup>712</sup> Investments not listed are permitted. *No. 40 Document*, Article 13.

<sup>713</sup> *Decision of the National Development and Reform Commission on Amending the Relevant Entries under the Catalogue for Guiding Industrial Restructuring (Version 2011) (2013)* (NDRC, Order [2013] No. 21, issued March 27, 2011, amended May 1, 2013).

<sup>714</sup> *No. 40 Document*, Articles 12-19.

110Wh/kg and cycle life  $\geq 2,000$  times; and driving motors of electric vehicles, with peak power density  $\geq 2.5\text{kW/kg}$ , high efficiency area: 65%, efficiency in working area  $\geq 80\%$ .<sup>715</sup> The *Structural Adjustment Catalogue* lists in the restricted category of investments: the manufacture of non-CNC metal-cutting machines tools; and new construction of free forging hydraulic machine projects of 10,000 tons or more continuous polymerization production units of conventional polyester (PET) with single-line annual production capacity  $< 200,000$  tons.<sup>716</sup>

### 3.2. Geographic Distribution of Industry

The *Guidance Catalogue on Industrial Transfer (2012 Edition)* (“*Industrial Transfer Catalogue*”),<sup>717</sup> which was issued pursuant to the *Guiding Opinion of the State Council on Central and Western Regions’ Undertaking of Industrial Transfer* (“*Guiding Opinion on Industrial Transfer*”),<sup>718</sup> is another industrial policy catalogue that channels investment based on government policy.<sup>719</sup> The *Industrial Transfer Catalogue* implements the government’s efforts to optimize the geographic distribution of industry in China (*i.e.*, the distribution or allocation of industry across the north, northeast, central and western regions of China, by means of “industrial transfer,” that is, the physical transfer or relocation of companies and/or plants from one region of China to another). According to the 2012 *Industrial Transfer Catalogue*, the purpose of the catalogue is to “specify the direction, guide inter-regional dislocated development, and turn disordered industrial transfer into ordered industrial transfer.”<sup>720</sup> The *Guiding Opinion on Industrial Transfer* and the *Industrial Transfer Catalogue* make clear that the government’s objective of achieving a rational, orderly, and scientific industrial transfer process is a response to a disorderly and dysfunctional industrial transfer process due to various factors including:

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<sup>715</sup> *Guidance Catalogue for the Structural Adjustment of Industry (2011 Edition) (2013 Revision)*, Item XVI.6 (“Encouraged Category”) (NDRC, Order [2013] No. 21, issued February 16, 2013).

<sup>716</sup> *Guidance Catalogue for the Structural Adjustment of Industry (2011 Edition) (2013 Revision)* (NDRC, Order [2013] No. 21, issued February 16, 2013), Items XI.11, XI.47 and XIII.1 (“Restricted Category”).

<sup>717</sup> *Guidance Catalogue on Industrial Transfer (2012 Edition)* (MIIT, Public Notice [2012] No. 31, issued July 26, 2012).

<sup>718</sup> *Guiding Opinions of the State Council on Central and Western Regions’ Undertaking of Industrial Transfer* (State Council, Guo Fa [2010] No. 28, issued August 31, 2010).

<sup>719</sup> See also a corollary catalogue for foreign investments in central and western regions, issued by NDRC and implemented by the General Administration of Customs. The first edition is the *Catalogue of Advantageous Industries for Foreign Investment in Central and Western Regions* (GAC, Shu Shui [2000] No. 426, issued August 3, 2000); *Catalogue of Advantageous Industries for Foreign Investment in Central and Western Regions* (MOFTEC, SDPC, Order [2000] No. 18, issued June 16, 2000). The most recent edition is the *Catalogue of Advantageous Industries for Foreign Investment in Central and Western Regions (2017 Revision)* (NDRC, MOFCOM, Order [2017] No. 33, issued February 17, 2017); *Public Notice on Implementing the Catalogue of Advantageous Industries for Foreign Investment in Central and Western Regions (2017 Revision)* (GAC, Order [2017] No. 14, issued March 17, 2017).

<sup>720</sup> *Guidance Catalogue on Industrial Transfer (2012 Edition)*, Preface (MIIT, Public Notice [2012] No. 31, issued July 26, 2012).



regional protectionism, excessive government examination and approval, lack of inter-regional coordination and cooperation on enterprises licensing and registration, inadequate private sector development and private sector investment, and the pricing and allocation of the factors of production.<sup>721</sup> In addition, the government intends to increase the concentration of particular industries in zones, clusters, and parks to promote both regional and national economic development, and to slow the rate of international industrial transfer through these inter-regional resource allocations.<sup>722</sup>

The *Industrial Transfer Catalogue* assigns certain industry segments to each province in each of the four regions of the country based on the region's installed industrial base, comparative advantage, development needs, and national development priorities.<sup>723</sup> Fifteen industries are covered, namely electronic information, medicines and pharmaceuticals, aviation and aerospace, machinery, railway transportation, autos, chemicals, iron and steel, ships and marine engineering equipment, light manufacturing, food, textiles, building materials, nonferrous metals, and certain services industries.<sup>724</sup>

Similar to the *Structural Adjustment Catalogue*, the *Industrial Transfer Catalogue* covers a wide and detailed list of investments by supplying for each province explicit guidance for industrial transfer at the *product* level. This guidance takes the form of a list of industry segments that each province should develop, and specifies the *order* in which the industry segments should be developed, based on the government's industrial policy priorities.<sup>725</sup> Guidance on the *direction* of industrial transfer, either to or from a particular geographic region, is also provided in the discussion on industrial development orientation at the beginning of each of the four regional chapters.<sup>726</sup>

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<sup>721</sup> *Guidance Catalogue on Industrial Transfer (2012 Edition)*, Preface (MIIT, Public Notice [2012] No. 31, issued July 26, 2012); *Guiding Opinions of the State Council on Central and Western Regions' Undertaking of Industrial Transfer*, Items IV preamble, IV.13, IV.15, V.16, VI preamble, VI.19 (State Council, Guo Fa [2010] No. 28, issued August 31, 2010).

<sup>722</sup> *Guidance Catalogue on Industrial Transfer (2012 Edition)*, Preface (MIIT, Public Notice [2012] No. 31, issued July 26, 2012); *Guiding Opinions of the State Council on Central and Western Regions' Undertaking of Industrial Transfer*, Item III.10 (State Council, Guo Fa [2010] No. 28, issued August 31, 2010). See also BMI Research, "Offshoring Trend to Ramp Up Despite Beijing's Best Efforts," *Asia Monitor*, July 1, 2016.

<sup>723</sup> *Guidance Catalogue on Industrial Transfer (2012 Edition)*, Preface (MIIT, Public Notice [2012] No. 31, issued July 26, 2012).

<sup>724</sup> *Ibid.* See also Dezan Shira and Associates, *China Issues Industrial Transfer Guidance Catalogue*, China Briefing, (August 6, 2012).

<sup>725</sup> *Guidance Catalogue on Industrial Transfer (2012 Edition)*, Preface (MIIT, Public Notice [2012] No. 31, issued July 26, 2012).

<sup>726</sup> *Ibid.*, Preface, the Preamble to Section I in each of Chapters 2-5.



Although the *Guiding Opinions on Industrial Transfer* states that, in principle, markets should be given full play in the allocation of resources,<sup>727</sup> this principle conflicts with the explicit and detailed guidance that the *Industrial Transfer Catalogue* provides. Moreover, as noted above, the *Industrial Transfer Catalogue* is the government's response to a disorderly industrialization process that is primarily the result of misallocations from government intervention. In other words, the *Industrial Transfer Catalogue* is an administrative solution devised by the central government to address an administrative problem at the local government level that concerns inter-regional resource allocations.

### 3.3. Science and Technology Development

As a recent OECD report states, “innovation – or more precisely science and technology – has long been considered in China as key for development and is therefore supported by a plethora of industrial policies.”<sup>728</sup>

The Chinese government's objective of promoting the indigenous development of S&T, which is not limited to basic research, has yielded a wide array of long-term industrial policies and plans. China's current S&T policy traces its roots to the *S&T MLP*, which identifies eleven “key areas,” eight “frontier technologies,” sixteen “engineering megaprojects,” and four “science megaprojects” as priorities for development (see **Appendix Tables 1 and 2**). According to the *S&T MLP*, the sixteen megaprojects were chosen because they are closely linked to China's social and economic development, foster indigenous intellectual property, raise China's overall industrial competitiveness, and contribute to both civilian and military development thereby increasing China's overall strength. The plan suggests certain policy measures to achieve its goals, which include:

- financial and tax policies encouraging technological innovation at the enterprise level, policies designed to encourage imported technologies that can then be absorbed to foster new innovation;
- government procurement policies that advance indigenous innovation, financing policies to encourage innovation (including encouraging financial institutions to provide preferential loans to the National Major Science and Technology Projects); and
- policies that encourage the “going out” of Chinese enterprises, both in terms of exporting high technology products and greater international cooperation.

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<sup>727</sup> *Guiding Opinion of the State Council on Central and Western Regions' Undertaking of Industrial Transfer*, Item I.2 (State Council, Guo Fa [2010] No. 28, issued August 31, 2010).

<sup>728</sup> OECD, *OECD Economic Surveys: China*, (Paris: OECD Publishing, 2017), 72.

Following the adoption of the *S&T MLP*, several measures were enacted to implement a funding mechanism for the sixteen megaprojects.<sup>729</sup> The budget announced for the entire program (*i.e.*, all sixteen projects) was approximately RMB 32.8 billion, RMB 30 billion and RMB 43.5 billion in 2009, 2010 and 2011, respectively.<sup>730</sup>

Pursuant to the *S&T MLP*, the Chinese government formulated a *FYP* for S&T development for the first time during the *11th FYP* period (2006-2010). The stated purpose of the plan includes ameliorating the “lagging state” of China’s high-technology industries, relatively weak indigenous innovation capacity, and weak core competitiveness of enterprises.<sup>731</sup> Accordingly, the document outlines numerous strategies to improve “indigenous innovation,” including government S&T funding and targeted procurement programs.<sup>732</sup> Key targets set forth in the *S&T MLP* for the year 2020 include, *inter alia*, to achieve a total R&D spending level equivalent to 2.5% of GDP by 2020 and to reduce the rate of dependency on foreign technology to below 30%.

In 2010, the State Council issued the *Decision on Accelerating the Nurturing and Development of Strategic and Emerging Industries* (“*SEI Decision*”).<sup>733</sup> The document identifies seven SEIs that overlap with some of the key areas and frontier technologies set forth in the *S&T MLP*. These seven industries are characterized as important forces to lead future economic and social development, and their development is characterized as an important strategy for the main nations of the world to occupy the high point of the new round of economic and science and technology development.<sup>734</sup> Pursuant to the *SEI Decision*, the Chinese government formulated the *12th Five-Year Plan for National Strategic and Emerging Industries Development* (“*12th Five-Year SEI Plan*”)<sup>735</sup> which sets a target for the SEIs to account for 8% of China’s economy by 2015 and 15% by 2020. Its successor, the *13th Five-Year Strategic and Emerging Industries*

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<sup>729</sup> See *e.g.*, *Interim Administrative Regulations on the National Science and Technology Major Projects* (MOST, MOF Guo Ke Fa Ji [2008] No. 453).

<sup>730</sup> China provided the 2008 and 2009 statistics in the WTO, *Chairperson's Report to the Council for Trade in Goods on Transitional Review of China*, Committee on Subsidies and Countervailing Measures, G/SCM/130.24. (October 28, 2009). This statement is corroborated by the *Implementation of Central and Local Budgets for 2009 and the Resolution of the Central and Local Budgets by Third Session of the Eleventh National People's Congress* (NPC, issued March 5, 2010). The 2011 budget figure is available online at <http://news.xinhuanet.com/politics/2012lh/2012-03/16/c.111666182.htm>.

<sup>731</sup> *11th Five-Year Plan for Science and Technology Development*, Part II(1) (MOST, issued October 27, 2006).

<sup>732</sup> *Ibid.*, Part III.

<sup>733</sup> *Decision on Accelerating the Nurturing and Development of Strategic and Emerging Industries* (State Council, Guo Fa [2010] No. 32, issued October 10, 2010).

<sup>734</sup> *Ibid.*

<sup>735</sup> *Notice on Issuing the 12th Five-Year Plan for National Strategic and Emerging Industries Development* (State Council, Guo Fa [2012] No. 28, issued July 9, 2012).

*Development Plan* (“13th Five-Year SEI Plan”),<sup>736</sup> issued in 2016, reviews the successes achieved during the 12th FYP period, and sets new goals for the 13th FYP period.

In conjunction with the *S&T MLP*, *12th Five-Year SEI Plan* and *13th Five-Year SEI Plan*, the Chinese government has also formulated industry-specific medium- and long-term plans. For example, for one of the seven technologies designated in the *SEI Plan*, NEVs, the State Council in 2012 released the *Energy-Saving and New-Energy Automotive Industry Development Plan (2012-2020)*,<sup>737</sup> which serves as the basis for numerous regulations and subsidy programs to support the domestic R&D, manufacturing, and utilization of NEVs. The document sets a target of achieving cumulative production and sales volume of 5 million NEV units by 2020.

Innovation policies have also been featured in China’s *FYPs* for economic and social development.<sup>738</sup> The most recent editions of these plans, formulated for the 12th FYP and 13th FYP periods, also discuss the importance of indigenous innovation.<sup>739</sup> In the 13th FYP, indigenous innovation is included as a focal point of the government’s national development strategy.<sup>740</sup> The government intends for both indigenous innovation and technology acquisition to drive China’s national economic development, lift total factor productivity growth, develop entrepreneurship, lead to breakthroughs in core technologies and key sectors, increase industry capacities and capabilities, facilitate the full integration of technology into the economy, and lead to an innovative society.<sup>741</sup> The explicit reference to “indigenous innovation” in the 13th FYP signals that achieving technological “self-sufficiency” is an important goal for the government.<sup>742</sup> The 13th FYP lists nine industrial policy initiatives that detail over 70 priority

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<sup>736</sup> *Notice on Issuing the 13th Five-Year Plan for National Strategic and Emerging Industries Development* (State Council, Guo Fa [2016] No. 67, issued November 29, 2016).

<sup>737</sup> *Energy-Saving and New-Energy Automotive Industry Development Plan (2012-2020)* (State Council, Guo Fa [2012] No. 22, issued June 28, 2012).

<sup>738</sup> China’s most recent three five-year plans for national economic and social development, the 11th 12th and 13th FYP, as well as the *No. 40 Document*, all discuss the importance of indigenous innovation for the technological upgrading of China’s industries and the development of advanced manufacturing capabilities, as well as the need to expand China’s “talent reservoir” through science and technology education, training and research. See Government of China, “Outline of the 11th Five-Year Program for National Economic and Social Development of the People’s Republic of China,” March 2006. See also Part I, Chapter 3: Main Objectives, and Part VII; Government of China, “Outline of the 12th Five-Year Program for National Economic and Social Development of the People’s Republic of China,” March 2011. See also Part One, Chapter 2: Guiding Thought, and Part Seven; Government of China, “13th Five-Year Plan,” March 2015. See also Part 1, Chapter 3: Main objectives, and Part II.

<sup>739</sup> 11th FYP, Part I, Chapter 3: “Main Objectives” and Part VII; 12th FYP, Part I, Chapter 2: “Guiding Thoughts” and Part VII; 13th FYP, Part I, Chapter 3: “Main objectives” and Part II.

<sup>740</sup> 13th FYP, Part I, Chapter 3: Main Objectives, and Part II.

<sup>741</sup> *Ibid.*, Chapter 3: Main Objectives.

<sup>742</sup> *Ibid.*, Part 1, Chapter 3: “Main objectives.” See also Center for Strategic and International Studies, *Perfecting China Inc.* (May 2016), 27-28.

technology areas for development and commercialization, which in turn, cover many more specific products and technologies.<sup>743</sup>

In 2015, the State Council released the *Made in China 2025 Decision*,<sup>744</sup> which outlines a new medium- and long-term strategy for S&T development. The implementation period for this strategy is from 2016 to 2025, thereby overlapping with the *S&T MLP* and *12<sup>th</sup> Five-Year SEI Plan* and *13<sup>th</sup> Five-Year SEI Plan*. The *Made in China 2025 Decision* is novel in its focus on upgrading all stages of China's industrial supply chain, including manufacturing and service sectors and lower value-added industries (such as steel and textiles) rather than focusing exclusively on high-technology sectors.<sup>745</sup> Nonetheless, it also specifies plans for a subset of ten high-technology industries, which overlap to some extent with those identified in the *S&T MLP* and *12<sup>th</sup> Five-Year SEI Plan* and *13<sup>th</sup> Five-Year SEI Plan*. A document released in October 2015, the "*China Manufacturing 2025*" *Key Sectors and Technologies Roadmap*,<sup>746</sup> provides further details on the plans for these high-technology industries. As is the case for the *S&T MLP* and *12<sup>th</sup> Five-Year SEI Plan* and *13<sup>th</sup> Five-Year SEI Plan*, MiC2025 has informed the issuance of industry-specific plans, such as the *Agricultural Machinery Equipment Development Action Plan (2016-2025)*.<sup>747</sup>

One goal under the MiC2025 is production self-sufficiency. Specifically, the government's specific self-sufficiency (localization) target for domestically sourced essential parts and key materials under MiC2025 is a 40% share of the market by 2020, and a 70% share by 2025.<sup>748</sup> In 2017, the Chinese government continues to use an industrial policy-based approach to innovation that has the effect of selecting winners and losers by targeting specific technologies and sectors, and then encouraging their development, both directly and indirectly, through financial supports, investment, and other means.<sup>749</sup>

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<sup>743</sup> *Ibid.*, 27.

<sup>744</sup> *Decision on Issuing "China Manufacturing 2025"* (State Council, Guo Fa [2015] No. 28, issued May 8, 2015).

<sup>745</sup> See Junko Yoshida, "Made in China 2025: Who Cares?" *EE Times*, July 20, 2017. In addition to "greatly pushing forward the breakthrough and development of major fields," the *Made in China 2025 Decision* outlines plans for "further pushing forward the structural adjustment of manufacturing industry," "Actively developing service-oriented manufacturing and producer service industries," and "improving the internationalized development of manufacturing industry."

<sup>746</sup> "*China Manufacturing 2025*" *Key Sectors and Technologies Roadmap* (NMSAC, issued October 2015).

<sup>747</sup> *Agricultural Machinery Equipment Development Action Plan (2016-2025)* (MIIT, MOA, and NDRC, Gong Xin Bu Lian Zhuang [2016] No. 413, issued November 28, 2016).

<sup>748</sup> Jost Wubbeke et al., *Made in China 2025: The Making of a High-Tech Superpower and Consequences for Industrial Countries*, MERICS Papers on China No. 2 (Mercator Institute for China Studies, December 2016), 7, 11.

<sup>749</sup> See European Union Chamber of Commerce in China, *China Manufacturing 2025: Putting Industrial Policy Ahead of Market Forces* (2017), 1. ("It is clear that this latest attempt [to promote S&T development through the MiC2025 policy] is not to be achieved through measures that will establish a market economy. Instead, government officials have tasked themselves with steering development and have handpicked the industries that they believe will drive China's economy in the future [...] Despite the rhetoric of the Third Plenum's *Decision* of 2013—which

#### 4. *Supply-Side Structural Reforms*

##### 4.1. Background on Supply-Side Structural Reforms

In the 2013 *Third Plenum Decision*, the CCP acknowledged China’s problematic industrial structure; its extensive, unbalanced, uncoordinated, and unsustainable growth path; and its weakness in scientific and technological innovation. The *Third Plenum Decision* outlined the CCP’s concern with the Chinese government’s role in the economy and the problem of excessive government interventions, including the government’s direct allocation of resources.<sup>750</sup> It stressed the importance of resolving this problem and properly handling the relationship between state and market, so that the market plays a “decisive role” in resource allocations and the government’s role is to ensure macroeconomic stability, promote economic development, strengthen market-supporting institutions, and address market failures.<sup>751</sup>

At the December 2015 Central Economic Work Conference of the CCP, high-level officials in the Chinese government, including President Xi Jinping, introduced a set of coordinated policies to address structural problems in China’s economy, referred to as “supply-side structural reform,” given the widely held view that a permanently slower growth environment in China is the “new normal.”<sup>752</sup> Current levels of investment and production in many industries are widely viewed as unsustainable and threatening to China’s long-term socio-economic development.<sup>753</sup> The five components of “supply-side structural reform” are summarized in the official phrase “three cuts, one reduction, one strengthening (*san qu yi jiang yi bu*)”: (1) cutting industrial excess capacity; (2) reducing property inventory (also referred to as “destocking”); (3) reducing corporate debt (also referred to as “deleveraging”); (4) lowering corporate costs; and (5) improving weak links within industrial supply chains.<sup>754</sup>

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strongly advocates market forces—it seems that the Chinese Government is determined to maintain a prominent role in guiding the economy. This is highlighted by the large number of domestic and international market share targets that have been set, along with references to ‘indigenous innovation’ included in the multiple planning documents related to [MiC2025]. The appearance of ‘indigenous innovation’—along with mentions of the need to realise ‘self-sufficiency’—is particularly concerning—it suggests that Chinese policies will further skew the competitive landscape in favour of domestic companies.”)

<sup>750</sup> *CCP Central Committee Decision on Several Major Issues for Comprehensively Deepening Reform*, Section 1.(3) (CCP Central Committee, issued November 12, 2013).

<sup>751</sup> *Ibid.*

<sup>752</sup> Barry Naughton, “Two Trains Running: ‘Supply-Side Reform, SOE Reform and the Authoritative Personage’,” *Hoover Institution/China Leadership Monitor*, 50 (July 2016): 2, 3, 8; Barry Naughton, “Supply-Side Structural Reform at Mid-Year: Compliance, Initiative, and Unintended Consequences,” *Hoover Institution/China Leadership Monitor*, 51 (August 2016): 1, 8.

<sup>753</sup> The Economist Intelligence Unit, *China’s Supply-Side Structural Reforms: Progress and Outlook* (2017), 3.

<sup>754</sup> See *Xinhua News Agency*, “Central Economic Work Conference Proposes Five Major Tasks for 2016,” December 22, 2015. See also The Economist Intelligence Unit, *China’s Supply-Side Structural Reforms: Progress and Outlook* (2017), 3.



In the 2016-2017 period, government authorities at the central and sub-central level have issued multiple measures to implement “supply-side structural reform” policies. For example, “supply-side structural reform” has been inserted as a guiding principle into long-term plans for industry,<sup>755</sup> guiding opinions on reducing corporate debt and corporate costs,<sup>756</sup> and industry-specific policies to reduce excess capacity and enhance productivity.<sup>757</sup> In a further indication of the priority accorded to “supply-side structural reform,” the State Council issued official statements in 2017 about the status of “supply-side structural reform” initiatives.<sup>758</sup>

The section below examines two of the fundamental problems underlying the “supply-side structural reform” initiative, namely (1) excess capacity in the industrial sector and (2) corporate sector leverage.

#### 4.2. Excess Capacity

Excess capacity has been a longstanding and widespread problem in China’s economy.<sup>759</sup> Its scale is indicated by low capacity utilization rates in numerous industries, including iron and

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<sup>755</sup> See e.g., *Notice on Issuing the 13th Five-Year Plan for Strategic Emerging Industries* (State Council, Guo Fa [2016] No. 67, issued November 29, 2016); *Approval of the National Mineral Resource Plan (2016-2020)* (State Council, Guo Han [2016] No. 178, issued November 2, 2016); the *Notice on Issuing the 13th Five-Year Plan for Science and Technology Innovation* (State Council, Guo Fa [2016] No. 43, issued July 28, 2016); the *Notice on Issuing the Action Plan to Promote the Conversion of Science and Technology Achievements* (State Council, Guo Ban Fa [2016] No. 28, issued April 21, 2016).

<sup>756</sup> See e.g., *Opinion on Actively and Steadily Reducing Corporate Leverage Rates* (State Council, Guo Fa [2016] No. 54, issued September 22, 2016) and the *Guiding Notice on Issuing the Work Plan for Lowering Corporate Costs in the Real Economy* (State Council, Guo Fa [2016] No. 48, issued August 8, 2016).

<sup>757</sup> See e.g., *Guiding Opinion on Structural Reform and Productivity Enhancement in the Petrochemical Industry* (State Council General Office, Guo Ban Fa [2016] No. 57, issued August 3, 2016); *Notice on Items Relating to the Utilization of Pricing Methods to Promote Structural Supply-Side Reform in the Steel Sector* (NDRC, MIIT, Fa Gai Jia Ge [2016] No. 2803, issued December 30, 2016); *Opinion on Shedding Excess Industrial Capacity in the Coal Industry to Achieve Development out of Difficulty* (State Council, Guo Fa [2016] No. 7, issued February 1, 2016).

<sup>758</sup> *Report on the Status of Work to Advance Supply-Side Structural Reform to Accelerate the Transformation and Upgrading of Manufacturing Industries* (State Council, issued April 24, 2017). See also *Government Work Report*, Section 1 (Premier Li Keqiang, at the 5th Session of the 12th National People’s Congress, March 5, 2017). (“2016 Work Retrospective”: Deepening the Promotion of Reform and Opening. Breakthrough progress has been achieved in the reform of important sectors and key linkages, with preliminary evidence of the efficacy of supply-side structural reform.)

<sup>759</sup> The government has also proceeded with efforts under SSSR to reduce excess housing stocks. A key problem is that excess housing stock for the most part is found in tier-2 and tier-3 cities and rural areas where relatively few people want to live and work. In many cases, excess housing stock arises because property developers build where land and financing are cheap, and local governments push land sales and development because it generates fiscal revenue and stimulates economic growth. Chinese government policies to reduce housing supply include, *inter alia*, limiting rural land conversions and the availability of construction land, and restricting land property developers’ access to bond and equity market financing. For further discussion, See Factor 4 of this report. See also The Economist Intelligence Unit, *China’s Supply-Side Structural Reforms: Progress and Outlook* (2017), 10; *The*



steel, coal and coke, cement, flat glass, shipbuilding, semi-conductors, construction materials, chemical fertilizers, metal-cutting machine tools, micro-computer equipment, autos, consumer appliances, phone sets, cell phones, petrochemicals, aluminum, optic fiber, carbon fiber, power generation (thermal, solar, wind and hydro), solar panels, and lithium batteries.<sup>760</sup> According to the Economist Intelligence Unit, “for years [China’s] authorities had tolerated expansions in capacity across a variety of industries, despite capacity utilisation rates dipping below 75% (normally a threshold for indicating a balanced relationship between supply and demand).”<sup>761</sup>

Excess capacity in China is largely the result of government policies. Key recurring factors include subcentral authorities protecting industries that support local industrial activity and employment; weak enforcement of regulations; low input prices due to government policies; and fiscal imbalances that incentivize local governments to attract excessive investment.<sup>762</sup> In addition, the government’s large stimulus package, introduced in or around the global financial crisis (2007-2009), exacerbated excess capacity by facilitating a rapid increase in lending and other financial support to industrial enterprises, in combination with expedited regulatory approvals, in order to expand industrial capacity and start infrastructure projects.<sup>763</sup>

Excess capacity is a chronic problem in China’s economy. Official measures dating back to at least 2003 illustrate that the Chinese government has repeatedly sought to mitigate this problem, although without preventing its recurrence. For example:

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*Economist*, “China’s Property Market: The Rotten Foundations of China’s Real Estate Market (Print Edition|Leaders),” October 13, 2016; IMF, *Resolving China’s Corporate Debt Problem*, WP/16/203 (October 2016), 6.

<sup>760</sup> *Guiding Opinions of the State Council on Resolving the Conflict of Rampant Overcapacity*, Article 1 (State Council, Guo Fa [2013], No. 41, issued October 6, 2013); Government of China, NDRC Macroeconomic Studies Institute, “Apply the Method of Reform to Resolve Production Overcapacity,” *Beijing Jingji Ribao Online*, December 13, 2013 (from OSC); *China Development Institute*, “Work Tirelessly to Eliminate Excess Capacity,” April 4, 2016; The Economist Intelligence Unit, *China’s Supply-Side Structural Reforms: Progress and Outlook* (2017), 5, 9.

<sup>761</sup> The Economist Intelligence Unit, *China’s Supply-Side Structural Reforms: Progress and Outlook* (2017), 5.

<sup>762</sup> European Union Chamber of Commerce in China, *Overcapacity in China: An Impediment to the Party’s Reform Agenda* (2016), 7-14.

<sup>763</sup> European Union Chamber of Commerce in China, *Overcapacity in China: An Impediment to the Party’s Reform Agenda* (2016), 2. (“Despite then National Development and Reform Commission (NDRC) Chairman Zhang Ping’s statement in 2009, that ‘there won’t be a penny spent on enlarging mass production or highly polluting and resource-intensive sectors’, the stimulus package resulted in a massive expansion of the production capacities of many state-owned enterprises (SOEs). This situation was perpetuated by a surge in lending – encouraged by the government, to meet the needs of the thousands of infrastructure investment projects that were being approved around the country – in conjunction with the ease with which producers were able to secure such loans. This wave of fixed asset investment (FAI) in infrastructure projects, as well as further FAI that has resulted from smaller subsequent stimulus measures, has only created short-term demand for input supplies, though. Consequently, the problem has worsened in many industries with easily available credit resulting from the stimulus package yet more expansion of industrial capacity that is disconnected from real market demand.”)

- The 2003 *Several Opinions on the Prevention of Blind Investment in Iron and Steel, Electrolytic Aluminum and Cement Industries*<sup>764</sup> finds that some regions and industries, driven by self-interest, and without regard to market, resource, or other external conditions, have improperly built new or expanded, large-scale projects in the steel, aluminum, and cement sectors. Blind investment; low-quality, duplicative construction; and illegal production has resulted.
- The 2006 *Notice of the State Council Regarding Hastening and Promoting Adjustment of the Industrial Structure in Overcapacity Industries*<sup>765</sup> finds that because of the crude economic growth model and imperfect structures and mechanisms, several sectors have manifested blind investment, low-quality expansion, and other problems during their rapid development. Further, some regions and enterprises in these spheres continue to install new projects, and the contradictions of production capacity exceeding demand have been exacerbated. The measure identifies steel, aluminum, cement, calcium carbide, iron alloys, coke, automobiles, coal, electricity, and textiles as problem industries.
- The 2009 *Several Opinions on Suppressing Overcapacity and Redundant Construction in Certain Sectors and Guiding Healthy Industrial Development* (State Council, Guo Fa [2009] No. 38, issued December 22, 2009)<sup>766</sup> states that there is overcapacity in many sectors, and the problem of “redundant construction is still very prominent and even worsening in some areas,” and specifically identifies overcapacity in steel, cement, flat glass, coal chemicals, polysilicon, wind power equipment, aluminum, shipbuilding, and soybean oil.
- The 2013 *Guiding Opinions of the State Council on Resolving the Conflict of Rampant Overcapacity* finds that excess capacity is increasingly obvious in some of the country’s industries. Excess capacity is the norm in traditional manufacturing industries and is especially clear in high-energy, high-emissions sectors like steel, cement, and aluminum.<sup>767</sup> In describing the causes of excess capacity, the measure essentially describes a resource allocation problem that reflects the lack of an effective market mechanism or process: lagging factor market reforms; “blind” investment and capacity expansion by firms with overly optimistic market expectations; industrial development without the leaderships of excellent firms, which results in disorderly competition and

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<sup>764</sup> *Notice on Issuing Several Opinions of the National Development and Reform Commission and Other Related Departments on the Prevention of Blind Investment in Iron and Steel, Electrolytic Aluminum and Cement Industries* (State Council, Guo Ban Fa [2003] No. 103, issued December 23, 2003).

<sup>765</sup> *Notice of the State Council Regarding Hastening and Promoting Adjustment of the Industrial Structure in Overcapacity Industries* (State Council, Guo Fa [2006] No. 11, issued March 12, 2006).

<sup>766</sup> *Notice of the State Council on Promulgating the Several Opinions of NDRC and Other Departments on Suppressing Overcapacity and Redundant Construction in Certain Sectors and Guiding Healthy Industrial Development* (State Council, Guo Fa [2009] No. 38, issued September 26, 2009).

<sup>767</sup> *Guiding Opinions of the State Council on Resolving the Conflict of Rampant Overcapacity*, Article 1 (State Council, Guo Fa [2013], No. 41, issued October 6, 2013).

redundant buildup of the industry; excessive market entry promoted and facilitated by investment-driven, growth-focused local governments that supply cheap land, low-cost resources and tax breaks; poor market exit channels; and ineffective administrative controls regarding investment regulation, policy and planning guidance and supervision, inspection and accountability.<sup>768</sup>

The Chinese government issued measures in 2016 and 2017 to reduce excess capacity in the coal and steel sectors after the launch of the “supply-side structural reform” initiative. The solutions to excess capacity set forth in the measures continue to reflect a high level of government intervention.

At the highest level of government, the State Council issued guiding opinions for coal (“*Coal Guiding Opinion*”) and steel (“*Steel Guiding Opinion*”) capacity shedding in February 2016.<sup>769</sup> Both documents instruct authorities to limit approvals of capacity increases. To downsize existing capacity, the *Steel Guiding Opinion* also assigns a series of tasks to lower-level authorities: (1) forcing capacity-shedding “according to the law” by enforcing stricter standards regarding environmental protection, energy consumption, quality, safety, and technology; (2) encouraging firms to “proactively” shed capacity by relocating production, engaging in mergers and acquisitions, lowering output targets in firm-level strategic plans, and other means; and (3) disabling production facilities by demolishing steel smelting equipment, or alternatively, resorting to means such as cutting off supplies of water and electricity.<sup>770</sup> Both documents also specify a series of policy measures to incentivize capacity shedding among individual enterprises, including: moderating taxation rates and exemptions; moderating access to lines of credit; encouraging private investment in enterprise restructuring; relocating laid-off workers; and establishing compensation funds through which the government can help indebted enterprises finance different capacity shedding actions.<sup>771</sup> These actions draw upon government power, not market mechanisms.

Several government authorities have issued implementing measures pursuant to the State Council *Guiding Opinions* for steel and coal. For example, NDRC and MIIT, in conjunction with PBOC, CBRC, and China Securities Regulatory Commission (CSRC), have established provisions to condition access to loans and other forms of financing. Access to capital is

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<sup>768</sup> *Ibid.*, Article 1.

<sup>769</sup> *Opinion on Shedding Excess Industrial Capacity in the Coal Industry to Achieve Development out of Difficulty* (State Council, Guo Fa [2016] No. 7, issued February 1, 2016); *Opinion on Shedding Excess Industrial Capacity in the Steel Industry to Achieve Development out of Difficulty* (State Council, Guo Fa [2016] No. 6, issued February 4, 2016).

<sup>770</sup> *Opinion on Shedding Excess Industrial Capacity in the Steel Industry to Achieve Development out of Difficulty*, Section 2 (State Council, Guo Fa [2016] No. 6, issued February 4, 2016).

<sup>771</sup> *Opinion on Shedding Excess Industrial Capacity in the Steel Industry to Achieve Development out of Difficulty*, Section 3 (State Council, Guo Fa [2016] No. 6, issued February 4, 2016); *Opinion on Shedding Excess Industrial Capacity in the Coal Industry to Achieve Development out of Difficulty*, Section 3 (State Council, Guo Fa [2016] No. 7, issued February 1, 2016).

restricted for enterprises with excess capacity that do not take capacity-shedding actions prescribed by the government; conversely, capital is to be provided on a preferential basis to enterprises that take the prescribed capacity-shedding actions.<sup>772</sup> Similarly, MLR has issued an opinion to, *inter alia*, limit access to land and minerals among steel and coal producers that have excess capacity; support the reallocation of land idled through capacity reductions, suspended projects, and enterprise restructuring; and reward successfully restructured coal enterprises by offering priority approvals to extract mineral resources.<sup>773</sup>

At the provincial level, authorities have signed target responsibility documents for steel and coal capacity reduction demanded by the central government,<sup>774</sup> and have issued corresponding implementing opinions<sup>775</sup> and implementation plans.<sup>776</sup> Several of these documents mandate capacity-shedding targets, in tonnage and percentage terms, for specific enterprises, as well as for the province on aggregate. As with the policies described above, these are top-down directives, not market mechanisms.

Taken together, the capacity-shedding measures outlined above entail a high degree of government intervention, while not adequately addressing the root causes of excess capacity or adopting market structures. Physically moving capacity from one region to another does not necessarily eliminate any excess from the national market.<sup>777</sup> The effect of more stringent industry standards and less access to bank credit is often mitigated by other forms of government

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<sup>772</sup> *Opinion on Supporting the Shedding of Excess Industrial Capacity in the Steel and Coal Industry to Achieve Development out of Difficulty* (PBOC, CBRC, CSRC, CIRC, Yin Fa [2016] No. 118, issued April 17, 2016); *Several Opinions on Financial Debt and Debt Obligations Problems Relating to Shedding Excess Capacity in the Steel and Coal Industries* (CBRC NDRC, MIIT, Yin Jian Fa [2016] No. 51, issued December 1, 2016).

<sup>773</sup> *Ministry of Land and Resources Opinion on Supporting Shedding Excess Industrial Capacity in the Steel and Coal Industry to Achieve Development out of Difficulty* (MLR, Guo Tu Zi Gui [2016] No. 3, issued March 30, 2016).

<sup>774</sup> Barry Naughton, "Supply-Side Structural reform at Mid-Year: Compliance, Initiative, and Unintended Consequences," *Hoover Institution/China Leadership Monitor*, 51 (August 2016): 2.

<sup>775</sup> See e.g., *Anhui Province People's Government Implementing Opinion on Shedding Excess Industrial Capacity in the Steel Industry to Achieve Development out of Difficulty* (Anhui Province People's Government, Wan Zheng [2016] No. 77, issued July 30, 2016); *Heilongjiang Province People's Government Implementing Opinion on Shedding Excess Industrial Capacity in the Steel Industry to Achieve Development out of Difficulty* (Heilongjiang Province People's Government, Hei Zheng Ban Fa [2016] No. 83, issued July 29, 2016); *Jiangsu Province People's Government Implementing Opinion on Shedding Excess Industrial Capacity in the Steel Industry to Achieve Development out of Difficulty* (Jiangsu Province People's Government, Su Zheng Fa [2016] No. 170, issued December 27, 2016).

<sup>776</sup> See e.g., *Jiangxi Province People's Government Implementation Plan for Shedding Excess Industrial Capacity in the Steel Industry to Achieve Development out of Difficulty* (Jiangxi Province People's Government, Gan Zheng Ting Zi [2016] No. 113, issued August 19, 2016) and *Yunnan Province People's Government Implementation Plan for Shedding Excess Industrial Capacity in the Steel Industry to Achieve Development out of Difficulty* (Yunnan Province People's Government, Yun Zheng Fa [2016] No. 51, issued June 28, 2016).

<sup>777</sup> *Ibid.*

support – for example, to purchase new equipment – such that many enterprises do not exit the market and aggregate capacity remains high.<sup>778</sup> In some of these industries, particularly steel and aluminum, excess capacity appeared to increase even as the government tried to reduce it.<sup>779</sup> Furthermore, by setting capacity-shedding targets, the government may under- or overestimate the degree of capacity reduction required to balance supply and demand. For example, in the case of steel, the reduction target is roughly 150 million metric tons (MMT) for the 13th *FYP* period;<sup>780</sup> however, current estimates of China’s excess steel capacity are nearly 400 MMT.<sup>781</sup>

In a market-driven process, capacity reductions would not cease once an administratively-determined level had been reached. Instead, plant closures and market exits would reduce capacity and employment over time until prices and profits indicated that the capacity and production of firms still in the market was economically viable. In addition, capacity reductions would result in the least efficient producers facing the greatest cuts, rather than the government determining which enterprises must exit or reduce capacity. In China, government authorities, rather than the market, effectively control entry and exit, extend financial support to non-viable and troubled firms, and negotiate with other government authorities over the extent of administratively determined capacity cuts.

#### 4.3. Excessive Corporate Debt

The credit intensity of China’s GDP (new credit per unit of additional GDP) has doubled since before the 2008 financial crisis and it continues to rise.<sup>782</sup> At the end of 2015, total credit and bank credit to the private non-financial sector stood at 202% and 153% of GDP, respectively.<sup>783</sup> The total credit-to-GDP ratio stood at 27% above trend.<sup>784</sup> This is well over the 10% that the Bank of International Settlements (BIS) considers a warning signal.<sup>785</sup> These figures suggest that credit growth exceeds optimal financial deepening for a country at China’s level of economic development.<sup>786</sup>

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<sup>778</sup> European Union Chamber of Commerce in China, *Overcapacity in China: An Impediment to the Party’s Reform Agenda* (2016), 16-18.

<sup>779</sup> *Rhodium Group*, “Exporting Overcapacity: China and Trump Search for Answers,” May 9, 2017.

<sup>780</sup> *Ibid.*

<sup>781</sup> *Ibid.*

<sup>782</sup> IMF, *People’s Republic of China: Selected Issues*, IMF Country Report No. 16/271 (August 2016), 5.

<sup>783</sup> *Statistical Tables* (Bank for International Settlements website, available at [http://www.bis.org/statistics/tables\\_f.pdf](http://www.bis.org/statistics/tables_f.pdf)). Credit growth and level are high regardless of whether and to what extent local government financing vehicles are included in the private non-financial sector.

<sup>784</sup> *Ibid.*

<sup>785</sup> Bank for International Settlements, “Early Warning Indicators,” *BIS March 2016 Quarterly Review* (March 6, 2016), 28.

<sup>786</sup> IMF, *People’s Republic of China: Selected Issues*, IMF Country Report No. 16/271 (August 2016), 32.



Excessive debt in China is largely a corporate sector problem, particularly among SIEs.<sup>787</sup> A report by the Economist Intelligence Unit finds that corporate debt accounted for 65% of China's total debt in September 2016, equivalent to 166.2% of China's GDP.<sup>788</sup> The IMF's 2016 *Global Financial Stability Report* notes a sharp increase in the debt overhang of listed firms in China between 2009 and 2015, to the extent that there is now a large divergence between listed firms in China and in other regions of the world. Several indicators show that the increase in debt has been large and rapid, while at the same time, debt servicing capacity has been deteriorating.<sup>789</sup> First, credit growth is concentrated in the corporate sector at a time of rising financial stress, falling profitability and growing inter-enterprise payment arrears.<sup>790</sup> The debt-to-earnings ratio for the median Chinese firm has more than doubled since 2010.<sup>791</sup> Second, roughly two-fifths of new debt goes to pay interest on existing loans, and in 2014, 16% of the 1,000 largest Chinese companies owed more interest than their earnings before taxes.<sup>792</sup> Third, according to IMF methodology, "loans potentially at risk" were estimated to account for more than 15% of total commercial bank loans to the corporate sector in 2015.<sup>793</sup>

Moreover, credit is often provided to non-viable enterprises in industries with excess capacity.<sup>794</sup> The share of loans going to firms with low debt-service capacity is increasing, and the lenders to these firms are increasingly smaller, under-capitalized and under-provisioned banks that are least

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<sup>787</sup> The Economist Intelligence Unit, *China's Supply-Side Structural Reforms: Progress and Outlook* (2017), 16.

<sup>788</sup> The Economist Intelligence Unit, *China's Supply-Side Structural Reforms: Progress and Outlook* (2017), 16. See also IMF, *Resolving China's Corporate Debt Problem*, WP/16/203 (October 2016), 3. ("The corporate sector has been the main driver of the excessive credit creation. Credit to households is consistent with the ratio for countries at a similar level of development. In contrast, credit to the corporate sector is well above the level in emerging market peers (exceeding even the level typical for developed economies) and growing fast. The financial performance of the corporate sector has also been deteriorating. After the initial deleveraging phase, the leverage ratio has been rising while profitability has been steadily falling, suggesting deteriorating debt servicing capacity. This is further illustrated by the rising ratio of liabilities to earnings (EBIT) and the falling interest coverage ratio (ICR = EBIT / interest expenses).")

<sup>789</sup> IMF, *Resolving China's Corporate Debt Problem*, WP/16/203 (October 2016), 3 and 7. See also IMF, *People's Republic of China: 2016 Article IV Consultation – Press Release; Staff Report; and Statement by the Executive Director for the People's Republic of China*, IMF Country Report No. 16/270 (August 2016), 10.

<sup>790</sup> IMF, *Global Financial Stability Report: Potent Policies for a Successful Normalization* (April 2016), 13-16.

<sup>791</sup> *Ibid.*

<sup>792</sup> *The Economist*, "The Coming Debt Bust," May 7, 2016.

<sup>793</sup> IMF, *Global Financial Stability Report: Potent Policies for a Successful Normalization* (April 2016), 16. ("'loan potentially at risk' can be defined as a bank loan to a borrower that has an interest coverage ratio (EBITDA divided by interest expenses) below one. Put another way, it is a loan to a borrower that doesn't have sufficient income to cover its interest payments.")

<sup>794</sup> *Ibid.*, 5.



able to manage the increased risk.<sup>795</sup> In addition, the banking sector continues to allocate resources disproportionately to SIEs, which according to the IMF account for a far greater share of total bank credit than industrial value-added.<sup>796</sup>

The causes of corporate debt are closely linked to excess capacity. The large stimulus program introduced in response to the global financial crisis combined expansionary fiscal and monetary policy with increased lending by state-owned commercial banks. The insertion of additional credit into the economy financed a rapid scaling up of industrial capacity, infrastructure, and real estate investment in excess of real demand. Consequently, many enterprises in China now have a large debt burden, but as a result of inefficient expansion, and owing to a general slowdown in the economy, are unable to turn over excess output and unsold housing stock. Borrowing costs not commensurate with returns and risks, together with easy access to financing, are key features distorting the allocation of resources and promoting the types of inefficiencies that have contributed to China's corporate debt problem.<sup>797</sup>

The Chinese government has used various methods to pursue corporate deleveraging under "supply-side structural reform." One method involves selling state-owned shares to private investors through capital injection, share acquisition, and debt-for-equity swaps, as stipulated in the 2015 *SOE Reform Opinion*.<sup>798</sup> Another involves the introduction of stricter accounting standards and corresponding government oversight.<sup>799</sup> Yet another is to restrict access to new credit; as discussed above, China's financial regulatory authorities have co-issued measures with NDRC and MIIT to condition access to loans and other forms of financing for coal and steel producers, based on their conformity with environmental, energy consumption, safety, quality and technical standards, as well as their progress in "actively shedding excess capacity."<sup>800</sup> These initiatives do not address the underlying causes of the problem, and as a result, the debt problem in the state sector continues to rise.<sup>801</sup>

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<sup>795</sup> Jason Bedford, "Are We Through the Worst of the Credit Cycle? What the Banks Tell Us," *UBS*, November 1, 2016, 17-18. *See also* Jason Bedford, "Have the Bailouts and Recapitalizations Begun?" *UBS*, August 11, 2016, 6.

<sup>796</sup> IMF, *People's Republic of China: Selected Issues*, IMF Country Report No. 16/271 (August 2016), 38.

<sup>797</sup> IMF, *Resolving China's Corporate Debt Problem*, WP/16/203 (October 2016), 5-8; IMF, *Global Financial Stability Report: Potent Policies for a Successful Normalization* (April 2016), 13-14.

<sup>798</sup> *Guiding Opinion on Deepening Reform of State-owned Enterprises*, Article 17 (CCP Central Committee and State Council, Guo Fa [2015] No. 22, issued August 24, 2015).

<sup>799</sup> *Notice on Issuing the "Provisions on Accounting Management for Activities Relating to "Three cuts, One Reduction, and One Strengthening"* (MOF, Cai Hui [2016] No. 17, issued September 22, 2016).

<sup>800</sup> *Opinion on Supporting the Shedding of Excess Industrial Capacity in the Steel and Coal Industry to Achieve Development out of Difficulty* (PBOC, CBRC, CSRC, CIRC, Yin Fa [2016] No. 118, issued April 17, 2016); *Several Opinions on Financial Debt and Debt Obligations Problems Relating to Shedding Excess Capacity in the Steel and Coal Industries* (CBRC NDRC, MIIT, Yin Jian Fa [2016] No. 51, issued December 1, 2016).

<sup>801</sup> Andrew Batson, "The State of the State Sector," *Gavekal/Dragonomics*, March 2017, 21. *See also* The Economist Intelligence Unit, *China's Supply-Side Structural Reforms: Progress and Outlook* (2017), 16-18. The Economist Intelligence Unit has noted that conventional deleveraging through tighter monetary policy does not

## B. Price Regulation

Price regulation is an important means by which a government can influence the economy. Part B of this section begins by discussing the prevalence of price distortions. It then discusses the status of formal price controls, including an explanation of how the Chinese government divides prices for goods and services into “market-regulated prices,” “government-guided prices,” and “government-set prices.” Part B concludes with a closer examination of Chinese government pricing policies in the electricity sector.

The Chinese government does not formally control prices directly for most goods and services, but nonetheless exerts a high degree of control over prices it deems essential or strategic. The government formally sets and guides prices for important factor inputs, including oil and gas, electricity, and transportation services, which undergird a complex system of price regulation at the sub-central and sectoral level. The government also influences prices through other means, such as trade policy measures and the administrative allocation of land-use rights.<sup>802</sup> To fulfill industrial policy objectives, the Chinese government also administers prices on a discriminatory basis through methods such as “differential pricing” of electricity. Thus, notwithstanding the aggregate reduction in China’s direct price controls, the remaining controls, especially as applied to factor inputs, influence costs and prices throughout China’s industry-intensive economy.

### 1. *The Prevalence of Price Distortions*

Reports by international institutions have pointed to significant price distortions in China’s economy, particularly in factor markets.

- OECD. A 2015 report finds that energy prices “do not reflect the true social and environmental cost of production, making for a widespread misallocation of resources.”<sup>803</sup> It recommends that China “move to full market-based pricing for natural gas and coal” and “[d]eregulate electricity prices, beginning in the generation sector, and avoid preferential electricity pricing for selected industrial users.”<sup>804</sup>

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suffice in China because tightening credit tends to “affect private firms first, despite their higher levels of efficiency and ability to generate more GDP per unit of debt.” Moreover: “[Debt-for-equity swaps] may buy some time for struggling companies, but if that time is not used to drive reforms and productivity gains, it will have only delayed the debt reckoning ... The modest scope of SOE reforms does not provide much encouragement on this front. The other risk, highlighted by the structuring of the debt-for-equity swap programme, is that the authorities look to shift the burden for corporate debt repayment to the household sector.”)

<sup>802</sup> This determination’s review of the Chinese government’s institutional structure for intervention in the economy through mechanisms such as the SIE sector, land allocation, industrial policies, financial system, as well as in restrictions to foreign investment, and control of the legal system in aggregate establish the conditions for the distortion of supply and demand.

<sup>803</sup> OECD, *OECD Economic Surveys: China* (Paris: OECD Publishing, March 2015), 31.

<sup>804</sup> *Ibid.*, 52.

- Asian Development Bank Institute. A 2011 report estimates the aggregate costs arising from the governmental interventions in the factor markets to lie in the range of about 10% of Chinese GDP each year during the first decade of the 21st century. It concludes:

During the reform period, the PRC government focused on reform of the product markets, including abandoning policy interventions in domestic markets and liberalizing trade of goods and services. Today, free markets determine the prices of more than 95% of products. In contrast, factor markets, including markets for labor, capital, land, energy, and the environment, remain highly distorted. [...] Some distortions in factor markets, such the *government's controls over energy prices* and land use fees for manufacturing investors, are deliberate policy measures to support economic growth.<sup>805</sup> (emphasis added)

- World Bank and the Development Research Center of the State Council. A 2012 report recommends higher prices on energy (carbon), water, and natural resources in the near to medium term because it “would encourage their more efficient use.” The report also calls for China to establish a “level playing field” within the enterprise sector by allowing for “market-driven factor and input prices.”<sup>806</sup>
- WTO. According to the WTO’s 2008 *Trade Policy Review*:

While China's high energy intensity may be partly explained by the share of industry (which tends to be relatively energy intensive) in GDP, it is also undoubtedly due to the existing insufficiently market-oriented price mechanism for oil, coal, electricity and natural gas, which sets artificially low prices and, as a consequence, leads to a waste of energy, to the detriment of the environment.<sup>807</sup>

Various academic studies have also discussed the extent of price distortions in China’s economy.<sup>808</sup>

## 2. *The Status of Formal Price Controls*

### 2.1. The System of Set, Guided, and Market-Regulated Prices

Under the command economy, the Chinese government set prices for all goods and services in the economy. Changes initiated in the 1970s culminated in the passage of the 1997 *Pricing Law*

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<sup>805</sup> Yiping Huang and Kunyu Tao, *Causes of and Remedies for the People’s Republic of China’s External Imbalances: The Role of Factor Market Distortion*, Working Paper Series No. 279 (Asian Development Bank Institute, April 2011), 12.

<sup>806</sup> World Bank, *China 2030: Building a Modern, Harmonious, and Creative Society*, Report No. 96299 (March 2013), 94, 103.

<sup>807</sup> WTO, *Trade Policy Review – Report by the Secretariat – China*, WT/TPR/S/199 (April 16, 2008), xiii.

<sup>808</sup> See Shi Xunpeng and Sun Sizhong, “Energy Price, Regulatory Price Distortion and Economic Growth: A Case Study of China,” *Energy Economics* 63 (March 2017), 261-271.

of the People's Republic of China ("Pricing Law"),<sup>809</sup> which divides prices for goods and services<sup>810</sup> into three categories: (1) "market-regulated prices," (2) "government-guided prices," and (3) "government-set prices."<sup>811</sup> Most prices in China today fall under the category of market-regulated prices.<sup>812</sup> The *Pricing Law* provides that the government "practices and gradually perfects the price mechanism shaped mainly by the market under macroeconomic regulation and control"<sup>813</sup> and "supports and promotes fair, open and lawful market competition."<sup>814</sup>

The *Pricing Law* defines the types of goods and services for which the government may implement when necessary government-set prices and government-guided prices: (1) a small number of goods that have a significant bearing on national economic development and people's livelihoods; (2) a small number of goods for which resources are scarce; (3) goods operated by natural monopoly; (4) important public utilities; and (5) important services that benefit the public.<sup>815</sup> Articles 22 through 25 provide that private and public interested parties may submit information to the state with respect to the setting of guidance prices, to ensure that pricing is in line with prevailing market conditions.<sup>816</sup>

Government authorities are required to formulate and administer government-set and government-guided prices in accordance with government-issued pricing catalogues.<sup>817</sup> Though not expressly set forth in the *Pricing Law*, central government authority to formulate prices rests primarily with NDRC, which publishes the *Catalogue of Pricing by the Central Government*

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<sup>809</sup> *Pricing Law of The People's Republic of China* (adopted at the 29th Meeting of the Standing Committee of the Eighth National People's Congress on December 29, 1997. effective May 1, 1998).

<sup>810</sup> The *Pricing Law* does not apply to interest rates, securities prices, insurance rates, or foreign exchange rates, which are regulated by other laws and administrative regulations. *Ibid.*, Article 47.

<sup>811</sup> *Ibid.*, Article 3. Market-regulated prices are defined as prices formulated independently by business operators and formed through market competition. Government-guided prices are defined as benchmark prices and their range of fluctuation that guide prices formulated by business operators, stipulated by the government department in charge of pricing or related departments within the price-setting rights and scope set forth in the provisions of this law. Government-set prices are defined as prices formulated by the government department in charge of pricing or related departments within the price-setting rights and scope set forth in the provisions of this law.

<sup>812</sup> The Economist Intelligence Unit, *China Country Commerce Report* (February 2017), 56. The WTO's bi-annual Trade Policy Review for China typically lists those items for which prices were liberalized during the period in question, as well as those prices still subject to various levels of government control. *See e.g.* WTO, *Trade Policy Review*, The People's Republic of China WT/TPR/S/342, (June 15, 2016), 91-93.

<sup>813</sup> The *Pricing Law*, Article 3.

<sup>814</sup> *Ibid.*, Article 4. The *Pricing Law* defines a number of unfair price acts, including price discrimination. *Ibid.*, Article 14.

<sup>815</sup> *Ibid.*, Article 18.

<sup>816</sup> *Ibid.*, Article 22 and 25.

<sup>817</sup> *Ibid.*, Article 19.

(“*Central Pricing Catalogue*”). The *Central Pricing Catalogue* lists all goods and services subject to government-set and government-guided prices at the central level.<sup>818</sup>

The most recent edition of the *Central Pricing Catalogue*, effective January 1, 2016, lists 11 items (and sub-items) of goods and services subject to price controls:

- (1) Natural gas; (2) water; (3) electricity; (4) special medicines and blood; (5) transportation services (divided into (a) railway, (b) civic air, (c) ports, and (d) tunnel transportation); (6) postal services; and (7) banking services.<sup>819</sup> These items are presented in a table that details how the prices are administered and which central government authorities participate in their formulation.
- (8) Refined oil products, (9) telecommunications and internet services, (10) edible salts, and (11) charges for certifying academic credentials.<sup>820</sup> These items are listed in a more informal manner in the footnotes of the *Central Pricing Catalogue*.

According to the WTO, prices for natural gas, refined oil products, and transportation services (railway, civic air, and ports) are subject to government-*guided* prices. Prices for the other categories listed above are subject to government-*set* prices.<sup>821</sup> In addition, local governments independently determine government-set or government-guided prices for land, residential real estate, and related services; municipal services (environmental protection, household garbage disposal, and sewage); and entrance fees to tourism sites.<sup>822</sup>

Upon accession to the WTO in 2001, China was permitted to maintain price controls on certain goods and services listed in Annex 4 of its Accession Protocol.<sup>823</sup> China, in turn, committed to use “best efforts” to reduce or eliminate these price controls.<sup>824</sup> China also committed that additional goods and services would not be added to the list of those subject to price controls

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<sup>818</sup> *Catalogue of Pricing by the Central Government* (NDRC, Order [2015] No. 29, issued October 8, 2015, effective January 1, 2016). See also *Pricing Catalogue of the State Development and Planning Commission and Related Departments* (SDPC, Order [2001] No. 11, issued July 4, 2001). The SDPC is the predecessor of NDRC, which was established in 2003.

<sup>819</sup> *Ibid.*

<sup>820</sup> *Ibid.*

<sup>821</sup> WTO, *Trade Policy Review*, The People’s Republic of China, WT/TPR/S/342 (June 15, 2016), 92.

<sup>822</sup> *Ibid.*, 12.

<sup>823</sup> WTO, *Protocol on the Accession of the People’s Republic of China*, WT/L/432 (November 10, 2001), Annex 4.

<sup>824</sup> *Ibid.*, 6. Before China’s WTO accession, tobacco, edible salt, natural gas, pharmaceuticals, and certain services and utilities (such as electricity tariffs and bank service fees) were subject to government-set prices. Grain, vegetable oil, processed oil, fertilizer, silkworm cocoons, and cotton were subject to government-guided prices. See also WTO, *Trade Policy Review*, The People’s Republic of China, WT/TPR/S/161 (February 28, 2006), 126.

“except in exceptional circumstances,” which must be reported to the WTO.<sup>825</sup> Since WTO accession, the Chinese government has not increased the number of goods and services formally subject to government-guided and government-set prices, and as of 2016, NDRC has removed several items from the *Central Pricing Catalogue*, including grain, cotton, sugar, filature silk, crude oil, processed oil, and chemical fertilizers.<sup>826</sup>

## 2.2. Residual Government Control through Formal Price Controls

Notwithstanding the aggregate reduction in formal price controls, the formal price controls that remain allow the government to exert substantial control over key prices in China’s economy. First, the *Pricing Law* provides the government with vague and expansive justifications to impose price controls, in particular controls on goods that have a significant bearing on national economic development and people’s livelihoods.<sup>827</sup> It is important to recognize that NDRC, which has primary authority to set prices at the central level, is also the principal authority responsible for formulating and implementing industrial policies. (See Factor 5.A. for further discussion.)

Second, for those goods and services for which the Chinese government maintains price controls, it employs a complex and extensive system of government measures to set and guide prices. Lists published by NDRC in December 2016 contain more than 2,500 laws, regulations, and normative documents issued by national and sub-central authorities.<sup>828</sup> The WTO also points out in its 2015 *Trade Policy Review*:

Although the list of goods and services subject to government prices and government-guided prices has not changed since the previous Review, there have been numerous adjustments to rates and fees. In 2013 (up to 10 December), NDRC issued a total of 22 announcements concerning the pricing of commodities and services, 13 of which related to increases or decreases in the price of fuels.<sup>829</sup>

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<sup>825</sup> *Ibid.*

<sup>826</sup> WTO, *Trade Policy Review*, The People’s Republic of China, WT/TPR/S/342 (June 15, 2016), 12. (“China applies price controls, at both the central and provincial levels, on commodities and services deemed to have a direct impact on the national economy and people’s livelihoods. These take two forms: government prices, which are fixed prices set by the authorities, and government-guided prices, set within a range. The commodities and services subject to price controls are listed in a Central Government Pricing Catalogue and in Local Government Pricing Catalogues. Since the last Review, China has liberalized the price of several goods and services, such as the ex-factory price of explosive materials, the charges for some construction projects, and the prices of military goods and of tobacco leaves. Government-set prices are currently applied to refined oil products, natural gas, certain medicines, and some services. Products classified as important central reserve materials (grain, cotton, sugar, filature silk, crude oil, processed oil, and chemical fertilizers) are no longer subject to government-set prices.”)

<sup>827</sup> The *Pricing Law*, Article 18.

<sup>828</sup> NDRC website, available at [http://jgs.ndrc.gov.cn/zcfg/201612/t20161208\\_829529.html](http://jgs.ndrc.gov.cn/zcfg/201612/t20161208_829529.html) and [http://jgs.ndrc.gov.cn/zcfg/201612/t20161208\\_829527.html](http://jgs.ndrc.gov.cn/zcfg/201612/t20161208_829527.html), accessed September 13, 2017).

<sup>829</sup> WTO, *Trade Policy Review*, The People’s Republic of China, WT/TPR/S/342 (June 15, 2016), 93.



Most importantly, China's formal price controls for natural gas, refined oil, electricity, water, and transportation services result in some of the most significant distortions in China's economy. These goods and services constitute factor markets that influence costs of production and the final prices of industrial goods, particularly in resource-intensive industries. According to the WTO, China has specific rationales for maintaining price controls for these goods and services, in conformity with provisions set forth in the *Pricing Law*.<sup>830</sup> Yet, authoritative studies have noted the extent to which price controls distort factor markets in China.

Owing to the importance of energy prices for the allocation of resources in China's economy, the electricity sector is discussed in more detail below as a prominent example of government control over key prices.

### 2.3. Electricity Pricing Policies

Electric power use in China has mirrored the country's rapid and sustained economic growth. Production increased from 590 terawatt hours ("TWh") in 1990 to a world-leading 5,388 TWh in 2014, an eight-fold increase and almost one-quarter of the world's total.<sup>831</sup> Coal-fired generators account for approximately 60% of installed power generating capacity.<sup>832</sup> Studies suggest that Chinese electricity consumers pay low prices by international standards. For example, the World Energy Council, which aggregates cross-country data on the cost of electricity per kilowatt-hour, estimates the 2012 cost at 5 cents in China, compared to 12 cents in the United States and 28 cents in Japan.<sup>833</sup>

The Chinese government conducted an overhaul of China's utility regulators and operators in 2002-2004. It established an independent electricity regulator, the State Electricity Regulatory Commission (SERC), and divided up the state's power monopoly into five state-owned power generation companies and two transmission and distribution companies—State Grid and the smaller China Southern Power Grid.<sup>834</sup> Concurrent with this institutional change, the government

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<sup>830</sup> *Ibid.*, 92. See e.g., electricity price controls: "The rationale for maintaining a price control is that power transmission and distribution are natural monopolies due to the network nature and should be regulated by the Government. In the case of feed-in and users' sales tariff not participating in market competition, the price-setting rationale is to guarantee the interests of producers and consumers." See also refined oil price controls: "The rationale for maintaining a price control is the lack of market competition." See also natural gas price controls: "The rationale for maintaining a price control is that natural gas is of vital importance to the public and that the natural gas system needs to be reformed comprehensively before prices are liberalized." See also railway transportation price controls: "The rationale is that state railways and railways operated by joint ventures in which the Central Government has a controlling stake are under the direction of the China Railway Corporation and therefore should be subject to prices regulated by the Government."

<sup>831</sup> U.S. Department of Energy/Energy Information Agency, *International Energy Statistics* (June 6 2017).

<sup>832</sup> *China Electricity Council*, "Power statistics China 2016: Huge Growth of Renewables amidst Thermal-based Generation," February 9, 2017.

<sup>833</sup> World Energy Council, *2013 Energy Sustainability Index* (2013).

<sup>834</sup> OECD, *China's Power Sector Reforms* (Paris: OECD Publishing, 2006), 13; Ma Chunbo and He Lining, "From State Monopoly to Renewable Portfolio: Restructuring China's Electric Utility," *Energy Policy* 36 (2008): 1703-

began to revise the system for pricing electricity. One important element of the current pricing system is that the government sets different rates at the wholesale (*i.e.* power transmission) and retail (*i.e.* power distribution) level; by province; and for agricultural, industrial, and residential uses, respectively.<sup>835</sup> Another important element of the pricing system is that electricity prices are to be set in accordance with changes in the price of coal, the main feedstock for electricity, based on a price co-movement system. This arrangement is designed so that higher coal prices are transmitted to end-users of coal-fired electricity.<sup>836</sup> This change was instituted after the government began to reduce price controls on power coal in 2004.<sup>837</sup>

In spite of these actions to modify electricity price regulation, several aspects of Chinese government policies serve to distort electricity prices. The first aspect is that SERC, China's independent electricity regulator, does not set electricity prices. Rather, prices are set by NDRC, the government authority that also has authority over industrial policies.<sup>838</sup> This arrangement weakens the ability of SERC to make independent decisions in response to developments in the electricity sector.

A second aspect is that the Chinese government has exercised inordinate discretion over when and how to adjust electricity prices in response to changes in coal prices. Coal prices rose exponentially in the 2006–2012 period, due to the coal price reforms and the rapid growth in Chinese energy consumption. This trend should have prompted an increase in the wholesale and retail electricity price, but NDRC did not make commensurate adjustments to electricity prices.<sup>839</sup> One academic study on this period notes:

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1705; Todd J. Edwards, "China's Power Sector Restructuring and Electricity Price Reforms," *Asia Papers* 6(2) (Brussels: Brussels Institute of Contemporary China Studies, January 18, 2012): 17-20.

<sup>835</sup> Yiping Huang and Kunyu Tao, *Causes of and Remedies for the People's Republic of China's External Imbalances: The Role of Factor Market Distortion*, Working Paper Series No. 279 (Asian Development Bank Institute, April 2011), 14; WTO, *Trade Policy Review*, The People's Republic of China, WT/TPR/S/342 (June 15, 2016), 92.

<sup>836</sup> Michael G. Pollitt, Chung-Han Yang, and Hao Chen, *Reforming the Chinese Electricity Supply Sector: Lessons from International Experience*, Working Paper 1704 (Energy Policy Research Group, March 2017), 5-6. OECD, *China's Power Sector Reforms* (Paris: OECD Publishing, 2006), 54-55. See also Ma Chunbo and He Lining, "From State Monopoly to Renewable Portfolio: Restructuring China's Electric Utility," *Energy Policy* 36 (2008): 1703-1705; Todd J. Edwards, "China's Power Sector Restructuring and Electricity Price Reforms," *Asia Papers* 6(2) (Brussels: Brussels Institute of Contemporary China Studies, January 18, 2012): 17-20.

<sup>837</sup> Zhong Xiang Zhang, "Energy Prices, Subsidies, and Resource Tax Reform in China," *Asia & Pacific Policy Studies* 1(3) (September 2014): 440. ("In 2004, NDRC abolished its guidance price for power coal and set price bands for negotiations between coal producers and electricity generators. NDRC widened those bands in 2005; in 2006, it scrapped them altogether.")

<sup>838</sup> Yiping Huang and Kunyu Tao, *Causes of and Remedies for the People's Republic of China's External Imbalances: The Role of Factor Market Distortion*, Working Paper Series No. 279 (Asian Development Bank Institute, April 2011), 15. ("Electricity tariffs are set by the National Development and Reform Commission (NDRC), although the authorities sometimes hold public hearings to improve decision-making quality.")

<sup>839</sup> Todd J. Edwards, "China's Power Sector Restructuring and Electricity Price Reforms," *Asia Papers* 6(2) (Brussels: Brussels Institute of Contemporary China Studies, January 18, 2012): 19-22.

To respond to electricity generators' concerns, NDRC proposed in May 2005 a coal electricity price 'co-movement' mechanism that would raise electricity tariffs if coal prices rose by 5 per cent or more in no less than six months, and allowed electricity generators to pass up to 70 per cent of increased fuel costs on to grid companies, and grid companies to pass costs on to consumers. However, because of fears of inflation, the co-movement policy had not been implemented as the conditions met, and power tariffs continue to remain flat while coal prices rise.<sup>840</sup>

Ryan Rutkowski, an economist at the Peterson Institute for International Economics, notes that "[i]f coal prices rise once again, the state still has complete control over end user pricing, and thus can limit pass-through of rising on-grid tariffs. The 5% threshold for annual adjustment to on-grid tariffs also leaves plenty of room to squeeze thermal power producers once again."<sup>841</sup> Notably, a similar disconnect between upstream and downstream prices is evident in China's regulation of oil prices.<sup>842</sup>

A third aspect that distorts electricity prices in China is the Chinese government's use of discriminatory pricing measures to achieve industrial policy objectives. An important facet of this policy is the use of "differential pricing." In 2006, NDRC issued the *Opinion on Optimizing Differential Electricity Pricing Policies*.<sup>843</sup> The measure calls for using differential energy pricing as a regular tool for pursuing national industrial policies to reduce excess and obsolete capacity, streamline industrial structures, and upgrade production technologies. It also calls for energy price increases specifically for companies that employ production technologies listed in the restricted or prohibited categories of the *Guidance Catalogue for the Structural Adjustment of Industries*.<sup>844</sup> According to one study:

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<sup>840</sup> Zhong Xiang Zhang, "Energy Prices, Subsidies, and Resource Tax Reform in China," *Asia & Pacific Policy Studies* 1(3) (September 2014): 440.

<sup>841</sup> Ryan Rutkowski, "Rebalancing and Rising Electricity Prices in China," *China Economic Watch* (Peterson Institute for International Economics, February 18, 2014).

<sup>842</sup> See Yiping Huang and Kunyu Tao, *Causes of and Remedies for the People's Republic of China's External Imbalances: The Role of Factor Market Distortion*, Working Paper Series No. 279 (Asian Development Bank Institute, April 2011), 15. ("In 1998, in an important step of oil price liberalization, the State Council announced a formula linking domestic prices to the weighted average of prices in New York, Singapore, and Rotterdam. NDRC would adjust domestic prices, with a couple of months' delay, if the international weighted average moved by more than 8%. In 2000, NDRC raised oil prices seven times in order to bring domestic prices closer to international levels. However, when international prices moved violently, NDRC became reluctant to follow for fear of disrupting economic growth. For instance, when international crude prices reached their recent peak at close to US\$150 per barrel in 2008, the equivalent domestic prices were only around US\$80 per barrel. But oil price distortions are highly volatile, given the State Council's formula and fluctuations in the international markets.")

<sup>843</sup> *State Council Notice on Reissuing the National Development and Reform Commission Opinion on Optimizing Differential Electricity Pricing Policies* (State Council, Guo Ban Fa [2006] No. 77, issued September 17, 2006).

<sup>844</sup> NDRC further specified differential pricing policies in subsequent measures, in conjunction with barring the use of "preferential prices" for specific industries. *Notice on Problems Relating to Further Carrying Out and Implementing Differential Pricing Policies* (NDRC, Fa Gai Jia Ge [2007] No. 155, issued September 30, 2007).

By 2015, the practice [of differential electricity pricing] has not only been implemented nationwide, it has also been generally accepted as a way to guide corporate decision making. While the actual contribution of differential energy pricing is hard to gauge and has been overshadowed by changing economic trends and policy strategies, differential pricing has become a mainstay of the industrial policy tool box. The number of laws, circulars, opinions, guidelines and measures that include this concept and similar approaches has increased across a wide range of policy fields.<sup>845</sup>

Recently, in the context of the “supply-side structural reform” initiative (see discussion in Factor 5.B.), the Chinese government has recommended the use of “differential pricing,” as well as “scaled pricing” and “punitive pricing,” as a tool to shed excess capacity. The 2017 *Guiding Opinion of 16 Government Departments on Utilizing Comprehensive Standards to Promote the Shedding of Obsolete Industrial Capacity According to the Law* calls for the application of these pricing policies to industrial capacity in the steel, cement and aluminum industries as well as other industries with energy and electricity consumption that exceed the mandatory standards. The guiding opinion also calls for application of these pricing policies to industries with obsolete industrial capacity as defined under the *Structural Adjustment Catalogue*.<sup>846</sup> The result of these policies is that the government not only sets prices, but also sets individual rates for specific end-users, thereby further distorting the electricity market.

The Chinese government recently reiterated its goals to modify electricity sector policy in its 2015 *Several Opinions on Further Deepening Institutional Reform of the Electric Power Industry*.<sup>847</sup> The proposed modifications focus on the wholesale market, introducing competition to the retail market, direct power sales to large industrial end-users, and cost-based transmission and distribution tariffs (the latter two on a trial basis).<sup>848</sup> Electric power distributors can now vary rates for residential users directly with demand and peak usage times.<sup>849</sup> Generators and large industrial end-users also in some cases directly negotiate electricity prices.<sup>850</sup> While these modified policies could mark an important step forward, they fall short of establishing true

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<sup>845</sup> Markus Taube and Christian Schmidkonz, *Assessment of the Normative and Policy Framework Governing the Assessment of the Normative and Policy Framework Governing the Chinese Economy and Its Impact on International Competition*, Final Extended Report for AEGIS Europe (Think!Desk China Research & Consulting, August 13, 2015), 196.

<sup>846</sup> *Guiding Opinion of 16 Government Departments on Utilizing Comprehensive Standards to Promote the Shedding of Obsolete Industrial Capacity According to the Law* (MIIT, Gong Xin Bu Lian Chan Ye [2017] No. 30, issued February 17, 2017).

<sup>847</sup> *Several Opinions on Further Deepening Institutional Reform of the Electric Power Industry* (CCPCC, State Council, Zhong Fa [2015] No. 9, issued March 15, 2015).

<sup>848</sup> National University of Singapore/Energy Studies Institute, *A New Chapter in China’s Electricity Market Reform*, Policy Brief No. 13 (March 21, 2016).

<sup>849</sup> Se Yan and Shuang Ding, *China – Price Guidelines Advance ‘Deep Reforms’* (Standard Chartered Global Research, November 2015), 4-5.

<sup>850</sup> The Energy Collective/Regulatory Assistance Project, *Wholesale Electricity Markets and Pricing in China: How is Reform Going?* (October 5, 2016).

market-based power markets and energy pricing. China’s electricity sector lacks independent systems operators; spot markets have yet to develop; and the government has yet to articulate the “rules of the game” in the retail market. In this institutional framework, competition is governed by administrative rules rather than market rules, particularly as the government still sets prices for industrial and residential users. Notably, some studies indicate that the return on assets of power companies in China remains below their cost of capital, suggesting that prices are still below cost.<sup>851</sup>

### C. The Financial Sector

The financial sector is central to the allocation of resources in China’s economy. Prior to 2017, the Department’s last full assessment of China’s financial sector for trade remedy purposes was in the *2006 PRC NME Determination*. The Department found a significant state role in the banking sector, particularly through the high degree of state-ownership or control; the lack of policy independence of PBOC from the Chinese government; and tight regulation of both retail deposit and lending interest rates. The Department concluded that China’s banking sector fundamentally distorted not only the allocation of financial resources in China, but also that of material inputs and other important resources.<sup>852</sup>

In July 2017, the Department issued a new review of China’s financial sector for the purposes of benchmarking countervailing duty rates (“*2017 CVD Review*”), updating the findings of *2006 PRC Lined Paper*.<sup>853</sup> At the time of *2006 PRC Lined Paper*, China’s financial sector was bank-dominated, such that the Department’s analysis focused exclusively on the formal banking sector. Due to financial sector growth outside the formal banking sector in the ensuing years, the *2017 CVD Review* expands the scope of analysis to include the interbank market, the bond market and “shadow banking,” as well as corresponding interest rates and yields.<sup>854</sup>

Part C begins by discussing institutional features of the formal banking sector. It then discusses interest rate controls and dynamics, including an evaluation of the recent changes to lending and deposit rate policy. Section C concludes with a discussion of “shadow banking” and bond markets.

The Department’s *2017 CVD Review* finds that in spite of PBOC’s relaxation of interest rate controls and other adjustments to financial regulation since 2006, fundamental distortions remain in China’s financial sector from both a risk pricing and a resource allocation standpoint. These

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<sup>851</sup> *Ibid.* See also Se Yan and Shuang Ding, *China – Price Guidelines Advance ‘Deep Reforms’* (Standard Chartered Global Research, November 2015), 4-5; National University of Singapore/Energy Studies Institute, *A New Chapter in China’s Electricity Market Reform*, Policy Brief No. 13, March 21, 2016; and Ryan Rutkowski, “Rebalancing and Rising Energy Prices in China,” in *China Economic Watch* (Washington: Peterson Institute for International Economics, February 18, 2014).

<sup>852</sup> *2006 PRC NME Determination*, 51-62.

<sup>853</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017).

<sup>854</sup> *Ibid.*, 3.



distortions are the result of government ownership and control, and the state's pervasive and intrusive role in China's financial system. The Department incorporates the *2017 CVD Review*, a summary of which is provided below, in its entirety into the current review of China's status as a NME country.

### 1. Institutional Features of the Formal Banking Sector

China's banking sector is the largest in the world, and China's four largest banks are also the world's four largest. Although other types of financial institutions are emerging, China's financial sector remains bank-dominated. For example, bank loans in the first quarter of 2016 were 142% of GDP, compared to 79% for "shadow banking" loans, 23% for net corporate bond financing, and 7% for non-financial enterprise equity.<sup>855</sup>

In spite of banking sector reforms and ownership diversification, effective state control over the banking sector remains dominant. China's banking sector is principally comprised of the following institutions:

- (1) five large commercial banks ("Big Five") that are majority state-owned, operate large branch networks on a nationwide basis, and accounted for approximately 40% of bank assets in 2015;
- (2) 12 joint-stock commercial banks (JSBs) that operate with generally lower levels of direct government ownership, operate on a nationwide basis, and accounted for approximately 19% of bank assets in 2015;
- (3) approximately 145 city commercial banks and credit unions that generally remain under local government control, serve local markets, and accounted for approximately 14% of bank assets in 2015;
- (4) three wholly state-owned policy banks that focus on infrastructure, agriculture and rural development, and foreign trade, respectively, and accounted for approximately 10% of bank assets in 2015;<sup>856</sup> and

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<sup>855</sup> *Ibid.*, 4. See e.g., IMF, *2016 Article IV Consultation – Press Release: Staff Report; and Statement by the Executive Director for the People's Republic of China*, IMF Country Report No. 16/270 (August 2016), 42; Moody's Investor's Service, *Quarterly China Shadow Banking Monitor* (April 2016), 6, for figure on shadow banking.

<sup>856</sup> U.S. Department of Commerce, *Review of China's Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 4-6. See e.g., China Banking Regulatory Commission, *China Banking Regulatory Commission 2015 Annual Report* (2015), 26, 192; Douglas Elliott and Kai Yan, *The Chinese Financial System: An Introduction and Overview*, Monograph Series, Number 6 (The Brookings Institution, John L. Thornton China Center, July 2013), 3; KPMG, "2016 Q3 China's Banking Sector: Performance of Listed Banks and Hot Topics," December 2016, 88. See also Reuters, "BRIEF – China Bank Sector's Total Assets Reach \$29.8 Trillion - Regulator," September 26, 2016.



- (5) foreign-owned banks and bank branches that accounted for 2% of bank assets in 2015, unchanged from 2006.

In addition to government ownership, government influence over banking decisions is evident from the following indicia:

- The CCP, through its Organization Department, appoints executive officials in state-owned banks and financial institutions. According to a report by the Brookings Institution, “[u]nlike in the West, the careers of the most important bankers are determined by the Party.”<sup>857</sup>
- PBOC meets frequently with large banks to ensure that their lending decisions align with PBOC and government objectives. PBOC “window guidance” on where (and where not) to direct credit is industry-specific and sometimes firm-specific.<sup>858</sup>
- The *Commercial Banking Law of the People’s Republic of China* (“*Commercial Banking Law*”) provides that “commercial banks shall conduct their business of lending in accordance with the needs of the national economic and social development and under the guidance of the industrial policies of the State.”<sup>859</sup>
- Industrial policy catalogues, such as the *Guidance Catalogue for the Structural Adjustment of Industry*, call on financial institutions to provide credit in support of investment projects.<sup>860</sup>

In many transactions in China’s banking sector, both the lender and the borrower are state-owned and -controlled. Several problems arise from this dynamic. First, according to the World Bank, there is “*disintermediation of the non-state sector*, especially micro, small, and medium enterprises that have significantly less access to formal financial institutions than state

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<sup>857</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 6. See also Douglas Elliott and Kai Yan, *The Chinese Financial System: An Introduction and Overview*, Monograph Series Number 6, (The Brookings Institution, John L. Thornton China Center, July 2013), 3.

<sup>858</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 7. See also Aidan Shevlin, and Lan Wu, *China: The Path to Interest Rate Liberalization* (J.P. Morgan Asset Management, 2015), 7; *PRC Macro*, “Bailing China ‘In’ to the Great State Refinancing,” February 19, 2016, 3.

<sup>859</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 6-7.

<sup>860</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 6-7. See e.g., the first edition, *Guidance Catalogue for the Structural Adjustment of Industry (2005 Edition)* (NDRC, Order [2005] No. 40, issued December 2, 2005). See also the most recent edition, *Guidance Catalogue for the Structural Adjustment of Industry (2011 Edition) (2013 Revision)* (NDRC, Order [2013] No. 21, issued February 16, 2013).

enterprises and large firms.” (emphasis added)<sup>861</sup> Second, many loans are backed by *implicit government guarantees*, wherein government assumption of the risk on the loans incentivizes both state-owned and non-state-owned banks to lend to SIEs, even if it is clear over time that SIEs are not putting the funds to best use.<sup>862</sup> Third, SIE borrowers experience *soft budget constraints*, *i.e.*, the lack of any meaningful budget constraint that makes an enterprise responsible for its own investment or production losses because the enterprise receives financial assistance or support to cover those losses on an ongoing basis. Soft budget constraints exacerbate the problems of implicit guarantees by further insulating SIE managers from the consequences of imprudent production and investment decisions.<sup>863</sup>

Whereas market-based banking systems in principle allocate credit to its best use, a significant share of total credit in China is put to unproductive use, owing largely to the problems described above. Several facts, taken together, point to systemic misallocation of credit. At the macro-level, the credit intensity of China’s GDP (new credit per unit of additional GDP) has doubled since before the 2008 financial crisis, in conjunction with an increase in the share of bank loans as a percentage of GDP.<sup>864</sup> Credit growth is concentrated in the corporate sector in spite of rising financial stress, falling profitability and growing inter-enterprise payment arrears.<sup>865</sup> Within the corporate sector, SIEs account for only 16% of value-added (down from 40% a decade earlier) but account for half of total bank credit.<sup>866</sup> Non-viable companies in industries with over-

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<sup>861</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 7. See also World Bank, *China 2030: Building a Modern, Harmonious, and Creative Society*, Report No. 96299 (March 2013), 28.

<sup>862</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 8. See *e.g.*, IMF, *The People’s Republic of China: Selected Issues*, IMF Country Report No. 16/271 (July 2016), 33; BNP Paribas, “China: Moving Towards a New Monetary Policy Era,” November 4, 2015, 2.

<sup>863</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 8. See *e.g.*, IMF, *Resolving China’s Corporate Debt Problem*, IMF Working Paper WP/16/203 (October 2016), 7, 14.

<sup>864</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 9-10. See *e.g.*, IMF, *The People’s Republic of China: Selected Issues*, IMF Country Report No. 16/271 (July 2016), 5; Moody’s Investor Service, *Quarterly China Shadow Banking Monitor* (April 2016), 6. See also IMF, *2016 Article IV Consultation – Press Release: Staff Report; and Statement by the Executive Director for the People’s Republic of China*, IMF Country Report No. 16/270 (August 2016), 39.

<sup>865</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 9. See *e.g.*, IMF, *Global Financial Stability Report: Potent Policies for a Successful Normalization* (April 2016), 13-16.)

<sup>866</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 9. See *e.g.*, IMF, *The People’s Republic of China: Selected Issues*, IMF Country Report No. 16/271 (July 2016), 38.)

capacity continue to receive financing,<sup>867</sup> and the share of loans going to firms with low debt-service capacity continues to increase.<sup>868</sup>

As a result of systemic credit misallocation, China now faces a serious debt problem. Two-fifths of new debt has gone toward paying interest on existing loans, while non-performing loans (NPLs) and special mention loans (SMLs) (loans with which borrowers are experiencing difficulties) have also increased rapidly in recent years.<sup>869</sup> Asset management companies, first established in the late 1990s to help commercial banks dispose of bad loans, have become a persistent presence in China's financial sector.<sup>870</sup>

## 2. Interest Rate Controls and Dynamics

As recently as 2013, PBOC set benchmark lending (and deposit) rates on an administrative basis, as well as floors (ceilings) under (above) which banks could not set their loan (deposit) rates. The combination of a lending rate floor and a deposit rate ceiling effectively guaranteed banks a minimum mark-up on all the RMB loans they made. As a result, banks became accustomed to viewing loan pricing as primarily an administrative process and did not sufficiently collect and

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<sup>867</sup> U.S. Department of Commerce, *Review of China's Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 9. See e.g., IMF, *The People's Republic of China: Selected Issues*, IMF Country Report No. 16/271 (July 2016), 5.

<sup>868</sup> U.S. Department of Commerce, *Review of China's Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 9. See e.g., IMF, *Resolving China's Corporate Debt Problem*, IMF Working Paper WP/16/203 (October 2016), 7. See also IMF, *2016 Article IV Consultation – Press Release: Staff Report; and Statement by the Executive Director for the People's Republic of China*, IMF Country Report No. 16/270 (August 2016), 10.

<sup>869</sup> U.S. Department of Commerce, *Review of China's Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 10. See e.g., IMF, *Global Financial Stability Report: Potent Policies for a Successful Normalization* (April 2016), 14; IMF, *2016 Article IV Consultation – Press Release: Staff Report; and Statement by the Executive Director for the People's Republic of China*, IMF Country Report No. 16/270 (August 2016), 20. See also *The Economist*, "Breaking Bad," May 7, 2016. See also Jason Bedford, "Are We Through the Worst of the Credit Cycle: What the Banks Tell Us," *UBS*, November 1, 2016, 1.

<sup>870</sup> U.S. Department of Commerce, *Review of China's Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 11. See e.g., AMCs were first established in 1999 to deal with the NPL problem at the time and help China's four largest banks clean up their balance sheets. Although these AMCs were to have a limited life span, they remain in operation today and continue to bleed NPLs out of the system. The original ten-year life span of the AMCs suggests they were established to deal with what was supposed to be a temporary problem. Their continued existence suggests that they have been simply treating symptoms, and not addressing underlying causes, of the NPL problem. The AMCs also refinance loans, which in many cases just delays NPL recognition, and banks sell some NPLs through repurchase agreements to AMCs, where the bank agrees to buy back the loans at a future date. For these reasons, many believe the actual NPL rate is much higher than official estimates suggest. *The Economist*, "Lipstick on a Pig," August 24, 2013; Jason Bedford, "China's AMCs: Cleaning Up or Kicking the Can?" *UBS*, February 6, 2017, 1 and 11; OECD, *OECD Economic Surveys: China* (Paris: OECD Publishing, 2017), 17.

analyze credit and market data to price risk.<sup>871</sup> Further reinforcing these tendencies were the implicit guarantees on loans to SIEs, as described above.<sup>872</sup>

Since 2006, China has removed formal interest rate controls – most recently, the floor on lending rates in July 2013 and the cap on deposit rates in October 2015. However, PBOC continues to publish benchmark deposit and lending rates, which are now referred to as “reference rates.”<sup>873</sup> While there may be some legal or policy distinction between the terms “benchmark rates” and “reference rates,” there appears to be little practical effect of this change.<sup>874</sup> For example, PBOC and other PRC government agencies continue to refer to “benchmark interest rates” in notices published in 2016, including one that directs lenders to set mortgage rates on the basis of PBOC’s “benchmark rate.”<sup>875</sup> A recent PBOC working paper found that benchmark deposit and loan rates remain the primary basis for pricing deposits and loans.<sup>876</sup> Indeed, respected analysts of China’s economy find that actual deposit rates are still closely tied to the benchmark deposit rate, and since benchmark deposit rates are well below market-clearing levels, actual deposit rates are still well below market-clearing levels as well.<sup>877</sup> Moreover, in a formal legal sense, the

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<sup>871</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 13. See e.g., World Bank, *China 2030: Building a Modern, Harmonious, and Creative Society*, Report No. 96299 (March 2013), 119.

<sup>872</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 13.

<sup>873</sup> *Ibid.*, 13. See e.g., Fitch Ratings, *China Deposit Cap Removal – Little Impact on Bank Margins* (October 27, 2015). See also Jinyue Dong and Le Xia, *China: Looking for New Monetary Policy Tools in the Liberalized-Interest-Rate Environment* (Banco Bilbao Vizcaya Argentina, February 2016), 2.

<sup>874</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 14-15. See e.g., In 2013, the PBOC launched the loan prime rate, essentially an average of commercial banks’ lending rates to their best clients, in an attempt to establish a reference rate that would encourage market-determined loan pricing. But if commercial banks for whatever reason are, to a large extent, still referring to the PBOC reference rate for loan pricing purposes, the loan prime rate would track the reference rate and in doing so would not function as an independent reference rate. Data indicate this is indeed the case. In 2015, two years after the lending rate floors were removed, approximately 90% of rates still clustered closely around the benchmark. Aiden Shevlin and Lan Wu, *China: The Path to Interest Rate Liberalization* (J.P. Morgan Asset Management, 2015), 5; IMF, *The People’s Republic of China: Selected Issues*, IMF Country Report No. 16/271 (July 2016), 14; OECD, *OECD Economic Surveys: China* (Paris: OECD Publishing, 2017), 17.

<sup>875</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 13. See e.g., *Notice of the People’s Bank of China, the China Banking Regulatory Commission, the China Insurance Regulatory Commission, and Other Departments on Issuing the Interim Measures for the Pilot Program of Granting Mortgage Loans Secured with Farmers’ Housing Property Rights*, Article 7 (PBOC, CBRC, CIRC, issued March 15, 2016).

<sup>876</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 13. See e.g., Jun Ma, Min Ji, Muhong Niu, and Xiang Zhang, *Transmission of Monetary Policy Via the Banking System*, Working Paper No. 2016/4 (PBOC, April 8, 2016), 6.

<sup>877</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 14. See OECD, *OECD Economic Surveys: China* (Paris: OECD Publishing, 2017), 17, on benchmark deposit rates being below market-clearing levels before controls were

Chinese government has not amended Article 38 of the *Commercial Banking Law*, which provides that “a commercial bank shall determine its loan rate in accordance with the upper and lower limit of loan rates set by the People’s Bank of China.”<sup>878</sup>

The distortive effects of PBOC interest rate guidance and administratively-set reference rates are further visible in the context of the interbank market, where controls on lending and repo rates have long been removed. In a market system, retail lending rates (as well as other financing rates, both short- and long-term) tend to rise and fall with changes in the (wholesale) cost of funds in the interbank market. Borrowers pay more for loans when interbank funding is relatively scarce, and less for loans when such funding is abundant. In China, however, the correlation between interbank rates and retail financing rates is relatively weak. A key reason is that banks set loans rates based on PBOC’s administratively-set reference rates rather than their interbank cost of (borrowed) funds. The same is true for (short-term) money market rates, which are one step removed from interbank rates towards the retail end of the market, because PBOC actually calibrates the liquidity impact of its policy actions to ensure that these rates closely track its own administratively-set benchmark rates.<sup>879</sup>

### 3. *Shadow Banking*

The Financial Stability Board broadly defines shadow banking as credit intermediation involving entities and activities outside the formal banking sector.<sup>880</sup> Because of binding regulatory constraints that limit the flow of loans in the formal bank channel, much of shadow banking in China is formal bank channel lending flowing or spilling over into the informal finance channel. Roughly two-thirds of shadow banking is effectively “bank loans in disguise,” where a bank serves as the driving force behind a loan transaction and assumes all the risk, but “channels” new loans through a non-bank financial institution (NBFI) intermediary to avoid costly capital and loan-loss provisioning requirements, reserve requirements, and government lending directives.<sup>881</sup>

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removed; Moody’s Investor Service, *Quarterly China Shadow Banking Monitor* (April 2016), 24. See also *Financial Times*, “China Lifts Interbank Rates Following Fed Hike,” March 15, 2017, on benchmark deposit and lending rates remaining unchanged.

<sup>878</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 14. (See also *Commercial Banking Law*, Article 38.)

<sup>879</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 15-16. See e.g., Nathan Porter and Tengeng Xu, “Money-Market Rates and Retail Interest Regulations in China: The Disconnect Between Interbank and Retail Credit Conditions,” *International Journal of Central Banking* (March 2016), 143; Jun Ma, Min Ji, Muhong Niu, and Xiang Zhang, *Transmission of Monetary Policy Via the Banking System*, Working Paper No. 2016/4 (The People’s Bank of China, April 8, 2016), 6. See also IMF, *2016 Article IV Consultation – Press Release: Staff Report; and Statement by the Executive Director for the People’s Republic of China*, IMF Country Report No. 16/270 (August 2016), 8.

<sup>880</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 16. See e.g., Financial Stability Board, *Global Shadow Banking Monitoring Report* (November 14, 2013), 1.

<sup>881</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 18. See e.g., Trade Beneficiary Rights (TBRs) and Directed Asset



There are several important institutional features of “shadow banking” in China:

- *Trust companies.* These NBFIs are the largest lenders in the Chinese shadow-banking sector and combine bank and investment company functions.<sup>882</sup> Most trust companies are state-owned.<sup>883</sup> Trust companies lend in increasing volumes to local government (-owned) financing vehicles (LGFVs) with inadequate risk pricing.<sup>884</sup>
- *Entrusted loans.* Non-financial companies lend and borrow money between themselves<sup>885</sup> in the form of entrusted loans.<sup>886</sup> A bank often facilitates the transaction for legal reasons, sometimes involving on-lent bank funds borrowed by the first company. The first company can be an SIE leveraging its preferential access to bank credit. Corporate subsidiaries account for 74% of this lending, and 7% is accounted for by more loosely associated group affiliates.<sup>887</sup>

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Management Plans (DAMPs) are two investment vehicles that banks use to make new loans that they keep on their books as investment products, rather than loans, thus avoiding the cost of meeting reserve, loan provisioning and capital requirements. Douglas Elliott, Arthur Kroeber, and Qiao Yu, *Shadow Banking in China: A Primer* (The Brookings Institution, March 2015), 1, 9-11.

<sup>882</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 16-17. See also Douglas Elliott, Arthur Kroeber, and Qiao Yu, *Shadow Banking in China: A Primer* (The Brookings Institution, March 2015), 7.

<sup>883</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 20. See e.g., there is a segment of shadow banking that is essentially made up by private actors on both the borrowing and lending sides. But this segment is only roughly 13.5% of shadow banking assets and 3.7% of total banking assets. The lenders are typically small micro credit companies, and the borrowers are small- and medium-sized firms with effectively no access to formal financing channels. Moody’s Investors Service, *Quarterly China Shadow Banking Monitor* (April 2016), 7.

<sup>884</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 16-17. See also Moody’s Investors Service, *Quarterly China Shadow Banking Monitor* (April 2016), 18.

<sup>885</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 20. See e.g., there is a segment of shadow banking that is essentially made up by private actors on both the borrowing and lending sides. But this segment is only roughly 13.5% of shadow banking assets and 3.7% of total banking assets. The lenders are typically small micro credit companies, and the borrowers are small- and medium-sized firms with effectively no access to formal financing channels. Moody’s Investors Service, *Quarterly China Shadow Banking Monitor* (April 2016), 7.

<sup>886</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 20. See also Moody’s Investors Service, *Quarterly China Shadow Banking Monitor* (April 2016), 7.

<sup>887</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 17. See also Douglas Elliott, Arthur Kroeber, and Qiao Yu, *Shadow Banking in China: A Primer* (The Brookings Institution, March 2015), 7.



- *Banker's Acceptances (BAs)*. BAs account for a sizable share of total shadow banking assets.<sup>888</sup> They are essentially IOUs issued by a bank client that constitute a claim on the bank, and as such, function as an off-balance sheet loan from the bank to the bank client, typically backed by the client's deposits with the bank. BAs are priced on the basis of either bank deposit rates (cost of funds basis) or bank lending rates (opportunity cost basis), both of which are set on the basis of administratively set PBOC rates.<sup>889</sup>
- *Wealth management products (WMPs)*. Off-balance sheet bank activities in shadow banking are in large part funded through WMPs, which are essentially investment products sold by banks through trust companies and other NBFIs, as well as independently by NBFIs. Retail investors view these as a high-yield, risk-free substitute for bank deposits. The estimated stock of such WMPs increased from nearly RMB 13 trillion in 2012 to over RMB 44 trillion in 2015.<sup>890</sup>

The available evidence indicates that many shadow banking loans are of a non-commercial nature and include refinanced troubled or special mention loans in support of economically unviable firms or financially stressed LGFVs.<sup>891</sup> This high-risk lending by banks (working with NBFIs) is increasingly concentrated in smaller banks with inadequate capital buffers, loan-loss provisioning and risk weighting.<sup>892</sup> This is a spillover of credit misallocation and risk-pricing problems from the formal banking sector into shadow banking.

The spillover problem is exacerbated by the implicit guarantees and soft budget constraints faced by many of the state-owned or state-linked lenders and borrowers.<sup>893</sup> On the funding side of

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<sup>888</sup> U.S. Department of Commerce, *Review of China's Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 17. See also Moody's Investors Service, *Quarterly China Shadow Banking Monitor* (April 2016), 7.

<sup>889</sup> U.S. Department of Commerce, *Review of China's Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 17-18.

<sup>890</sup> U.S. Department of Commerce, *Review of China's Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 19. See also Lan Shen and Shuang Ding, *China – Taking Stock of Wealth Management Products* (Standard Chartered Global Research, June 7, 2016), 9.

<sup>891</sup> U.S. Department of Commerce, *Review of China's Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 19. See Jason Bedford, "Are We Through the Worst of the Credit Cycle? What the Banks Tell Us," *UBS*, November 1, 2016, 9. See also Lan Shen and Shuang Ding, *China – Taking Stock of Wealth Management Products* (Standard Chartered Global Research, June 7, 2016), 4. See also IMF, *Resolving China's Corporate Debt Problem*, IMF Working Paper WP/16/203 (October 2016), 4.

<sup>892</sup> U.S. Department of Commerce, *Review of China's Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 20. See Jason Bedford, "Shadow Loan Books, WMPs and a Rmb3.1trn Capital Hole," *UBS*, June 2, 2016, 1, 3-5, 11, 13, 15-16. See also IMF, *2016 Article IV Consultation – Press Release: Staff Report; and Statement by the Executive Director for the People's Republic of China*, IMF Country Report No. 16/270 (August 2016), 10.

<sup>893</sup> U.S. Department of Commerce, *Review of China's Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 19. See Douglas Elliott and Kai Yan, *The Chinese Financial System: An*

shadow banking, retail investors frequently treat WMP investments as fully protected and backed by a bank or ultimately the government,<sup>894</sup> and therefore accept a lower yield than they would otherwise. Investors have also purchased WMPs sold by smaller institutions that tend to be more aggressive in pursuing risky investments.<sup>895</sup> Because investors are willing to accept returns lower than what would reflect the true risk of the investment, the cost of funds for the borrowers is also lower.<sup>896</sup>

Shadow banking attempts to meet the growing needs of China's household and SME sectors, which are under-served by the formal banking sector. However, it does so within an institutional framework in which it is not, and indeed cannot be, isolated or insulated from the distortions that pervade the formal banking sector.

#### 4. Bond Markets

China hosts a rapidly growing domestic bond market,<sup>897</sup> now the world's third largest. Yet, measured as a share of GDP, China's bond market is only the tenth largest in the world, and it is much smaller than China's banking sector.<sup>898</sup> Corporate sector bonds account for only one-third

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*Introduction and Overview*, John L. Thornton China Center Monograph Series Number 6 (The Brookings Institution, July 2013), 27.

<sup>894</sup> U.S. Department of Commerce, *Review of China's Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 20. See Douglas Elliott and Yu Qiao, *Reforming Shadow Banking in China* (The Brookings Institution, May 2015), 10.

<sup>895</sup> U.S. Department of Commerce, *Review of China's Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 20. See also IMF, *2016 Article IV Consultation – Press Release: Staff Report; and Statement by the Executive Director for the People's Republic of China*, IMF Country Report No. 16/270 (August 2016), 10.

<sup>896</sup> U.S. Department of Commerce, *Review of China's Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 20. See also OECD, *OECD Economic Surveys: China* (Paris: OECD Publishing, 2017), 20.

<sup>897</sup> U.S. Department of Commerce, *Review of China's Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 21-22. See e.g., Contributing to the growth of municipal and corporate bonds is the new budget law, passed in 2014, which permits local governments to issue bonds, and the relaxation of government restrictions on access to the market. All companies, not just those listed on exchanges, now have access to the corporate bond market, and the approval process has been simplified. Becky Liu and Shankar Narayanaswamy, *China's Bond Markets: The Start of a Golden Age* (Standard Chartered Global Research, February 29, 2016), 15.

<sup>898</sup> U.S. Department of Commerce, *Review of China's Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 21. See also Becky Liu and Shankar Narayanaswamy, *China's Bond Markets: The Start of a Golden Age* (Standard Chartered Global Research, February 29, 2016), 1, 5, 8.

of China's bond market; they largely constitute short-term bonds including commercial paper and medium term notes, as well as enterprise bonds, which include local government bonds.<sup>899</sup> In several respects, China's bond markets do not operate on a market-oriented basis. First, similar to bank loan transactions, state-owned and government-linked entities predominate on both the supply and demand sides of the bond market. Ninety-four percent of bonds are issued by government-owned entities,<sup>900</sup> including policy banks, SIEs, local governments, and LGFVs.<sup>901</sup> SIEs and LGFVs have issued an estimated 94% of the corporate bonds outstanding, including shorter-dated instruments such as commercial bills and medium-term notes.<sup>902</sup> With commercial banks holding over 60% of all bonds and over 70% of Treasury bonds,<sup>903</sup> government-owned entities account for the majority of bond holdings. Experts believe banks will remain the primary buyers of local government bonds in the near-term.<sup>904</sup> Such transactions raise concerns about the possibility of non-arm's-length relationships and "aligned interests" among the parties that do not characterize market-determined transactions.<sup>905</sup> Moreover, funds raised through the issuance of corporate bonds are required under the *Securities Law of the People's Republic of China* to comply with state industrial policies and yield rates are not to exceed the interest rate level set by the State Council.<sup>906</sup>

Second, bond yield curves are not fully market-determined. In a market system, a (risk-free) government bond yield curve typically serves as a reference point or benchmark for the pricing

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<sup>899</sup> U.S. Department of Commerce, *Review of China's Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 22. See also Kenneth Ho, MK Tang, Hao Tang, and Maggie Wei, *China's Domestic Bond Market* (Goldman Sachs, September 21, 2015), 8-9.

<sup>900</sup> *Ibid.*

<sup>901</sup> U.S. Department of Commerce, *Review of China's Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 22. See also *Financial Times*, "China Local Governments Revive Off-Budget Fiscal Stimulus," September 21, 2016.

<sup>902</sup> U.S. Department of Commerce, *Review of China's Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 22-23. See also IMF, *The People's Republic of China: Selected Issues*, IMF Country Report No. 16/271 (July 2016), 32-33.

<sup>903</sup> U.S. Department of Commerce, *Review of China's Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 23. See also JC Sambor and Kevin Sanker, *China Spotlight: Onshore Bond Market: Where to from Here?* (Institute of International Finance, April 27, 2016), 6.

<sup>904</sup> U.S. Department of Commerce, *Review of China's Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 23. See also Becky Liu and Shankar Narayanaswamy, *China's Bond Markets: The Start of a Golden Age* (Standard Chartered Global Research, February 29, 2016), 22.

<sup>905</sup> U.S. Department of Commerce, *Review of China's Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 23.

<sup>906</sup> U.S. Department of Commerce, *Review of China's Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 23. See also *Securities Law of the People's Republic of China*, Articles 16(4) and 16(5) (National People's Congress, issued December 29, 1998, amended August 28, 2004, further amended June 29, 2013 and August 31, 2014).

of corporate bonds, which are essentially marked up to produce a higher yield for risk the investor assumes.<sup>907</sup> In China, however, the benchmark effect of the Treasury yield curve remains weak due to lower trading volumes and frequencies. Problems with the issuance structure impact the completeness of the yield curve.<sup>908</sup> Commercial banks do 70% of all trading in the interbank bond market, but at the same time hold 75% of all outstanding bonds to maturity.<sup>909</sup>

Finally, the implicit guarantees for state-owned and -controlled entities encourage commercial banks to view bond purchases and sales purely in paperwork or administrative terms, rather than as market transactions requiring careful consideration of economic and financial factors. According to a recent IMF report, “the prevalence of implicit state guarantees prevents the appropriate (usually countercyclical) pricing of credit risk in the bond market.”<sup>910</sup>

#### D. Assessment of Factor

Under this factor, the Department analyzed China’s (1) state industrial policies; (2) price regulation; and (3) financial sector. The Department discussed in each of these areas the government’s direct and indirect role in resource allocations, which in turn distort price and output decisions of enterprises. In sum, the Department finds that the extent of government control over the allocation of resources is significant and far-reaching.

Industrial policies remain a prominent mechanism through which the Chinese government influences the allocation of resources in China’s economy. State planning remains an important feature of industrial policies, as evidenced by formal mechanisms of plan formulation and review and the scope and specificity of sectoral-level plans. Various institutions participate in plan formulation and execution, including central regulatory authorities, local governments, organs of the CCP, and the enterprise sector. Indeed, industry policy-making is a key instrument linking the CCP to state administration: formulating and executing state plans remains one of the most important tasks for government officials, the majority of whom are CCP members and are subject to internal evaluation by the CCP for future promotion.

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<sup>907</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 24. See also J.P. Morgan, *China Onshore Bond Market: Kill Two Birds with One Stone*, August 2015, 2.

<sup>908</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 24. See also Jun Ma, Min Ji, Muhong Niu, and Xiang Zhang, *Transmission of Monetary Policy Via the Banking System*, Working Paper No. 2016/4 (PBOC, April 8, 2016), 9. See also *Bloomberg News*, “Figuring Out China’s Monetary Policy Just Got Trickier,” October 26, 2015.

<sup>909</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 24. See also J.P. Morgan, *China Onshore Bond Market: Kill Two Birds with One Stone* (August 2015, 7).

<sup>910</sup> U.S. Department of Commerce, *Review of China’s Financial System for Countervailing Duty (CVD) Benchmarking Purposes* (July 21, 2017), 24-25. See also IMF, *The People’s Republic of China: Selected Issues*, IMF Country Report No. 16/271 (July 2016), 14.

The Chinese government is also able to employ numerous mechanisms to implement industrial policy objectives, including, *inter alia*, investment approvals, access standards, guiding catalogues, financial supports, and quantitative restrictions. Science and technology development and industrial restructuring are two areas that demonstrate the extent to which the government is willing and able to use industrial policies to achieve objectives such as transferring industrial assets between sectors and regions and promoting indigenous innovation. Efforts to reduce corporate debt and shed excess capacity, in the context of the recent SSSR initiative, also demonstrate how the government seeks to increase government intervention in the economy to resolve problems that primarily affect SIEs and that are largely the result of government policies.

An essential element of a market-based economic system is the predominance of prices that reflect relative scarcity. In a well-functioning market economy, scarcity-based prices determine the allocation of resources, guide the selection of investments, and help determine the relationship between supply and demand of factors of production and goods and services. The prices of most goods and services in China today are not formally controlled by the government. However, the Chinese government retains substantial discretion and employs an extensive system of national and local government policies and regulations through which it explicitly determines or otherwise exerts a high degree of control over prices it deems essential or strategic. The system of price controls is characterized by an extensive web of national and local price control regulations, and by the prominent role of NDRC in setting prices in tandem with its functions in formulating industrial policies.

The Chinese government's ability to set and influence factor input prices, in particular, results in distorted costs and prices throughout the economy and a serious misallocation of resources. In the electricity sector, the government has altered institutional arrangements and pricing systems, partly in order to better align electricity prices with the cost of coal inputs. However, these alterations have not significantly reduced the government's ability to set prices at very low levels, and to employ "differential pricing" as a policy tool to achieve capacity shedding and other industrial policy objectives. Government-set and -guided prices do not reflect the real degree of scarcity in the economy, and the government's tight control over the allocation of factors of production means that the role of the market in setting factor and input prices is subordinate to the government's discretionary intervention.

Although there has been nominal liberalization of most prices in China, the state continues to directly influence or regulate the price of key inputs and primary factors of production, including capital, land, labor and energy. Moreover, the state's pervasive and intrusive role in how these factors and other resources are allocated necessarily distorts prices, in general, on a systemic basis.

The financial sector remains fundamentally distorted, from both a risk pricing and a resource allocation standpoint. In addition, although the government nominally removed the last remaining control on lending and deposit rates at the end of 2015, an analysis of interest rate dynamics suggests that interest rates are still closely tied to government-published "reference rates," and are thus not yet market-determined. Soft budget constraints, non-arm's-length pricing, implicit government guarantees and government policy directives directly or indirectly distort the formal banking sector, the interbank market, the bond market, and "shadow banking."

These distortions can be directly tied to government ownership and control and to the state's pervasive and intrusive role in China's financial system, and most clearly manifest themselves in the growing corporate debt problem. At the end of 2015, total credit and bank credit to the private non-financial sector stood at 202% and 153% of GDP, respectively,<sup>911</sup> with a very high total credit-to-GDP ratio some 27% over trend.<sup>912</sup> This is well over the 10% that the BIS considers a warning signal,<sup>913</sup> and suggests credit growth that far exceeds optimal financial deepening for a country at China's level of economic development.<sup>914</sup> Much of this credit is allocated to economically unviable firms that do not make productive use of the borrowed funds.

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<sup>911</sup> *Statistical Tables* (Bank for International Settlements website, available at [http://www.bis.org/statistics/tables\\_f.pdf](http://www.bis.org/statistics/tables_f.pdf)). Credit growth and level are high regardless of whether and to what extent local government financing vehicles are included in the private non-financial sector.

<sup>912</sup> *Ibid.*

<sup>913</sup> Bank for International Settlements, "Early Warning Indicators," *BIS March 2016 Quarterly Review* (March 6, 2016), 28.

<sup>914</sup> IMF, *People's Republic of China: Selected Issues*, IMF Country Report No. 16/271 (August 2016), 32.



## **Factor Six: Such other factors as the administering authority considers appropriate.**

Under this factor, the Department can address any additional issues relevant to its consideration of NME status.<sup>915</sup> In this section, the Department will review the role of China’s legal system as a factor bearing on China’s economy.<sup>916</sup> Part A considers the institutional role of the CCP that is enshrined in China’s legal system, and its impact on economic outcomes. Part B reviews the extent to which individuals and firms are afforded the opportunity to have meaningful independent input into administrative rulemaking or to challenge administrative decisions. Finally, Part C describes how corruption remains a serious concern in China and continues to affect market decisions.

### **A. China’s Legal System and the CCP**

The *PRC Constitution* formally entrenches the CCP at the apex of China’s legal hierarchy, where it occupies a position “above the law.”<sup>917</sup> The *PRC Constitution* repeatedly emphasizes the “leadership” role of the CCP and does not limit the CCP’s exercise of power.<sup>918</sup> In particular, the preamble to the constitution includes several references to the CCP’s leadership role, while it is otherwise unmentioned in the articles of the constitution that limit the powers of Chinese government institutions.<sup>919</sup> Accordingly, to the extent the CCP acts beyond or even in

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<sup>915</sup> This section also incorporates by reference the discussion of law and legal process in earlier sections of this determination, including, but not limited to, the state’s instrumental use of law and the limitations of law in labor dispute resolution, land-use, bankruptcy, antimonopoly, and administrative licensing and regulation.

<sup>916</sup> The Department’s analysis focuses on certain key structural features of the Chinese legal system in connection with the Department’s analysis of the preceding five factors. This analysis cannot address fully within the context of this memorandum all of the issues in China’s legal system. There is a wide body of literature concerning rule of law issues in China, including, *inter alia*, Jianfu Chen, *Chinese Law: Context and Transformation* (Leiden, The Netherlands: Brill Nijhoff, 2015); Yuhua Wang, *Tying the Autocrat’s Hands: The Rise of the Rule of Law in China* (New York: Cambridge University Press, 2014); Weifang He, *In the Name of Justice: Striving for the Rule of Law in China* (Washington, D.C.: Brookings Institution Press, 2012); R.P. Peerenboom, *China’s Long March Toward Rule of Law* (Cambridge U.K.: Cambridge University Press, 2002); and Stanley Lubman, *Bird in a Cage: Legal Reform in China After Mao* (Stanford, California: Stanford Univ. Press, 2001).

<sup>917</sup> See e.g., Donald Clarke, *China’s Legal System and the Fourth Plenum*, Public Law Research Paper No. 2015-27 (George Washington University Law School, 2015), 1-2. (Noting recently announced legal reforms, “the party will remain above the law” and that “the system in which powerful interests can override the law if they wish remains comfortably in place.”)

<sup>918</sup> The preamble of the *PRC Constitution* reads: “Under the leadership of the Communist Party of China and the guidance of Marxism-Leninism, Mao Zedong Thought, Deng Xiaoping Theory and the important thought of Three Represents, the Chinese people of all nationalities will continue to adhere to the people’s democratic dictatorship and the socialist road [...]”

<sup>919</sup> See *PRC Constitution*, Chapter III. See also Cheng Li, *Chinese Politics in the Xi Jinping Era: Reassessing Collective Leadership* (Washington, D.C.: Brookings Institution Press, 2016), 43. (“[China’s constitution] is rather vague about who wields supreme political power in China. In practice, the CCP is unequivocally in charge at all levels, and the state merely executes party directives.”) Larry Cata Backer and Keren Wang, “The Emerging Structures of Socialist Constitutionalism with Chinese Characteristics: Extra-judicial Detention and the Chinese

contravention of a particular law, it may be acting consistently with the *PRC Constitution*.<sup>920</sup> The *PRC Constitution* supports the CCP's instrumental use of law to achieve its political and economic objectives.<sup>921</sup> The CCP's primacy over the law is reflected in its control over China's chief legal and lawmaking institutions, including the People's Congresses at the central and local levels of government, and the People's Courts.

### 1. The Legislature

China's national legislature, NPC, is formally the "highest organ of state power" under the *PRC Constitution*.<sup>922</sup> In this capacity, NPC is empowered to enact and amend basic laws, and the NPC Standing Committee is empowered to enact and amend all other laws, ratify and abrogate treaties, and approve economic and social development plans.<sup>923</sup> According to the *PRC Constitution*, the NPC Standing Committee supervises the State Council, the Central Military

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Constitutional Order," *Pacific Rim Law and Policy Journal* 23 (2014): 252, 256. ("The CCP is organized on the basis of its own constitutional instrument, and its constitutional role is not specified within the State Constitution.") Jianfu Chen, "Out of The Shadows and Back to the Future: CPC and Law in China," *Asia Pacific Law Review* 24(2) (2016): 176-201, 188, 200. ("China, until very recently, had followed the practice found in other socialist countries, that is that the leadership of the Party is to be recognized in the preamble of the constitution, with its actual exercise of power to be carried out through extra-legal constitutional methods." "The Xi-Li administration has now brought the integration of the Party with the state into the open, and thus effectively regressed back to the 1970s in terms of separation of the Party and the state.")

<sup>920</sup> Xin He, "The Party's Leadership as a Living Constitution in China," *Hong Kong Law Journal* 42(1) (2012): 92. ("[T]he CCP, as the ultimate decision-maker, decides which questions shall be decided by it (jurisdiction) and when it intervenes (timing). It can also review its own previous decisions, and make changes without clear constitutional constraints.") See also Kjeld Erik Brødsgaard, "Assessing the Fourth Plenum of the Chinese Communist Party: Personnel Management and Corruption," *Asia Policy* 20 (2015): 35. (Noting that notwithstanding recent CCP statements supporting the "rule of law," "the party will continue to define the law and the Chinese constitutional order.") Stanley Lubman, "The Future of 'Rule According to Law' in China," *Asia Policy* 20 (2015): 2. ("Although the CCP intends to enhance the role of the courts in the party-state governing structure...many questions remain concerning China's legal environment, and the continued primacy of the party, which remains above the law and constitution.")

<sup>921</sup> Rogier Creemers, "China's Constitutionalism Debate: Content, Context And Implications," *The China Journal* 74 (2015), 108. (The "[l]aw is considered as one among many political instruments that can be used to achieve [the CCP's] desired outcomes and coordinate actors' activities."). See also Jacques de Lisle, "Law in the China Model 2.0: Legality, Developmentalism and Leninism under Xi Jinping," *Journal of Contemporary China* 26 (2017): 83. ("[The Xi regime's] narrowly instrumentalist conception of law (which implies that perceived conflicts between law reform and the goals of economic development and political stability will not be resolved in law's favor.")

<sup>922</sup> *PRC Constitution*, Article 57.

<sup>923</sup> *Ibid.*, Articles 52, 57, 62, and 67. Similarly, local people's congresses and their respective standing committees are constitutionally empowered to formulate and promulgate local regulations; ensure the implementation of the constitution, the law, and administrative rules and regulations at the local level; adopt and issue resolutions; decide on plans for economic and cultural development; and elect and recall local political and judicial leaders. See e.g., *PRC Constitution*, Chapter III Section 5. ("The Local People's Congresses and Local People's Governments at Various Levels.")

Commission, the Supreme People's Court, and the Supreme People's Procuratorate.<sup>924</sup> NPC also has formal power to appoint and remove the leading officials of each of those organizations, including the President and Vice President, as well as the officials in charge of various ministries and commissions.<sup>925</sup>

In practice, however, the CCP retains strict control over all legislative activity and administrative appointments. First, the CCP generally deliberates and approves all major legislation internally before consideration by NPC.<sup>926</sup> Despite its formal power, NPC has not vetoed legislation referred to it by the CCP.<sup>927</sup> NPC has primarily served the role of translating pre-approved CCP policies into formal laws or regulations. Similarly, provincial people's congresses typically consult provincial Party Committees to vet major legislative decisions.<sup>928</sup> Second, while the *PRC Constitution* formally empowers NPC to appoint officials to key leadership positions of the Chinese state, the CCP's Organization Department and *nomenklatura* process decide who serves in these positions.<sup>929</sup> NPC lacks the institutional authority to reject candidates referred to it by the

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<sup>924</sup> *Ibid.*, Article 67.

<sup>925</sup> *Ibid.*, Articles 62, 63, and 67.

<sup>926</sup> Tony Saich, *The National People's Congress: Functions and Membership* (Ash Center for Democratic Governance and Innovation, Harvard Kennedy School, 2015), 3.

<sup>927</sup> See Jianfu Chen, "Out of the Shadows and Back to the Future: CPC and Law in China," *Asia Pacific Law Review* 24 (2016), 188. ("One thing however is clear: neither the NPC nor its Standing Committee has ever refused to adopt a law suggested by the Party and neither of them has ever adopted law without the prior approval of the Central Committee of the Party."). See also Xin He, "The Party's Leadership as a Living Constitution in China," *Hong Kong Law Journal* 42(1) (2012): 79. ("Indeed, it is still not realistic for the NPC to veto a bill or a nominee proposed by the party.")

<sup>928</sup> Guobin Zhu, "Constitutional Review in China: An Unaccomplished Project or a Mirage?" *Suffolk University Law Review* 43 (2010): 627. See also Tony Saich, *The National People's Congress: Functions and Membership* (Ash Center for Democratic Governance and Innovation, Harvard Kennedy School, 2015), 3. ("At first glance, these powers seem extensive, as indeed they are, but in practice it is not the NPC that actually exerts them. Major decisions and appointments are made by the CCP, usually ratified by the Central Committee before the NPC and passed on to the NPC for its 'consideration.'")

<sup>929</sup> Susan Lawrence, *China's Political Institutions*, CRS Report No. R43303 (Congressional Research Service, November 12, 2013), 8. ("The head of the [CCP] Organization Department [is] responsible for the recruitment of Party members and their assignment to jobs across the party and state, the legislatures, state-owned corporations, universities, and other public institutions."); Tony Saich, *Governance and Politics of China* (Houndmills, Basingstoke, Hampshire: Palgrave Macmillan, 2011), 123. ("Basically, the [Organization] Department oversees the CCP's *nomenklatura* appointments, these cover all senior ministry appointments, senior judicial appointees, heads of major state-owned enterprises, top university presidents...the editors of key party publications and other media, provincial leaders and the directors of think tanks.") See also Kjeld Brødsgaard, "Cadre and Personnel Management in the CPC," *China: An International Journal* 10(2) (2012): 69–83.

CCP.<sup>930</sup> Moreover, in practice, CCP officials typically occupy all key leadership positions of the Chinese state.<sup>931</sup>

More recently, CCP leadership has reaffirmed its control over lawmaking activities in China.<sup>932</sup> For example, in a September 2014 speech, China's President Xi Jinping emphasized that NPC and local people's congresses "must adhere" to the leadership of the Chinese Communist Party.<sup>933</sup> Later that year, the CCPCC proclaimed the CCP's intent to strengthen its leadership over law-making and further stipulated that any major legislative issue that affects a major institutional system or involves major policy adjustment must be submitted to the [CCPCC] for discussion and decision.<sup>934</sup>

## 2. *The Judicial System*

The *PRC Constitution* provides that courts at all levels of government are to exercise judicial power independently and without interference from any administrative organ, public organization or individual.<sup>935</sup> The constitution further provides that the NPC Standing Committee is responsible for supervising China's court system.<sup>936</sup> In practice, however, China's courts also remain under CCP control and are expected to perform their judicial functions consistent with the CCP's political, social, and macroeconomic policy objectives.<sup>937</sup> Notwithstanding recent

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<sup>930</sup> Xin He, "The Party's Leadership as a Living Constitution in China," *Hong Kong Law Journal* 42(1) (2012): 79.

<sup>931</sup> Cheng Li, *Chinese Politics in the Xi Jinping Era: Reassessing Collective Leadership* (Washington, D.C.: Brookings Institution Press, 2016), 42. ("Because China operates under a one party-state structure, it is no accident that since the establishment of the PRC, the top leaders have concurrently held the most important positions in the government.")

<sup>932</sup> *China Daily*, "CPC to Strengthen Leadership in Law Making," October 28, 2014.

<sup>933</sup> Xi Jinping, *In the Celebration of the 60th Anniversary of the Founding of the National People's Congress*. [Speech] at the 60th Anniversary of the Founding of the National People's Congress, September 2014. ("In supporting and improving the People's Congress system we must unwaveringly adhere to the leadership of the Communist Party.")

<sup>934</sup> *CCP Central Committee Decision Concerning Certain Major Issues in Comprehensively Moving Forward Ruling the Country According to Law*, Article II(2) (adopted by the 18th Central Committee of the CCP at the Fourth Plenary Session on October 23, 2014) ("Fourth Plenum Decision"). See also *Law on Legislation of the People's Republic of China (Law on Legislation)*, Article 3 (adopted by NPC on March 15, 2000, amended March 15, 2015). (Law-making shall observe the basic principles of the Constitution, take economic construction as its central task, follow the socialist road, adhere to the people's democratic dictatorship, uphold the leadership of the Communist Party[...]) (emphasis added)

<sup>935</sup> *PRC Constitution*, Article 126. ("The people's courts exercise judicial power independently, in accordance with the provisions of law, and not subject to interference by any administrative organ, public organization or individual.")

<sup>936</sup> *Ibid.*, Article 67.

<sup>937</sup> Carl Minzner, "Legal Reform in the Xi Jinping Era," *Asia Policy* (July 2015), 7. ("Party political-legal committees remain intact, and courts are still expected to follow their guidance.")

initiatives to change aspects of the judicial system, the CCP retains the ability to intervene in judicial proceedings and obtain preferred outcomes in individual cases as needed.

The CCP has the ability to exert control over the judicial system through a variety of mechanisms. First, the CCP plays a central role in selecting and promoting judges and other judicial officers, most of whom are themselves members of the CCP.<sup>938</sup> In addition, the CCP supervises the courts through the Central Political and Legal Affairs Committee (CPLC). The CPLC, which falls under the CCPCC, oversees China's courts and other legal institutions on behalf of the CCP, and a member of the Politburo typically serves as its chairperson.<sup>939</sup> The CPLC sets broad judicial policies to ensure that courts carry out their functions consistent with the CCP's policy objectives, including specific regulatory policy objectives being advanced by the CCP.<sup>940</sup> The CPLC also operates as a channel through which the CCP communicates its views on how the courts should handle sensitive cases.<sup>941</sup> While there is no singular definition of what constitutes a "sensitive" case, sensitive cases are generally those that could affect China's political or social stability or economic development,<sup>942</sup> which may include bankruptcy, antidumping, price-setting, antimonopoly, and other types of competition law cases.<sup>943</sup> Local court presidents are usually members of the local-level political and legal affairs committee (PLC) and are obligated to implement policy directives and instructions issued by the CPLC.<sup>944</sup>

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<sup>938</sup> Jacques Delisle, "China's Legal System," in *Politics in China: An Introduction*, (ed.) William A. Joseph (Oxford: Oxford University Press, 2014), 227. *See also* Harry Liu, "Court System" in *Doing Business in China*, (ed.) Moser M., F. Yu (Huntington, NY: Juris Publishing, 2014), Section 2.1.05[1]. ("The Organizational Department of the Central Party Committee screens candidates for top judicial positions before the Standing Committee of the NPC appoints the judges. The same occurs at the local level with the corresponding Party organizational department.")

<sup>939</sup> Xin He, "The Party's Leadership as a Living Constitution in China," *Hong Kong Law Journal* 42(1) (2012): 43.

<sup>940</sup> Ling Li, "The Chinese Communist Party and People's Courts: Judicial Dependence in China," *American Journal of Comparative Law* 64 (2016): 60. ("The party is likely to take initiatives and instruct courts to issue certain judicial policies if concerted judicial actions are deemed a necessary step to enforcing particular regulatory policies that the party is advancing at the time.")

<sup>941</sup> Yuhua Wang, *Tying the Autocrats Hands* (New York: Cambridge University Press, 2014), 44. ("A concrete mechanism to manipulate judicial cases is the 'three heads meeting' in which the political and legal committee secretary convenes the court president, procuratorate president, and police chief to discuss politically sensitive cases."); Xin He, "The Party's Leadership as a Living Constitution in China," *Hong Kong Law Journal* 42(1) (2012): 83 (on "difficult" and "significant" cases).

<sup>942</sup> Ling Li, "The Chinese Communist Party and People's Courts: Judicial Dependence in China," *American Journal of Comparative Law* 64 (2016): 67-68.

<sup>943</sup> Yulin Fu and Randall Peerenboom, "A New Analytic Framework for Understanding and Promoting Judicial Independence in China," in *Judicial Independence in China: Lessons for Global Rule of Law Promotion*, (ed.) Randall Peerenboom (New York: Cambridge University Press, 2010) 96. *See also* Harry Liu, "Court System," in *Doing Business in China*, (ed.) Moser M., F. Yu (Huntington, NY: Juris Publishing, 2014), Section 2.1.05[1].

<sup>944</sup> *Ibid.* *See also* Ling Li, "Chinese Characteristics of the 'Socialist Rule of Law': Will the Fourth Plenum Cure the Problems of the Chinese Judicial System?" *Asia Policy* 20 (2015): 19. ("As party institutions, these groups are mandated to carry out any instructions that they receive from their party superiors through their work as key decision-makers of the courts. When the party engages in judicial decision-making, it does not argue its case.



The CCP thus retains the ability to direct courts to adopt judicial policies that support the advancement of CCP policies and to mandate outcomes in individual court cases. Courts overseeing high profile or “sensitive” cases are expected to adjudicate them in accordance with the CCP’s instructions.<sup>945</sup> In high profile cases, CCP officials have issued instructions for the court through either formal letters or discussions with judicial officers.<sup>946</sup> For example, between 2010 and 2011, the Supreme People’s Court (SPC) of China received instructions from central CCP leaders regarding food safety scandals and subsequently issued notices urging all courts to increase the severity of punishment for violations of food safety regulations.<sup>947</sup> Moreover, while Chinese courts might be able to accept cases brought against government institutions and adjudicate claims of administrative overreach under the letter of the law,<sup>948</sup> the courts may lack the authority to compel institutions to comply with their rulings without CCP support.<sup>949</sup> The CCP ultimately has the power to shape judicial activities on a large scale by retaining the ability to directly intervene on a case-by-case basis.<sup>950</sup> While the CCP may not intervene in day-to-day judicial activities, since the courts are accountable to the CCP, the judicial system is not designed to operate as a meaningful independent check on the CCP or other state institutions.<sup>951</sup>

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Instead, it is entitled to instruct courts in an authoritarian manner... Such a decision-making mechanism is institutionalized in all courts nationwide, which enables the CCP to communicate its instructions and have them implemented by courts and judges of every level and rank whenever and wherever necessary.”)

<sup>945</sup> Harry Liu, “Court System,” in *Doing Business in China*, (ed.) Moser M., F. Yu (Huntington, NY: Juris Publishing, 2014), Section 2.1.05[1].

<sup>946</sup> Benjamin Liebman, “China’s Courts: Restricted Reform,” *Columbia Journal of Asian Law* 21 (2007): 14.

<sup>947</sup> Ling Li, “The Chinese Communist Party and People’s Courts: Judicial Dependence in China,” *American Journal of Comparative Law* 64 (2016): 61.

<sup>948</sup> In fact, China has permitted citizens and enterprises to litigate in court against the government, with administrative laws in place since the early 1990s. *See e.g., Administrative Litigation Law of the People’s Republic of China* (adopted by NPC on April 4, 1989, amended November 1, 2014, further amended June 27, 2017).

<sup>949</sup> Ling Li, “The Chinese Communist Party and People’s Courts: Judicial Dependence in China,” *American Journal of Comparative Law* 64 (2016): 64-66. Even where courts are able to render judgments without significant interference from the CCP, they have little power to enforce those orders without its affirmative backing. This is in part a feature of China’s “bureaucratic ranking” system, under which every state institution—including the courts—is assigned a “rank” and the accompanying rule that institutions of equal rank cannot issue binding orders to each other. A court can “command compliance by institutions and individuals of lower or no rank, but not by those of equal or higher rank or those who can draw influence from the former, unless the party authorizes it.” *Ibid.* 50-51.

<sup>950</sup> Ling Li, “The Chinese Communist Party and People’s Courts: Judicial Dependence in China,” *American Journal of Comparative Law* 64 (2016): 72-74.

<sup>951</sup> Xin He, “The Party’s Leadership as a Living Constitution in China,” *Hong Kong Law Journal* 42(1) (2012): 85. (“Most importantly, judicial innovation, just like judicial independence and the interference of the party in significant and difficult cases, has also conformed to the interests of the party. If allowing the courts to handle mundane cases independently and efficiently improves certainty in investment and boosts the legitimacy of the regime, some judicial innovation in judicialization of administrative behavior helps the upper-level government and ultimately the Central Party Committee to oversee the administrative agencies.”) *See also* Ling Li, “Chinese Characteristics of the “Socialist Rule of Law”: Will the Fourth Plenum Cure the Problems of the Chinese Judicial



In recent years, the CCP has announced several efforts to modify China's court system.<sup>952</sup> However, none of the announced modifications contemplate a change in the fundamental relationship between the legal system and the CCP.<sup>953</sup> In fact, some of the changes are designed to address the problem of local protectionism, a phenomenon whereby local courts may display favoritism toward local litigants, often in response to pressure from local government officials.<sup>954</sup> Although proposals from the Third Plenary Session and Fourth Plenary Session of the 18th National Congress of the CCP may seek to reduce the incidence of local political interference into judicial proceedings, they do not alter the fact that China's courts do not operate independently of the CCP or other state institutions.<sup>955</sup> For example, the *Third Plenum Decision*, despite its focus on "promoting rule of law," repeatedly emphasizes the leadership of the CCP.<sup>956</sup> Similarly, the SPC's *Opinions on Court Reform* stress that people's courts must adhere to the leadership of the CCP.<sup>957</sup> The *Fourth Plenum Decision* states that judges should be loyal to the Party, the country, the people, and the law<sup>958</sup>— in that order of precedence, which legal experts note is of significance.<sup>959</sup> Furthermore, in a January 2017 widely reported address, the president of the SPC explicitly rejected the notion that China's courts should seek to operate independently

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System?" *Asia Policy* 20 (2015):19. ("[I]t is important to point out that the party does not regularly exercise this interfering power in day-to-day judicial activities because it would be neither possible nor necessary to do so. After all, most run-of-the-mill court cases do not generate the immediate interest of the party. However, once the channel to legitimize interference with judicial decision-making is installed and institutionalized, it cannot be switched off.")

<sup>952</sup> For example, proposals have been introduced to establish a more professional track for judges. Other proposals include the creation of circuit courts that cross provinces to address issues of local protectionism. Donald Clarke, *China's Legal System and the Fourth Plenum*, Public Law Research Paper No. 2015-27 (George Washington University Law School, 2015), 10-13.

<sup>953</sup> *Ibid.*, 9.

<sup>954</sup> Yuhua Wang, "Court Funding and Judicial Corruption in China," *The China Journal* 69 (2013): 46. ("Rampant corruption in economic litigation has become a hurdle for business. One consequence is local protectionism. Local courts, under pressure from local governments, tend to favor firms in their jurisdiction.")

<sup>955</sup> George Chen, *China's New Circuit Tribunals Allow Tighter Control of Judiciary*, OxHRH Blog, March 6, 2017. ("[E]ach circuit tribunal has a party committee whose members are appointed and dispatched by the SPC, and a full-time CCP official ensures party control and oversees anti-corruption affairs at the tribunal."); Matt Schiavenza, Carl Minzner, and Neysun Mahboubi, "The Future of China's Legal System," *China File*, August 11, 2016. (Minzner: "Chinese authorities are interested in figuring out how to make courts more independent from local interest groups, even if there is no interest in making them independent from Party control.")

<sup>956</sup> *See Third Plenum Decision*.

<sup>957</sup> *Ibid.*

<sup>958</sup> *CCP Central Committee Decision Concerning Certain Major Issues in Comprehensively Moving Forward Ruling the Country According to Law*, Article 6 (adopted at the Fourth Plenary Session of the 18th Central Committee of the CCP, October 2014).

<sup>959</sup> Donald Clarke, *China's Legal System and the Fourth Plenum*, Public Law Research Paper No. 2015-27 (George Washington University Law School, 2015), 2.

of the CCP.<sup>960</sup> Moreover, even if the CCP seeks to lessen the overall incidence of political interference in judicial proceedings,<sup>961</sup> the chief institutional mechanisms through which it exerts control over the courts – the political legal committees and the adjudication committee system – remain intact. While the CCP references the need to improve the professionalism and technical competence of the judiciary,<sup>962</sup> it has not signaled any intent to relinquish the CCP’s control over the selection and promotion of judges.

## B. Administrative Law and Regulatory Transparency

Administrative regulations and procedures play an important role in China’s economic legal framework. According to one study, China issued more than 500 trade and economic related administrative regulations and departmental rules in a single year.<sup>963</sup> In addition, as discussed under Factor 5, administrative approval is one of the key mechanisms through which the Chinese government implements industrial policy. As a result, if firms effectively lack the ability to challenge administrative rules and procedures, their ability to make investment and operational decisions that fall outside the scope of government-determined outcomes is undermined. In this section, the Department will analyze the formal legal mechanisms through which market actors are permitted to challenge administrative actions and participate in the administrative rulemaking process, namely (i) judicial review of administrative action under the *Administrative Litigation Law of the People’s Republic of China* (“ALL”),<sup>964</sup> (ii) reconsideration of administrative action under the *Administrative Reconsideration Law of the People’s Republic of China* (“ARL”),<sup>965</sup> and (iii) the extent of public participation and transparency in the formation of administrative regulations. In addition, the Department will analyze the extent to which market actors have been able to avail themselves of these mechanisms in practice.

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<sup>960</sup> Lucy Hornby, “China’s Top Judge Denounces Judicial Independence,” *Financial Times*, January 17, 2017. (“China’s top judge has fired a warning shot at judicial reformers by formally acknowledging that China’s court system is not independent of the Communist Party and rejecting attempts to make it so.”) The SPC president’s rejection of judicial independence is especially striking given that the Supreme People’s Court most recent five-year plan expressly emphasized the need to ensure that the people’s courts exercise judicial power independently and impartially in accordance with the law. See *Opinions on Deepening People’s Courts Reform – Fourth Five-Year Reform of the People’s Courts (2014-2018)* (Supreme People’s Court of China, SPC Release 2015 No. 3, February 26, 2015).

<sup>961</sup> Sui-Lee Wee and Li Hui, “With Legal Reforms, China Wants Less Interfering in Cases, Fewer Death Penalty Crimes,” *Reuters*, March 9, 2014.

<sup>962</sup> *Third Plenum Decision*, Article 32. (“We will establish a judicial personnel management system fitting their professional characteristics, improve the system for unified recruitment, orderly exchange and level-by-level promotion of judges, procurators and the police [...].”)

<sup>963</sup> U.S. China Business Council, *China 2014 Regulatory Scorecard* (2014), 5.

<sup>964</sup> *Administrative Litigation Law of the People’s Republic of China* (adopted by NPC on April 4, 1989, amended November 1, 2014, further amended June 27, 2017).

<sup>965</sup> *Administrative Reconsideration Law of the People’s Republic of China* (adopted by NPC on April 29, 1990, amended August 27, 2009, further amended September 1, 2017).

### 1. *Administrative Litigation Law*

The *ALL* provides detailed procedures for bringing administrative lawsuits against Chinese government agencies at the central and local levels of government. NPC enacted the *ALL* in 1989, with the stated purpose of “ensur[ing] the impartial and timely trial of administrative cases by the people’s courts, settl[ing] administrative disputes, [and] protect[ing] the lawful rights and interests of citizens, legal persons, and other organizations.”<sup>966</sup> Specifically, the *ALL* allows citizens and legal persons to file a legal claim in “a people’s court” if they consider that administrative action taken by an administrative agency has infringed on lawful rights and interests.<sup>967</sup> In 2014, NPC amended the *ALL* to address certain substantive and procedural features that have reportedly limited its effectiveness.<sup>968</sup> Nonetheless, in many cases administration action remains effectively immune from review under the *ALL* as both a formal and practical matter.

The *ALL* strictly limits the sorts of administrative acts that members of the public can challenge under the law. In particular, the *ALL* specifically enumerates the types of administrative actions subject to judicial review under the law and excludes any administrative acts not so-specified from court review.<sup>969</sup> While the 2014 version of the *ALL* expands the list of permissible subject matter from eight to twelve types of administrative actions,<sup>970</sup> it remains unclear whether courts have any authority to review administrative actions beyond those specifically enumerated. In addition, the *ALL* prohibits courts from conducting challenges to an administrative regulation or departmental rule that is generally binding.<sup>971</sup> Instead, under the *ALL*, courts are limited to

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<sup>966</sup> *ALL*, Article 1.

<sup>967</sup> *ALL*, Article 2.

<sup>968</sup> *Decision of the Standing Committee of the National People’s Congress on Amending the Administrative Procedure Law of the People’s Republic of China* (NPC Standing Committee, Order No.15 of the President, issued November 1, 2014).

<sup>969</sup> Jianfu Chen, *Chinese Law: Context and Transformation* (Leiden, The Netherlands: Brill Nijhoff 2016), 333. *See also* Qianfan Zhang, “From Administrative Rule of Law to Constitutionalism? The Changing Perspectives of the Chinese Public Law,” *Asia Law Review* (3)1 (2006): 56. (“According to the prevailing understanding of the Chinese legal community, Articles 11 and 12 work in conjunction to limit the jurisdiction of administrative litigations. In essence the *ALL* defines jurisdiction by the model of enumeration. While Article 11 enumerates the specific areas of administrative acts reviewable by the courts, Article 12 further takes away certain areas of acts from judicial review.”)

<sup>970</sup> *Decision of the Standing Committee of the National People’s Congress on Amending the Administrative Procedure Law of the People’s Republic of China*, Article 12 (NPC Standing Committee, Order No.15 of the President, issued November 1, 2014).

<sup>971</sup> *ALL*, Article 13. Under Chinese law, administrative actions are divided into two main categories: (1) “specific administrative acts” and; (2) “abstract administrative acts.” Specific administrative acts refer to an administrative action that is directed at a specific person or entity (in relation to a specific matter), rather than the public at large. Abstract administrative acts, in contrast, are actions directed to unspecified persons in relation to unspecified matters, with general applicability to the public. Abstract administrative acts usually take the form of issuing administrative regulations, rules, and other normative documents of general applicability. *See* Jianfu Chen, *Chinese*

assessing the legality of the particular application of a regulation, rule, or other measure to a particular individual or legal person, in a particular instance.<sup>972</sup> The *ALL* does not permit courts to determine whether a regulation, rule, or other regulatory document is itself unlawful.<sup>973</sup> Therefore, as a practical matter, agency rulemaking remains difficult for Chinese courts to review.<sup>974</sup>

In practice, Chinese courts have tended to reject administrative litigation cases outright or otherwise pressure plaintiffs to withdraw their complaints.<sup>975</sup> Even when courts do accept and adjudicate cases under the *ALL*, courts decide such cases in favor of the administrative agency in the vast majority of cases.<sup>976</sup> The 2014 version of the *ALL* includes provisions that may narrow courts' discretion in deciding whether to accept or reject administrative lawsuits.<sup>977</sup> However, given the overall context of the courts in the Chinese legal system, the amended *ALL* does not suggest a greater scope of independence for courts.

## 2. Administrative Reconsideration Law

The *ARL* provides for a formal administrative review process under which members of the public can request that a Chinese government agency “reconsider” the legality or propriety of a specific

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*Law: Context and Transformation* (Leiden, The Netherlands: Brill Nijhoff 2016), 298; Randall Peerenboom and Xin He, “Dispute Resolution in China: Patterns, Causes and Prognosis,” *East Asia Law Review* 4(1) (2016): 45.

<sup>972</sup> *ALL*, Article 2.

<sup>973</sup> Nicholas Howson, “Enforcement without Foundation: Insider Trading and China’s Administrative Law Crisis,” *American Journal of Comparative Law* 60(4) (2012): 989. (“The Administrative Litigation Law proves equally unhelpful for private claims seeking to challenge any properly-issued administrative norms on their face, because that Law provides no affirmative legal basis for abstract review of such norms by the PRC judiciary (permitting only judicial review of specific administrative acts.)” Jianfu Chen notes that even after the 2014 amendment, “abstract administrative acts will continue to be outside the scope of the *ALL*, with the ‘normative documents’ being the only exception.” Jianfu Chen, *Chinese Law: Context and Transformation* (Leiden, The Netherlands: Brill Nijhoff 2016), 335.

<sup>974</sup> See *ALL*, Article 77. See also Wei Cui, “What is the ‘Law’ in Chinese Tax Administration?” *Asia Pacific Law Review* 19(1) (2010): 76-94, 82. (“This is partly attributable to the fact that, according to the *ALL*, no suits may be brought to court against government agencies merely for the adoption of ‘administrative regulations, regulations, or decisions and orders with general binding force.’”) The amended version of the *ALL*, now also allows courts to examine whether an administrative act is “inappropriate.”

<sup>975</sup> Ian Johnson, “China Grants Courts Greater Autonomy on Limited Matters,” *New York Times*, January 3, 2016; Stanley Lubman, “China: The Quest for Procedural Justice,” in *A Revolution in the International Rule of Law: Essays in Honor of Don Wallace, Jr.*, (eds.) Borzu Sabahi et al. (New York: Juris Publishing, 2014), 86.

<sup>976</sup> *Caixin*, “Less than 10% Success Rate for Citizens Who Sue Government Officials,” November 5, 2014.

<sup>977</sup> *ALL*, Article 51 (as amended in 2014). In particular, courts must now (1) document the receipt of all legal complaints submitted to the court; (2) accept (or “register”) all legal complaints that are properly-filed; and (3) provide a written legal explanation whenever a court declines to register a complaint (*e.g.*, for jurisdictional, standing reasons, *etc.*). In addition, under the amended *ALL*, a court’s decision to reject a legal complaint can be appealed to the People’s Court at the next highest level.

administrative act taken by the agency.<sup>978</sup> If the agency determines that the administrative act under review is “unlawful” or “improper,” the *ARL* requires the agency to “revoke” or “alter” the administrative act within a fixed period of time, and in some circumstances, to provide compensation to the individual or entity that requested administration reconsideration.

In practice, the *ARL* is even less frequently used as a means of redressing administrative action than the *ALL*.<sup>979</sup> One reason for this is that the *ARL* does not permit a challenge to the legality of departmental rules.<sup>980</sup> As a practical matter, this is problematic because Chinese government agencies frequently – and by some accounts primarily – rely on departmental rules to carry out their regulatory functions.<sup>981</sup> In addition, it is recognized that those who decide administrative reconsideration cases within an agency are not independent of the agency, and there is a lack of professional staff to hear cases.<sup>982</sup> As noted under Factor 3, the lack of transparency in the foreign investment approval process and the broad discretion granted to approval authorities creates an environment in which government authorities are able to impose requirements beyond what is written in the law (see Factor 3 for further detail). This problem has been able to persist in part because of the lack of meaningful administrative or judicial review. Moreover, foreign investors rarely invoke such processes given the low likelihood of success and the potential for retaliation from Chinese government approval authorities that have considerable power to affect their business prospects in China.<sup>983</sup>

### 3. Regulatory Transparency

China has promulgated a variety of legal instruments and directives related to promoting regulatory transparency and “open government” more broadly. While the NPC Standing Committee and State Council are generally required to publish all draft laws and administrative

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<sup>978</sup> Under the *ARL*, citizens, legal persons, and other organizations that consider that their lawful rights or interests have been infringed by the specific administrative act apply for administrative reconsideration with the administrative organ (*i.e.*, the government agency or department) that took the act. *See ARL*, Article 2.

<sup>979</sup> Li Cheng, “On the Improvement of the Administrative Reconsideration Committee System of China: From the Quasi-Judicial Perspective,” *Canadian Social Science* 11 (2015): 70.

<sup>980</sup> *ARL*, Article 7. (The provisions listed in the preceding paragraph do not include rules formulated by the ministries and commissions under the State Council and by local people's governments.)

<sup>981</sup> Peking University Center for Legal Information, available at LawInfoChina.com, accessed July 25, 2017, indicating that departmental rules constitute a majority of the legal instruments governing areas such trade and commerce (~90%), customs administration (~87%), banking and finance (~78%), industry and commerce (~58%), and intellectual property (~56%).

<sup>982</sup> Li Cheng, “On the Improvement of the Administrative Reconsideration Committee System of China: From the Quasi-Judicial Perspective,” *Canadian Social Science* 11 (2015): 73; OECD, *OECD Reviews of Regulatory Reform - China: Defining the Boundary between the Market and the State* (Paris: OECD Publishing, 2009), 106.

<sup>983</sup> U.S. Chamber of Commerce, *China's Approval Process for Inbound Foreign Investment: Impact on Market Access, National Treatment and Transparency* (November 2012), 40.

regulations for public comment,<sup>984</sup> existing law allows the Standing Committee and State Council to forgo this requirement at their discretion.<sup>985</sup> Moreover, Chinese government agencies are not obligated to publish or solicit public comment on draft department rules, even though departmental rules – not laws or administrative regulations – may often be the most relevant legal instrument to market participants.

China has had a poor track record of publishing draft regulatory documents for public comment. Based on a recent survey, for example, the State Council published less than 18% of its economic and trade related regulatory documents for public comment during calendar year 2014.<sup>986</sup> Moreover, during the same period, with respect its draft economic and trade related regulatory documents, NDRC released less than 13% of such documents for public comment during calendar year 2014; MOFCOM released less than 14%; and MOF released less than 11%.<sup>987</sup> In addition, of the nine economic and trade related laws considered by NPC in 2014, only three were released for public comment.<sup>988</sup>

### C. Corruption

Chinese officials have generally acknowledged that high levels of corruption are a threat to the country's economic policy process and legitimacy of the CCP. In recent years, China has taken various actions with the stated aim of combatting corruption.<sup>989</sup> Nonetheless, corruption remains

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<sup>984</sup> In 2015, NPC revised the *Law on Legislation* to include new provisions that generally require the NPC Standing Committee to make public all draft laws and amendments on the NPC's legislative agenda and require the State Council to solicit public opinions on all draft administrative regulations.

<sup>985</sup> Specifically, Article 37 of the *Law on Legislation* also provides that draft laws shall be released to the public for comments, except where the Chairman's Committee makes a decision to not release it. Similarly, Article 67 provides that draft administrative regulations shall be released to the public to solicit comments, except where the State Council decides not to release them.

<sup>986</sup> U.S. China Business Council, *China 2015 Regulatory Scorecard* (2015), 4. ("USCBC tracked 673 broad regulatory documents released by the State Council and seven priority government agencies in 2014. However, only 119 of these (17.7 percent) were open for public comment at any point on either SCLAO or the respective agency website. Though USCBC analysis shows that these numbers are an improvement from past years, these agencies still have a poor record of compliance with China's transparency commitments.")

<sup>987</sup> *Ibid.*, 5. This results correspond to a broad set of economic regulatory documents; USCBC tracks both "narrow regulatory documents," which are defined as documents that are clearly marked as administrative regulations and departmental rules, and "broad regulatory documents," which include "narrow regulatory documents" plus any other regulatory documents that have a broad economic impact. China's record of posting narrow regulatory documents for public comment is better than its record for broad regulatory documents. *Ibid.*

<sup>988</sup> *Ibid.*, 4.

<sup>989</sup> China amended the *Criminal Law* in 2011 to criminalize the bribery of foreign public officials. The government has also issued a number of bribery-related administrative rules and judicial interpretations to complement the provisions in the Criminal Law and the AML. See Samuel R. Gintel, "Fighting Transnational Bribery: China's Gradual Approach," *Wisconsin International Law Journal* 31(1) (2013): 9.



a serious concern in China; observers note that its anticorruption laws and other measures are sporadically and selectively enforced.<sup>990</sup>

Instances of corrupt behavior appear particularly acute in the areas involving frequent interactions between market actors and government regulators or other public officials who are able to exert control over economic resources and their distribution.<sup>991</sup> For example, a 2016 study by GAN Integrity found that foreign companies operating in China continue to “experience bribery, political interference or facilitation payments when acquiring public services and dealing with the judicial system.”<sup>992</sup> Similarly, a recent report by Charney Research found that over one-third of Chinese firms surveyed noted having to pay bribes or unofficial fees, or provide gifts to public officials.<sup>993</sup> A 2016 report by Freedom House notes that foreign companies continue to contend with “arbitrary regulatory obstacles, demands for bribes and other inducements.”<sup>994</sup>

To the extent China has taken steps to address corruption, it has done so largely outside of the country’s legal system. Instead, most corruption cases are handled by the by the CCP’s Discipline Inspection Commission (CDI), which performs its work in secret.<sup>995</sup> While the CDI

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<sup>990</sup> See e.g., Bertelsmann Stiftung, *China Country Report – Bertelsmann Stiftung’s Transformation Index (BTI) 2016* (2016), 4. (“Although laws against corruption are in place, they are rarely enforced, except in the form of campaigns.”)

<sup>991</sup> See e.g., Daniel C.K. Chow, “How China’s Crackdown on Corruption Has Led to Less Transparency in the Enforcement of China’s Anti-Bribery Laws,” *U.C. Davis Law Review* 49 (2015): 694. (“By placing its members in all-powerful positions in government and in SOEs, the Party is able to control the government and the economy. An important consequence of this pervasive control is that many corruption cases involve a member of the Party.”) See also Yukon Huang, “The Truth about Chinese Corruption,” *The Diplomat*, May 29, 2015. (“Most of the corruptive behaviors lie in the state’s control over resources and financing, and the influence of local officials on their distribution [...] [S]tate-owned banks have an outsized influence on economic activity through their preferential access to the huge savings of Chinese households. The pressure that these banks feel to enter into transactions that are unduly influenced by Party and local officials is a major vulnerability in the current system.”) See also Ting Gong and Na Zhou, “Corruption and Marketization: Formal and Informal Rules in Chinese Public Procurement,” *Regulation & Governance* 9(1) (2015): 63–76. (“Public procurement looms as both promise and peril: while it is expected to foster competition and thereby contain corrupt activities, it has nevertheless become an area highly contaminated with corruption... The official requirement for market competition and the formal rules regulating public procurement are regularly bent to make room for informal rules favoring special interests. As a consequence, corruption is rampant beneath the structural outlook of market competition.”)

<sup>992</sup> GAN Integrity, *China Corruption Report* (2016).

<sup>993</sup> Craig Charne and Shehzad Qazi, *Corruption in China: What Companies Need to Know* (Charney Research, January 1, 2015), 1-2.

<sup>994</sup> Freedom House, *Freedom in the World 2016*, available at <https://freedomhouse.org/report/freedom-world/2016/china>, accessed September 11, 2017.

<sup>995</sup> See Daniel C.K. Chow, “How China’s Crackdown on Corruption Has Led to Less Transparency in the Enforcement of China’s Anti-Bribery Laws,” *U.C. Davis Law Review* 49 (2015): 694. (“The Central Commission for Discipline Inspection handles all corruption cases; instead of openly referring to the cases as concerning corruption, a politically sensitive term, the CDI uses the less provocative term “discipline” as a surrogate for corruption. All of the inner working of the Central Commission for Discipline Inspection, like all Party work, is held in secrecy.”) See also Jacque deLisle, “The Rule of Law with Xi-Characteristics: Law for Economic Reform,

disciplined dozens of high-ranking officials during China's most recent anticorruption campaign, only a "mere fraction" appeared to be referred to the court system for prosecution under China's anticorruption laws.<sup>996</sup> In particular, some commentators have emphasized the "highly political fashion" in which the CCP has carried out its anticorruption campaigns.<sup>997</sup> In many instances, commentators note that the chief criterion that appears to determine whether an individual is disciplined for corruption is not whether the individual engaged in corrupt activity, but rather his or her political status within the CCP.<sup>998</sup> Others have observed that the CCP has primarily focused on addressing highly visible displays of corruption that pose immediate reputational risks to the CCP,<sup>999</sup> while expending considerably less energy to root out more chronic and pervasive forms of corruption.<sup>1000</sup>

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Anticorruption, and Illiberal Politics," *Asia Policy* 20 (2015): 23. ("At the same time, one of the most dramatic initiatives of Xi's early tenure—a remarkably energetic drive against corruption—has been conducted primarily through the party's extralegal discipline inspection commission under the leadership of Politburo Standing Committee member and venerable regime trouble-shooter Wang Qishan.") See also George Chen and Mareike Ohlberg, *A National Supervision System: the CCP's New Permanent Anti-Corruption Campaign*, European Voices on China MERICS Blog (Mercator Institute for China Studies, January 12, 2017). ("Since the 1990s, the DICs [*i.e.*, the "party's disciplinary and inspection committees"], not the procuratorates, handled the overwhelming majority of anti-corruption cases. Official statistics suggest that anti-corruption bureaus at the government level have played an insignificant role in the daily work.")

<sup>996</sup> Bertelsmann Stiftung, *China Country Report – Bertelsmann Stiftung's Transformation Index (BTI) 2016* (2016), 8. ("[D]ozens of high-ranking officials (above the rank of vice-minister) have been targeted, but merely a fraction of cases are submitted to the state judicial organs for prosecution.")

<sup>997</sup> Hualing Fu, "China's Striking Anticorruption Adventure" in *The Beijing Consensus? How China Has Changed Western Ideas of Law and Economic Development* (Cambridge: Cambridge University Press, April 2017), 266. ("The Party's disciplinary mechanism is not to enforce the criminal law but to deal with the risk party members might pose to the Party.")

<sup>998</sup> Jon Quah, "Hunting the Corrupt 'Tigers' and 'Flies' in China: An Evaluation of Xi Jinping's Anti-Corruption Campaign (November 2012 to March 2015)," *Maryland Series in Contemporary Asian Studies* 1(220) (2015): 68.

<sup>999</sup> See Hualing Fu, "China's Striking Anticorruption Adventure" in *The Beijing Consensus? How China Has Changed Western Ideas of Law and Economic Development* (Cambridge: Cambridge University Press, April 2017), 266.

<sup>1000</sup> Bertran Lang, *Engaging China in the Fight Against Transnational Bribery: "Operation Skynet" as a New Opportunity for OECD Countries*, 2017 OECD Global Anticorruption & Integrity Forum (OECD, 2017), 6. ("CCP-driven anti-corruption efforts equally remain moralistic and deliberately focused on individual responsibility, *i.e.* the punishment and public repentance of 'morally deprived' Party and government officials, rather than institutional deficiencies and the need for systemic reforms.") See also Jean-Pierre Cebestan, "Why Corruption Is Here to Stay in China," *The World Post*, March 15, 2017. ("This is the reason why Xi's anti-corruption campaign has been highly political, opaque and selective. It suppresses the most apparent features of corruption (like banquets and travels) and purges his rivals with the help of the party's very secretive discipline inspection commissions... Corruption has become more discreet but has continued — the bribes have actually increased in proportion to the risks taken. In other words, party cadres' corrupt practices have been hidden, rather than really put under control and ferreted out.")

#### D. Assessment of Factor

China's legal system continues to function as an instrument by which the CCP and the state apparatus ultimately have the ability to secure discrete economic outcomes, channel broader economic policy, and pursue industrial policy goals. The legal system is designed and operates to be subordinate to CCP and state policy and guidance. Key legal institutions are structured to be able to respond to CCP direction. The CCP ultimately has the power to shape judicial activities on a large scale by retaining the ability to directly intervene on a case-by-case basis.<sup>1001</sup> The judicial system is not designed to operate as a meaningful independent check on the CCP or other state institutions and instead the courts are ultimately accountable to the CCP. In addition, firms effectively lack the ability to challenge administrative rules and procedures, and thus, have limited ability to make investment and operational decisions that fall outside the scope of government-determined outcomes. Moreover, corruption continues to be a serious concern and distorts rule-based outcomes between market actors and government regulators or other public officials who are able to exert control over economic resources and their allocation. Accordingly, China's legal system is a factor that supports the Department's assessment that China remains a NME country.

### FINAL ASSESSMENT

China's economy has grown rapidly and developed significantly since the Department's last inquiry in 2006. In the intervening period, the Chinese government has taken a range of steps to modify the laws, regulations, and institutions that govern China's economy. The *Third Plenum Decision* of 2013 has been interpreted by some observers to suggest an intent by the Chinese government and the CCP to introduce a certain level of market dynamics into China's economy. The Chinese government and the CCP have recently adopted a series of coordinated policy initiatives they have called supply-side structural reform and state-owned enterprise reform.

Nonetheless, after assessing the six factors, the Department finds that the Chinese government continues to maintain and exercise broad discretion to allocate resources with the goal of achieving specific economic outcomes. China's institutional structure, and the control the Chinese government and the CCP exercise through that structure, result in fundamental economic distortions, such that non-market conditions prevail in the operation of China's economy. These non-market conditions are built upon deeply entrenched institutional and governance features of China's Party-state, and on a legal mandate to "maintain a leading role for the state sector." Accordingly, China is a NME country. It does not operate sufficiently on market principles to permit the use of Chinese prices and costs for purposes of the Department's antidumping analysis.

The government continues to exert significant ownership and control over the means of production. Land is not sufficiently allocated or priced according to market principles – all land

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<sup>1001</sup> Ling Li, "The Chinese Communist Party and People's Courts: Judicial Dependence in China," *American Journal of Comparative Law* 64 (2016): 72-74.

is the property of the state, and the Chinese government controls rural land acquisition, monopolizes the distribution of urban land-use rights, and places restrictions on the tenure and scope of land-use rights. Labor is not sufficiently allocated or priced according to market principles – there are significant institutional constraints on the extent to which wage rates are determined through free bargaining, and the government restricts labor mobility through the *hukou* system. Capital is not sufficiently allocated or priced according to market principles – the state retains ownership and control over the largest commercial banks, while the majority of bank and interbank loans, as well as corporate bond transactions, occur between state-owned and -controlled parties. The price of energy and other key factor inputs is either set or guided by the Chinese government, resulting in distorted costs and prices throughout the economy.

In conformity with the legal mandate to “maintain a leading role for the state sector,” SIEs have maintained a strong and sustained presence in China’s economy. The largest enterprises in key industries, including the financial sector, are under government ownership and control. Government authorities across China, at both the national and sub-national level, own and control tens of thousands of enterprises. SIEs account for a substantial share of total credit, investment, and assets in China’s economy, in spite of their generally poor performance when compared with the private sector. Studies have also shown that SIEs are far more prevalent in China’s economy than in France and other large economies.

In China’s economic framework, state planning through industrial policies conveys instructions regarding sector-specific economic objectives, particularly for those sectors deemed strategic and fundamental. The Chinese government employs numerous mechanisms to implement industrial policy objectives, including investment approvals, access standards, guidance catalogues, financial supports, and quantitative restrictions. Science and technology development, industrial restructuring and upgrading, and the geographic distribution of industry are three areas that demonstrate the extent to which the government uses industrial policies to influence economic outcomes.

The Chinese government also retains substantial control over the manner in which China’s economy is exposed to external market forces. Although the Chinese government has made market-oriented modifications to its capital account and exchange rate system, and has taken steps to develop its FOREX market, it still maintains significant restrictions on capital account transactions and intervenes considerably in onshore and offshore FOREX markets. It remains unclear to what extent market forces affect the exchange rate. With respect to foreign investment, administrative costs and hurdles remain significant enough to ensure that the Chinese government can channel foreign investment to the producers, products, technologies and industries it seeks to bolster. At the same time, these administrative instruments provide the government with discretion to limit foreign investment from reaching industries that the Chinese government finds strategically important to maintain under its control alone.

The Department also finds that China’s legal system continues to function as an instrument by which the Chinese government and the CCP can secure discrete economic outcomes, channel broader economic policy, and pursue industrial policy goals. Key legal institutions, such as the courts, respond as necessary to their direction in broad policy or case-specific ways. Individuals

and firms are constrained in their ability to have meaningful independent input into administrative rulemaking or to challenge administrative decisions.

China's economy continues to be significantly tied to the institutional structures established by the Chinese government and the CCP for the purpose of achieving a "socialist market economy." In this system, the Chinese government must "maintain a leading role for the state sector" and market forces are to be contained within that framework. Policy signals from the Chinese government on the direction and pace of relevant proposals to modify the relationship between the state, the CCP, and the economy have been unclear, uncertain, and inconsistent. Accordingly, the Department has determined that China remains an NME country under the U.S. antidumping and countervailing duty laws.

10/26/2017

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Signed by: GARY TAVERMAN

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Gary Taverman  
Deputy Assistant Secretary  
for Antidumping and Countervailing Duty Operations,  
performing the non-exclusive functions and duties of the  
Assistant Secretary for Enforcement and Compliance

## APPENDIX

Appendix Table 1: Sample of Planning Documents for the 13<sup>th</sup> FYP Period, 2016-2020

Measure	Agency	Date Issued
<i>Energy</i>		
Shale Gas Development Plan	MIIT	9/14/2016
13 <sup>th</sup> Five-Year Development Plan for Natural Gas	NDRC	12/24/2016
13 <sup>th</sup> Five-Year Development Plan for Oil	MIIT	12/24/2016
Renewable Energy Development Plan	NDRC	12/10/2016
Solar Energy Development Plan	NEA	12/8/2016
Electric Power Development Plan	NDRC/NEA	11/7/2016
Wind Power Development Plan	NEA	11/16/2016
Energy Development Plan	NEA	12/2016
Energy Technology Innovation Plan	NEA	12/2016
Coal Industry Development Plan	NDRC, NEA	12/2016
Geothermal Energy Exploration and Usage Plan	NEA	1/23/2017
<i>Science and Technology</i>		
National Strategic and Emerging Industries Development Plan	State Council	11/29/2016
National Science and Technology Innovation Plan	State Council	7/28/2016
National Informatization Plan	State Council	12/15/2016
Smart Manufacturing Development Plan	MIIT, MOF	12/8/2016
Made in China 2025 Agricultural Machinery	MIIT	11/28/2016
Made in China 2025 Key Area Technology Roadmap	MIIT	10/2015
<i>Sector-Level Plans</i>		
Information Industry Development Guide	MIIT, NDRC	12/30/2016
Civil Aviation Development Plan	CAAC, NDRC, MOT	2/17/2017
Software and Information Technology Services Development Plan	MIIT	12/18/2016
Information and Telecommunications Industry Development Plan (2016-2020)	MIIT	12/18/2016
Steel Adjustment and Upgrading Plan	MIIT	10/28/2017
Textile Industry Development Plan	MIIT	9/20/2016
Building Material Industry Development Plan	MIIT	9/28/2016
Petrochemical and Chemical Industry Development Plan	MIIT	9/29/2016
Pharmaceutical Industry Development Guide	MIIT, NDRC, MOST, MOFCom, NHFPC, CFDA	10/26/2016
Civil Explosive Products Industry Development Plan	MIIT	10/12/2016
Non-Ferrous Metal Industry Development Plan	MIIT	9/28/2016
Shipping Industry Structure Adjustment and Transformation and Upgrade Action Plan	MIIT, NDRC, MOF, PBOC, CBRC, State Administration of Science, Technology and Industry for National Defense	1/12/2017
Chemical Fiber Industry Development Guide	MIIT, NDRC	11/25/2016
<i>Other Sector-Level Plans</i>		
Industry Green Development Plan	MIIT	6/30/2016
Big Data Industry Development Plan	MIIT	12/18/2016
State Radio Management Plan	MIIT	8/2016
Rare Earth Industry Development Plan	MIIT	9/29/2016
Robotics Industry Development Plan	MIIT, NDRC, MOF	3/21/2016



Industrial Technology Innovation Plan	MIIT	10/21/2016
Information and Industry Integration Plan	MIIT	10/12/2016
Promoting the Development of Small and Medium-Sized Enterprises Plan	MIIT	6/28/2016
Five-Year Action Plan to Promote the Internationalization of Small and Medium-Sized Enterprises	MIIT	8/1/2016
New Materials Industry Development Guide	MIIT, NDRC, MOST, MOF	12/30/2016
National Standard System Building Development Plan	State Council	12/17/2015
Smart Health Elderly Caring Industrial Development Action Plan	MIIT, MCA, National Health and Family Planning Commission	2/6/2017
Agricultural Machinery Equipment Development Action Plan	MIIT, MOA, NDRC	11/28/2016
<i>Project Implementation Guides and Action Plans</i>		
Smart Manufacturing Project Implementation Guide	MIIT, NDRC, MOST, MOF	4/12/2016
Green Manufacturing Project Implementation Guide	MIIT, NDRC, MOST, MOF	4/12/2016
Manufacturing Industry Innovation Center Construction Project Implementation Guide	MIIT, NDRC, MOST, MOF	4/12/2016
High-End Equipment Innovation Project Implementation Guide	MIIT, NDRC, MOST, MOF	4/12/2016
Strong Industrial Base Project Implementation Guide	MIIT, NDRC, MOST, MOF	4/12/2016
Manufacturing Industry Talents Development Guide	MOE, MIIT, MOHRSS	12/27/2016
Promoting Auto Battery Industrial Development Action Plan	MIIT, NDRC, MOST, MOF	2/20/2017
Industries Using Textile Products Development Guide	MIIT, NDRC	12/30/2016
Developing Service-Oriented Manufacturing Action Guide	MIIT, NDRC, CAE	7/12/2016
Promoting Upgrading of the Brand and Quality of the Equipment Manufacturing Industry Action Guide	MIIT, AQSIQ, SASTIND	8/15/2016

Sources: Government documents including *S&T MLP*, *SEI Decision*, *12th Five-Year SEI Plan*, *13th Five-Year SEI Plan*, and documents pertaining to MiC2025.

**Appendix Table 2: Key Technologies and Sectors Targeted in Science and Technology Plans**

<b>2006-2020 MEDIUM AND LONG-TERM PLAN FOR SCIENCE AND TECHNOLOGY</b>
<b>Key Areas (11):</b>
agriculture
energy
environment
IT and modern services
manufacturing
national defense
population and health
public securities
transportation
urbanization and urban development
water and mineral resources
<b>Frontier Technologies (8):</b>
advanced energy
advanced manufacturing
aerospace and aeronautics
biotechnology
information
laser
new materials
ocean
<b>Engineering Megaprojects (16):</b>
advanced numeric-controlled machinery and basic manufacturing technology
control and treatment of AIDS, hepatitis, and other major diseases
core electronic components, high-end generic chips, and basic software
drug innovation and development
extra-large-scale integrated circuit manufacturing and technique
genetically-modified new-organism variety breeding
high-definition Earth observation systems
large advanced nuclear reactors
large aircraft
large-scale oil and gas exploration
manned aerospace and moon exploration
new-generation broadband wireless mobile telecommunications
water pollution control and treatment
(#14-16) undisclosed military programs
<b>Science Megaprojects (4):</b>
development and reproductive biology

nanotechnology
protein science
quantum research
<b>STRATEGIC AND EMERGING INDUSTRIES</b>
energy efficient and environmental technologies
next generation information technology
biotechnology
high-end equipment manufacturing
new energy
new materials
new-energy vehicles (NEVs)
<b>MADE IN CHINA 2025</b>
<b>Major Breakthrough Fields:</b>
<b>1. IT Industry</b>
integrated circuits and special equipment
information and communication equipment
operating system and industrial software
<b>2. high-grade computer numerical control (CNC) machine tools and robots</b>
<b>3. aerospace</b>
aviation equipment
aerospace equipment
<b>4. marine engineering equipment and high-tech ships</b>
<b>5. advanced rail transportation equipment</b>
<b>6. energy-saving and new-energy vehicles</b>
<b>7. electricity equipment</b>
<b>8. agricultural machinery and equipment</b>
<b>9. new materials</b>
special metal functional materials
high-performance structural materials
functional polymers
special inorganic nonmetals
advanced composite materials
superconducting materials
nanomaterials
graphene
bio-based materials
<b>10. biomedical and high-performance medical equipment</b>

Sources: Government documents including *S&T MLP*, *SEI Decision*, *12th Five-Year SEI Plan*, *13th Five-Year SEI Plan*, and documents pertaining to MiC2025.

## LIST OF ABBREVIATIONS

ABC	Agricultural Bank of China
ACFTU	All-China Federation of Trade Unions
ADBC	Agricultural Development Bank of China
ADB I	Asian Development Bank Institute
AD/CVD	Antidumping/Countervailing Duties
ALL	Administrative Litigation Law of the People's Republic of China
AmCham	American Chamber of Commerce
AML	Anti-Monopoly Law of the People's Republic of China
ARL	Administrative Reconsideration Law of the People's Republic of China
BA	Banker's Acceptance
BCM	Bank of Communications
BIS	Bank for International Settlements
BoC	Bank of China
BRIICS	Brazil, Russia, India, Indonesia, China, and South Africa
CBRC	China Banking Regulatory Commission
CCBC	China Construction Bank Corporation
CCP	Chinese Communist Party
CCPCC	Chinese Communist Party Central Committee
CDI	Central Commission for Discipline Inspection
CFETS	China Foreign Exchange Trade System
CGDC	China Guodian Corporation
CIRC	China Insurance Regulation Commission
CJV	Contractual Joint Venture
CNH	Offshore Chinese Renminbi
CNY	Onshore Chinese Renminbi
COMAC	Commercial Aircraft Corporation of China, Ltd.
CPLC	Central Political and Legal Affairs Committee
CSRC	China Securities Regulatory Commission
DAMP	Directed Asset Management Plan
EBIT	Liabilities-to-Earnings Ratio
EBL	Enterprise Bankruptcy Law of the People's Republic of China
EJV	Equity Joint Venture
EU	European Union
FAI	Fixed Asset Investment
FDI	Foreign Direct Investment
FDIC	Federal Deposit Insurance Corporation
FIE	Foreign-Invested Enterprise
FOREX	Foreign Exchange
FYP	Five-Year Plan for Economic and Social Development
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GERD	Gross Expenditure on Research & Development
GNI	Gross National Income

ICBC	Industrial and Commercial Bank of China
ICR	Interest Coverage Ratio
ILO	International Labour Organization
IMF	International Monetary Fund
JSB	Joint-Stock Commercial Bank
LGfV	Local Government-Owned Financing Vehicle
LTC	Land Transfer Center
MiC 2025	Made in China 2025 Initiative
MIIT	Ministry of Industry and Information Technology, People's Republic of China
MLR	Ministry of Land and Resources, People's Republic of China
MMT	Million Metric Tons
MOA	Ministry of Agriculture, People's Republic of China
MOF	Ministry of Finance, People's Republic of China
MOFCOM	Ministry of Commerce, People's Republic of China
MOFTEC	Ministry of Foreign Trade and Economic Cooperation, People's Republic of China
MOHRSS	Ministry of Human Resources and Social Security, People's Republic of China
MOST	Ministry of Science and Technology, People's Republic of China
NBFI	Non-Bank Financial Institution
NBS	National Bureau of Statistics, People's Republic of China
NDRC	National Development and Reform Commission, People's Republic of China
NEV	New Energy Vehicle
NFTTC	National Fund for Technology Transfer and Commercialization, People's Republic of China
NGO	Non-Governmental Organization
NME	Non-Market Economy
NMSAC	National Manufacturing Strategy Advisory Committee
NOC	National Oil Company
NPC	National People's Congress
NPL	Non-Performing Loan
OECD	Organization for Economic Cooperation and Development
OTC	Over-The-Counter
PBOC	People's Bank of China
PICC	People's Insurance Company of China
PLC	Political and Legal Affairs Committee
PRC	People's Republic of China
QDII	Qualified Domestic Institutional Investor
QFII	Qualified Foreign Institutional Investor
R&D	Research & Development
RLCL	Rural Land Contracting Law of the People's Republic of China
RMB	Renminbi
S&T	Science & Technology
S&T MLP	Medium- and Long-Term Plan for Science and Technology

SAFE	State Administration of Foreign Exchange
SAIC	State Administration of Industry and Commerce
SASAC	State-Owned Assets Supervision and Administration Commission
SCIO	State Capital Investment and/or Operations Company
SDPC	State Development Planning Commission
SDR	Special Drawing Right
SEG	State Enterprise Group
SEI	Strategic and Emerging Industry
SERC	State Electricity Regulatory Commission
SEZ	Special Economic Zone
SIE	State-Invested Enterprise
SME	Small- and Medium-Sized Enterprise
SML	Special-Mention Loan
SOCB	State-Owned Commercial Bank
SOE	State-Owned Enterprise
SPC	Supreme People's Court, People's Republic of China
SSSR	Supply-Side Structural Reform
State Council DRC	Development Research Center of the State Council, People's Republic of China
STE	State-Trading Enterprise
SWIFT	Society for Worldwide Interbank Financial Telecommunications
TBR	Trade Beneficiary Right
TRIMS	Trade-Related Investment Measures
TVE	Township and Village Enterprise
TWh	Terawatt Hours
USD	U.S. Dollar
VAT	Value-Added Tax
WB	World Bank
WFOE	Wholly Foreign-Owned Enterprise
WMP	Wealth Management Product
WTO	World Trade Organization



## ACKNOWLEDGEMENTS

The successful completion of this assessment would not have been possible without the dedication, energy, effort and manifold contributions of Amina Derby, Damian Felton, Iacob Koch-Weser, Jonathan Hall-Eastman, Keenton Chiang and Tyler O’Daniel in all project phases, including source collection and analysis, drafting, editing and cite checking.

# **2022 Report to Congress On China's WTO Compliance**



**United States Trade Representative  
February 2023**

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On China's WTO Compliance**



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February 2023**

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## ABBREVIATIONS

ACFTU	All China Federation of Trade Unions
CBIRC	China Banking and Insurance Regulatory Commission
CED	U.S.-China Comprehensive Economic Dialogue
CFDA	China Food and Drug Administration
CNIPA	China's National Intellectual Property Administration
GACC	General Administration of Customs of China
ISO	International Organization for Standardization
JCCT	U.S.-China Joint Commission on Commerce and Trade
MIIT	Ministry of Industry and Information Technology
MARA	Ministry of Agriculture and Rural Affairs
MOF	Ministry of Finance
MOFCOM	Ministry of Commerce
MOST	Ministry of Science and Technology
MPS	Ministry of Public Security
NBC	National Biosafety Committee
NDRC	National Development and Reform Commission
NMPA	National Medical Products Administration
PBOC	People's Bank of China
SAC	Standardization Administration of China
SAIC	State Administration for Industry and Commerce
SAMR	State Administration for Market Regulation
SASAC	State-owned Assets Supervision and Administration Commission
SAT	State Administration of Taxation
SCLAO	State Council's Legislative Affairs Office
SED	U.S.-China Strategic Economic Dialogue
S&ED	U.S.-China Strategic and Economic Dialogue
SPB	State Postal Bureau
SPC	Supreme People's Court
SPP	Supreme People's Procuratorate
WTO	World Trade Organization

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### FOREWORD

This is the 21st report prepared pursuant to section 421 of the U.S.-China Relations Act of 2000 (P.L. 106-286), 22 U.S.C. § 6951 (the Act), which requires the United States Trade Representative (USTR) to report annually to Congress on compliance by the People's Republic of China (China) with commitments made in connection with its accession to the World Trade Organization (WTO), including both multilateral commitments and any bilateral commitments made to the United States. The report covers calendar year 2022. It also incorporates the findings of the Overseas Compliance Program, as required by section 413(b)(2) of the Act, 22 U.S.C. § 6943(b)(2).

In preparing this report, USTR drew on its experience in overseeing the U.S. Government's monitoring of China's WTO compliance efforts. USTR chairs the Trade Policy Staff Committee (TPSC) Subcommittee on China, an inter-agency body whose mandate is, *inter alia*, to assess China's efforts to comply with its WTO commitments. This TPSC subcommittee is composed of experts from USTR, the Departments of Agriculture, Commerce, Labor, Justice, State and Treasury, the Environmental Protection Agency, the Federal Trade Commission and the U.S. Patent and Trademark Office, among other agencies. Members

of the TPSC subcommittee work closely with State Department economic officers, Foreign Commercial Service officers, Enforcement and Compliance officers and Intellectual Property Attachés from the Commerce Department, Foreign Agricultural Service officers, Customs and Border Protection attachés and Immigration and Customs Enforcement attachés at the U.S. Embassy and Consulates General in China, who are active in gathering and analyzing information, maintaining regular contacts with U.S. industries operating in China and maintaining a regular dialogue with Chinese government officials at key ministries and agencies. The TPSC subcommittee meets in order to evaluate and coordinate U.S. engagement with China in the trade context.

To aid in its preparation of this report, USTR as chair of the TPSC published a notice in the Federal Register on August 29, 2022. The notice asked interested parties to submit written comments. A number of written comments were received from interested parties. In lieu of a public hearing, the TPSC then posed written questions to certain of the interested parties, and the interested parties subsequently responded to those questions in writing. All of these written materials are available at [www.regulations.gov](http://www.regulations.gov) under docket no. USTR-2022-0012.

## EXECUTIVE SUMMARY

### OVERVIEW

In this report, we provide an updated assessment of China's WTO membership. This assessment reveals the unique and very serious challenges that China's state-led, non-market approach to the economy and trade continues to pose for the multilateral trading system. While the United States and other like-minded WTO Members have pursued various WTO-focused strategies over the years to address the unique problems posed by China, it has become clear that new and more effective strategies – including strategies that involve taking actions outside the WTO where necessary – are critically needed to address those problems.

### CHINA'S WTO RECORD

When China acceded to the WTO in 2001, it voluntarily agreed to embrace the WTO's open, market-oriented approach and to embed it in China's trading system and institutions. China also agreed to take on the obligations set forth in existing WTO rules, while also making numerous China-specific commitments. As we previously documented, and as remains true today, China's record of compliance with these terms has been poor.

After more than 20 years of WTO membership, China still embraces a state-led, non-market approach to the economy and trade, despite other WTO Members' expectations – and China's own representations – that China would transform its economy and pursue the open, market-oriented policies endorsed by the WTO. In fact, China's embrace of a state-led, non-market approach to the economy and trade has increased rather than decreased over time, and the mercantilism that it generates has harmed and disadvantaged U.S.

workers and companies, as well as workers and companies of other WTO Members, often severely. China also has a long record of violating, disregarding and evading WTO rules to achieve its industrial policy objectives. China continues to use numerous and constantly evolving unfair, non-market and distortive trade policies and practices in pursuit of harmful and anticompetitive industrial policy objectives. At the same time, China has sought to frustrate WTO oversight mechanisms, such as through its poor record of adhering to its WTO transparency obligations.

### WTO-FOCUSED STRATEGIES

For many years following China's accession to the WTO, a variety of bilateral and multilateral efforts were pursued by the United States and other WTO Members to address the unique challenges presented by China's WTO membership. However, even though these efforts were persistent, they did not result in meaningful changes in China's state-led, non-market approach to the economy and trade.

For example, the United States pursued a dual track approach in an effort to resolve the many concerns that arose in our trade relationship with China. One track involved using high-level bilateral dialogues, and the other track focused on enforcement at the WTO.

The United States approached its bilateral dialogues with China in good faith and put a great deal of effort into them. These dialogues were intended to push China toward complying with and internalizing WTO rules and norms and making other market-oriented changes. However, they only achieved isolated, incremental progress. At times, the United States did secure broad commitments from China for fundamental shifts in the direction of Chinese policies and practices, but these commitments were unenforceable and China repeatedly failed to follow through on them. Moreover, over time, commitments from China became more difficult to secure.

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Meanwhile, at the WTO, the United States brought 27 cases against China, often in collaboration with like-minded WTO Members. The United States secured victories in every one of its cases that was decided. Other WTO Members were also successful in many cases that they brought against China. Still, even when China changed the specific practices that had been challenged, it did not typically change the underlying policies, and meaningful reforms by China remained elusive.

As has become clear, the WTO's dispute settlement mechanism is of only limited value in addressing a situation where a WTO Member is dedicated to a state-led economic and trade regime that prevails over market forces. The WTO's dispute settlement mechanism is designed to address good faith disputes in which one member believes that another member has adopted a measure or taken an action that breaches a WTO obligation. This mechanism is not designed to address a trade regime that broadly conflicts with the fundamental underpinnings of the WTO system. No amount of WTO dispute settlement by other WTO Members would be sufficient to remedy this systemic problem. Indeed, many of the most harmful policies and practices being pursued by China are not even directly disciplined by WTO rules.

In addition to pursuing WTO dispute settlement cases, the United States has actively participated in meetings at the WTO addressing China's adherence to its WTO obligations over the years. For example, the United States took on a leading role in the numerous China-specific Transitional Review Mechanism meetings from 2002 through 2011. However, China consistently approached these meetings in ways that frustrated WTO Members' efforts to secure a meaningful assessment of China's compliance efforts. The United States also raised, and continues to raise, China-related issues at regular meetings of WTO committees and councils, including the WTO's General Council. Among other things, the United States sought to highlight how

China's trade-disruptive economic model works, the costs that it exacts from other WTO Members and the benefits that China receives from it. While these efforts raised awareness among WTO Members, they did not lead to meaningful changes in China's approach to the economy and trade.

In theory, the WTO membership could have adopted new rules expressly requiring members like China to abandon non-market economic systems and state-led, mercantilist trade regimes. For two basic reasons, however, members have not pursued any negotiation of new WTO rules that would change China's current approach to the economy and trade in a meaningful way.

First, new WTO rules disciplining China would require agreement among all WTO Members, including China. China has shown no willingness at the WTO to consider fundamental changes to its economic system or trade regime. Given the extent to which China has benefited and continues to benefit from the current state of affairs, it was not realistic to expect that China would agree to effective new WTO disciplines on its behavior. Indeed, China has been using its WTO membership to develop rapidly – but in an anticompetitive manner that comes at the expense of others. In 2001, when China acceded to the WTO, China's economy was the sixth largest in the world. China's economy is now four times larger than it was in 2001, and it is the second largest economy in the world. China also has risen to become the largest goods trader among WTO Members. It is therefore highly unlikely that China would agree to new WTO disciplines targeted at its policies and practices. In fact, in connection with ongoing discussions at the WTO relating to needed WTO reform, China has stated that it would not alter its state-led, non-market approach to the economy and trade.

Second, China has a long record of not pursuing ambitious outcomes at the WTO. Past agreements, even relatively narrow ones, have been difficult to



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achieve, and even when an agreement is achieved, it is significantly less ambitious because of China's participation.

As these experiences make clear, it is unrealistic to believe that actions at the WTO alone will be sufficient to force or persuade China to make fundamental changes to its economic and trade regime. The WTO system was designed for countries that are truly committed to market principles, not for an economically powerful country determined to maintain a state-led, non-market system, and China has demonstrated no willingness to change its approach in any meaningful way.

### STRATEGIES OUTSIDE THE WTO

In recent years, it became evident to the United States that new strategies were needed to deal with the many problems posed by China's state-led, non-market approach to the economy and trade, including solutions independent of the WTO. For example, the United States launched an investigation into China's acts, policies and practices relating to technology transfer, intellectual property and innovation under Section 301 of the Trade Act of 1974. The findings made in this investigation led to substantial U.S. tariffs on imports from China as well as corresponding retaliation by China. Against this backdrop of rising tensions, in January 2020, the two sides signed what is commonly referred to as the "Phase One Agreement." This Agreement included commitments from China to improve market access for the agriculture and financial services sectors, along with commitments relating to intellectual property and technology transfer and a commitment by China to increase its purchases of U.S. goods and services.

Many of the commitments in the Phase One Agreement reflected changes that China had already been planning or pursuing for its own benefit or that otherwise served China's interests, such as the changes involving intellectual property protection and the opening up of more financial services

sectors. Other commitments to which China agreed reflected a political calculation, as evidenced by the attention paid to the agriculture sector in the Phase One Agreement and the novel commitments relating to China's purchases of U.S. goods and services ostensibly as a means to reduce the bilateral trade deficit.

Given these dynamics, and given China's interest in a more stable relationship with the United States, China followed through in implementing some provisions of the Phase One Agreement. At the same time, China has not yet implemented some of the more significant commitments that it made in the Phase One Agreement, such as commitments in the area of agricultural biotechnology and the required risk assessment that China is to conduct relating to the use of ractopamine in cattle and swine. China has also fallen far short of implementing its commitments to purchase U.S. goods and services in 2020 and 2021.

The reality is that this Agreement did not meaningfully address the more fundamental concerns that the United States has with China's state-led, non-market policies and practices and their harmful impact on the U.S. economy and U.S. workers and businesses. China's government continues to employ a wide array of interventionist industrial policies and supporting measures, which provide substantial government guidance, massive financial resources and favorable regulatory support to domestic industries across the economy, often in pursuit of specific targets for capacity and production levels and market shares. In furtherance of its industrial policy objectives, China has also limited market access for imported goods and services and restricted the ability of foreign manufacturers and services suppliers to do business in China. It has also used various, often illicit, means to secure foreign intellectual property and technology to further its industrial policy objectives.

The principal beneficiaries of these non-market policies and practices are China's state-owned and

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state-invested enterprises and numerous nominally private domestic companies. The benefits that Chinese industries receive largely come at the expense of China's trading partners, including their workers and businesses. As a result, markets all over the world have faced distorted signals, and the playing field is heavily skewed against foreign businesses that seek to compete against Chinese enterprises, whether in China, in the United States or globally.

The industrial policies that flow from China's non-market economic system have systematically distorted critical sectors of the global economy such as steel, aluminum, solar and fisheries, devastating markets in the United States and other countries. At the same time, as is their design, China's industrial policies are increasingly responsible for displacing companies in new, emerging sectors of the global economy, as the Chinese government and the Chinese Communist Party (the CCP or the Party) powerfully intervene in these sectors on behalf of Chinese companies. Companies in economies disciplined by the market cannot effectively compete with both China's domestic companies and the Chinese state.

### NEW STRATEGIES

In the United States' view, new strategies are needed to deal with the many problems posed by China's state-led, non-market approach to the economy and trade, including solutions independent of the WTO. These strategies also need to be based on a realistic assessment of China's economic and trade regime and need to be calibrated not only for the near-term but also for the longer term. Accordingly, as first explained in last year's report, the United States is now pursuing a multi-faceted strategic approach that accounts for the current realities in the U.S.-China trade relationship and the many challenges that China poses for the United

States and other trading partners, both now and likely in the future.

The U.S. Trade Representative announced the initial steps of the United States' strategic approach one year ago. This approach includes several components, which the United States has begun to implement.

First, it is critical that the United States take steps domestically to invest in, and build policies supportive of, the industries of today and tomorrow. Important steps taken to date include the passage of the CHIPS and Science Act, the Inflation Reduction Act and the Infrastructure Investment and Jobs Act.

Second, the United States is continuing to pursue bilateral engagement with China. China is an important trading partner, and every avenue for obtaining real change in its economic and trade regime must be utilized. We are focused on the United States' most fundamental concerns with China's state-led, non-market approach to the economy and trade, which includes China's industrial policies. At the same time, the United States will work to hold China accountable for its existing commitments, including under the Phase One Agreement.

Third, it is clear that domestic trade tools – including updated or new domestic trade tools reflecting today's realities – will be necessary to secure a more level playing field for U.S. workers and businesses. The United States is exploring how best to use and improve domestic trade tools to achieve that end.

Finally, it is equally critical for the United States to work more intensely and broadly with allies and like-minded partners in order to build support for solutions to the many significant problems that China's state-led, non-market approach to the economy and trade has created for the global trading system. This work is taking place in bilateral, regional and multilateral fora, including the WTO.

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### INTRODUCTION

In this report, we first provide a broad assessment of China's WTO membership to date. We then discuss U.S. strategies for addressing the many unique challenges that China's state-led, non-market trade regime continues to pose for the United States and other WTO Members. Finally, we catalogue the many specific trade concerns generated by that trade regime.

### ASSESSMENT OF CHINA'S WTO MEMBERSHIP

In assessing China's WTO membership below, we first recall the terms of China's accession to the WTO. As we have previously explained, these terms included not only commitments to adhere to the rules and principles set forth in the WTO agreements but also an unprecedented number of China-specific commitments intended to address the unique challenges posed by a state-led, non-market economy that appeared to be transitioning toward a market economy. We then review China's record of compliance as a WTO member, which has been poor. Finally, we describe the numerous challenges that still must be confronted in light of China's continued adherence to a state-led, non-market approach to the economy and trade.

### CHINA'S WTO ACCESSION

In July of 1986, China applied for admission to the WTO's predecessor, the General Agreement on Tariffs and Trade (GATT). The GATT formed a Working Party in March of 1987, composed of all interested GATT contracting parties, to examine China's application and negotiate terms for China's accession. For the next eight years, negotiations were conducted under the auspices of the GATT Working Party. Following the formation of the WTO on January 1, 1995, pursuant to the Marrakesh Agreement Establishing the World Trade

Organization (WTO Agreement), a successor WTO Working Party, composed of all interested WTO Members, took over the negotiations.

Like all WTO accession negotiations, the negotiations with China had three basic aspects. First, China provided information to the Working Party regarding its trade regime. China also updated this information periodically during the 15 years of negotiations to reflect changes in its trade regime. Second, each interested WTO Member negotiated bilaterally with China regarding market access concessions and commitments in the goods and services areas, including, for example, the tariffs that would apply on industrial and agricultural goods and the commitments that China would make to open up its market to foreign services suppliers. The most trade liberalizing of the concessions and commitments obtained through these bilateral negotiations were consolidated into China's Goods and Services Schedules and apply to all WTO Members. Third, overlapping in time with these bilateral negotiations, China engaged in multilateral negotiations with Working Party members on the rules that would govern trade with China. Throughout these multilateral negotiations, U.S. leadership in working with China was critical to removing obstacles to China's WTO accession and achieving a consensus on appropriate rules commitments. These commitments are set forth in China's Protocol of Accession and an accompanying Report of the Working Party.

WTO Members formally approved an agreement on the terms of accession for China on November 10, 2001, at the WTO's Fourth Ministerial Conference, held in Doha, Qatar. One day later, China signed the agreement and deposited its instrument of ratification with the Director-General of the WTO. China became the 143rd member of the WTO on December 11, 2001.

China's Protocol of Accession, accompanying Working Party Report and Goods and Services Schedules are available on the WTO's website ([www.wto.org](http://www.wto.org)).

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To accede to the WTO, China agreed to take concrete steps to remove trade barriers and open its markets to foreign companies and their exports from the first day of accession in virtually every product sector and for a wide range of services. Supporting these steps, China also agreed to undertake important changes to its legal framework, designed to add transparency and predictability to business dealings.

Like all acceding WTO Members, China also agreed to assume the obligations of more than 20 existing multilateral WTO agreements. Areas of principal concern to the United States and China's other trading partners, as evidenced by the accession negotiations, included core principles of the WTO, such as most-favored nation treatment, national treatment, transparency and the availability of independent review of administrative decisions. Other key concerns arose in the areas of agriculture, sanitary and phytosanitary measures, technical barriers to trade, trade-related investment measures, customs valuation, rules of origin, import licensing, antidumping, subsidies and countervailing measures, trade-related aspects of intellectual property rights and services. For some of its obligations, China was allowed minimal transition periods, where it was considered necessary.

Through its membership in the WTO, China also became subject to the same expectations as other WTO Members, as set forth in the Marrakesh Declaration issued in April 1994 at the conclusion of the Uruguay Round negotiations. There, among other things, WTO Members expressly affirmed their view that the WTO Member economies would participate in the international trading system based on "open, market-oriented policies."

Even though the terms of China's accession agreement are directed at the opening of China's market to WTO Members, China's accession agreement also includes provisions designed to address issues related to any injury that U.S. or other WTO Members' industries and workers might experience based on import surges or unfair trade

practices, particularly during what was envisioned to be a time of transition for China from a non-market economy to a market economy. These mechanisms include: (1) a special textile safeguard mechanism (which expired on December 11, 2008, seven years after China's WTO accession); (2) a unique, China-specific safeguard mechanism allowing a WTO Member to take action against increasing Chinese imports that disrupt its market (which expired on December 11, 2013, 12 years after China's WTO accession); (3) an expression of the ability of WTO Members to use an antidumping methodology that is not based on a strict comparison with domestic prices or costs in China if the producers under investigation cannot clearly show that market economy conditions prevail in the industry producing the like product with regard to the manufacture, production and sale of that product; and (4) an expression of the ability to use methodologies for identifying and measuring subsidy benefits to Chinese enterprises that are not based on terms and conditions prevailing in China.

With China's consent, the WTO also created a special multilateral mechanism for reviewing China's compliance on an annual basis. Known as the Transitional Review Mechanism, this mechanism operated annually for eight years after China's accession. A final review, looking back over the first 10 years of China's WTO membership, took place in 2011.

### EXPECTATIONS OF WTO MEMBERSHIP

For all WTO Members, the expectations of WTO membership are clearly set forth in the Marrakesh Declaration issued in April 1994 at the conclusion of the Uruguay Round negotiations. There, WTO Members expressly affirmed their view that the establishment of the WTO ushers in a "new era of global economic cooperation" that "reflect[s] the widespread desire to operate in a fairer and more open multilateral trading system." WTO Members further made clear their determination that their economies would participate in the international trading system, based on both "open, market-

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oriented policies” and “the commitments set out in the Uruguay Round Agreements and Decisions.”

As this language makes clear, it was not contemplated that any WTO Member would reject market-based policies in favor of a state-led trade regime. It also was not contemplated that any WTO Member would pursue mercantilist outcomes instead of policies promoting a fairer and more open multilateral trading system. Rather, it was expected that each WTO Member would pursue open, market-oriented policies designed to achieve more efficient outcomes. The pursuit of open, market-oriented policies means not only adhering to the agreed rules but also observing in good faith the fundamental principles that run throughout the many WTO agreements, which include non-discrimination, openness, reciprocity, fairness and transparency.

When China acceded to the WTO in 2001, it agreed to embrace the WTO's open, market-oriented approach and embed it in its trading system and institutions. Through China's commitments and representations, WTO Members understood that China intended to dismantle existing state-led, mercantilist policies and practices, and they expected China to continue on its then-existing path of economic reform and successfully complete a transformation to a market-oriented economy and trade regime.

China's protocol of accession to the WTO sets out China's obligations under the WTO agreements as well as numerous additional China-specific commitments made necessary because of the need for China to transform its approach to the economy and trade. China itself acknowledged “the evolving nature of its economy,” and it confirmed that “a socialist market economy system was applied” in China. Similarly, WTO Members highlighted that “China was continuing the process of transition towards a full market economy.” WTO Members noted, for example, that “the special features of China's economy, in its present state of reform, still

created the potential for a certain level of trade-distorting subsidization.”

For these reasons, it was agreed that special safeguard-like provisions would be included among the terms of China's protocol of accession as protective measures while China completed its transformation into a market economy. As noted above, for example, China's protocol of accession included a China-specific safeguard mechanism, special antidumping rules and special methodologies for identifying and measuring subsidy benefits. It also created a unique, 10-year review mechanism designed to monitor China's progress in implementing its many WTO commitments and to secure updated information on the use of industrial plans by China.

### CHINA'S WTO COMPLIANCE RECORD

As has been catalogued in prior reports, China has a poor record when it comes to complying with WTO rules and observing the fundamental principles on which the WTO agreements are based – non-discrimination, openness, reciprocity, fairness and transparency. Too often, China flouts the rules to achieve industrial policy objectives. In addition, and of more serious concern to the United States and other WTO Members, China has not made sufficient progress in transitioning toward a market economy. China continues to embrace a state-led, non-market and mercantilist approach to the economy and trade. This approach results in sophisticated and expansive policies and practices that often evade WTO disciplines and cause serious harm to markets, workers and industries in the United States and other WTO Members. At the same time, China has used the benefits of WTO membership – including its guarantee of open, non-discriminatory access to the markets of other WTO Members – to become the WTO's largest trader, while resisting calls for further liberalization of its trade regime by claiming to be a “developing” country.

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### Adoption of Market-Oriented Policies

Since last year's report, our assessment of China's record in terms of transitioning to a market economy has not changed. More than 20 years after its accession to the WTO, China has still not embraced open, market-oriented policies. The state remains in control of China's economy, and it heavily intervenes in the market to achieve anticompetitive industrial policy objectives. Indeed, the state's role continues to grow, not recede.

As we detailed in prior reports, China pursues a wide array of continually evolving interventionist policies and practices. It offers substantial government guidance, resources and regulatory support to domestic industries, including China's state-owned enterprises and numerous other domestic companies. At the same time, it also seeks to limit market access for imported goods and services and restrict the ability of foreign manufacturers and services suppliers to do business in China in various ways. The benefits that China's industries realize from these non-market policies and practices largely come at the expense of China's trading partners and their workers and companies, as markets all over the world are distorted, and the playing field is heavily skewed against foreign companies that seek to compete against Chinese companies, whether in China's market or markets outside of China.

This situation has worsened in recent years. Since new leaders assumed power in China in 2013, the state's role in the economy – effectuated by the Chinese government and, increasingly, the CCP – has grown. While China has repeatedly signaled in recent years that it is pursuing “economic reform,” China's concept of “economic reform” differs from the type of change that a country would be pursuing if it were embracing open, market-oriented principles. For China, “economic reform” appears to mean perfecting the management of the economy by the government and the Party and strengthening the state sector, particularly state-owned and state-invested enterprises. Meanwhile, as the state's role

in the economy has increased in recent years, the depth and breadth of challenges facing U.S. and other foreign companies doing business in China – or competing with favored Chinese companies in markets outside of China – have similarly increased.

To fully appreciate the challenges presented by China's non-market economy, it is vital to understand the extent to which the state still maintains control over economic decision-making in China. As we catalogued in prior reports, a thorough examination of China's Constitution, relevant directives and pronouncements by China's leadership, legislative and regulatory measures issued by the Chinese government, China's industrial plans and the actions of the Chinese government and the CCP leave no doubt that the state maintains a tight grip on virtually all economic activity. Indeed, the government and the Party have constitutional mandates to develop a “socialist market economy with Chinese characteristics.” To fulfill these mandates, the framework of China's economy is set by the government and the Party, which exercise control directly and indirectly over the allocation of resources through instruments such as government ownership and control of key economic actors and innumerable government directives. The government and the Party also direct and channel economic actors to meet the state's planning targets. The government and the Party permit market forces to operate only to the extent that they accord with the objectives of national economic and industrial policies. When there is conflict between market outcomes and state objectives, the government and the Party intervene to ensure that the state's objectives prevail.

Aside from the role of the government and the Party in managing the economy, there are also serious concerns over how the government and the Party exercise influence over the operations and investment decisions of both state-owned and state-invested enterprises and private companies, including foreign-invested enterprises. This influence appears to be growing, as the Party is



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increasing its control over key actors in China's economy and not, as had been hoped, enabling China's transition to a market economy.

China claims that its state-owned and state-invested enterprises make business decisions independently of the state and based on market principles. However, the government and the Party continue to exercise control over state-owned and state-invested enterprises. Among other things, they appoint and control key executives through the Chinese Communist Party Organization Department. They also provide state-owned and state-invested enterprises with preferential access to important inputs (such as land and capital) and other competitive advantages unavailable to private Chinese companies. State-owned and state-invested enterprises, in turn, play an outsized role in China's economy. For example, state-owned and state-invested enterprises outstrip private Chinese companies in terms of their share of total credit, their market dominance in key industries and their share of total market capitalization on China's stock market.

Both state-owned and state-invested enterprises and private Chinese companies also host internal Party committees capable of exercising government and Party influence over their corporate governance and business decisions. This arrangement is codified in Chinese law under Article 19 of the *Company Law*, which applies to both state-owned and state-invested enterprises and private Chinese companies. In recent years, moreover, the Party has taken steps to increase the strength and presence of Party committees within all of these companies. For example, state-owned and state-invested enterprises and private Chinese companies are being pressured to amend their articles of association to ensure Party representation on their boards of directors, usually as the Chairman of the Board, and to ensure that important company decisions are made in consultation with Party cells.

Increasingly in recent years, China has also taken "golden shares" in large private Chinese companies.

Under this type of arrangement, the Chinese government via a government guidance fund or other state-backed entity purchases a small stake in the company in exchange for a seat on the board of directors or veto rights. The result is stronger Chinese government oversight and control of the company's operations.

As we explained in prior reports, U.S. industry associations report that the Party is also taking steps to influence the managerial and investment decisions of foreign-invested enterprises in China through the insertion of Party cells. According to these reports, these efforts, in some cases, are beginning to affect the decision-making processes of some Chinese-foreign joint ventures in China.

Further reinforcing the Party's influence over enterprises in China is the *Social Credit System*, a tool endorsed by the Party that the government will increasingly be using to monitor, rate and condition not only the conduct of all individuals in China, but also all domestic and foreign companies in China. This system has become operational, but so far there is no fully integrated national system for assigning comprehensive social credit scores for companies, and the social credit system remains highly fragmented, as local governments experiment with their own pilot social credit schemes. In any event, it appears that the government will use the threat of poor ratings and corresponding adverse consequences under the *Social Credit System*, among other things, to ensure that all economic actors in China operate in accordance with China's industrial policy objectives and do not cross political redlines on sensitive matters like human rights.

Separate from these various mechanisms used to control company behavior, the government and the Party continue to control or otherwise influence the prices of key factors of production. The result is that the means of production in China are not allocated or priced according to market principles. For example, all land in China is property of the state, as either state-owned urban land or collectively owned rural land. The state also exerts a high degree of

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control over energy and other input prices. In addition, there are significant institutional constraints on the extent to which wage rates are determined through free bargaining between labor and management, contrary to International Labor Organization principles. China denies workers the right of association and the right to organize and collectively bargain. China prohibits the formation of independent trade unions to represent workers, and workers do not have the legal right to strike, which is an important lever in collective action and negotiation with management over wages in market economies. In addition, government restrictions on labor mobility continue to inhibit and guide labor flows, causing distortions on the supply side of the labor market.

The government and the Party also exercise strong control over the financial sector. Five large commercial banks that are majority state-owned entities operate large branch networks on a nationwide basis and account for nearly half of total commercial bank assets. There are also three large state-owned policy banks, as well as scores of city commercial banks and credit unions under local government control. In addition to the ownership of these banks by the government, the state exercises other forms of influence over banking decisions. The Party, through its Organization Department, appoints executives in state-owned banks and other state-owned financial institutions. China's central bank, the People's Bank of China (PBOC), also meets frequently with large banks in China to ensure that their lending decisions align with PBOC and government objectives. In addition, the *Law on Commercial Banks* provides that "commercial banks are to conduct their business of lending in accordance with the needs of national economic and social development and under the guidance of the industrial policies of the state."

Similarly, China's legal system continues to function as an instrument by which the government and the Party can secure discrete economic outcomes, channel broader economic policy and pursue industrial policy objectives. Key legal institutions,

such as the courts, are structured to respond to the Party's direction, both broadly and on a case-specific basis. As a general matter, to the extent that companies and individuals seek to act independently of government or Party direction, the legal system does not provide a venue for them to achieve these objectives on a systemic or consistent basis. In addition, companies and individuals continue to face challenges in obtaining impartial outcomes, either because of local protectionism or corruption.

The larger issue of China's restrictions on the freedom of information also impacts China's economic system. For example, while China's Internet firewall and the Party's regular censorship of audio-visual and print media have many negative effects outside China's economic system, they also create distortions in China's economy, and these distortions affect the ability of foreign companies to operate and compete effectively in China's market.

In March 2021, China finalized and issued the *14th Five-Year Plan (2021-2025) for National Economic and Social Development*, which runs from 2021 through 2025. Like its predecessor, the *14th Five-year Plan* covers all sectors of China's economy and is not limited to one overarching plan, but instead will include hundreds of sub-plans. In this regard, various institutions participate in plan formulation and execution, including central government bodies with legislative and regulatory authority, thousands of provincial and local government authorities, various organs of the Party and key Chinese companies.

When compared to the industrial plans of other WTO Members, China's industrial plans are fundamentally different. In several significant ways, China's industrial plans go well beyond traditional approaches to guiding and supporting domestic industries. First, adherence to the objectives of China's industrial plans is effectively mandatory. Chinese companies have little discretion to ignore them, even when market forces would dictate different commercial behavior. Second, the financial support that the state provides to domestic

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industries in support of China's industrial plans is significantly larger than in other countries. The state also provides massive, market-distorting financial support to the ongoing operations of China's domestic industries. This support often leads to severe excess capacity in China – followed by China's widespread dumping of the inevitable excess production into the markets of other WTO Members. This assault on global markets causes serious harm to other WTO Members' industries and workers. The WTO does not provide effective mechanisms for addressing this problem. Third, China's industrial planning is more complex than in any other country, as it is made up of hundreds of plans across industries and at all levels of government. Fourth, China actively seeks to help its domestic producers through myriad additional policies and practices that impede, disadvantage and harm the foreign competition and skew the playing field against imported goods and services and foreign manufacturers and services suppliers.

When combined with the large size of China's economy and China's large share of global trade, the policies and practices that China pursues in support of its industrial plans transform China into a unique and pressing problem for the United States and other market economies as well as for the WTO and the multilateral trading system. Moreover, this troubling situation is not static. New mechanisms to maintain and enhance the state's control over the economy in China continue to emerge.

### Compliance with WTO Rules

Since last year's report, our assessment of China's record in terms of complying with WTO rules and observing the fundamental principles on which the WTO agreements are based has not changed. China's record remains poor.

As we detailed in prior reports, China's economic and trade regime has generated many WTO compliance concerns over the years. Too often,

WTO Members have had to resort to the WTO's dispute settlement mechanism to change problematic Chinese policies and practices. The United States, for example, has brought 27 cases against China at the WTO covering a wide range of important policies and practices, such as: (1) local content requirements in the automobile sector; (2) discriminatory taxes in the integrated circuit sector; (3) hundreds of prohibited subsidies in a wide range of manufacturing sectors; (4) inadequate intellectual property rights enforcement in the copyright area; (5) significant market access barriers in copyright-intensive industries; (6) severe restrictions on foreign suppliers of financial information services; (7) export restraints on numerous raw materials; (8) a denial of market access for foreign suppliers of electronic payment services; (9) repeated abusive use of trade remedies; (10) excessive domestic support for key agricultural commodities; (11) the opaque and protectionist administration of tariff-rate quotas for key agricultural commodities; and (12) discriminatory regulations on technology licensing. Even though the United States has routinely prevailed in these WTO disputes, as have other WTO Members in their disputes against China, they take years to litigate, consume significant resources and often require further efforts when China fails to comply with WTO rules.

In addition, China has often taken steps to obscure its actions to make it more difficult for trading partners to even challenge them in the WTO's adjudicative system. The WTO's dispute settlement mechanism was designed to facilitate the resolution of disagreements over whether an action breaches a WTO obligation, but where the action is so obscured that it is difficult to demonstrate it as a factual matter, the dispute settlement mechanism can fail to be an effective disciplinary tool. In this regard, as USTR has explained in prior reports, China disregards many of its WTO transparency obligations, which places its trading partners at a disadvantage and often serves as a cloak for China to conceal unfair, non-market and distortive trade policies and practices from scrutiny.

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For example, during the first 15 years of its WTO membership, China failed to notify any sub-central government subsidies to the WTO, despite the fact that most subsidies in China are provided by provincial and local governments. The magnitude and significance of this problem is illustrated by the five WTO cases that the United States has brought challenging prohibited subsidies maintained by China. While those cases involved hundreds of subsidies, most of the subsidies were provided by sub-central governments. The United States was able to bring those cases only because of its own extensive investigatory efforts to uncover China's opaque subsidization practices. Most other WTO Members lack the resources to conduct the same types of investigations.

Today, China continues to shield massive sub-central government subsidies from the scrutiny of other WTO Members, while also obscuring massive central government subsidies provided through a newer vehicle known as "government guidance funds." While China claims that the government has no role in these government guidance funds, the facts plainly reveal that these government guidance funds are run by government agencies and state-owned enterprises and provide state capital to Chinese companies. Together with other non-market practices, the massive subsidies provided by China's central government and sub-central governments contribute to the serious excess capacity problems that have been plaguing industries like steel, aluminum, solar panels and fishing and have been devastating global markets and foreign competitors, and similar results can be expected in other industries now being targeted by China for dominance.

As has become clear, the WTO's dispute settlement mechanism has not been effective in addressing the serious issues that arise from a WTO Member's state-led, non-market approach to the economy and trade that systematically disadvantages that Member's trading partners and broadly conflicts with the fundamental, market-oriented underpinnings of the WTO system. The value of the

dispute settlement mechanism is also undermined where a WTO Member does not operate in good faith. As a result, over time, despite the enforcement efforts of the United States and other WTO Members, China has been able to reinforce its state-led, non-market policies and practices, which WTO rules and the dispute settlement mechanism have so far proven unable to discipline effectively.

### UNRESOLVED PROBLEMS

A long list of problems with China's state-led, non-market trade regime persist. Because China is the largest trader among WTO Members, the harm caused by these problems is significantly magnified.

Most importantly, fundamental structural issues remain unaddressed. These include, for example, China's heavy reliance on market-distorting industrial policies covering virtually every sector of the economy, preferential treatment of state enterprises, massive subsidization of domestic industries (including financial support to and through state-owned enterprises and other state entities at multiple levels of government and a banking system dominated by state-owned banks favoring state-owned enterprises and targeted industries), forced technology transfer, state-sponsored theft of intellectual property and severe and persistent non-market excess capacity in key industries.

A host of other serious issues also remain outstanding. Key examples include significant market access restrictions, unjustified non-tariff barriers, import substitution, violations of internationally recognized labor rights (including forced labor), lax or unenforced environmental standards, increased adoption of unique Chinese national standards (including reportedly through the China Standards 2035 plan, which seeks to set the global standards for next-generation technologies), continued gaps in intellectual property protection and enforcement, overly broad cybersecurity regulation designed to favor domestic companies, unwarranted data localization requirements and cross-border data transfer restrictions, the misuse of

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competition policy for industrial policy objectives, purposeful obfuscation of trade and economic policies, especially with regard to China's subsidies practices, and inadequate regulatory transparency.

Overlaying all of these problematic policies and practices is China's economic system. Unlike the U.S. system, China's economic system is state-led, and it facilitates control and direction of all aspects of the economy by the Chinese government and the CCP, along with a reliance on rule *by* law rather than rule *of* law. The very fact that decisions in the marketplace are made based on the goals of the state, rather than based on commercial considerations, distorts the global economy in ways that can weaken and damage trading partners' economies. As has become evident to China's trading partners, one significant result of China's non-market economic system is the creation of excess capacity – that is, capacity that would not have been created and would not persist if market forces were operating properly.

In the past, China itself has acknowledged excess capacity in several industries, including steel, cement, electrolytic aluminum, flat glass and shipbuilding. Numerous other excess capacity industries have been identified by industry associations in the United States and other countries. Some of the Chinese industries most likely to inflict the disastrous consequences of severe excess capacity on the world in the future can be found in the *Made in China 2025* industrial plan. Through that plan, the Chinese government is seeking to create dominant Chinese companies in 10 sectors, including advanced information technology, robotics and automated machine tools, aircraft and aircraft components, maritime vessels and marine engineering equipment, advanced rail equipment, new energy vehicles, electrical generation and transmission equipment, agricultural machinery, new materials and pharmaceuticals and medical devices. By some estimates, the Chinese government is making available more than \$500 billion of financial support to these sectors, often using large government guidance funds that China

attempts to shield from scrutiny by claiming that they are wholly private. Based on the recent history of the steel and aluminum industries, China's non-market distortions in these newer sectors will likely result in oversupply, leading to loss of jobs and production in market economies.

Another example of the harm that can be caused by China's non-market economic system involves forced technology transfer. In USTR's Section 301 investigation into China's unfair acts, policies and practices related to technology transfer, intellectual property and innovation, USTR issued two extensive factual reports that detailed how the Chinese government uses foreign ownership restrictions, such as formal and informal joint venture requirements, to require or pressure technology transfer from U.S. companies to Chinese entities. The reports also explained how China imposes substantial restrictions on, and intervenes in, U.S. companies' investments and activities, including through restrictions on technology licensing terms. In addition, the reports analyzed how the Chinese government directs and unfairly facilitates the systematic investment in, and acquisition of, U.S. companies and assets by Chinese entities to obtain cutting-edge technologies and intellectual property and to generate large-scale technology transfer in industries deemed important by state industrial plans. Finally, the reports illustrated how the Chinese government has conducted or supported cyber intrusions into U.S. commercial networks, with the targets being intellectual property and sensitive commercial information held by U.S. firms. While these reports focused on the harm caused to U.S. interests, it is not a problem borne solely by the United States. As in the case of excess capacity, China's unfair policies and practices relating to forced technology transfer also affect other WTO Members whose companies have developed or are developing advanced technologies.

In addition to severe and persistent excess capacity and forced technology transfer, China's non-market economic system causes other serious harm to industries and workers in the United States and

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other WTO Members. This harm occurs because Chinese companies use the artificial competitive advantages provided to them by the extensive interventionist policies and practices of the Chinese state to undersell their foreign competition around the world. To some extent, the harm to foreign manufacturers is reflected in the very large number of antidumping and countervailing duty investigations that have been initiated against China by the investigating authorities of WTO Members. Since China joined the WTO in 2001, it has been the number one target for both antidumping and countervailing duty investigations. At the same time, many types of interventionist policies and practices are not capable of being addressed by antidumping and countervailing duty regimes, so the harm caused by China's interventionist policies and practices is only partially reflected in those antidumping and countervailing duty investigations.

### U.S. TRADE POLICY TOWARD CHINA

Below, we first summarize the various challenges that the United States and other WTO Members face as a result of China's continued pursuit of a state-led, non-market approach to the economy and trade. We then outline the multi-faceted strategic approach that forms the foundation of the United States' trade policy toward China.

#### CURRENT CHALLENGES

The United States expects, and is seeking to ensure, that its trading partners' economic and trade regimes promote fair, market-oriented conditions for competition. Market orientation implies the freedom for enterprises and individuals to pursue their interests and goals on a level playing field. Indeed, in establishing the WTO, members agreed that "open, market-oriented policies" were at the foundation of the multilateral trading system.

In the case of China, more than 20 years after its accession to the WTO, it has still not embraced market-oriented policies. The state remains in control of China's economy, and it heavily intervenes in the market to achieve national industrial policy objectives. It subsidizes industries that would not otherwise form or thrive, funds acquisitions for the purpose of accessing technologies and directs activities that a private business would not choose to undertake. The evidence is clear, moreover, that when a trading partner with China's size – China is the largest goods trader among WTO Members and the second largest economy in the world – pursues non-market policies and practices, the distortions that it creates impose substantial costs on its trading partners. The Chinese state's decisions in the marketplace are not driven by market factors, but their effects on markets push U.S. and international companies out of sectors, such as steel, aluminum, solar panels and fisheries. Once China's dominance is established, barriers to entry can lock-in China's dominance over the long term. As a result, markets all over the world are less fair and well-functioning than they should be, and the playing field is heavily skewed against U.S. and other foreign companies that seek to compete against Chinese companies, whether in China's market or markets outside of China.

This view is also held by many other WTO Members, particularly the democratic market economies that participated in the Summit for Democracy in December 2021. It has become widely accepted that China's approach to the economy and trade has not moved toward a stronger embrace of open, market-oriented principles and instead has seen a doubling-down on state capitalism "with Chinese characteristics." It has become equally evident that China's approach to the economy and trade has severely harmed workers and businesses in the United States and in many other countries.

In the United States, it has also become widely accepted that the existing WTO rules do not, and cannot, effectively discipline many of China's most



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harmful policies and practices. It is similarly evident to us that China has become quite adept at circumventing the existing rules, as well as the attempted enforcement of those rules, by obscuring state involvement in the economy in ways that the WTO rules did not anticipate at the time of their negotiation.

As a result, while the WTO still has a significant role to play, enforcement of WTO rules has become less significant and solutions independent of the WTO are necessary, including solutions pursued through bilateral engagement and the use of domestic trade tools. It was in large part from that perspective that, in August 2017, the United States launched an investigation under Section 301 of the Trade Act of 1974 into China's unfair acts, policies and practices related to technology transfer, intellectual property and innovation. As reported previously, USTR subsequently issued a detailed report, finding that China had engaged in a range of unfair and harmful conduct. USTR then began the process of imposing tariffs on imports from China and pursued a bilateral negotiation with China that resulted in an economic and trade agreement, commonly referred to as the "Phase One Agreement," which was signed in January 2020.

While substantial Section 301 tariffs remain in place on imports from China, we are not seeking to build a wall between the United States and China. Indeed, even if that were possible, it would not address the problems posed by China. It would also ignore China's importance to, and integration into, the world economy.

Over the last few years, as changes have taken place in how the United States and U.S. stakeholders view the United States' trade relationship with China, it has become apparent that the views of other WTO Members have also been evolving toward this view. More and more trading partners appear to understand that China's state-led, non-market approach to the economy and trade has been severely harming their workers and businesses. While each trading partner is impacted differently by

China, there is also a growing consensus that this situation will not change unless new strategies are pursued.

While the WTO remains a strong focus for the United States and many of the United States' trading partners, there is a growing awareness that it may be necessary to pursue some solutions outside the WTO in order to avoid the severe harm that will likely continue to result from China's state-led, non-market economic and trade regime. For example, some of the United States' trading partners are now exploring possible new domestic trade tools to address the challenges posed by China's state-led trade regime. These and other like-minded trading partners have also begun working with the United States — sometimes confidentially — in pursuit of new joint strategies to address China's harmful non-market policies and practices, including China's increasing use of economic coercion.

At the same time, still other trading partners appear to be replicating some of China's unfair trade practices, or at least accepting them as a result of China's tactics to coerce or entice countries to acquiesce to its practices. Consequently, addressing these practices in China could have the additional benefit of dissuading these countries from following China's example.

Meanwhile, many of China's trading partners are increasingly skeptical of China's rhetoric. For example, China often touts its strong commitment to win-win outcomes in international trade matters, but its actions plainly belie its words. Through state-led industrial plans like *Made in China 2025*, which targets 10 strategic emerging sectors, China pursues a zero-sum approach. It first seeks to develop and dominate its domestic markets. Once China develops, acquires or steals new technologies and Chinese enterprises become capable of producing the same quality products in those industries as the foreign competition, the state suppresses the foreign competition domestically and then supports Chinese enterprises as they "go out" and seek dominant positions in global markets. Based on the

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world's past experiences with industries like steel, aluminum, solar panels and fisheries, a new wave of severe and persistent non-market excess capacity can be expected in industries like those targeted by *Made in China 2025*, to the detriment of China's trading partners.

It has also not gone unnoticed among China's trading partners — particularly the democratic market economies — that China's leadership appears confident in its state-led, non-market approach to the economy and trade and feels no need to conform to global norms. China's leadership demonstrates confidence in its ability to quiet dissenting voices. Indeed, it has become increasingly evident that China's leadership is seeking to establish new global norms that better reflect and support China's approach to the economy and trade and China's governance model, providing a potentially attractive alternative for other authoritarian regimes around the world.

China has also regularly used its economic clout in a coercive way if it perceives that a foreign company or a foreign country has spoken or acted in a way that undermines China's economic and trade interests. This economic coercion can mute international objections to China's non-market policies and practices, even when China flouts the WTO's rules-based international trading system. In recent years, China has increasingly expanded its use of economic coercion to take on foreign governments whose policies or practices are perceived to undermine not only China's economic and trade interests but also China's political interests. China's coercive economic measures in this context have taken a variety of forms, including, for example, import restrictions, export restrictions, restrictions on bilateral investment, regulatory actions, state-led and state-encouraged boycotts, and travel bans. Many countries have been subjected to this economic coercion.

In sum, the reality confronting the United States and other market economies — especially the

democratic market economies — is not simply that China has a different economic system from ours. China plainly does not hold the same core values held by democratic market economies like the United States, China's state-led, non-market approach to the economy and trade conflicts in significant and harmful ways with our market-oriented approaches, to the detriment of our workers and businesses.

### U.S. STRATEGIC APPROACH

As a starting point, any U.S. trade policy toward China must account for current realities in the U.S.-China trade relationship and the many challenges that China poses for the United States and other trading partners, both now and in the future. Given that China's approach to the economy and trade has evolved and become more sophisticated, our strategies also need to evolve and become more sophisticated. We also need to find ways to address — and to protect ourselves against — China's many harmful, non-market policies and practices. Those policies and practices directly harm American workers, farmers and businesses, threaten our technological edge, weaken the resiliency of our supply chains and undermine our national interest. They also inflict similar harm on many of our trading partners.

Given these circumstances, it is clear that any strategic approach pursued by the United States must focus not only on the near-term, but also on the longer term, if the United States is to compete effectively with China. Any strategic approach should also be pursued in coordination with our many important, like-minded trading partners around the world.

Looking back over the first 20 years of China's WTO membership, and observing China's current leadership and clear policy direction, it would be appropriate to assume that the problems currently posed by China will be with us for some time. We

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cannot expect that China will willingly make fundamental changes to its state-led, non-market approach to the economy and trade in the near-term or even the medium-term.

It is also clear that effective strategies for dealing with China need to be flexible. The United States must be prepared to adapt and adjust its strategic approach over time as China's non-market policies and practices evolve and as global trade patterns shift and alliances and interests change.

For all of these reasons, the United States is now pursuing a multi-faceted strategic approach as it seeks to address the unique challenges posed by China and its state-led, non-market approach to the economy and trade. This approach involves the pursuit of strategic domestic investment, bilateral engagement of China, enforcement actions, the deployment of domestic trade tools and close coordination with allies and partners.

### Domestic Investment

The United States has been working to ensure that we are taking the steps domestically to invest in, and build policies supportive of, the industries of today and tomorrow. We therefore have been working to strengthen our economy, our supply chains, our infrastructure, our workers, our farmers and our businesses and to lay a solid foundation for us to continue to innovate and maintain our technological edge. Important steps taken to date include the passage of the CHIPS and Science Act, the Inflation Reduction Act and the Infrastructure Investment and Jobs Act.

### Bilateral Engagement

The United States remains intent on pursuing bilateral engagement with China and is seeking to find areas where some progress can be achieved. China is an important trading partner, and every avenue for obtaining real change in its trade regime must be utilized.

At the same time, it is clear that prior U.S. efforts have not led to fundamental changes in China's trade regime, and many serious challenges remain, including in the wake of the Phase One Agreement. Priority concerns currently include state-led industrial plans that target specific industries for dominance, massive subsidization, the non-market activities of state-owned and state-invested enterprises, severe and persistent excess capacity, discriminatory regulation, forced technology transfer, state-sponsored theft of intellectual property, market access restrictions, repression of internationally recognized labor rights, including the use of forced labor, and economic coercion.

Ultimately, it will be up to China to decide whether and to what extent it is willing to work constructively with the United States to address these significant concerns.

### Enforcement

It is important for the bilateral relationship to demonstrate that China must honor its promises. We therefore have been working to ensure that China lives up to its existing trade commitments, including the ones that China made in the Phase One Agreement.

### Domestic Trade Tools

The use of domestic trade tools is also a key focus of U.S. trade policy toward China. To the extent that China's unfair, non-market and distortive policies and practices persist, the United States is prepared to use domestic trade tools strategically as needed in order to achieve a more level playing field with China for U.S. workers and businesses.

It is also apparent that existing trade tools need to be strengthened, and new trade tools need to be forged. China pursues unfair policies and practices that were not contemplated when many of the U.S. trade statutes were drafted decades ago, and we are

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therefore exploring ways in which to work with the Congress to update our trade tools to counter them.

In one significant action to date, as previously discussed, USTR pursued an investigation under the authority of Section 301 of the Trade Act of 1974 into China's unfair acts, policies and practices related to technology transfer, intellectual property and innovation. In March 2018, after a thorough review and analysis of the evidence, USTR issued a detailed report, finding that China had engaged in a range of unfair and harmful conduct. First, USTR found that China uses foreign ownership restrictions, including joint venture requirements, equity limitations and other investment restrictions, to require or pressure technology transfer from U.S. companies to Chinese entities. USTR also found that China uses administrative review and licensing procedures to require or pressure technology transfer, which, *inter alia*, undermines the value of U.S. investments and technology and weakens the global competitiveness of U.S. companies. Second, USTR found that China imposes substantial restrictions on, and intervenes in, U.S. companies' investments and activities, including through restrictions on technology licensing terms. These restrictions deprive U.S. technology owners of the ability to bargain and set market-based terms for technology transfer. As a result, U.S. companies seeking to license technologies must do so on terms that unfairly favor Chinese recipients. Third, USTR found that China directs and facilitates the systematic investment in, and acquisition of, U.S. companies and assets by Chinese companies to obtain cutting-edge technologies and intellectual property and to generate large-scale technology transfer in industries deemed important by Chinese government industrial plans. Fourth, USTR found that China conducts and supports unauthorized intrusions into, and theft from, the computer networks of U.S. companies. These actions provide the Chinese government with unauthorized access to intellectual property, trade secrets and confidential business information, such as technical data, negotiating positions and sensitive and

proprietary internal business communications. The purpose of these actions is to support China's strategic development goals, including its science and technology advancement, military modernization and economic development.

Based on these findings, the United States took a range of responsive actions. These actions included the successful prosecution of a WTO dispute settlement case challenging Chinese measures that deny foreign patent holders the ability to enforce their patent rights against a Chinese joint venture partner after a technology transfer contract ends and that impose mandatory adverse contract terms that discriminate against and are less favorable for imported foreign technology as compared to Chinese technology, as well as the imposition of substantial additional tariffs on imports of Chinese goods. Over time, as has been previously reported, these tariffs eventually covered \$370 billion of Chinese imports, with additional tariffs of 25 percent on \$250 billion of Chinese imports and additional tariffs of 15 percent on a further \$120 billion of Chinese imports, while China responded through the imposition of retaliatory tariffs on various imports of U.S. goods.

In December 2019, after one year of negotiations, the United States announced that the two sides had finalized the text of an economic and trade agreement, which was later signed in January 2020. This agreement, commonly referred to as the "Phase One Agreement," included commitments from China on intellectual property, technology transfer, agriculture, financial services, currency and foreign exchange, and the purchase of U.S. goods and services. The commitments varied in ambition, and in effectiveness. For example, some commitments related to financial services reflected reforms that China was already contemplating or pursuing, as China had begun easing foreign investment restrictions in some financial services sectors in 2017. In addition, in the area of intellectual property rights, while China committed to make a number of changes to its laws and regulations, China saw many of these changes as now needed by its domestic

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businesses, given their own increasing efforts at innovation. It also remains unclear how faithfully and fairly China will actually enforce the changes to its laws and regulations. Meanwhile, other commitments that China made, such as in the area of technology transfer, are difficult to verify given the tactics that China takes to obscure its activities.

Notably, the Phase One Agreement did not address many of the U.S. concerns that the United States had been seeking to address in its negotiations with China. The unresolved issues included critical concerns in areas such as industrial plans, subsidies, state-owned enterprises, excess capacity, state-sponsored cyber-enabled theft of intellectual property, standards, cybersecurity, data localization requirements, restrictions on cross-border data transfers, competition law enforcement and regulatory transparency as well as certain issues in the areas of intellectual property, technology transfer and services market access that were not addressed in the Phase One Agreement.

In light of the limited progress represented by the Phase One Agreement, the United States did not make major changes to the existing Section 301 tariffs. After some minor adjustments, the United States kept in place tariffs on \$370 billion of Chinese imports, which included 25 percent tariffs on \$250 billion of Chinese imports and 7.5 percent tariffs on \$120 billion of Chinese imports. The United States also decided not to move forward with plans to raise the tariff rate for some of the existing Section 301 tariffs or to impose new tariffs on additional Chinese imports.

Since the Phase One Agreement entered into force in February 2020, the United States has been closely monitoring China's progress in implementing its commitments. The United States has also been utilizing the consultation arrangements set forth in the agreement, including regular meetings required by the agreement between the two sides. Through these many engagements, the United States has raised various concerns that have arisen regarding China's implementation progress. In addition,

official trade data appears to show that China fell far short of implementing its commitments to purchase U.S. goods and services in calendar years 2020 and 2021. Serious concerns with China's implementation efforts have also arisen in other areas, including agriculture, particularly with regard to China's commitments relating to agricultural biotechnology and the risk assessment that China is required to conduct relating to the use of ractopamine in cattle and swine.

### Allies and Partners

The United States cannot do it alone. There are limits to bilateral engagement and the impact of enforcement actions and domestic trade tools. That is why the United States is working more intensely and broadly with allies and like-minded trading partners. Just as we are reassessing our domestic trade tools, we are also re-thinking how the United States engages with its trading partners to address the challenges that China poses for the global economy.

As more and more U.S. allies and like-minded trading partners come to understand the need for new approaches to China, the United States is working more intensely and broadly with them, both in existing international trade fora and initiatives and in new ones. The COVID-19 pandemic, and its impacts on supply chains and global economic conditions, have laid bare the vulnerabilities and interdependencies of global economies and have underscored the need for new coalitions to build up economic security and resiliency. There is a strong need for new thinking and new coalitions of allies and like-minded partners, including not only on a bilateral basis — especially with major trading partners — but also regionally and multilaterally, to find global solutions to the many serious problems posed by China's state-led, non-market approach to the economy and trade.

As part of this effort, the United States is continuing to work directly with allies and like-minded trading

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partners outside of a multilateral organization context in pursuit of new initiatives to explore strategies for addressing the unique problems posed by non-market policies and practices.

For example, the United States and the European Union (EU) have established a Trade and Technology Council, and the United States and Japan have established a Partnership for Trade. In both venues, one important component of the engagement focuses on better understanding and developing strategies for addressing non-market policies and practices.

Notably, as a result of meetings of the Trade and Technology Council held in 2022, the United States and the EU have started to exchange information on China's non-market policies and practices in the medical devices sector and China's extensive use of government guidance funds that provide financial support to domestic companies. The two sides have also expressed serious concerns regarding China's use of economic coercion, including against allies and partners of the United States and the EU, and resolved to cooperate on strategies for addressing this problem.

Separately, the United States and the EU also held the first Ministerial Meeting of the Working Group on Large Civil Aircraft in 2022. The two sides agreed to continue the Working Group's efforts to confront the challenges posed by China's non-market policies and practices.

Over the past year, the United States, the EU and Japan have also begun to deepen their trilateral work, focusing on the identification of problems arising from non-market policies and practices, the identification of gaps in existing trade tools and where further work is needed to develop new tools to address non-market policies and practices, and possible cooperation in utilizing existing tools. The three trading partners have also highlighted the importance of WTO reform in an effort to build a

free and fair rules-based multilateral trading system that benefits all its members and helps secure shared prosperity for all.

The United States is also holding discussions with many other like-minded trading partners, including in the Indo-Pacific region, on how to strengthen our existing trade relationships. Given that trade with China poses so many serious risks and potential harms, the United States believes that market economies should enhance their trade with each other.

As part of its discussions with like-minded trading partners, the United States is also working to make critical supply chains less vulnerable and more secure, sustainable and resilient. The United States recognizes the need to cooperate with trading partners to diversify international suppliers and reduce geographic concentration risk, especially in China, and to address vulnerabilities that can result in shortages of key goods. This joint work can also enable more effective responses to non-market policies and practices that have eroded critical supply chains.

At the same time, the United States is continuing to pursue initiatives at the WTO. For example, the U.S. agenda at the WTO includes pushing for and building support for meaningful WTO reforms to update the organization and respond to contemporary challenges, including China's accession to the WTO. One U.S. proposal relates to "special and differential treatment," where certain WTO Members rely on self-declared developing country status to inappropriately seek "special and differential treatment" to avoid making meaningful commitments in WTO negotiations. The United States has also offered, and will continue to pursue, proposals to respond to certain policies and practices of China and other non-market economies. They include a proposal intended to increase consequences for WTO Members who fail to adequately notify industrial subsidies.



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Similar work is taking place in fora such as the Group of Seven (G7), the Group of Twenty and the Organization for Economic Cooperation and Development. For example, at the G7 Leaders Meeting, held in June 2022, the United States and the other members of the G7 discussed the challenges that China's non-market policies and practices pose to the multilateral trading system. They agreed to continue to build a shared understanding of this problem and to consult on collective approaches for addressing it. They also specifically committed to work together to develop coordinated actions to ensure a level playing field, to counter economic coercion and to reduce strategic dependencies.

### SPECIFIC TRADE CONCERNS

At present, China pursues numerous unfair, non-market and distortive policies and practices that cause particular concern for the United States and U.S. stakeholders. The key concerns are summarized below.

#### STATE-LED, NON-MARKET TRADE REGIME

##### Industrial Plans

China continues to pursue a wide array of industrial plans and related policies that seek to limit market access for imported goods, foreign manufacturers and foreign services suppliers, while offering substantial government guidance, resources and regulatory support to Chinese companies. The beneficiaries of these constantly evolving policies are not only state-owned enterprises but also other domestic Chinese companies.

One of the more far-reaching and harmful industrial plans is *Made in China 2025*. China's State Council released this industrial plan in May 2015. It is a 10-year plan targeting 10 strategic sectors, including advanced information technology, automated machine tools and robotics, aviation and spaceflight

equipment, maritime engineering equipment and high-tech vessels, advanced rail transit equipment, new energy vehicles (NEVs), power equipment, farm machinery, new materials, biopharmaceuticals and advanced medical device products. While ostensibly intended simply to raise industrial productivity through more advanced and flexible manufacturing techniques, *Made in China 2025* is emblematic of China's evolving and increasingly sophisticated approach to "indigenous innovation," which is evident in numerous supporting and related industrial plans. Under China's harmful and anticompetitive approach to indigenous innovation, the common, overriding aim is to replace foreign technologies, products and services with Chinese technologies, products and services in the China market through any means possible so as to enable Chinese companies to dominate international markets.

*Made in China 2025*, which represents the first 10 years of a 30-year strategy known as the "Strong Manufacturing Nation Strategy," seeks to build up Chinese companies in the 10 targeted, strategic sectors at the expense of, and to the detriment of, foreign companies and their technologies, products and services through a multi-step process over 10 years. The initial goal of *Made in China 2025* is to ensure, through various means, that Chinese companies develop, extract or acquire their own technology, intellectual property and know-how and their own brands. The next goal of *Made in China 2025* is to substitute domestic technologies, products and services for foreign technologies, products and services in the China market. The final goal of *Made in China 2025* is to capture much larger worldwide market shares in the 10 targeted, strategic sectors.

In pursuit of these goals, subsequently released documents set specific targets for capacity and production levels and market shares for the dozens of industries that comprise the 10 broad sectors targeted in *Made in China 2025*. In October 2015, China's National Manufacturing Strategic Advisory Committee published the *Made in China 2025 Key*

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*Area Technology Roadmap*, and since then it has published two updated editions of this document. The first update took place in February 2018, with the issuance of the *Made in China 2025 Key Area Technology and Innovation Greenbook – Technology Roadmap (2017)*. Like its predecessor, the updated document sets explicit market share and other targets to be attained by Chinese companies in dozens of high-technology industries, often both in the China market and globally. For example, it calls for “indigenous new energy vehicle annual production” to have a “supplying capacity that can satisfy more than 80 percent of the market” in China by 2020, up from a 70 percent target set in the 2015 document. In November 2020, the 2017 document was updated with the issuance of the *Made in China Key Area Technology Innovation Greenbook – Technology Roadmap (2019)*.

Many of the policy tools being used by the Chinese government to achieve the goals of *Made in China 2025* raise serious concerns. Several of these tools are unprecedented and include a wide array of state intervention and support designed to promote the development of Chinese industry in large part by restricting, taking advantage of, discriminating against or otherwise creating disadvantages for foreign enterprises and their technologies, products and services. Indeed, even facially neutral measures can be applied in favor of domestic enterprises, as past experience has shown, especially at sub-central levels of government.

*Made in China 2025* also differs from industry support pursued by other WTO Members in its level of ambition and, perhaps more importantly, in the scale of resources the government is investing in the pursuit of its industrial policy goals. Indeed, by some estimates, the Chinese government is making available more than \$500 billion of financial support to the *Made in China 2025* sectors, often using large government guidance funds, which China attempts to shield from scrutiny by claiming that they are wholly private. Even if China fails to fully achieve the industrial policy goals set forth in *Made in China 2025*, it is still likely to create or exacerbate market

distortions and create severe excess capacity in many of the targeted sectors. It is also likely to do long-lasting damage to U.S. interests, as well as the interests of the United States’ allies and partners, as China-backed companies increase their market share at the expense of foreign companies operating in these sectors.

While public references to *Made in China 2025* subsided after June 2018 reportedly in response to an order from the central government, it is clear that China remains committed to achieving the underlying goals of *Made in China 2025* and continues to seek dominance for Chinese firms in the sectors that it views as strategic, both in China’s market and globally. For example, in September 2020, the central government issued a guiding opinion encouraging investment in “strategic emerging industries,” a term used to describe an earlier initiative from which *Made in China 2025* evolved. Among other things, the guiding opinion called for the support and creation of industrial clusters for strategic emerging industries, along with the use of various types of government support and funding. The guiding opinion specifically encouraged provincial and local governments to support industries such as advanced information technology, NEVs and biopharmaceuticals.

In March 2021, the National People’s Congress passed the *14th Five-Year Plan (2021-2025) for National Economic and Social Development (the 14th Five-Year Plan)*, together with a document titled *Long-Range Objectives Through Year 2035*. The *14th Five-Year Plan* and subsequently issued sector-specific five-year plans, along with five-year plans issued by sub-central governments, make clear that China will continue to pursue its industrial policy objectives. While industrial plans like *Made in China 2025* were not named in the *14th Five-Year Plan*, there continues to be overlap between the industries identified in China’s five-year plans with both *Made in China 2025* industries and strategic emerging industries. In addition, other longer-ranging industrial plans, such as the *New Energy Vehicle Industry Development Plan (2021-2035)* and

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*China Standards 2035*, continue to demonstrate China's commitment to a state-led, non-market approach to the economy and trade.

### Technology Transfer

For years, longstanding and serious U.S. concerns regarding technology transfer remained unresolved, despite repeated, high-level bilateral commitments by China to remove or no longer pursue problematic policies and practices. In August 2017, USTR sought to address these concerns by initiating an investigation under Section 301 focused on policies and practices of the Government of China related to technology transfer, intellectual property and innovation. Specifically, in its initiation notice, USTR identified four categories of reported Chinese government conduct that would be the subject of its inquiry: (1) the use of a variety of tools to require or pressure the transfer of technologies and intellectual property to Chinese companies; (2) depriving U.S. companies of the ability to set market-based terms in technology licensing negotiations with Chinese companies; (3) intervention in markets by directing or unfairly facilitating the acquisition of U.S. companies and assets by Chinese companies to obtain cutting-edge technologies and intellectual property; and (4) conducting or supporting cyber-enabled theft and unauthorized intrusions into U.S. commercial computer networks for commercial gains. In March 2018, USTR issued a report supporting findings that the four categories of acts, policies and practices covered in the investigation are unreasonable or discriminatory and burden and/or restrict U.S. commerce. In November 2018, USTR issued an updated report that found that China had not taken any steps to change its problematic policies and practices. Based on the findings in USTR's Section 301 investigation, the United States took a range of responsive actions, including the pursuit of a successful WTO case challenging certain discriminatory technology licensing measures maintained by China in addition to the imposition of additional tariffs on Chinese imports.

The Phase One Agreement, signed in January 2020, addresses certain aspects of the unfair trade practices of China that were identified in USTR's Section 301 report. In the agreement, China committed to end its longstanding practice of forcing or pressuring foreign companies to transfer their technology to Chinese companies as a condition for obtaining market access, securing administrative approvals or receiving advantages from the Chinese government. China also committed to provide transparency, fairness and due process in administrative proceedings and to ensure that technology transfer and licensing take place on market terms that are voluntary and reflect mutual agreement. Separately, China committed to refrain from directing or supporting outbound investments aimed at acquiring foreign technology pursuant to its distortive industrial plans.

Since the entry into force of the Phase One Agreement in February 2020, the United States has continually engaged with the U.S. business community, which has expressed concern about China's informal, unwritten actions that force or pressure U.S. companies to transfer their technology to Chinese entities, including as a condition for obtaining market access. The United States has engaged China as issues arise and will continue to monitor developments closely.

### Indigenous Innovation

Policies aimed at promoting China's so-called "indigenous innovation" continue to represent an important component of China's industrialization efforts. Through intensive, high-level bilateral engagement with China since 2009, the United States has attempted to address these policies, which provide various preferences when intellectual property is owned or developed in China, both broadly across sectors of China's economy and specifically in the government procurement context.

For example, at the May 2012 meeting of the U.S.-China Strategic and Economic Dialogue (S&ED),

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China committed to treat intellectual property owned or developed in other countries the same as intellectual property owned or developed in China. The United States also used the U.S.-China Joint Commission on Commerce and Trade (JCCT) process in 2012 and subsequent discussions to press China to revise or eliminate specific measures that appeared to be inconsistent with this commitment. At the December 2014 JCCT meeting, China clarified and underscored that it will treat intellectual property owned or developed in other countries in the same manner as domestically owned or developed intellectual property. Once again, however, these commitments were not fulfilled. China continues to pursue myriad policies that require or favor the ownership or development of intellectual property in China.

The United States secured a series of similar commitments from China in the government procurement context, where China agreed to de-link indigenous innovation policies at all levels of the Chinese government from government procurement preferences, including through the issuance of a State Council measure mandating that provincial and local governments eliminate any remaining linkages by December 2011. Many years later, however, this promise had not been fulfilled. At the November 2016 JCCT meeting, in response to U.S. concerns regarding the continued issuance of scores of inconsistent measures, China announced that its State Council had issued a document requiring all agencies and all sub-central governments to “further clean up related measures linking indigenous innovation policy to the provision of government procurement preference.”

Over the years, the underlying thrust of China's indigenous innovation policies has remained unchanged, as China's leadership has continued to emphasize the necessity of advancing indigenous innovation capabilities. Through plans such as the *14th Five-Year Plan for the Protection and Utilization of National Intellectual Property Rights*, China has continued to implement discriminatory policies encouraging “indigenous intellectual property

rights” and “core technologies” that are owned or developed in China. Accordingly, USTR has been using mechanisms like a Section 301 investigation to seek to address, among other things, China's use of indigenous innovation policies to force or pressure foreigners to own or develop their intellectual property in China.

### STATE-OWNED ENTERPRISES

While many provisions in China's WTO accession agreement indirectly discipline the activities of state-owned and state-invested enterprises, China also agreed to some specific disciplines. In particular, it agreed that laws, regulations and other measures relating to the purchase of goods or services for commercial sale by state-owned and state-invested enterprises, or relating to the production of goods or supply of services for commercial sale or for non-governmental purposes by state-owned and state-invested enterprises, would be subject to WTO rules. China also affirmatively agreed that state-owned and state-invested enterprises would have to make purchases and sales based solely on commercial considerations, such as price, quality, marketability and availability, and that the government would not directly or indirectly influence the commercial decisions of state-owned and state-invested enterprises.

In subsequent bilateral dialogues with the United States, China made further commitments. In particular, China committed to develop a market environment of fair competition for enterprises of all kinds of ownership and to provide them with non-discriminatory treatment in terms of credit provision, taxation incentives and regulatory policies.

However, instead of adopting measures giving effect to its commitments, China instead took steps intended to strengthen the role of state-owned and state-invested enterprises in the economy and to protect them against foreign competition. China established the State-owned Asset Supervision and Administration Commission (SASAC) and adopted

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the *Law on State-owned Assets of Enterprises* in addition to numerous other measures that mandate state ownership and control of many important industrial sectors. The CCP also ensured itself a decisive role in state-owned and state-invested enterprises' major business decisions, personnel changes, project arrangements and movement of funds. The fundamental premise of these measures was to enable the government and the Party to intervene in the business strategies, management and investments of these enterprises in order to ensure that they play a dominant role in the national economy in line with the overall objective of developing China's "socialist market economy" and China's industrial plans. Over the past few years, Party leadership in state-owned and state-invested enterprises has been strengthened through practices such as appointing a person as both the chairman of the board and the Party secretary for a state-owned enterprise.

Separately, the Chinese government also has issued a number of measures that restrict the ability of state-owned and state-invested enterprises to accept foreign investment, particularly in key sectors. Some of these measures are discussed below in the Investment section.

In its 2013 *Third Plenum Decision*, China endorsed a number of far-reaching economic reform pronouncements, which called for making the market "decisive" in allocating resources, reducing Chinese government intervention in the economy, accelerating China's opening up to foreign goods and services and improving transparency and the rule of law to allow fair competition in China's market. It also called for "reforming" China's state-owned and state-invested enterprises.

However, rather than actually embrace the role of the market, China sought to strengthen the role of the state in the economy. Statements by China's President also made clear that China continues to view the role of the state very differently from the United States and other democratic market

economies. In October 2016, he called for strengthening the role of the CCP in state-owned enterprises and emphasized that state-owned enterprises should be "important forces" to implement national strategies and enhance national power. In February 2019, in an article in a CCP journal, he further called for the strengthening of the Party's "leadership over the rule of law," and he vowed that China "must never copy the models or practices of other countries" and "we must never follow the path of Western 'constitutionalism,' 'separation of powers' or 'judicial independence.'"

With regard to the reform of China's state-owned enterprises, one example of China's efforts included an announcement that China would classify these enterprises into commercial, strategic or public interest categories and require commercial state-owned and state-invested enterprises to garner reasonable returns on capital. However, this plan also allowed for divergence from commercially driven results to meet broadly construed national security interests, including energy and resource interests and cyber and information security interests. Similarly, in recent years, China has pursued reforms through efforts to realize "mixed ownership." These efforts included pressuring private companies to invest in, or merge with, state-owned and state-invested enterprises as a way to inject innovative practices into and create new opportunities for inefficient state-owned and state-invested enterprises.

China has also previously indicated that it would consider adopting the principle of "competitive neutrality" for state-owned enterprises. However, China has continued to pursue policies that further enshrine the dominant role of the state and its industrial plans when it comes to the operation of state-owned and state-invested enterprises. For example, China has adopted rules ensuring that the government continues to have full authority over how state-owned and state-invested enterprises use allocations of state capital and over the projects that state-owned enterprises pursue.

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Overall, while China's efforts at times have appeared to signal a high-level determination to accelerate needed economic reforms, those reforms have not materialized. Indeed, the Chinese state's role in the economy has increased rather than decreased. It also seems clear that China's past policy initiatives were not designed to reduce the presence of state-owned and state-invested enterprises in China's economy or to force them to compete on the same terms as private commercial operators. Rather, the reform objectives were to strengthen state-owned and state-invested enterprises and to place them on a more competitive footing, both in China and globally, through consolidation, increased access to state capital, preferential access to goods and services and the use of other policies and practices designed to give these enterprises artificial advantages over their private competitors.

This unfair situation is made worse for foreign companies. Like China's state-owned and state-invested enterprises, China's private companies also benefit from a wide array of state intervention and support designed to promote the development of China's domestic industries in accordance with China's industrial plans. These interventions and support are deployed in concert with other policies and practices that restrict, take advantage of, discriminate against or otherwise create disadvantages for foreign companies and their technologies, products and services.

### SUBSIDIES

#### Industrial Subsidies

China continues to provide massive subsidies to its domestic industries, which have caused injury to U.S. industries. Some of these subsidies also appear to be prohibited under WTO rules. To the extent possible, the United States has sought to address these subsidies through countervailing duty proceedings conducted by the Commerce

Department and dispute settlement cases at the WTO.

The United States and other WTO Members also have continued to press China to notify all of its subsidies to the WTO in accordance with its WTO obligations while also submitting counter notifications listing hundreds of subsidy programs that China has failed to notify. China's WTO subsidy notifications have marginally improved over the years in terms of timeliness and completeness. Nevertheless, since joining the WTO more than 20 years ago, China has not yet submitted to the WTO a complete notification of subsidies maintained by the central government, and it did not notify a single sub-central government subsidy until July 2016, when it provided information largely only on sub-central government subsidies that the United States had challenged as prohibited subsidies in a WTO case.

The United States began working with the EU and Japan in 2018 to identify further effective action and potential rules that could address problematic subsidies practices not currently covered by existing obligations. In January 2020, the trade ministers of the United States, the EU and Japan issued a statement agreeing to strengthen the WTO subsidy rules by: (1) prohibiting certain egregious types of subsidies; (2) requiring the subsidizing country to demonstrate for other distortive subsidy types that the subsidy provided did not cause adverse effects; (3) building upon the existing "serious prejudice" rules; (4) putting some teeth into the notification rules; and (5) developing a new definition of what constitutes a "public body." In November 2021, the trade ministers of the United States, the EU and Japan renewed their commitment to work together, including with regard to the identification of areas where further work is needed to develop new tools and other measures to address non-market policies and practices. Since then, the United States, the EU and Japan have also been working together at the staff level to uncover China's subsidies practices in specific sectors, such as the semiconductors sector.



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### Excess Capacity

Because of its state-led approach to the economy, China is the world's leading offender in creating non-market capacity, as evidenced by the severe and persistent excess capacity situations in several industries. China is also well on its way to creating severe excess capacity in other industries through its pursuit of industrial plans such as *Made in China 2025*, pursuant to which the Chinese government is doling out hundreds of billions of dollars to support Chinese companies and requiring them to achieve preset targets for domestic market share – at the expense of imports – and global market share in each of 10 advanced manufacturing industries.

In manufacturing industries such as steel and aluminum, China's economic planners have contributed to massive excess capacity in China through various government support measures. For steel, the resulting over-production has distorted global markets, harming U.S. workers and manufacturers in both the U.S. market and third country markets, where U.S. exports of steel products compete with exports from China. This over-production has similarly harmed the workers and manufacturers of many of the United States' allies and partners. While China has publicly acknowledged excess capacity in these industries, among others, it has yet to take meaningful steps to address the root causes of this problem in a sustainable way.

From 2000 to 2021, China accounted for 71 percent of global steelmaking capacity growth, an increase well in excess of the increase in global and Chinese demand over the same period. Currently, China's capacity represents about one-half of global capacity and more than twice the combined steelmaking capacity of the EU, Japan, the United States and Brazil.

At the same time, China's steel production is continually reaching new highs, eclipsing demand. In 2020, China's steel production climbed above one billion metric tons for the first time, reaching 1,065

million metric tons, a seven percent increase from 2019, and remained high at 1,033 million metric tons in 2021, despite a significant contraction in domestic steel demand. This sustained ballooning of greenhouse gas (GHG) emissions-intensive steel production, combined with weakening economic growth and a slowdown in the Chinese construction sector, has flooded the global market with excess steel supply at a time when the steel sector outside of China is still recovering from the severe demand shock brought on by the COVID-19 pandemic and the ongoing effects of Russia's war of aggression against Ukraine. In 2021, China exported more steel than the world's second and third largest steel producers, India and Japan, combined. Today, China remains by far the world's largest exporter of steel.

Similarly, primary aluminum production capacity in China increased by more than 1,400 percent between 2000 and 2021, with China accounting for more than 80 percent of global capacity growth during that period. Much of this capacity addition has been built with government support, has taken place during periods of decline in global aluminum prices and relies on GHG emissions-intensive sources of electricity. China's primary aluminum capacity now accounts for more than 57 percent of global capacity and is more than double the capacity of the next ten aluminum-producing countries combined. As in the steel sector, China's aluminum production has also ballooned in recent years, as China's aluminum production has continued to increase despite global demand shocks. China's capacity and production continue to contribute to major imbalances and price distortions in global markets, harming U.S. aluminum producers and workers.

Excess capacity in China hurts various U.S. workers and industries not only through direct exports from China to the United States, but also through its impact on global prices and supply, which makes it difficult for competitive manufacturers throughout the world to remain viable. Indeed, domestic industries in many of China's trading partners continue to petition their governments to impose trade measures to respond to the trade-distortive

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effects of China's excess capacity. In addition, the United States has acted under Section 232 of the Trade Expansion Act of 1962 to increase import duties on steel and aluminum products after finding that excessive imports are a threat to U.S. national security.

### Agricultural Domestic Support

For several years, China has been significantly increasing domestic subsidies and other support measures for its agricultural sector. China maintains direct payment programs, minimum support prices for basic commodities and input subsidies. China has implemented a cotton reserve system, based on minimum purchase prices, and cotton target price programs. In 2016, China established subsidies for starch and ethanol producers to incentivize the purchase of domestic corn, resulting in higher volumes of exports of processed corn products from China in 2017 and 2018. In addition, in 2022, China began encouraging soybean production through various support programs, such as through increased subsidies for crop rotations, awards to counties with high oilseed production, incentives to promote the intercropping of corn and soybeans, and subsidies for "demonstration farming" of soybeans on alkali and salty land.

China submitted a notification concerning domestic support measures to the WTO in May 2015, but it only provided information up to 2010. In December 2018, China notified domestic support measures for the period 2011-2016. This notification showed that China had exceeded its *de minimis* level of domestic support for soybeans (in 2012, 2014 and 2015), cotton (from 2011 to 2016), corn (from 2013 to 2016), rapeseed (from 2011 to 2013) and sugar (2012). The situation was likely even worse, as the methodologies used by China to calculate domestic support levels result in underestimates. Moreover, the support programs notified by China seemingly failed to account for support given at the sub-national level by provincial and local governments and, possibly, support administered through state-owned enterprises.

In September 2016, the United States launched a WTO case challenging China's government support for the production of wheat, corn and rice as being in excess of China's commitments. Like other WTO Members, China committed to limit its support for producers of agricultural commodities. China's market price support programs for wheat, corn and rice appear to provide support far exceeding the agreed levels. This excessive support creates price distortions and skews the playing field against U.S. farmers. In October 2016, consultations took place. In January 2017, a WTO panel was established to hear the case. Hearings before the panel took place in January and April 2018, and the panel issued its decision in February 2019, ruling that China's domestic support for wheat and rice was WTO-inconsistent. China originally agreed to come into compliance with the panel's recommendations by March 31, 2020. The United States subsequently agreed to extend this deadline to June 30, 2020. In July 2020, the United States submitted a request for authorization to suspend concessions and other obligations pursuant to Article 22 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) on the ground that China had failed to bring its measures into compliance with its WTO obligations. After China objected to this request, the matter was referred to arbitration in accordance with Article 22 of the DSU. The arbitration is currently suspended, and the United States continues to closely monitor the operation of China's market price support programs for wheat and rice.

### Fisheries Subsidies

It is estimated that China is the world's largest provider of harmful fisheries subsidies, with support exceeding \$4 billion annually. These subsidies contribute to overfishing and overcapacity that threatens global fish stocks. Indeed, China is the world's largest producer of marine capture fisheries and, in the years since its WTO accession, has continued to support its fishing fleet through subsidies and other market-distorting means. China's annual fisheries harvest is nearly double that

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of the next largest producer in the world in terms of marine capture and triple that of other top producers, like the United States, India and Japan. At the same time, reports continue to emerge about Chinese-flagged fishing vessels engaging in illegal, unreported and unregulated (IUU) fishing in distant waters, including in areas under the jurisdiction of other WTO Members. While China has made some progress in reducing subsidies to domestic fisheries, it continues to shift its overcapacity to international fisheries by providing a much higher rate of subsidy support to Chinese distant water fishery enterprises.

For several years, the United States has been raising its long-standing concerns over China's fisheries subsidies programs. In 2015, the United States submitted a written request for information pursuant to Article 25.8 of the WTO Agreement on Subsidies and Countervailing Measures (Subsidies Agreement). This submission addressed fisheries subsidies provided by China at central and sub-central levels of government. The subsidies at issue were set forth in nearly 40 measures and included a wide range of subsidies, including fishing vessel acquisition and renovation grants, grants for new fishing equipment, subsidies for insurance, subsidized loans for processing facilities, fuel subsidies and the preferential provision of water, electricity and land. When China did not respond to this request, the United States submitted an Article 25.10 counter notification covering these same measures. More recent subsidy notifications by China have been more fulsome, but still incomplete.

In addition, the United States has long been an active and constructive participant in the WTO fisheries subsidies negotiations, pressing for a meaningful outcome to prohibit the most harmful types of fisheries subsidies. The United States and various like-minded WTO Members have put forward several proposals designed to achieve an ambitious outcome for those negotiations. Notably, in June 2022, WTO Members adopted the text of the WTO Agreement on Fisheries Subsidies, which includes several important disciplines, including prohibitions on subsidies to vessels or operators

engaged in IUU fishing, subsidies to fishing regarding stocks that are overfished and subsidies to fishing on the unregulated high seas. This agreement also contains robust transparency provisions to strengthen WTO Members' subsidy notifications and to enable effective monitoring of WTO Members' implementation of their obligations. The agreement will enter into force when it has been accepted by two-thirds of WTO Members.

Going forward, the United States will continue to investigate the full extent of China's fisheries subsidies and will continue to press China to fully comply with its relevant WTO subsidy obligations. The United States also will urge WTO Members to support additional, ambitious disciplines on harmful fisheries subsidies as part of the further WTO negotiations on fisheries subsidies.

## IMPORT POLICIES

### Trade Remedies

As of December 2022, China had in place 121 antidumping measures, affecting imports from 17 countries or regions. China also had in place seven countervailing duty measures, affecting imports from five countries or regions. The greatest systemic shortcomings in China's antidumping and countervailing duty practice continue to be in the areas of transparency and procedural fairness. Over the years, China has often utilized antidumping and countervailing duty investigations as more of a retaliatory tool than as a mechanism to nullify the effects of dumping or unfair subsidization within its domestic market. In response, the United States has pressed China bilaterally, in WTO meetings and through written comments submitted in connection with pending antidumping and countervailing duty proceedings to adhere strictly to WTO rules in the conduct of its trade remedy investigations.

The conduct of antidumping investigations by China's Ministry of Commerce (MOFCOM) continues to fall short of full commitment to the fundamental

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tenets of transparency and procedural fairness embodied in the WTO's Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994, commonly known as the Antidumping Agreement. The United States and other WTO Members accordingly have expressed concerns about key lapses in transparency and procedural fairness in China's conduct of antidumping investigations. The principal areas of concern include: MOFCOM's inadequate disclosure of key documents placed on the record by domestic Chinese producers; insufficient disclosures of the essential facts underlying MOFCOM decisions, such as dumping margin calculations and evidence supporting injury and dumping conclusions; MOFCOM's failure to issue supplemental questionnaires in instances where MOFCOM identifies information deficiencies; the improper rejection of U.S. respondents' reported cost and sales data; the unjustified use of facts available; and MOFCOM's failure to adequately address critical arguments or evidence put forward by interested parties. These aspects of China's antidumping practice have been raised with MOFCOM in numerous proceedings over the past several years.

A review of China's conduct of countervailing duty investigations makes clear that, as in the antidumping area, China needs to improve its transparency and procedural fairness when conducting these investigations. In addition, the United States has noted procedural concerns specific to China's conduct of countervailing duty investigations. For example, China initiated investigations of alleged subsidies that raised concerns, given the requirements regarding "sufficient evidence" in Article 11.2 of the Subsidies Agreement. The United States is also concerned about China's application of facts available under Article 12.7 of the Subsidies Agreement.

On several occasions in the past, the United States has expressed serious concerns about China's pursuit of antidumping and countervailing duty remedies that appear to be retaliatory and intended to discourage the United States and other trading

partners from the legitimate exercise of their rights under WTO antidumping and countervailing duty rules and the trade remedy provisions of China's accession agreement. More recently, it also appears that China has used arbitrary economic and trade measures, including antidumping and countervailing duty investigations, as a form of economic coercion designed to achieve China's political goals. Obvious examples include MOFCOM's antidumping and countervailing duty investigations of imports of Australian barley and Australian wine.

In certain recent investigations of U.S. imports, China has determined — without legal or factual support — that costs and prices in certain U.S. markets are distorted, and therefore unusable, because of so-called "non-market situations." For example, in four final antidumping determinations on imports of n-propanol, polyphenylene sulfide, ethylene propylene diene monomer and polyvinyl chloride from the United States in 2020 and 2021, China found a "non-market situation" in certain energy sectors in the United States. However, these findings were made without defining the term "non-market situation" or identifying any legal basis in China's law to make these findings. Separately, in the final countervailing duty determination on imports of n-propanol from the United States, China also found that alleged subsidies to the U.S. oil and gas sector automatically passed through to petrochemical products without providing the analysis required by the Subsidies Agreement.

### Tariff-Rate Quota Administration for Agricultural Commodities

Market access promised through the tariff-rate quota (TRQ) system set up pursuant to China's WTO accession agreement has yet to be fully realized as of December 2022. Due to China's poorly defined criteria for applicants, unclear procedures for distributing TRQ allocations and failure to announce quota allocation and reallocation results, traders are unsure of available import opportunities and producers worldwide have reduced market access opportunities. As a result, China's TRQs for wheat,

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corn and rice seldom fill even when they are oversubscribed. For example, from 2020 to 2022, China's corn imports significantly exceeded TRQ levels, but the TRQ issuance, application and allocation processes lacked transparency, and large state-owned enterprises in China appear to have been the only beneficiaries of the increased imports.

In December 2016, the United States launched a WTO case challenging China's administration of TRQs for wheat, corn and rice. Consultations took place in February 2017. A WTO panel was established to hear the case at the United States' request in September 2017, and 17 other WTO Members joined as third parties. The panel issued its decision in April 2019, ruling that China's administration of tariff-rate quotas for wheat, corn and rice was WTO-inconsistent. In July 2021, the United States submitted a request for authorization to suspend concessions and other obligations pursuant to Article 22 of the DSU on the ground that China had failed to bring its measures into compliance with its WTO obligations. After China objected to this request, the matter was referred to arbitration in accordance with Article 22 of the DSU. The arbitration is currently suspended, and the United States continues to closely monitor China's ongoing administration of the tariff-rate quotas for wheat, corn and rice.

As part of the Phase One Agreement, China agreed that, from December 31, 2019, its administration of TRQs for wheat, corn and rice would conform to its WTO obligations. In addition, China agreed to make specific improvements to its administration of the wheat, corn and rice TRQs, including with regard to the allocation methodology, and to the treatment of non-state trading quota applicants. China also committed to greater transparency. To date, however, China has not demonstrated full implementation of these commitments.

### VAT Rebates for Agricultural Commodities

The Chinese government attempted to manage imports of primary agricultural commodities by

raising or lowering the value-added tax (VAT) rebate to manage domestic supplies. China sometimes reinforces its domestic objectives by imposing or retracting VATs. These practices have caused tremendous distortion and uncertainty in the global markets for wheat, corn and soybeans, as well as intermediate processed products of these commodities.

## ENVIRONMENTAL POLICIES

### Import Ban on Scrap Materials

Currently, China restricts almost all imports of unprocessed scrap materials. China only allows imports of certain processed scrap materials, including "recycled raw materials" such as copper, steel, aluminum and brass that meet purity standards, pelletized scrap plastic and pulped scrap paper.

Since 2017, China has issued numerous measures that limit or ban imports of most scrap and recovered materials, such as certain types of plastic, paper and metals. China has also employed import licensing and inspection measures to restrict imports of scrap materials contrary to international standards and practices. Notably, China does not universally apply similar restrictions to domestic processors of domestically sourced scrap and recovered materials.

In 2020, China amended the *Law on the Prevention and Control of Environmental Pollution by Solid Waste*. This amended law is designed to "basically realize zero imports of solid waste."

U.S. exports to China of the unprocessed scrap and recovered materials covered by China's restrictive measures totaled \$479 million in 2016, the year before China started to pursue its more restrictive policies. U.S. exports of these materials to China have been significantly reduced.

In addition to impacting the global market for scrap and recovered materials, the tightened restrictions

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have raised the costs of recycling in the United States, leading some communities to end recycling programs. While markets for U.S. scrap and recovered materials have shifted, taking up some of the lost exports to China, significant amounts of U.S. scrap materials have not found new buyers, leading to increased landfilling and incineration and increased demand for virgin materials globally.

### Import Ban on Remanufactured Products

China prohibits the importation of remanufactured products, which it typically classifies as used goods. China also maintains restrictions that prevent remanufacturing process inputs (known as cores) from being imported into China's customs territory, except special economic zones. These import prohibitions and restrictions undermine the development of industries in many sectors in China, including mining, agriculture, healthcare, transportation and communications, because companies in these industries are unable to purchase high-quality, lower-cost remanufactured products produced outside of China. Nevertheless, China is apparently prepared to pay this price in order to limit imports of remanufactured goods.

### LABOR

The Chinese government represses internationally recognized labor rights and does not adequately enforce existing prohibitions on forced labor. China has been the subject of international attention for its forced labor practices, especially in the Xinjiang Uyghur Autonomous Region (Xinjiang), where China has arbitrarily detained more than one million Uyghurs and other mostly Muslim minorities. Victims, news media and think tanks report that factories, including factories producing cotton and tomato products, frequently engage in coercive recruitment, limit workers' freedom of movement and communication and subject workers to constant surveillance, retribution for religious beliefs, exclusion from community and social life, and isolation. It is currently estimated that hundreds of thousands of Uyghurs, ethnic Kazakhs and members

of other Muslim minority groups are being subjected to forced labor in China following detention. Based on the U.S. Government's independent analysis of these sources, the U.S. Government has taken several actions to address forced labor and other human rights abuses in Xinjiang.

U.S. Customs and Border Protection has issued several withhold release orders (WROs) pursuant to section 307 of the Tariff Act of 1930 based on information that reasonably indicates the use of detainee or prison labor and situations of forced labor in Xinjiang, including a region-wide WRO on cotton and tomato products from Xinjiang in January 2021. The scope of this WRO includes cotton and tomatoes and downstream products that incorporate these products as inputs.

In July 2021, the United States issued an updated Xinjiang Supply Chain Business Advisory for U.S. businesses whose supply chains run through Xinjiang, China. The advisory calls urgent attention to U.S. businesses' supply chain risks and identifies serious investing and sourcing considerations for businesses and individuals with exposure to entities engaged in forced labor and other human rights abuses linked to Xinjiang. The advisory also describes U.S. government actions taken to date to counter the use of forced labor in Xinjiang and to prohibit the importation of goods produced in whole or in part with forced labor or convict labor.

In December 2021, President Biden signed into law the Uyghur Forced Labor Prevention Act (UFLPA), which, among other things, establishes a rebuttable presumption that the importation of goods from Xinjiang is prohibited under section 307 of the Tariff Act of 1930. This rebuttable presumption took effect in June 2022.

In advance of the rebuttable presumption taking effect, several U.S. agencies hosted a public hearing on the use of forced labor in China. Witnesses, included private individuals, industry associations, consultancy and risk-management companies, civil society organizations, non-governmental



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organizations (NGOs), labor unions and others who shared their views on potential measures to prevent the importation of goods mined, produced or manufactured wholly or in part with forced labor in China into the United States. The UFLPA's Strategy, which was published in June 2022, takes this witness testimony into account. The main components of the Enforcement Strategy include (1) an assessment of the risk of importing goods made with forced labor in China, (2) the development of the UFLPA Entity List and descriptions of forced-labor schemes, (3) the consideration of efforts, initiatives and tools to identify and trace the origin of goods, (4) a description of relevant legal authorities and tools to prevent entry of violative goods, (5) a description of resources, (6) the development of importer guidance and (7) the development of a coordination plan with NGOs and the private sector.

In June 2022, President Biden issued the Memorandum on Combating Illegal, Unreported, and Unregulated Fishing and Associated Labor Abuses. The Memorandum notes that, if left unchecked, IUU fishing and associated labor abuses threaten the livelihoods and human rights of fishers around the world and will undermine U.S. economic competitiveness, national security and fishery sustainability. It also notes that this behavior will exacerbate the environmental and socioeconomic effects of climate change. In December 2022, the Treasury Department sanctioned individuals associated with China's distant water fishing vessels for serious human rights abuse, including forced labor, of workers aboard these vessels.

It also remains concerning that China does not adhere to certain other internationally recognized labor standards, including the freedom of association and effective recognition of the right to collective bargaining. Chinese law provides for the right to associate and form a union, but does not allow workers to form or join an independent union of their own choosing. Unions must affiliate with the official All-China Federation of Trade Unions (ACFTU), which is under the direction of the CCP. Workers at enterprises in China are required to

accept the ACFTU as their representative. They cannot instead select another union or decide not to have any union representation. Only collective bargaining through the ACFTU is permitted, and there is no legal obligation for an employer to bargain in good faith. Striking is also prohibited.

## SANITARY AND PHYTOSANITARY MEASURES

### Overview

China remains a difficult and unpredictable market for U.S. agricultural exporters, largely because of inconsistent enforcement of regulations and selective intervention in the market by China's regulatory authorities. China's unwillingness to routinely follow science-based, international standards and guidelines and to apply regulatory enforcement in a transparent and rules-based manner further complicates and impedes agricultural trade.

### Agricultural Biotechnology Approvals

The Chinese regulatory approval process for agricultural biotechnology products creates significant uncertainty among developers and traders, slowing commercialization of products and creating adverse trade impacts, particularly for U.S. exports of corn, soy and alfalfa. It continues to be inordinately lengthy, causing uncertainty among traders and limiting trade, particularly for U.S. exports of corn and alfalfa. In addition, the asynchrony between China's biotechnology product approvals and the product approvals made by other countries has widened considerably in recent years.

For many years, biotechnology product approvals by China's regulatory authorities mainly materialized only after high-level political intervention. In the Phase One Agreement, the United States was able to secure China's commitment to implement a transparent, predictable, efficient and science- and risk-based system for the review of products of agricultural biotechnology. The agreement also called for China to improve its regulatory

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authorization process for agricultural biotechnology products, including by completing reviews of products for use as animal feed or further processing within an average of no more than 24 months and by improving the transparency of its review process. China also agreed to work with importers and the U.S. government to address situations involving low-level presence of genetically engineered (GE) materials in shipments. In addition, China agreed to establish a regulatory approval process for all food ingredients derived from genetically modified microorganisms (GMMs), rather than continue to restrict market access to GMM-derived enzymes only.

In 2021, China held two meetings of the National Biosafety Committee (NBC), the body responsible for biosafety approval of GE products. In total, China issued new biosafety certificates for only two GE crops for import, both of which were cotton products. China also renewed existing biosafety certificates that were due to expire for 32 GE crops for import. In 2022, China held an NBC meeting in March that led only to one new biosafety certificate for a crop for import, a soybean product, while renewing existing certificates for 10 GE crops for import. The NBC also held a meeting in December resulting in the issuance of new biosafety certificates for six products that had been developed by U.S. companies. Three of them were cotton products, two of them were alfalfa products, and one of them was a canola product. All of the companies' applications had been pending for well over 24 months, including three for more than 10 years and two others for more than five years.

Meanwhile, since 2021, China has issued numerous approvals and renewals for Chinese developers. China has issued approximately 165 new biosafety certificates for products intended for domestic cultivation, including 126 new GE cotton products, eight new GE corn products and two new GE soybean product.

China's approach to agricultural biotechnology remains among the most significant commitments

under the Phase One Agreement for which China has not demonstrated full implementation. There remains a significant lack of transparency regarding the procedures for convening meetings of the NBC, including regarding dates and agenda items for these meetings and the process for notifying applicants of outcomes and for soliciting additional information to support product applications. While the NBC is required to meet at least two times each year, the meetings are not held pursuant to a regular schedule, and information about the meetings is not widely shared with the public in a transparent and predictable manner. In addition, in conducting its approval process, China continues to ask for information that is not relevant to a product's intended use or information that applicants have previously provided. For this and other reasons, China has not reduced the average time for its approval process for agricultural biotechnology products for feed or further processing to no more than 24 months, as it had committed to do, even when taking into account the approvals issued following the December 2022 NBC meeting.

### Food Safety Law

China's ongoing implementation of its 2015 *Food Safety Law* has led to the introduction of myriad new measures. These measures include exporter facility and product registration requirements for almost all food and agricultural products. Overall, China's notification of these measures to the WTO TBT Committee and the WTO Sanitary and Phytosanitary Committee (SPS Committee) has been uneven.

Despite facing strong international opposition and agreeing to a two-year implementation delay of an official certification requirement for all food products, China's regulatory authorities issued draft measures for public comment in November 2019 that would require the registration of all foreign food manufacturers. The United States submitted comprehensive written comments on the draft measures to China's regulatory authorities. The United States also raised concerns about them before the WTO TBT Committee and the WTO SPS

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Committee. More than 15 WTO Members supported the concerns raised by the United States.

In April 2021, China's regulatory authorities issued final versions of these measures, now known as Decrees 248 and 249, with an implementation date of January 1, 2022. In correspondence delivered to foreign missions in Beijing in September 2021, China's regulatory authorities laid out a non-transparent, multi-tier system where producers of certain products are required to be registered by foreign regulatory authorities, while producers of other products are eligible to self-register. Decrees 248 and 249 also establish new labeling and conformity assessment requirements.

These Decrees and similar prior measures continue to place excessive strain on food producers, traders and exporting countries' regulatory authorities, with no apparent added benefit to food safety. They instead provide China with a tool to control food imports, as decided by China's state planners, and to retaliate against food producers from countries whose governments challenge Chinese government policies or practices in non-trade areas.

According to China's customs authorities, by July 1, 2023, certain foreign food producers will be required to upload additional detailed information to China's online facility registration portal, and foreign regulatory authorities will be required to review and certify the uploaded information. These tasks are fundamentally beyond the traditional roles of regulatory authorities. If implemented, these new requirements will impose even greater burdens on food manufacturers and food safety regulatory authorities and will therefore pose a new threat to food trade with China.

In the Phase One Agreement, China committed that it would not implement food safety regulations that are not science- or risk-based and that it would only apply food safety regulations to the extent necessary to protect human life or health. China also agreed to certain procedures for registering U.S. facilities that produce various food products. Despite repeated

U.S. requests for clarification regarding the relationship between the facility registration procedures set forth in the Phase One Agreement and the requirements of Decrees 248 and 249, China has not provided sufficient information.

### Poultry

Starting in February 2022, the United States notified China of detections of high pathogenicity avian influenza (HPAI) in multiple U.S. states. In the ensuing months, several states recovered from these detections, and they were deemed HPAI-free by the United States. The United States submitted reports to China for these states and requested approval to resume exporting poultry from these states to China. China has yet to confirm the restoration of market access.

In the Phase One Agreement, China agreed to maintain measures consistent with the World Organization for Animal Health (WOAH) guidelines for future outbreaks of avian influenza. China also agreed to sign a regionalization protocol within 30 days of entry into force of the agreement, which it did, to help avoid unwarranted nationwide animal disease restrictions in the future. This protocol requires that China resume acceptance of poultry imports from states with HPAI detections within five days of receiving a U.S. report that the states are HPAI-free.

### Beef

In May 2017, China committed to allow the resumption of U.S. beef shipments into its market consistent with international food safety and animal health standards. However, China back-tracked one month later and insisted that it would retain certain conditions relating to veterinary drugs, growth promotants and animal health that were inconsistent with international food safety and animal health standards. For example, China insisted on maintaining a zero-tolerance ban on the use of beta-agonists and synthetic hormones commonly used by global cattle producers under

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strict veterinary controls and following Codex Alimentarius (Codex) guidelines. Beef from only about three percent of U.S. cattle qualified for importation into China under these conditions.

In the Phase One Agreement, China agreed to expand the scope of U.S. beef products allowed to be imported, to eliminate age restrictions on cattle slaughtered for export to China and to recognize the U.S. beef and beef products' traceability system. China also agreed to establish maximum residue levels (MRLs) for three synthetic hormones legally used for decades in the United States consistent with Codex standards and guidelines. Where Codex standards and guidelines do not yet exist, China agreed to use MRLs established by other countries that have performed science-based risk assessments.

While China confirmed to the United States that it had adopted Codex-consistent MRLs for use of the three synthetic hormones in beef, China still has not published the MRLs. The lack of publication contributes to regulatory ambiguity for U.S. beef producers and traders, who remain uncertain regarding which products will be allowed for import into China. China's failure to publish the MRLs is another example of China's inadequate implementation of the Phase One Agreement.

### Pork

China maintains an approach to U.S. pork that is inconsistent with international standards, limiting the potential of an important export market given China's growing meat consumption and major shortages of domestic pork due to African swine fever. Specifically, China bans the use of certain veterinary drugs and growth promotants instead of accepting the MRLs set by Codex.

As part of the Phase One Agreement, China agreed to broaden the list of pork products that are eligible for importation, including processed products such as ham and certain types of offal that are inspected by the U.S. Department of Agriculture's Food Safety

and Inspection Service for both domestic and international trade. China also agreed to conduct a risk assessment for ractopamine in swine and cattle as soon as possible and to establish a joint working group with the United States to discuss next steps based on the risk assessment. To date, China has not completed the risk assessment and therefore has not yet made any progress on next steps based on the risk assessment, which will need to include the establishment of MRLs or import tolerances.

## TECHNICAL BARRIERS TO TRADE

### Standards

The Chinese government continues to pursue improvements in its standards system, including by moving from a government-led system to one that incorporates both government guidance and "bottom up" input from the marketplace. At the same time, the Chinese government also continues to limit foreign participation in standards setting and, at times, pursue unique national standards for strategic reasons.

In January 2018, China's revised *Standardization Law* entered into force. Since then, China has issued numerous implementing measures, some of which contain positive references to the ability of foreign-invested enterprises to participate in China's standardization activities and purport to recognize the value of international standards. Unfortunately, many of these implementing measures cause concern for U.S. industry as they appear to focus on the development of Chinese standards without sufficient consideration being given to existing, internationally developed standards. In addition, they do not explicitly provide that all foreign stakeholders may participate on equal terms with domestic competitors in all aspects of the standardization process, and they fall short of explicitly endorsing internationally accepted best practices.

As these implementing measures have been issued, China's existing technical committees have

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continued to develop standards. U.S. and other foreign companies have reported that they are often not permitted to participate in these domestic standards-setting processes, and even in technical committees where participation has been possible for some foreign stakeholders, it has typically been on terms less favorable than those applicable to their domestic competitors. For example, the technical committee for cybersecurity standards (known as TC-260) allows foreign companies to participate in standards development and setting, with several U.S. and other foreign companies being allowed to participate in some of the TC-260 working groups. However, foreign companies are not universally allowed to participate as voting members, and they report challenges to participating in key aspects of the standardization process, such as drafting. They also remain prohibited from participating in certain TC-260 working groups, such as the working group on encryption standards.

Over the years, U.S. stakeholders have also reported that, in some cases, Chinese government officials have pressured foreign companies seeking to participate in the standards-setting process to license their technology or intellectual property on unfavorable terms. In addition, China has continued to pursue unique national standards in a number of high technology areas where international standards already exist. The United States continues to press China to address these specific concerns, but to date this bilateral engagement has yielded minimal progress.

Notably, U.S. concerns about China's standards regime are not limited to the implications for U.S. companies' access to China's market. China's ongoing efforts to develop unique national standards aims eventually to serve the interests of Chinese companies seeking to compete globally, as the Chinese government's vision is to use the power of its large domestic market to influence the development of international standards. The United States remains very concerned about China's policies with regard to standards and has expressed, and will

continue to express, concerns to China bilaterally and multilaterally as China continues to develop and issue implementing measures for its revised *Standardization Law*.

In October 2021, the Central Committee of the Chinese Communist Party and the State Council issued the *Outline for the Development of National Standardization*, which set targets for China's standardization system. It reiterates the desire for China's standardization system to be both guided by the government and driven by the market. It also calls for China's standardization system to refocus from quantity to quality and to shift from a domestic focus to an equal domestic and international focus. In addition, it calls for standards to support not just a particular industry, but also the economy and society as a whole.

The October 2021 *Outline for the Development of National Standardization* is partly based on an initiative that China announced in 2019, known as *China Standards 2035*. A lack of transparency with regard to the initiative's findings is troubling, particularly given longstanding global concerns about inadequate foreign participation in China's standards-setting processes, China's use of standards that differ from international standards without basis and certain licensing practices in China's standards-setting processes.

### Cosmetics

Over the past several years, the United States and U.S. industry have engaged with China's Food and Drug Administration (CFDA) and its successor, the National Medical Products Administration (NMPA), to highlight serious concerns with China's regulation of cosmetics. Currently, the regulation of cosmetics in China is governed by the Cosmetics Supervision and Administration Regulation (CSAR), which was issued in June 2020 and entered into effect in January 2021. The United States has repeatedly raised serious concerns with the CSAR and its numerous implementing measures, both bilaterally and in meetings of the WTO TBT Committee and the

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Council for Trade in Goods, as have several other WTO Members.

The CSAR implementing measures contain provisions that would require companies to disclose full product formulations, ingredient suppliers, manufacturing methods, claims and safety data to both NMPA and local agents in China when products are registered or notified. In addition, these measures require companies to publish claims abstracts that may contain trade secrets and confidential business information on NMPA's website. The United States has expressed concern to China that its regulators are applying the same approach to general and special cosmetics as is used with drugs and medical devices, despite the generally lower risk in cosmetics. China's filing and registration requirements for cosmetics also significantly diverge from those in other major markets and do not align with international standards, making compliance very burdensome for importers.

The United States is particularly concerned that the CSAR implementing measures do not provide adequate assurances as to how undisclosed information, trade secrets and confidential business information will be protected from unauthorized disclosure. China also has not addressed requests from the United States and cosmetics right holders that NMPA provide a legally enforceable mechanism to monitor and protect the trade secrets and confidential business information typically identified by companies in their cosmetics filings.

In addition, China continues to require duplicative in-country testing to assess many product and ingredient safety and performance claims, without considering the applicability of international data or other means of establishing conformity. In response to U.S. concerns, China indicated that it would allow foreign laboratories with facilities in China to conduct its required testing. However, this change does not address the burden of China's requirement, which does not consider the applicability of testing conducted via internationally recognized

laboratories outside of China, as well as other means used by foreign regulators and industries to assess the conformity of product and ingredient safety and performance claims.

The United States also questions China's assertion that its cosmetics good manufacturing practices (GMP) requirements provide equal treatment for imported and domestic general and special cosmetics. If the government of a cosmetics importer does not issue GMP or manufacturing export certificates, the only means that China provides to establish conformity with China's GMP for general cosmetics is animal testing. The United States and other WTO Members have made repeated requests that China consider the many alternative means available to establish GMP conformity, including utilizing second party or third party certificates based upon the ISO 22716 Cosmetics GMP Guidelines. China also provides no means for exemptions regarding GMP for imported special cosmetics.

In sum, after years of the United States engaging with China bilaterally and via the International Cooperation on Cosmetics Regulation, the WTO and other fora to share views and expertise regarding the regulation of cosmetics, China has not yet addressed key U.S. concerns, including the use of international standards and good regulatory practices to facilitate cosmetics conformity assessment and avoid discriminatory treatment, nor has it provided confidence that U.S. intellectual property will be protected. Until China addresses these concerns, many U.S. companies will be impeded in accessing, or simply unable to access, the China market.

### INVESTMENT RESTRICTIONS

China seeks to protect many domestic industries through a restrictive investment regime. Many aspects of China's current investment regime continue to cause serious concerns for foreign investors. For example, China's *Foreign Investment Law* and implementing regulations, both of which



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entered into force in January 2020, perpetuate separate regimes for domestic investors and investments and foreign investors and investments and invite opportunities for discriminatory treatment.

There has also been a lack of substantial liberalization of China's investment regime, evidenced by the continued application of prohibitions, foreign equity caps and joint venture requirements and other restrictions in certain sectors. China's most recent version of its *Foreign Investment Negative List*, which entered into force in January 2022, leaves in place significant investment restrictions in a number of areas important to foreign investors, such as key services sectors, agriculture, certain extractive industries and certain manufacturing industries. With regard to services sectors in particular, China maintains prohibitions or restrictions in key sectors such as cloud computing services and other Internet-related services, telecommunications services, film production and film distribution services, and video and entertainment software services.

China's *Foreign Investment Law*, implementing regulations and other related measures suggest that China is pursuing the objective of replacing its case-by-case administrative approval system for a broad range of investments with a system that would only be applied to "restricted" sectors. However, it currently remains unclear whether China is fully achieving that objective in practice. Moreover, even for sectors that have been liberalized, the potential for discriminatory licensing requirements or the discriminatory application of licensing processes could make it difficult to achieve meaningful market access. In addition, the potential for a new and overly broad national security review mechanism, and the increasingly adverse impact of China's *Cybersecurity Law*, *Data Security Law* and *Personal Information Protection Law* and related implementing measures, including ones that unduly restrict cross-border data flows and impose data localization requirements, have serious negative implications for foreign investors and investments.

Foreign companies also continue to report that Chinese government officials may condition investment approval on a requirement that a foreign company transfer technology, conduct research and development (R&D) in China, satisfy performance requirements relating to exportation or the use of local content or make valuable, deal-specific commercial concessions.

Over the years, the United States has repeatedly raised concerns with China about its restrictive investment regime. Given that China's investment restrictions place pressure on U.S. companies to transfer technology to Chinese companies, they were a focus of USTR's Section 301 investigation. The responsive actions taken by the United States in that investigation are intended in part to address this concern.

### COMPETITION POLICIES

In March 2018, as part of a major government reorganization, China announced the creation of the State Administration for Market Regulation (SAMR), a new agency that incorporated the former anti-monopoly enforcement authorities from the National Development and Reform Commission (NDRC), MOFCOM and the State Administration of Industry and Commerce (SAIC) into one of its bureaus. It had been hoped that more centralized anti-monopoly enforcement would lead to policy adjustments that address the serious concerns raised by the United States and other WTO Members in this area, but to date it does not appear to have led to significant policy adjustments.

In November 2021, China elevated the status of SAMR's anti-monopoly bureau, by designating a vice minister as its official-in-charge and re-naming it the National Anti-monopoly Bureau. It remains to be seen how this elevated status will impact anti-monopoly policy enforcement in China.

In June 2022, the National People's Congress Standing Committee passed amendments to the *Anti-Monopoly Law*. These amendments gave SAMR

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expanded authority to evaluate and investigate potential anti-competitive behavior, as well as the authority to impose higher fines, up to 50 percent of an alleged violator's annual sales, in order to punish actions determined to be anti-competitive.

As previously reported, China's implementation of the *Anti-monopoly Law* has generated various concerns. A key concern is the extent to which the *Anti-monopoly Law* is applied to foreign companies as opposed to state-owned enterprises. While Chinese regulatory authorities have clarified that the *Anti-monopoly Law* does apply to state-owned enterprises, to date they have brought enforcement actions primarily against provincial government-level state-owned enterprises, rather than central government-level state-owned enterprises under the supervision of SASAC. In addition, provisions in the *Anti-monopoly Law* protect the lawful operations of state-owned enterprises and government monopolies in industries deemed nationally important. Many U.S. companies have cited selective enforcement of the *Anti-monopoly Law* against foreign companies seeking to do business in China as a major concern, and they have highlighted the comparatively limited enforcement of this law against state-owned enterprises.

Another concern expressed by U.S. industry is that remedies imposed on U.S. and other foreign-owned companies in merger cases do not always appear to be aimed at restoring competition. Instead, these remedies seem to be designed to further China's industrial policy goals, such as when the regulatory authorities seek to require the transfer of technology or a reduction in licensing fees for intellectual property.

U.S. industry has also expressed concern about insufficient predictability, procedural fairness and transparency in *Anti-monopoly Law* investigative processes of foreign companies. For example, U.S. industry reports that, through the threat of steep fines and other penalties, China's regulatory authorities have pressured foreign companies to "cooperate" in the face of unspecified allegations

and have discouraged or prevented foreign companies from bringing counsel to meetings. In addition, U.S. companies continue to report that the Chinese regulatory authorities sometimes make "informal" suggestions regarding appropriate company behavior, including how a company is to behave outside China, strongly suggesting that a failure to comply may result in investigations and possible punishment. More recently, high-level policy statements suggest increased *Anti-monopoly Law* enforcement where technology owned or controlled by foreign companies allegedly implicates national security concerns or implicates technology being prioritized for indigenous innovation in China.

In 2021, a local intermediate court in China issued a decision finding that certain intellectual property developed by a foreign company was an "essential facility" and that the foreign company's failure to license this intellectual property to particular Chinese companies, the plaintiffs in a series of related cases, constituted an abuse of dominance exposing the foreign company to civil liability and mandatory licensing requirements – notwithstanding the foreign company's existing licenses to other Chinese companies. This legal decision, currently on appeal to China's Supreme People's Court, raises concerns that China's regulatory authorities may target foreign patent holders for *Anti-monopoly Law* enforcement, especially in areas of technology being prioritized for indigenous innovation in China.

State-directed mergers of state-owned enterprises are also a concern. SAMR does not provide sufficient information about decisions made regarding these "administrative mergers," so it is not clear how SAMR evaluates them. It is possible for these transactions to provide the merged company with excessive market power that can be used anti-competitively in China and in markets around the world.

Given the state-led nature of China's economy, the need for careful scrutiny of anti-competitive government restraints and regulation is high. The *Anti-monopoly Law's* provisions on the abuse of

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administrative (i.e., government) power are potentially important instruments for reducing the government's interference in markets and for promoting the establishment and maintenance of increasingly competitive markets in China. The State Council's adoption of the *Opinions on Establishing a Fair Competition Review System* in 2016 reflects a useful widening of oversight by China's anti-monopoly enforcement agencies over undue government restraints on competition and anti-competitive regulation of competition. However, implementing measures contain a broad list of exemptions, including for national economic security, cultural security, national defense construction, poverty alleviation, disaster relief and general "public interest" considerations. It appears unlikely that the Fair Competition Review System established by the *Opinions on Establishing a Fair Competition Review System* will be able to achieve its stated goals, given China's continuing efforts to ensure a strong role for the state in China's economy.

### EXPORT POLICIES

#### Export Restraints

Over the years, China has deployed a combination of export restraints, including export quotas, export licensing, minimum export prices, export duties and other restrictions, on a number of raw material inputs where it holds the leverage of being among the world's leading producers. In many instances, through these export restraints, it appears that China has been able to provide substantial economic advantages to a wide range of downstream producers in China at the expense of foreign downstream producers, while creating pressure on foreign downstream producers to move their operations, technologies and jobs to China.

In 2013, China removed its export quotas and duties on several raw material inputs of key interest to the U.S. steel, aluminum and chemicals industries after the United States won a dispute settlement case

against China at the WTO. In 2014, the United States won a second WTO case, focusing on China's export restraints on rare earths, tungsten and molybdenum, which are key inputs for a multitude of U.S.-made products, including hybrid automobile batteries, wind turbines, energy-efficient lighting, steel, advanced electronics, automobiles, petroleum and chemicals. China removed those export restraints in 2015. In 2016, the United States launched a third WTO case challenging export restraints maintained by China. The challenged export restraints include export quotas and export duties maintained by China on various forms of 11 raw materials, including antimony, chromium, cobalt, copper, graphite, indium, lead, magnesia, talc, tantalum and tin. These raw materials are key inputs in important U.S. manufacturing industries, including aerospace, automotive, construction and electronics. While China appears to have removed the challenged export restraints, the United States continues to monitor the situation. In the United States' view, it is deeply concerning that the United States was forced to bring multiple cases to address the same obvious WTO compliance issues.

A more recent concern involves China's potential regulation of rare earth exports under its export controls regime. In this regard, the Ministry of Industry and Information Technology issued the draft *Regulations on the Administration of Rare Earths* for public comment in January 2021, and one of the provisions in the draft measure provides that rare earth exporters need to abide by laws and regulations in the area of export controls.

In November 2021, China announced an export ban on certain fertilizers. Despite repeated requests from its trading partners to lift this export ban and help address growing international concern over rising commodity prices and disrupted global supply chains, China continues to impose this export ban.

Meanwhile, U.S. companies report that China has also instituted export restrictions on corn starch. To date, however, the Chinese government still has not published an official notice.

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### VAT Rebates and Related Policies

As in prior years, in 2021, the Chinese government attempted to manage the export of many primary, intermediate and downstream products by raising or lowering the VAT rebate available upon export. China sometimes reinforces its objectives by imposing or retracting export duties. These practices have caused tremendous disruption, uncertainty and unfairness in the global markets for some products, particularly downstream products for which China is a leading world producer or exporter, such as products made by the steel, aluminum and soda ash industries. These practices, together with other policies, such as excessive government subsidization, have also contributed to severe excess capacity in these same industries.

An apparently positive development took place at the July 2014 S&ED meeting, when China committed to improve its VAT rebate system, including by actively studying international best practices, and to deepen communication with the United States on this matter, including regarding its impact on trade. Once more, however, this promise remains unfulfilled. To date, China has not made any movement toward the adoption of international best practices.

### INTELLECTUAL PROPERTY PROTECTION

#### Overview

After its accession to the WTO, China undertook a wide-ranging revision of its framework of laws and regulations aimed at protecting the intellectual property rights of domestic and foreign right holders, as required by the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (the TRIPS Agreement). Despite various plans and directives issued by the State Council, inadequacies in China's intellectual property protection and enforcement regime continue to present serious barriers to U.S. exports and investment. As a result, China was again placed on the Priority Watch List in USTR's 2022 Special 301 Report. In addition, in

February 2022, USTR announced the results of its 2021 Review of Notorious Markets, which identifies online and physical markets that exemplify key challenges in the global struggle against piracy and counterfeiting and explains the harm not only to U.S. businesses, but also to U.S. workers. Several markets in China were among those named as notorious markets.

The Phase One Agreement addresses numerous longstanding U.S. concerns relating to China's inadequate intellectual property protection and enforcement. Specifically, the agreement requires China to revise its legal and regulatory regimes in a number of ways in the areas of trade secrets, pharmaceutical-related intellectual property, patents, trademarks and geographical indications. In addition, the agreement requires China to make numerous changes to its judicial procedures and to establish deterrent-level penalties. China must also take a number of steps to strengthen enforcement against pirated and counterfeit goods, including in the online environment, at physical markets and at the border.

China has published a number of draft measures for comment and issued some final measures relating to implementation of the intellectual property chapter of the Phase One Agreement. Notably, China amended the *Patent Law*, the *Copyright Law* and the *Criminal Law*. China has also reported increased enforcement actions against counterfeit medicines and increased customs actions against pirated and counterfeit goods. At the same time, China has outstanding work to finalize the draft measures that it has published and to publish other draft measures in accordance with the Intellectual Property Action Plan that it released in April 2020, such as certain patent, geographical indications and trade secret measures. In addition, China has yet to demonstrate that it has published data on enforcement actions online on a regular basis, increased enforcement actions against counterfeits with health and safety risks and at physical markets, increased training of customs personnel or ensured the use of only licensed software in government agencies and state-

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owned enterprises. The United States continues to monitor China's implementation of the intellectual property chapter of the Phase One Agreement, including the impact of the final measures that have been issued.

### Trade Secrets

Serious inadequacies in the protection and enforcement of trade secrets in China have been the subject of high-profile engagement between the United States and China in recent years. Several instances of trade secret theft for the benefit of Chinese companies have occurred both within China and outside of China. Offenders in many cases continue to operate with impunity. Particularly troubling are reports that actors affiliated with the Chinese government and the Chinese military have infiltrated the computer systems of U.S. companies, stealing terabytes of data, including the companies' proprietary information and intellectual property, for the purpose of providing commercial advantages to Chinese enterprises.

In high-level bilateral dialogues with the United States over the years, China has committed to issue judicial guidance to strengthen its trade secrets regime. China has also committed not to condone state-sponsored misappropriation of trade secrets for commercial use. In addition, the United States has urged China to make certain key amendments to its trade secrets-related laws and regulations, particularly with regard to a draft revision of the *Anti-unfair Competition Law*. The United States has also urged China to take actions to address inadequacies across the range of state-sponsored actors and to promote public awareness of trade secrets disciplines.

At the November 2016 JCCT meeting, China claimed that it was strengthening its trade secrets regime and bolstering several areas of importance, including the availability of evidence preservation orders and damages based on market value as well as the issuance of a judicial interpretation on preliminary injunctions and other matters. In 2016 and 2017,

China circulated proposed revisions to the *Anti-unfair Competition Law* for public comment. China issued the revised law in November 2017, effective January 2018. Despite improvements in the protection of trade secrets relative to prior law, the final measure reflects a number of missed opportunities for the promotion of effective trade secrets protection. China subsequently amended the *Anti-unfair Competition Law*, the *Foreign Investment Law* and the *Administrative Licensing Law*, but the amendments still do not fully address critical shortcomings in the scope of protections and obstacles to enforcement. In 2022, China published additional draft amendments to the *Anti-Unfair Competition Law*, but they contain few changes to the law's trade secrets provisions.

The Phase One Agreement significantly strengthens protections for trade secrets and enforcement against trade secret theft in China. In particular, the chapter on intellectual property requires China to expand the scope of civil liability for misappropriation beyond entities directly involved in the manufacture or sale of goods and services, to cover acts such as electronic intrusions as prohibited acts of trade secret theft and to shift the burden of proof in civil cases to the defendants when there is a reasonable indication of trade secret theft. It also requires China to make it easier to obtain preliminary injunctions to prevent the use of stolen trade secrets, to allow for initiation of criminal investigations without the need to show actual losses, to ensure that criminal enforcement is available for willful trade secret misappropriation and to prohibit government personnel and third party experts and advisors from engaging in the unauthorized disclosure of undisclosed information, trade secrets and confidential business information submitted to the government.

In 2020, China published various measures relating to civil, criminal and administrative enforcement of trade secrets. In September 2020, the Supreme People's Court issued the *Provisions on Several Issues Concerning the Application of Law in Civil Cases of Trade Secret Infringement and the*

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*Interpretation III on Several Issues Concerning the Application of Law in Handling Criminal Cases of Infringement of Intellectual Property Rights.* In September 2020, the Supreme People's Procuratorate (SPP) and the Ministry of Public Security (MPS) also issued the *Decision on Amendment of Docketing for Prosecution of Criminal Trade Secrets Infringement Cases Standards*. These measures relate to issues such as the scope of liability for trade secret misappropriation, prohibited acts of trade secret theft, preliminary injunctions and thresholds for initiations of criminal investigations for trade secret theft. In December 2020, the National People's Congress passed amendments to the *Criminal Law* that included changes to the thresholds for criminal investigation and prosecution and the scope of criminal acts of trade secret theft. The *Criminal Law* amendments require revisions to certain previously issued judicial interpretations and prosecution standards. However, two years after the passage of the *Criminal Law* amendments, these other measures remain unchanged, and implementation of the *Criminal Law* amendments therefore remains incomplete. The United States will continue to monitor the effectiveness of all of these measures.

### Bad Faith Trademark Registration

The continuing registration of trademarks in bad faith in China remains a significant concern. For example, so-called "trademark squatters" have attempted to take advantage of the fact that a genuine trademark owner has not yet registered its trademark in China by registering that trademark and then trying to sell it to the genuine trademark owner. Bad faith trademark registration also occurs when trademarks intending to deceive or confuse consumers are registered.

At the November 2016 JCCT meeting, China publicly noted the harm that can be caused by bad faith trademarks and asserted that it was taking further steps to combat bad faith trademark filings. Amendments to the *Trademark Law* made in 2019 and subsequent implementing measures require the

disallowance of bad faith trademark applications. However, implementation by China to date suggests that right holders remain insufficiently protected, as bad faith trademarks remain widespread and problems persist with the large number of inconsistent decisions and low rate of success for oppositions. As a result of these deficiencies, U.S. companies across industry sectors continue to face Chinese applicants registering their marks and "holding them for ransom" or seeking to establish a business building off of U.S. companies' global reputations. The Phase One Agreement requires China to address longstanding U.S. concerns regarding bad-faith trademark registration, such as by invalidating or refusing bad faith trademark applications. The United States will continue to monitor developments in this area of long-standing concern closely.

### Online Infringement

Online piracy continues on a large scale in China, affecting a wide range of industries, including those involved in distributing legitimate music, motion pictures, books and journals, software and video games. While increased enforcement activities have helped stem the flow of online sales of some pirated offerings, much more sustained action and attention is needed to make a meaningful difference for content creators and right holders, particularly small and medium-sized enterprises. In response to the COVID-19 pandemic, reports indicate that many infringers have moved online to distribute their pirated and counterfeit goods, which further increases the need for targeted and sustained enforcement measures in the online environment.

The United States has urged China to consider ways to create a broader policy environment to help foster the growth of healthy markets for licensed and legitimate content. The United States has also urged China to revise existing rules that have proven to be counterproductive.

At the November 2016 JCCT meeting, China agreed to actively promote electronic commerce-related



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legislation, strengthen supervision over online infringement and counterfeiting, and work with the United States to explore the use of new approaches to enhance online enforcement capacity. In December 2016 and November 2017, China published drafts of a new *E-Commerce Law* for public comment. In written comments, the United States stressed that the final version of this law should not undermine the existing notice-and-takedown system and should promote effective cooperation in deterring online infringement. In August 2018, China adopted its new *E-Commerce Law*, which entered into force in January 2019. This law was an opportunity for China to institute strong provisions on intellectual property protection and enforcement for its electronic commerce market, which is now the largest in the world. However, as finalized, the law instead introduced provisions that weaken the ability of right holders to protect their rights online and that alleviate the liability of China-based electronic commerce platforms for selling counterfeit and other infringing goods.

The Phase One Agreement requires China to provide effective and expeditious action against infringement in the online environment, including by requiring expeditious takedowns and by ensuring the validity of notices and counter-notifications. It also requires China to take effective action against electronic commerce platforms that fail to take necessary measures against infringement.

In May 2020, the National People's Congress issued the *Civil Code*, which included updated notice-and-takedown provisions. In September 2020, the SPC issued *Guiding Opinions on Hearing Intellectual Property Disputes Involving E-Commerce Platform* and the *Official Reply on the Application of Law in Network-Related Intellectual Property Infringement Disputes*. These measures relate to issues such as expeditious takedowns and the validity of notices and counter-notifications, but have only recently taken effect. In November 2020, the National People's Congress adopted long-pending amendments to the *Copyright Law*, including

provisions relating to increasing civil remedies for copyright infringement, new rights of public performance and broadcasting for producers of sound recordings, and protections against circumvention of technological protection measures. Right holders have welcomed these developments but have noted the need for effective implementation as well as new measures to address online piracy. The United States will closely monitor the impact of these measures going forward.

More recently, in August 2021, SAMR issued draft amendments to the *E-Commerce Law* for public comment. These draft amendments further attempt to address concerns that have been raised about procedures and penalties under China's notice-and-takedown system.

### Counterfeit Goods

Counterfeiting in China remains widespread and affects a wide range of goods. In April 2019, China amended its *Trademark Law*, effective November 2019, to require civil courts to order the destruction of counterfeit goods, but these amendments still do not provide the full scope of civil remedies for right holders. One of many areas of particular U.S. concern involves medications. Despite years of sustained engagement by the United States, China still needs to improve its regulation of the manufacture of active pharmaceutical ingredients to prevent their use in counterfeit and substandard medications. At the July 2014 S&ED meeting, China committed to develop and seriously consider amendments to the *Drug Administration Law* that will require regulatory control of the manufacturers of bulk chemicals that can be used as active pharmaceutical ingredients. At the June 2015 S&ED meeting, China further committed to publish revisions to the *Drug Administration Law* in draft form for public comment and to consider the views of the United States and other relevant stakeholders. In October 2017, China published limited draft revisions to the *Drug Administration Law* and stated that future proposed revisions to the

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remainder of this law would be forthcoming. Although the final *Drug Administration Law*, issued in August 2019, requires pharmaceuticals products and active pharmaceutical ingredients to meet manufacturing standards, it remains unclear how these requirements will be implemented or enforced.

The Phase One Agreement requires China to take effective enforcement action against counterfeit pharmaceuticals and related products, including active pharmaceutical ingredients, and to significantly increase actions to stop the manufacture and distribution of counterfeits with significant health or safety risks. The agreement also requires China to provide that its judicial authorities shall order the forfeiture and destruction of pirated and counterfeit goods, along with the materials and implements predominantly used in their manufacture. In addition, the agreement requires China to significantly increase the number of enforcement actions at physical markets in China and against goods that are exported or in transit. It further requires China to ensure, through third party audits, that government agencies and state-owned enterprises only use licensed software.

In August 2020, SAMR issued the *Opinions on Strengthening the Destruction of Infringing and Counterfeit Goods*, and the State Council amended the *Provisions on the Transfer of Suspected Criminal Cases by Administrative Organs for Law Enforcement*, which relate to the transfer of intellectual property cases from administrative authorities to criminal authorities. China has reported increased enforcement actions against counterfeit medicines and increased customs actions against pirated and counterfeit goods, but it also needs to show that it has increased enforcement actions against counterfeits with health and safety risks and at physical markets, increased training of customs personnel and ensured the use of only licensed software in government agencies and state-owned enterprises.

## PHARMACEUTICALS AND MEDICAL DEVICES

### Pharmaceuticals

For several years, the United States has pressed China on a range of pharmaceuticals issues. These issues have related to matters such as overly restrictive patent application examination practices, regulatory approvals that are delayed or linked to extraneous criteria, weak protections against the unfair commercial use and unauthorized disclosure of regulatory data, issues with the implementation of an efficient mechanism to resolve patent infringement disputes, and restrictions on receiving patent term extensions for unreasonable marketing approval delays. In particular, China's narrow definition of "new drug" as a drug that has not been marketed anywhere else before it is launched in China continues to have negative implications for China's provision of patent term extensions for unreasonable marketing approval delays and China's potential implementation of regulatory data protection, and it may indirectly pressure foreign companies to bring their products to China first regardless of patient demand or other important factors. While China has implemented some helpful reforms, the United States still has many of the same concerns with China's pharmaceutical market, especially as it pertains to treatment of foreign companies.

CFDA also issued several draft notices in 2017 setting out a conceptual framework to protect against the unfair commercial use and unauthorized disclosure of undisclosed test or other data generated to obtain marketing approval for pharmaceutical products. In addition, this proposed framework sought to promote the efficient resolution of patent disputes between right holders and the producers of generic pharmaceuticals. However, in 2018, CFDA's successor agency, NMPA, issued draft *Drug Registration Regulations* and draft implementing measures on drug trial data that would preclude or condition the duration of regulatory data protection

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on whether clinical trials and first marketing approval occur in China. Subsequently, China issued a revised *Drug Administration Law* in 2019, followed by NMPA's revised draft *Drug Registration Regulations* in 2020 and NMPA's revised draft *Drug Administration Law Implementing Regulations* in 2021. Despite the opportunities that these revised draft measures afforded China's regulatory authorities, the concerning limitations on regulatory data protection have not been removed.

Since 2018, volume-based procurement has presented a new market access complication for foreign suppliers of pharmaceuticals, largely because of the opaque and unpredictable nature of the bidding processes. In November 2018, a National Drug Centralized Procurement Pilot Scheme was launched. Then, in January 2019, the State Council issued a Pilot Plan for National Centralized Drug Procurement and Use. In December 2021, the National Healthcare Security Administration published the 2021 edition of its annual National Reimbursement Drug List, which became effective on January 1, 2022. U.S. industry also cites the need for increased transparency and greater harmony between national and provincial bidding processes as well as a greater emphasis on a competitive, market-based approach to evaluating a product's value and relevant bids.

As part of the Phase One Agreement, the two sides agreed that China would establish a nationwide mechanism for the early resolution of potential pharmaceutical patent disputes that covers both small molecule drugs and biologics, including a cause of action to allow a patent holder to seek expeditious remedies before the marketing of an allegedly infringing product. The United States has been working closely with U.S. industry to monitor developments and to ensure that China's new system works as contemplated. Separately, the agreement also provides for patent term extensions to compensate for unreasonable patent and marketing approval delays that cut into the effective patent term as well as for the use of supplemental data to meet relevant patentability criteria for

pharmaceutical patent applications. The United States and China agreed to address data protection for pharmaceuticals in future negotiations.

In October 2020, China amended the *Patent Law* to provide for patent term extensions for unreasonable patent and marketing approval delays, and it also added a mechanism for the early resolution of potential patent disputes, known as patent linkage. Implementing measures for the patent linkage mechanism were issued in July 2021, as NMPA and CNIPA jointly issued the *Trial Implementation Measures for the Mechanism for Early Resolution of Drug Patent Disputes* and the Supreme People's Court issued the *Regulations on Several Issues Concerning the Application of Law in the Trial of Civil Patent Disputes Related to Drug Registration Application*. In 2021 and 2022, CNIPA issued draft implementing rules for the amended *Patent Law* and drafts of amendments to the *Patent Examination Guidelines*. Among other things, U.S. right holders have expressed concern about China's implementation of patent term extensions for unreasonable marketing approval delays, including China's use of unfair localization requirements and limits on the type of protection provided. Going forward, the United States will continue to monitor closely China's progress in implementing its commitments, with regard to both patent term extensions for unreasonable patent and marketing approval delays and the patent linkage mechanism.

### Medical Devices

For many years, working closely with U.S. industry, the United States has raised concerns about China's pricing and tendering procedures for medical devices and its discriminatory treatment of imported medical devices. At the November 2015 JCCT meeting, China did commit that, in terms of accessing the market, it will give imported medical devices the same treatment as medical devices manufactured or developed domestically. Unfortunately, this promise has not been fulfilled. China continues to pursue a wide range of policies that direct China's purchasing authorities to

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prioritize the procurement of domestic medical device manufacturers over imported medical device manufacturers.

In recent years, the United States has continued to press China's regulatory authorities to develop sound payment systems that are transparent, predictable and competitive. The United States has also urged China to adequately recognize quality, safety and the costs of R&D in its approach to procurement policy.

In 2019, China's State Council launched a volume-based procurement (VBP) approach for medical devices in a few provinces and municipalities in an attempt to cut healthcare costs. Since then, the VBP approach has become further engrained in China's system, with the formation of multi-province and municipal alliances to conduct joint procurements under VBP. In 2020, China implemented its first national VBP tender, which has been followed by additional national tenders in 2021 and 2022. In practice, implementation of China's VBP prioritizes cost over the product's value or quality. With China perceiving the resulting price cuts as successes, U.S. industry expects that China will continue to expand the categories of medical devices subject to VBP in the future.

According to U.S. industry, if China continues to pursue VBP without significant changes, it could lead to the creation of a low-cost, low-quality medical devices sector and low-quality monopolies in China, which would operate to the disadvantage of innovative medical device companies, many of which are foreign companies, and the patients who rely on advanced medical technologies. Currently, medical device companies that are successful at winning bids often have very thin profit margins or even lose money. Reportedly, some medical device companies are reducing training to healthcare providers in order to offer the expected price cuts. In addition, given the size of China's medical device market, low-quality monopolies from China could expand and then prioritize exports of their medical devices to third countries. With the choice between a higher

cost but more effective product or a lower cost, lower quality product, countries with greater budget constraints, and greater vulnerability to Chinese influence, may be more inclined to procure China's offerings. Overall, China's VBP approach poses a risk to the medical device sector and the provision of high-quality medical treatment worldwide.

In July 2022, China's Ministry of Finance issued a revised *Government Procurement Law*. While China has a history of distributing unofficial, non-public guidance to give preference to domestic over foreign medical devices companies, China's revisions to the *Government Procurement Law* also officially expands the coverage of products for which domestic alternatives should be given preference.

Meanwhile, the *Made in China 2025* industrial plan announced by the State Council in 2015 seeks to prop up China's domestic medical device sector through a series of support policies, including targeted funds and procurement policies. The goal of these policies is to significantly increase the market share of domestically owned and domestically manufactured medical devices, and correspondingly decrease market share of foreign medical devices, by 2025. At the same time, some provincial governments directly subsidize the purchase of domestically manufactured medical devices. In addition, some provincial governments have issued guidelines urging medical institutions to prioritize the procurement of local medical equipment over imported equipment. In at least one province, the guidelines suggest that only imported medical devices for which there is not a domestic replacement will be eligible for procurement. Going forward, the United States will continue to urge China to provide foreign medical devices with fair and equal access to China's market.

U.S. industry also reports that while sub-central governments in China have always provided some financial support to domestic medical devices companies, their support appears to have increased between 2020 and 2022. U.S. industry notes that this trend could be attributed to either the COVID-19

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pandemic or China's five-year industrial plan for medical equipment covering the years 2021 to 2025, or perhaps both. The United States will monitor this situation closely and will encourage China to be transparent in its approach.

### SERVICES

#### Overview

The prospects for U.S. service suppliers in China should be promising, given the size of China's market. Nevertheless, the U.S. share of China's services market remains well below the U.S. share of the global services market, and the Organization for Economic Cooperation and Development continues to rate China's services regime as one of the most restrictive among the world's major economies.

In 2022, numerous challenges persisted in a number of services sectors. As in past years, Chinese regulators continued to use discriminatory regulatory processes, informal bans on entry and expansion, case-by-case approvals in some services sectors, overly burdensome licensing and operating requirements, and other means to frustrate the efforts of U.S. suppliers of services to achieve their full market potential in China. These policies and practices affect U.S. service suppliers across a wide range of sectors, including cloud computing, telecommunications, film production and distribution, online video and entertainment services, express delivery and legal services. In addition, China's *Cybersecurity Law* and related implementing measures include mandates to purchase domestic information and communications technology (ICT) products and services, while China's *Cybersecurity Law*, *Data Security Law* and *Personal Information Protection Law* and related implementing measures include excessive restrictions on cross-border data flows, and requirements to store and process data locally. These types of data measures undermine U.S. services suppliers' ability to take advantage of market access opportunities in China by prohibiting

or severely restricting cross-border transfers of information that are routine in the ordinary course of business and are fundamental to any business activity. China also has failed to fully address U.S. concerns in areas that have been the subject of WTO dispute settlement, including electronic payment services and theatrical film importation and distribution.

The Phase One Agreement, signed in January 2020, addresses a number of longstanding trade and investment barriers to U.S. providers of a wide range of financial services, including banking, insurance, securities, asset management, credit rating and electronic payment services, among others. The barriers addressed in the agreement include joint venture requirements, foreign equity limitations and various discriminatory regulatory requirements. Removal of these barriers should allow U.S. financial service providers to compete on a more level playing field and expand their services export offerings in the China market. Nevertheless, China's excessive restrictions on cross-border data flows could continue to create significant challenges for U.S. financial service providers in China.

#### Banking Services

Although China has opened its banking sector to foreign competition in the form of wholly foreign-owned banks, China has maintained restrictions on market access in other ways that have kept foreign banks from establishing, expanding and obtaining significant market share in China. Recently, however, China has taken some steps to ease or remove market access restrictions.

For example, China has removed a number of longstanding barriers for foreign banks, including the \$10 billion minimum asset requirement for establishing a foreign bank in China and the \$20 billion minimum asset requirement for setting up a Chinese branch of a foreign bank. China has also removed the cap on the equity interest that a single foreign investor can hold in a Chinese-owned bank.

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In the Phase One Agreement, China committed to remove some of these barriers and to expand opportunities for U.S. financial institutions, including bank branches, to supply securities investment fund custody services by considering their global assets when they seek licenses. China also agreed to review and approve qualified applications by U.S. financial institutions for securities investment fund custody licenses on an expeditious basis. One U.S. bank was approved for this license in 2021. In addition, China committed to consider the international qualifications of U.S. financial institutions when evaluating license applications for Type-A lead underwriting services for all types of non-financial debt instruments in China.

### **Securities, Asset Management and Futures Services**

In the Phase One Agreement, China committed to remove the foreign equity caps in the securities, asset management and futures sectors by no later than April 1, 2020. It also committed to ensure that U.S. suppliers of securities, asset management and futures services are able to access China's market on a non-discriminatory basis, including with regard to the review and approval of license applications.

Consistent with its commitments in the Phase One Agreement, China announced that it would allow wholly foreign-owned companies for the securities and asset (i.e., fund) management sectors as of April 1, 2020, and that it would allow wholly foreign-owned companies for the futures sector as of January 1, 2020. Prior to these announcements, China had maintained a foreign equity cap of 51 percent for these sectors. Over the past three years, some U.S. financial institutions have applied for and received licenses to operate as wholly foreign-owned enterprises in these sectors. The United States is monitoring these and other developments as U.S. companies continue to seek to obtain licenses and undertake operations in these sectors.

### **Insurance Services**

In the Phase One Agreement, China committed to accelerate the removal of the foreign equity caps for life, pension and health insurance so that they are removed no later than April 1, 2020. In addition, it confirmed the removal of the 30-year operating requirement, known as a "seasoning" requirement, which had been applied to foreign insurers seeking to establish operations in China in all insurance sectors. China also committed to remove all other discriminatory regulatory requirements and processes and to expeditiously review and approve license applications.

Consistent with China's commitments in the Phase One Agreement, the China Banking and Insurance Regulatory Commission (CBIRC) announced that China would allow wholly foreign-owned companies for the life, pension and health insurance sectors as of January 1, 2020. Prior to this announcement, China had maintained foreign equity caps and only permitted foreign companies to establish as Chinese-foreign joint ventures in these sectors. In December 2020, CBIRC issued a measure that provided further transparency regarding its intention to allow foreign-invested companies to take advantage of this opening.

In other insurance sectors, the United States continues to encourage China to establish more transparent procedures so as to better enable foreign participation in China's market. Sectors in need of more transparency include export credit insurance and political risk insurance.

Finally, some U.S. insurance companies established in China have encountered difficulties in getting the CBIRC to issue timely approvals of their requests to open up new internal branches to expand their operations. The United States continues to urge CBIRC to issue timely approvals when U.S. insurance companies seek to expand their branch networks in China.



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### Electronic Payment Services

In a WTO case that it launched in 2010, the United States challenged China's restrictions on foreign companies, including major U.S. credit and debit card processing companies, which had been seeking to supply electronic payment services to banks and other businesses that issue or accept credit and debit cards in China. The United States argued that China had committed in its WTO accession agreement to open up this sector in 2006, and a WTO panel agreed with the United States in a decision issued in 2012. China subsequently agreed to comply with the WTO panel's rulings in 2013, but China did not allow foreign suppliers to apply for licenses until June 2017, when China's regulator – PBOC – finalized the establishment of a two-step licensing process in which a supplier must first complete one year of preparatory work before being able to apply for a license.

As of January 2020, when the United States and China entered into the Phase One Agreement, no foreign supplier of electronic payment services had been able to secure the license needed to operate in China's market due largely to delays caused by PBOC. At times, PBOC had refused even to accept applications to begin preparatory work from U.S. suppliers, the first of two required steps in the licensing process. Meanwhile, throughout the years that China actively delayed opening up its market to foreign suppliers, China's national champion, China Union Pay, has used its exclusive access to domestic currency transactions in the China market, and the revenues that come with it, to support its efforts to build out its electronic payment services network abroad, including in the United States. In other words, China consciously decided to maintain market-distorting practices that benefit its own companies, even in the face of adverse rulings at the WTO.

In the Phase One Agreement, China committed to ensure that PBOC operates an improved and timely licensing process for U.S. suppliers of electronic

payment services so as to facilitate their access to China's market.

In June 2020, four months after the entry into force of the Phase One Agreement, American Express became the first foreign supplier of electronic payment services to secure a license to operate in China's market. Meanwhile, the United States continues to closely monitor developments as applications from two other U.S. suppliers, Visa and MasterCard, are progressing slowly through PBOC's licensing process.

### Internet-Enabled Payment Services

PBOC first issued regulations for non-bank suppliers of online payment services in 2010, and it subsequently began processing applications for licensees. Regulations were further strengthened in 2015, with additional provisions aimed at increasing security and traceability of transactions. According to a U.S. industry report, of more than 200 licenses issued as of June 2014, only two had been issued to foreign-invested suppliers, and those two were for very limited services. This report provided clear evidence supporting stakeholder concerns about the difficulties they faced entering China's market and the slow process foreign firms face in getting licensed. In 2018, PBOC announced that it would allow foreign suppliers, on a nondiscriminatory basis, to supply Internet-enabled payment services. At the same time, as in many other sectors, PBOC requires suppliers to localize their data and facilities in China. In January 2021, PayPal became the first foreign company to obtain full ownership of a payment platform in China, along with a license to supply payment services. The United States will continue to closely monitor developments in this area.

### Telecommunications Services

China's restrictions on basic telecommunications services, such as informal bans on new entry, a 49-percent foreign equity cap, a requirement that foreign suppliers can only enter into joint ventures

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with state-owned enterprises and exceedingly high capital requirements, have blocked foreign suppliers from accessing China's basic telecommunications services market. Since China acceded to the WTO almost two decades ago, not a single foreign firm has succeeded in establishing a new joint venture to enter this sector.

Restrictions maintained by China on less highly regulated value-added telecommunications services also have created serious barriers to market entry for foreign suppliers seeking to enter this sector. These restrictions include opaque and arbitrary licensing procedures, foreign equity caps and periodic, unjustified moratoria on the issuance of new licenses. As a result, only a few dozen foreign-invested suppliers have secured licenses to provide value-added telecommunications services, while there are thousands of licensed domestic suppliers.

### Internet Regulatory Regime

China's Internet regulatory regime is restrictive and non-transparent, affecting a broad range of commercial services activities conducted via the Internet, and is overseen by multiple agencies without clear lines of jurisdiction. China's Internet economy has boomed over the past decade and is second in size only to that of the United States. Growth in China has been marked in service sectors similar to those found in the United States, including retail websites, search engines, vocational and adult online education, travel, advertising, audio-visual and computer gaming services, electronic mail and text, online job searches, Internet consulting, mapping services, applications, web domain registration and electronic trading. However, in the China market, Chinese companies dominate due in large part to restrictions imposed on foreign companies by the Chinese government. At the same time, foreign companies continue to encounter major difficulties in attempting to offer these and other Internet-based services on a cross-border basis.

China continues to engage in extensive blocking of legitimate websites, imposing significant costs on both suppliers and users of web-based services and products. According to the latest data, China currently blocks most of the largest global sites, and U.S. industry research has calculated that more than 10,000 sites are blocked, affecting billions of dollars in business, including communications, networking, app stores, news and other sites. Even when sites are not permanently blocked, the often arbitrary implementation of blocking, and the performance-degrading effect of filtering all traffic into and outside of China, significantly impair the supply of many cross-border services, often to the point of making them unviable.

### Voice-Over-Internet Protocol Services

While computer-to-computer voice-over-Internet (VOIP) services are permitted in China, China's regulatory authorities have restricted the ability to offer VOIP services interconnected to the public switched telecommunications network (i.e., to call a traditional phone number) to basic telecommunications service licensees. There is no obvious rationale for such a restriction, which deprives consumers of a useful communication option, and the United States continues to advocate for eliminating it.

### Cloud Computing Services

Especially troubling is China's treatment of foreign companies seeking to participate in the development of cloud computing services, including computer data processing and storage services and software application services provided over the Internet. China prohibits foreign companies established in China from directly providing any of these services. Given the difficulty in providing these services on a cross-border basis (largely due to restrictive Chinese policies), the only option that a foreign company has to access the China market is to establish a contractual partnership with a Chinese company, which is the holder of the necessary

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Internet data center license, and turn over its valuable technology, intellectual property, know-how and branding as part of this arrangement. While the foreign service supplier earns a licensing fee from the arrangement, it has no direct relationship with customers in China and no ability to independently develop its business. It has essentially handed over its business to a Chinese company that may well become a global competitor. This treatment has generated serious concerns in the United States and among other WTO Members as well as U.S. and other foreign companies.

In major markets, including China, cloud computing services are typically offered through commercial presence in one of two ways. They are offered as an integrated service in which the owner and operator of a telecommunication network also offers computing services, including data storage and processing function, over that network, or they are offered as a stand-alone computer service, with connectivity to the computing service site provided separately by a telecommunications service supplier. Although China's commitments under the WTO's General Agreement on Trade in Services (GATS) include services relevant to both of these approaches, neither one is currently open to foreign-invested companies in China.

### Audio-Visual and Related Services

China prohibits foreign companies from providing film production and distribution services in China. In addition, China's restrictions in the area of theater services have wholly discouraged investment by foreign companies in cinemas in China.

China's restrictions on services associated with television and radio greatly limit participation by foreign suppliers. For example, China prohibits retransmission of foreign TV channels, foreign investment in TV production and foreign investment in TV stations and channels. China also imposes quotas on the amount of foreign programming that can be shown on a Chinese TV channel each day. In addition, in September 2018, the National Radio and

Television Administration's (NRTA) issued a problematic draft measure that would impose new restrictions in China's already highly restricted market for foreign creative content. It would require that spending on foreign content account for no more than 30 percent of available total programs in each of several categories, including foreign movies, TV shows, cartoons, documentaries and other foreign TV programs, made available for display via broadcasting institutions and online audio-visual content platforms. It also would prohibit foreign TV shows in prime time. Although this measure has not yet been issued in final form, it continues to raise serious concerns, as it appears that, as a matter of practice, it is already being implemented in China, including by online audio-visual content platforms.

### Theatrical Films

In February 2012, the United States and China reached an alternative resolution with regard to certain rulings relating to the importation and distribution of theatrical films in a WTO case that the United States had won. The two sides signed a memorandum of understanding (MOU) providing for substantial increases in the number of foreign films imported and distributed in China each year, along with substantial additional revenue for U.S. film producers. However, China has not yet fully implemented its MOU commitments, including with regard to critical commitments to open up film distribution opportunities for imported films. As a result, the United States has been pressing China for full implementation of the MOU.

In 2017, in accordance with the terms of the MOU, the two sides began discussions regarding the provision of further meaningful compensation to the United States in an updated MOU. These discussions continued until March 2018, before stalling when China embarked on a major government reorganization that involved significant changes for China's Film Bureau. Discussions resumed in 2019 as part of the broader U.S.-China trade negotiations that began following a meeting between the two countries' Presidents on the margins of the Group of

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20 Heads of State and Government Summit in Buenos Aires in December 2018. To date, no agreement has been reached on the further meaningful compensation that China owes to the United States. The United States will continue pressing China to fulfill its obligations.

### Online Video and Entertainment Services

China restricts the online supply of foreign video and entertainment services through measures affecting both content and distribution platforms. China requires foreign companies to license their content to Chinese companies and also imposes burdensome restrictions on content, which are implemented through exhaustive content review requirements that are based on vague and otherwise non-transparent criteria. With respect to distribution platforms, NRTA has required Chinese online platform suppliers to spend no more than 30 percent of their acquisition budget on foreign content. NRTA has also instituted numerous measures that prevent foreign suppliers from qualifying for a license, such as requirements that video platforms all be Chinese-owned. NRTA and other Chinese regulatory authorities have also taken actions to prevent the cross-border supply of online video services, which may implicate China's GATS commitments relating to video distribution.

### Legal Services

China restricts the types of legal services that can be provided by foreign law firms, including through a prohibition on foreign law firms hiring lawyers qualified to practice Chinese law. It also restricts the ability of foreign law firms to represent their clients before Chinese government agencies and imposes lengthy delays on foreign law firms seeking to establish new offices. In addition, beginning with the version of China's *Foreign Investment Negative List* that entered into force in July 2020, China has added an explicit prohibition on the ability of a foreign lawyer to become a partner in a domestic law firm. Reportedly, China is also considering draft

regulatory measures that would even further restrict the ability of foreign law firms to operate in China.

### Express Delivery Services

The United States continues to have concerns regarding China's implementation of the 2009 *Postal Law* and related regulations through which China prevents foreign service suppliers from participating in the document segment of its domestic express delivery market. In the package segment, China applies overly burdensome and inconsistent regulatory approaches, including with regard to security inspections, and reportedly has provided more favorable treatment to Chinese service suppliers when awarding business permits.

## DIGITAL TRADE AND ELECTRONIC COMMERCE POLICIES

### Data Restrictions

In 2022, China continued to build out its expansive regulation of the collection, storage, processing and sharing of data. China's *Data Security Law* entered into force in September 2021, and China's *Personal Information Protection Law* entered into force in November 2021. These laws operate together with the *Cybersecurity Law*, which took effect in June 2017, the *National Security Law*, which has been in effect since 2015, and various implementing measures, including the *Security Assessment Measures for Outbound Transfers of Data*, which took effect in September 2022, to prohibit or severely restrict cross-border transfers of "important data," a broadly and vaguely defined term, and, in certain cases, personal information collected by companies through their operations in China. These laws and implementing measures also impose local data storage and processing requirements on companies operating in China that collect "important data" and, in certain cases, personal information. Cross-border transfers of data are routine in the ordinary course of business and are fundamental to any business activity. Given the

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wide range of businesses and business activities that are dependent on cross-border transfers of data and flexible access to global computing facilities, these developments continue to generate serious concerns in the United States and many other countries.

### Secure and Controllable ICT Policies

Implementing measures for China's *Cybersecurity Law* remain a continued source of serious concern for U.S. companies since the law's enactment in 2016. Of particular concern are the *Measures for Cybersecurity Review*, first issued in 2016 and later updated in 2020 and 2021. This measure implements one element of the cybersecurity regime created by the *Cybersecurity Law*. Specifically, the measure puts in place a review process to regulate the purchase of ICT products and services by critical information infrastructure operators and online platform operators in China. The review process is to consider, among other things, potential national security risks related to interruption of service, data leakage and reliability of supply chains. In addition, in September 2022, China published a draft revision of the *Cybersecurity Law* with a 15-day public comment period. The draft revision would introduce penalties on operators of critical information infrastructure who use products or services that have not undergone the required security review, and it would also raise fines for certain violations of the *Cybersecurity Law*.

As demonstrated in implementing measures for the *Cybersecurity Law*, China's approach is to impose severe restrictions on a wide range of U.S. and other foreign ICT products and services with an apparent goal of supporting China's technology localization policies by encouraging the replacement of foreign ICT products and services with domestic ones. U.S. and other foreign stakeholders and governments around the world expressed serious concerns about requirements that ICT equipment and other ICT products and services in critical sectors be "secure and controllable," as these requirements are used by

the Chinese government to disadvantage non-Chinese firms.

In addition to the *Cybersecurity Law*, China has referenced its "secure and controllable" requirements in a variety of measures dating back to 2013. Through these measures, China has mandated that Chinese information technology users purchase Chinese products and favor Chinese service suppliers, imposed local content requirements, imposed domestic R&D requirements, considered the location of R&D as a cybersecurity risk factor and required the transfer or disclosure of source code or other intellectual property. In the 2019 update of the *Measures for Cybersecurity Review*, China added political, diplomatic and other "non-market" developments as potential risk factors to be considered.

In addition, in 2015, China enacted a *National Security Law* and a *Counterterrorism Law*, which include provisions citing not only national security and counterterrorism objectives but also economic and industrial policies. The State Council also published a plan in 2015 that sets a timetable for adopting "secure and controllable" products and services in critical government ministries by 2020.

Meanwhile, sector-specific policies under this broad framework continue to be proposed and deployed across China's economy. A high-profile example from December 2014 was a proposed measure drafted by the China Banking Regulatory Commission that called for 75 percent of ICT products used in the banking system to be "secure and controllable" by 2019 and that would have imposed a series of criteria that would shut out foreign ICT providers from China's banking sector. Not long afterwards, a similar measure was proposed for the insurance sector.

In 2015, the United States, in concert with other governments and stakeholders around the world, raised serious concerns about China's "secure and controllable" regime at the highest levels of government within China. During a state visit in

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September 2015 in Washington, D.C., the U.S. and Chinese Presidents committed to a set of principles for trade in information technologies. The issue also was raised in connection with the June 2015 S&ED meeting and the November 2015 JCCT meeting, with China making a series of additional important commitments with regard to technology policy. China reiterated many of these commitments at the November 2016 JCCT meeting, where it affirmed that its “secure and controllable” policies are not to unnecessarily limit or prevent commercial sales opportunities for foreign ICT suppliers or unnecessarily impose nationality-based conditions and restrictions on commercial ICT purchases, sales or uses. China also agreed that it would notify relevant technical regulations to the WTO Committee on Technical Barriers to Trade (TBT Committee).

Again, however, China has not honored its promises. The numerous draft and final implementation measures issued by China from 2017 through 2022 in the area of cybersecurity raise serious questions about China's approach to cybersecurity regulation. China's measures do not appear to be in line with the non-discriminatory, non-trade restrictive approach to which China has committed, and global stakeholders have grown even more concerned about the implications of China's ICT security measures across the many economic sectors that employ digital technologies. Accordingly, throughout the past year, the United States conveyed its serious concerns about China's approach to cybersecurity regulation through bilateral engagement and multilateral engagement, including at WTO committee and council meetings, in an effort to persuade China to revise its policies in this area in light of its WTO obligations and bilateral commitments. These efforts are currently ongoing.

### Encryption

Use of ICT products and services is increasingly dependent on robust encryption, an essential functionality for protecting privacy and safeguarding sensitive commercial information. Onerous

requirements on the use of encryption, including intrusive approval processes and, in many cases, mandatory use of indigenous encryption algorithms (e.g., for WiFi and 4G cellular products), continue to be cited by stakeholders as a significant trade barrier.

In October 2019, China adopted a *Cryptography Law* that includes restrictive requirements for commercial encryption products that “involve national security, the national economy and people's lives, and public interest,” which must undergo a security assessment. This broad definition of commercial encryption products that must undergo a security assessment raises concerns that the new *Cryptography Law* will lead to unnecessary restrictions on foreign ICT products and services. In August 2020, the State Cryptography Administration issued the draft *Commercial Cryptography Administrative Regulations* to implement the *Cryptography Law*. This draft measure did not address the concerns that the United States and numerous other stakeholders had raised regarding the *Cryptography Law*.

Going forward, the United States will continue to monitor implementation of the *Cryptography Law* and related measures. The United States will remain vigilant toward the introduction of any new requirements hindering technologically neutral use of robust, internationally standardized encryption.

### GOVERNMENT PROCUREMENT

In its WTO accession agreement, China made a commitment to accede to the WTO Agreement on Government Procurement (GPA) and to open up its vast government procurement market to the United States and other GPA parties. More than two decades later, this commitment remains unfulfilled, while China's government procurement has continued to grow exponentially. Indeed, government procurement at the central level of government alone now exceeds \$500 billion, even without considering procurement by state-owned enterprises.



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The United States, the EU and other GPA parties have viewed China's GPA offers over the years as highly disappointing in scope and coverage. China submitted its sixth revised offer in October 2019. This offer showed progress in a number of areas, including thresholds, coverage at the sub-central level of government, entity coverage and services coverage. Nonetheless, it fell short of U.S. expectations and remains far from acceptable to the United States and other GPA parties as significant deficiencies remain in a number of critical areas, including thresholds, entity coverage, services coverage and exclusions. Although China has since stated that it will "speed up the process of joining" the GPA, it has not submitted a new offer since October 2019. China's most recent submission, made in June 2021, was only an update of its checklist of issues, which informs GPA parties of changes to China's existing government procurement regime since its last update.

China's current government procurement regime is governed by two important laws. The *Government Procurement Law*, administered by the Ministry of Finance, governs purchasing activities conducted with fiscal funds by state organs and other organizations at all levels of government in China, but does not apply to procurements by state-owned enterprises. The *Tendering and Bidding Law* falls under the jurisdiction of NDRC and imposes uniform tendering and bidding procedures for certain classes of procurement projects in China, notably construction and works projects, without regard for the type of entity (e.g., a government agency or a state-owned enterprise) that conducts the procurement. Both laws cover important procurements that GPA parties would consider to be government procurement eligible for coverage under the GPA.

China's *Foreign Investment Law*, which entered into force in January 2020, and a related October 2021 Ministry of Finance measure state that China will provide equal treatment to foreign companies invested in China and to domestic Chinese companies with regard to government procurement

opportunities. However, it is not yet clear how these measures may be impacting government procurement in China.

Under both its government procurement regime and its tendering and bidding regime, China continues to implement policies favoring products, services and technologies made or developed by Chinese-owned and Chinese-controlled companies through explicit and implicit requirements that hamper foreign companies from fairly competing in China. For example, notwithstanding China's commitment to equal treatment, foreign companies continue to report cases in which "domestic brands" and "indigenous designs" are required in tendering documents. China also has proposed but has not yet adopted clear rules on what constitutes a domestic product. As a result, there are no specific metrics, such as a percentage of value-added within China, for foreign products to qualify for many procurements and tenders, which often works to the disadvantage of foreign companies.

### ADMINISTRATIVE PROCESS

#### Administrative Licensing

U.S. companies continue to encounter significant problems with a variety of administrative licensing processes in China, including processes to secure product approvals, investment approvals, business expansion approvals, business license renewals and even approvals for routine business activities. While there has been an overall reduction in license approval requirements and a focus on decentralizing licensing approval processes, U.S. companies continue to report that one of their key concerns involves China's problematic licensing approval processes.

#### Transparency

##### Overview

One of the core principles reflected throughout China's WTO accession agreement is transparency.

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Unfortunately, after more than 20 years of WTO membership, China still has a poor record when it comes to adherence to its transparency obligations.

### Publication of Trade-Related Measures

In its WTO accession agreement, China committed to adopt a single official journal for the publication of all trade-related laws, regulations and other measures. China adopted a single official journal, to be administered by MOFCOM, in 2006. However, it appears that China only publishes trade-related measures from some, but not all, central-government entities in this journal. It also appears that China does not publish any trade-related measures from sub-central governments in the journal.

At the central government level, moreover, China tends to take a narrow view of the types of trade-related measures that need to be published in the official journal. For those government entities whose trade-related measures are published in the official journal, China more commonly (but still not regularly) publishes trade-related administrative regulations and departmental rules in the journal, but it is rare for China to publish other measures such as opinions, circulars, orders, directives and notices, which are known as “normative documents” in China’s legal system. Normative documents are regulatory documents that do not fall into the category of administrative regulations or departmental rules, but still impose binding obligations on enterprises and individuals. Although the State Council introduced a definition for “administrative normative documents” in 2014, this definition is narrow and does not appear to encompass all normative documents, nor has it resulted in their regular publication as required by China’s WTO commitments.

Meanwhile, China rarely publishes certain types of trade-related measures from either the central level or the sub-central level of government in the official

journal. As discussed above in the Industrial Subsidies section, an important example involves subsidy measures.

### Notice-and-Comment Procedures

In its WTO accession agreement, China committed to provide a reasonable period for public comment before implementing new trade-related laws, regulations and other measures. While little progress has been made in implementing this commitment at the sub-central government level, the National People’s Congress instituted notice-and-comment procedures for draft laws in 2008, and shortly thereafter China indicated that it would also publish proposed trade- and economic-related administrative regulations and departmental rules for public comment. Subsequently, the National People’s Congress began regularly publishing draft laws for public comment. China’s State Council often (but not regularly) published draft administrative regulations for public comment, but many of China’s ministries were not consistent in publishing draft departmental rules or normative documents for public comment.

At the May 2011 S&ED meeting, China committed to issue a measure implementing the requirement to publish all proposed trade- and economic-related administrative regulations and departmental rules on the website of the State Council’s Legislative Affairs Office (SCLAO) for a public comment period of not less than 30 days. In April 2012, the SCLAO issued two measures that appear to address this requirement.

Currently, the process for issuing new regulatory measures in China can be opaque and unpredictable and implemented without adequate notice. China still needs to improve its practices relating to the publication of administrative regulations and departmental rules for public comment. China also needs to formalize its use of notice-and-comment procedures for all normative documents.

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In the Phase One Agreement, China committed to provide no less than 45 days for public comment on all proposed laws, regulations and other measures implementing the Phase One Agreement. Since the entry into force of this commitment in February 2020, China has generally been providing the required 45-day public comment period and working constructively with the United States whenever it has raised questions or concerns regarding provisions in proposed implementing measures.

### Translations

In its WTO accession agreement, China committed to make available translations of all of its trade-related laws, regulations and other measures at all levels of government in one or more of the WTO languages, i.e., English, French and Spanish. Prior to 2014, China had only compiled translations of trade-related laws and administrative regulations (into English), but not other types of measures, such as departmental rules, normative documents and sub-central government measures. Even for trade-related laws and administrative regulations, China was years behind in publishing these translations. At the July 2014 S&ED meeting, China committed that it would extend its translation efforts to include not only trade-related laws and administrative regulations but also trade-related departmental rules. Subsequently, in March 2015, China issued a measure requiring trade-related departmental rules to be translated into English. This measure also provides that the translation of a departmental rule normally must be published before implementation.

Notably, however, even if China were to fully implement its existing measures requiring translations, they would not be sufficient to bring China into full WTO compliance in this area. China does not consistently publish translations of trade-related laws, administrative regulations and departmental rules in a timely manner (i.e., before implementation), nor does it publish any translations of trade-related normative documents or trade-related measures issued by sub-central governments.

### Inquiry Point

In its WTO accession agreement, China committed to establish an inquiry point that would respond to requests for information relating to legal measures required to be published in its official journal. At times, however, China has refused to provide copies of legal measures in response to legitimate requests directed to its inquiry point.

In April 2020, for example, the United States submitted a request concerning five Chinese legal measures covering semiconductors and fisheries subsidy programs that had not been published in China's official journal and were not otherwise available online, nor had they been notified to the WTO. Despite the obligation in its WTO accession agreement to either provide the documents or respond in writing within 45 days, China did not meet this deadline. The United States made repeated follow-up requests, to no avail. Five months after the United States submitted its request to China's inquiry point, MOFCOM orally informed the U.S. Embassy in Beijing that it would not be providing any of the requested legal measures because two of the measures would soon be replaced and the other three measures, in China's view, were not relevant to China's WTO obligations. USTR promptly responded to MOFCOM in writing, countering its assertions and urging it to provide the requested documents. Since then, China has continued to refuse to provide a written response to the United States' request or to provide any of the requested legal measures, even though the United States and other WTO Members have repeatedly raised this matter before the WTO's Subsidies Committee and Council for Trade in Goods.

### Corporate Social Credit System

Since 2014, China has been working to implement a national "social credit" system for both individuals and companies. The implementation of this system is at a more advanced stage for companies versus individuals, as "unified social credit codes" are assigned to every domestic and foreign company in

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China. These 18-digit codes will provide a way for the Chinese government to track a company's record of administrative and regulatory compliance and generate public credit information. Over the past year, China has been increasingly focused on making the social credit system fully functional. Indeed, in his report to the 20th National Party Congress in October 2022, Xi Jinping in his capacity as the General Secretary of the Chinese Communist Party emphasized the need to refine the social credit system.

Under the corporate social credit system, government records and market-generated corporate compliance data are collected on every legal entity in China. The collected information contains regulatory and administrative records contributed by at least 44 state agencies and their branch offices across every province in China. Previously disparate information relating to a company's financial records, regulatory compliance, inspection results and other administrative enforcement activities is being consolidated under a company's unified social credit code. All of this data will be aggregated and shared between regulatory agencies via the National Credit Information Sharing Platform. Reportedly, approximately 75 percent of the records collected on companies is intended to be designated as "open to the public," while the remaining 25 percent that is intended to be withheld will include potentially sensitive information, such as approval records related to national development projects and details of any criminal cases.

Nationwide data collection under the corporate social credit system provides mechanisms to penalize companies with poor corporate and legal compliance records by, among other things, subjecting them to public censure via what China calls "blacklists," while rewarding compliant companies with positive incentives via so-called "redlists." Negative ratings or placement on a government agency's censure list can lead to various restrictions on a company's business activities. A company could face increased inspections, reduced access to loans and tax incentives, restrictions on

government procurement, reduced land-use rights, monetary fines or permit denials, among other possible penalties.

However, currently, there is no fully integrated national system for assigning comprehensive social credit scores for companies, and the social credit system remains highly fragmented. Certain central government agencies and sub-central government agencies maintain their own rating systems, with each agency making its own decisions about the types of transgressions that warrant negative ratings or placing a company on a censure list.

In November 2022, NDRC and PBOC jointly published a draft law that would give the social credit system a legal basis, further embedding it into China's regulatory network. The draft law seeks to establish NDRC and PBOC as the main government agencies for construction of the social credit system. Their responsibilities would include overall coordination, supervision and guidance of the construction of the social credit system and taking the lead in organizing the formulation and implementation of relevant policies and standards. The draft law also seeks to provide formal legal definitions for certain terms used in implementing the social credit system, such as "untrustworthy," "credit supervision" and "credit information." In addition, the draft law seeks to codify the protection of certain rights, as it calls for the establishment of a social credit system that maintains the security of social credit information and strictly protects state secrets, business secrets and personal privacy, while also protecting the lawful rights and interests of natural persons, legal persons and unincorporated organizations.

Earlier in 2022, prior to the publication of the draft law, NDRC issued a draft update of the 2021 *National Basic Catalogue of Public Credit Information* and a draft update of the 2021 *National Basic List of Disciplinary Measures against Dishonest Acts*. The draft Catalogue compiles the scope and types of credit information that can be collected by government agencies. It also stipulates that certain categories of information are exempt from

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collection, including state secrets and trade secrets. The draft List includes a range of punitive actions that may be applied to violators of trust, such as duties, fees, restrictions on market activity, prohibitions or limitations on occupations and bans from government procurement bidding.

The corporate social credit system has been tied to larger policy objectives as well. For example, the General Office of the State Council and the General Office of the Chinese Communist Party issued a joint opinion on promoting a high-quality credit system in order to further China's "dual circulation" objectives. In addition, in November 2022, the Ministry of Science and Technology (MOST) announced a new pilot project for evaluating STEM talent. Under MOST's new pilot project, evaluation of scientists' performance is to incorporate metrics related to their moral character, which includes their social credit record, in order to ensure that scientific researchers have no history of plagiarism or academic fraud. This pilot project appears to reflect China's struggle to improve the quality of its scientific research talent.

Foreign companies are concerned that the corporate social credit system will be used by the Chinese government to pressure them to act in furtherance of China's industrial policies or other state priorities or otherwise to make investments or conduct their business operations in ways that run counter to market principles or their own business strategies. Foreign companies are also concerned that the Chinese government will use the corporate social credit system as another tool to ensure that they do not cross political redlines on sensitive matters like human rights. In addition, foreign companies are concerned about the opaque nature of the corporate social credit system. Currently, for example, a company sometimes only learns about its negative ratings when, for example, it requests a permit and receives a denial, even though the *Measures for Administration of the List of Serious Violators of Trust and Law* includes a requirement that companies be informed of their being censured in advance. Other times, a company learns for the

first time that it has been censured when a Chinese government agency posts its name on the agency's website, even though the censuring of a company can cause severe harm to the company's reputation and adversely impact its efforts to attract customers, secure needed financing or make new investments. When Chinese government agencies begin to pursue joint punishment in the way that NDRC envisions, it will mean that an infraction in one regulatory context could have wider consequences across the company's entire business operations.

Another key concern regarding the corporate social credit system involves its links to individual social credit. In addition, the Chinese government could also potentially use corporate social credit in the future to exert extraterritorial influence by threatening the social credit standing of foreign multinationals or citizens for behavior or speech outside of China.

To date, the corporate social credit system does not appear to explicitly disadvantage U.S. or other foreign companies or provide favorable treatment to domestic companies. Nevertheless, concerns remain regarding how this system will be applied in practice, and the need to comply with an increasingly complex and expansive social credit system may impose barriers to entry into China's market for foreign companies that are unfamiliar with the legal and regulatory requirements associated with corporate social credit compliance and reporting.

### OTHER NON-TARIFF MEASURES

A number of other non-tariff measures can adversely affect the ability of U.S. industry to access or invest in China's market. Key areas of concern include laws governing land use in China, commercial dispute resolution and the treatment of non-governmental organizations. Corruption among Chinese government officials, enabled in part by China's incomplete adoption of the rule of law, is also a key area of concern.

## Understanding social dumping in the European Union

### SUMMARY

Although a recurring term in discussions related to working mobility, wages and the social security of workers, social dumping has neither a generally accepted definition, nor easily definable limits. It is rather a set of practices on an international, national or inter-corporate level, aimed at gaining an advantage over competitors, which could have significant negative consequences for economic processes and workers' social security. Examples include actions taken by actors from 'low wage' Member States to gain market advantage over actors from Member States with higher pay and social standards; multinational companies from 'high wage' countries searching for ways to avoid legal constraints by employing subcontractors from low-wage countries; and companies engaging cheaper and more vulnerable temporary and agency workers, or relocating production to lower wage and less regulated locations. Social dumping takes different forms in different sectors.

Suppressing social dumping is a component of different regulations on working mobility, undeclared work, and the status of transport workers. However, as the legislative competence of the European Union is limited in the labour law domain, soft law and social dialogue are also used to tackle the phenomenon. Several cases before the Court of Justice of the EU (such as the *Viking* and the *Laval* cases) show that the applicable EU rules can only be effective if adequate implementation and enforcement by the Member States is guaranteed.

In September 2016, the European Parliament adopted an own-initiative resolution on social dumping, calling for a number of actions to reinforce controls, close regulatory gaps, revise working conditions and promote social convergence.



### In this briefing:

- Introduction
- Varieties of social dumping and sectors concerned
- Social dumping in EU legislation
- EU activities to counter social dumping
- Stakeholders' views
- Main references



## Introduction

Social dumping (as with '[unfair competition](#)' or '[welfare tourism](#)') is a term increasingly frequently used in public discussion and often applied pejoratively, as a way of condemning companies that seek to maximise profit through lower labour costs in another Member State, or within the same country or company. In the EU internal market, characterised by the free movement of persons, goods, capital and services as fundamental rights, the exploitation of diverging labour standards can be a potential source of competitive advantage. This practice is often perceived as social dumping.

### Definitions of social dumping

Despite increasing usage of the expression 'social dumping', there is no clear, universally accepted definition of the term.

The academic [definitions](#) of social dumping are manifold, capturing different aspects of the phenomenon (for instance economic, social, or fiscal). Vaughan-Whitehead (2003) points out that there is a difference between a narrow definition of social dumping, limited to respecting or failing to respect the law, and a more general definition, based on the notion of 'unfair competition'.<sup>1</sup> A 2014 [study](#) from the European Trade Union Institute (ETUI) described social dumping as 'the practice, undertaken by self-interested market participants, of undermining or evading existing social regulations with the aim of gaining competitive advantage'.

It is difficult to establish the limits of social dumping; 'competitive advantages through lower wages and inferior employment standards' is in itself not a sufficient criterion to allege social dumping. According to the book '[Market Expansion and Social Dumping in Europe](#)', to determine whether a certain type of behaviour constitutes social dumping, one needs to consider the intentions behind the actor's actions (for example, to gain short-term advantage over competitors); that is, it is necessary to focus on mechanisms instead of visible manifestations. This could allow for the identification of seemingly distant phenomena under a common umbrella.

According to the 2015 [definition](#) of the economist André Sapir, social dumping is 'downward pressure on social conditions due to competition from countries with lower social conditions'.

In the context of the discussion on [posted workers](#), the European Commission described this practice as a situation 'where foreign service providers can undercut local service providers because their labour standards are lower'. There are, unavoidably, differences between Member States in terms of direct or indirect labour costs. These can give companies based in countries with comparatively lower costs (wages, bonuses, allowances) and standards (social protection, healthcare, insurance) a competitive advantage.

On 14 August 2015, Marianne Thyssen, European Commissioner for Employment, Social Affairs, Skills and Labour Mobility, [answered](#) a written [question](#) from the European Parliament on definitions, stating: 'There is no definition of the concept of "social dumping" in EC law. The term is generally used to point to unfair competition due to the application of different wages and social protection rules to different categories of workers'.

### Misconceptions related to social dumping

There are some frequent stereotypes or misconceptions related to social dumping. Firstly, one has to bear in mind that social dumping is not exclusively generated by actors coming from 'new' Member States<sup>2</sup> or 'low wage' older Member States. Often,

multinational companies originating from 'high wage' countries search for ways to avoid legal constraints and introduce social dumping at lower levels of the production chain (occupied by subcontractors from low-wage third countries or Member States, or migrant workers).

Secondly, social dumping is not only a strategy at company level: workers themselves can also participate in 'the race to the bottom' by accepting disadvantageous conditions. In other cases, governments themselves reduce corporate taxes, and make labour markets more flexible in order to attract investors.<sup>3</sup>

Thirdly, although social dumping is in many cases a transnational phenomenon (as disparate traditions and regulations facilitate disloyal practices), it can also be observed at national or company levels, for instance through the engagement of cheaper and more vulnerable temporary and agency workers.

## Varieties of social dumping and concerned sectors

### Varieties of social dumping

There is not only a large variety of definitions, the phenomenon of social dumping itself is also far from being homogenous. According to a study<sup>4</sup> carried out by Berentsen and Lillie, it can be classified in a 'norm-based' manner (for example, breach or circumvention of wage norms, abuses concerning working time or non-wage benefits, as well as security and safety standards), or in a 'process based' manner, depending on ways in which the actors comply with EU and national regulatory systems. In this respect, one can distinguish between three types of social dumping:

- Regulatory evasion: formal national industrial relation rules are violated and the violation concealed from the regulatory authorities, making it difficult to check whether the employment conditions meet the standards (for instance, employees are hired in a different national jurisdiction to that in which the work is performed).
- Regulatory arbitrage: this practice is based on the exploitation of differences between national systems within the constraints of EU rules and corresponding national rules (for instance, firms locate themselves and post employees so as to benefit from the differences between national security systems in the EU).
- Regulatory conformance: firms comply with the regulatory framework but manipulate rules for cost advantage (for example, by claiming that there are no skilled local workers available). Another example of this practice is the zero-hour contract, which automatically restarts after forced working breaks.

It is also possible to distinguish between illegal and legal social dumping, even though it is often difficult to define the limits. In the first case, written rules are breached, and in the second, practices respect the law but disregard informal social norms.

A special case of social dumping is related to the relocation of production in lower wage or less regulated locations (generally in third countries, or in Southern or Central-Eastern EU regions).

### Social dumping in different sectors

Some sectors are particularly subject to social dumping. These include road transport, construction, and steel and automotive industries, but dumping also occurs in the Information Technology (IT) and hospitality sectors.<sup>5</sup> Social dumping appears in different forms, depending on the sector. In sectors where trade unions are powerful, such as the

construction sector, breaches of collective agreements can occur through subcontracting arrangements and the recourse to recruitment agencies. In more 'de-unionised' sectors, for instance hospitality, an 'informal work culture' can be observed (no collective bargaining, non-compliance with existing employment regulations).

## Social dumping in EU legislation

### Free movement of workers

Citizens of the European Union have authorisation to live and work in another Member State since the [Treaty of Rome](#) (1957). Workers have the right to reside with their families in the new host country and to be treated on an equal basis to citizens of the host country. The coordination of social security schemes was one of the first regulated fields of EU-level cooperation. It is based on the principle that workers moving in the EU are subject to only one social security scheme. According to [Regulation \(EC\) No 883/2004](#), this is the scheme of the host country for the self-employed and workers hired directly by host country firms; for posted workers,<sup>6</sup> the home country scheme applies.

**Figure 1 – Social policy fields relevant for the movement of workers**

Category/issue	Social security (Regulation 883/2004 & Regulation 987/2009)	Working conditions and pay
1. EU citizens	As nationals	As nationals (national legal and bargaining frame)
2. Self-employed EU citizens	As nationals	As nationals (not regulated)
3. Posted workers	Home country	Directive 96/71

Source: J. Cremers: EU economic freedoms and social dumping, in M. Bernaciak: [Market Expansion and Social Dumping in Europe](#), 2015, p.175.

The [2006 Services Directive](#), transposed in 2009, aims to remove barriers to trade in services in the EU, by simplifying administrative procedures for service providers; enhancing the rights of consumers and businesses receiving services; and fostering cooperation among EU countries. The directive covers a wide range of services including: retail and wholesale trade in goods and services; the activities of most regulated professions such as legal and tax advisers, architects and engineers; construction services; business-related services such as office maintenance, management consultancy and event organisation; and tourism and leisure services.

### European labour law

The EU has limited competence in the field of labour law. The [Treaty on European Union](#) contains provisions enabling the EU to act to facilitate the free movement of workers, and [Article 137](#) of the Treaty establishing the European Community allows for the introduction of directives on working conditions, information and consultation of workers, and equality at work between men and women. In other areas of labour law, legislative competence is limited, and therefore soft law techniques or social dialogue have to be used. Introduced by the [Treaty of Maastricht](#) in 1992, the social dialogue includes representatives of the two sides of industry (management and labour). The agreements concluded between the two parties may be given force of law through a Council decision.

**Enforcement problems**

The applicable EU rules can only be effective if adequate implementation and enforcement by the Member States is guaranteed.<sup>7</sup> In addition, issues such as the authenticity of the recruiter or the existence of an adequate employment contract and the compliance of the latter with the corresponding working conditions, have not always been sufficiently controlled. Another problematic point is the degree to which collective action may be used to resist social dumping.

*Cases before the Court of Justice of the EU*

In several cases (amongst others, the [Viking](#) and [Laval](#) cases – see box), the Court of Justice of the EU (CJEU) was asked to clarify the extent to which collective action may be used to resist social dumping within the EU. The judgments of the Court met with widespread condemnation from labour law experts, who claimed that the Court failed to give due regard to the respect of human rights and placed business freedom above the interests of working people.

**The Viking case**

Viking Line ABP, a ferry operator registered under Finnish law ran regular services on the route between Tallinn and Helsinki. In 2003, the company sought to reflag its vessel by registering it in Estonia, to avoid the higher wages applicable under a collective bargaining agreement governed by Finnish law with the Finnish Seaman's Union (FSU). This had caused Viking to run its services at a loss on the above-mentioned route. The International Transport Workers Federation's (ITWF) policy was to oppose such 'reflagging' for convenience by companies registering their ship abroad in a low labour cost jurisdiction, when their real headquarters are in another country. A member of the ITWF, the FSU, planned industrial action: the ITWF told its partners not to negotiate with Viking and to hinder its business. Viking Line ABP responded by seeking an injunction in the English courts, claiming that the industrial action would infringe its right to freedom of establishment. The CJEU held that, although it was for the national court to ultimately answer the question, it was possible that collective action taken by workers to protect their interests could be unlawful because it infringed the employer's interests under Article 56 TFEU.

**The Laval case**

In 2007, the Latvian company Laval Un Partneri Ltd won a tender from the Swedish government for construction work at a school in the town of Vaxholm. They posted workers from Latvia to Sweden to fulfil the contract. These workers earned much less compared to Swedish workers. The Swedish Building Workers' Union started negotiations with Laval in order to sign its collective agreement with regard to wages and other working conditions (which contained more favourable conditions, as required by the Posted Workers Directive). Laval refused the contract and instead signed a collective agreement in Latvia. Swedish trade unions took action by blockading the construction site. CJEU held that the 'right to take collective action for the protection of the workers of the host state against possible social dumping may constitute an overriding reason of public interest', which could justify an infringement of free movement of services. However, in this case, it did not, because the systems for Sweden's collective bargaining (on a case by case basis) was viewed to be not 'sufficiently precise and accessible' for the company to know its obligations in advance.

**EU activities to counter social dumping****European Commission**

The prevention of social dumping is an important concern for the Commission and as such, it appears in different legislative acts on working mobility, undeclared work or services. The [posting of workers](#)<sup>8</sup> is an area strongly affected by social dumping. The [Posting of Workers Directive](#) (Directive 96/71/EC, adopted in 1996 and in force since

December 1999) provided a first framework to protect the social rights of posted workers and to prevent social dumping. Member States have to ensure that posted workers are subject to the host country's laws, regulations and administrative provisions concerning:

- maximum work periods and minimum rest periods;
- minimum paid annual holidays;
- minimum rates of pay, including overtime rates;
- conditions for hiring out workers, in particular the supply of workers by temporary employment undertakings;
- health, safety and hygiene at work;
- protective measures in the terms and conditions of employment of pregnant women or those who have recently given birth; of children and of young people;
- equal treatment between men and women and other provisions on non-discrimination.

Following an [impact assessment](#) carried out in 2012, which pinpointed the shortcomings of the directive, as well as a European Parliament [resolution](#), the Commission came up with a proposal in March 2012 for an [Enforcement Directive on Posted Workers](#), seeking to improve the implementation and enforcement of the existing Posting of Workers Directive, without changing its provisions. The Directive (2014/67/EU) was adopted by the Parliament and Council in May 2014. Improvements include:

- increased worker and company awareness of their rights and obligations as regards the terms and conditions of employment;
- improved cooperation between national authorities in charge of posting;
- clarified definition of posting, so as to increase legal certainty for posted workers and service providers (while at the same time dealing with the issue of 'letter-box' companies that use posting to circumvent the law);
- defined Member States responsibilities to verify compliance with the rules laid down in the 1996 Directive (designation of specific enforcement authorities responsible for verifying compliance; necessary supervisory and enforcement measures for service providers established in the Member State);
- improved enforcement of rights and the handling of complaints, by requiring both host and home Member States to insure posted workers, with the support of trade unions and other interested third parties;
- ensure that administrative penalties and fines imposed on service providers by one Member State for failure to respect the requirements of the 1996 Directive can be enforced and recovered in another Member State.

The [targeted revision of the Posting of Workers Directive](#) proposed by the European Commission in March 2016 should effect content changes in the directive in three main areas: the remuneration of posted workers (making pay equal to that of local workers, even when subcontracting), more coherent rules on temporary agency workers, and long-term posting. Rules on remuneration and allowances that are applied to local workers in the host Member State would also have to be granted to affect posted workers (with a contract from another Member State). Remuneration would thus not only comprise the minimum rates of pay, but also other elements such as bonuses or allowances (if applicable). In order to ensure equity and transparency, Member States would be required to specify the different constituent elements of remuneration on their territory. In addition, the proposal would ensure that national rules also apply to temporary workers hired out by temporary agencies established in the Member State where the

work is carried out. Further to the protocol on the application of the principles of subsidiarity and proportionality, 11 national parliaments submitted a reasoned opinion.<sup>9</sup> On 20 July 2016, after careful consideration of the Member States' views, the European Commission [concluded](#) that the proposal for a revision of the directive does not constitute a breach of the subsidiarity principle and decided to maintain it.

The 2008 [Directive on Temporary Agency Work](#) delineates a general framework related to the working conditions of temporary workers in the European Union. The Directive's aim is to guarantee a minimum level of protection for temporary workers and to contribute to the development of the temporary work sector, which could be a flexible option for employers and workers. The directive sets out the principle of non-discrimination, as regards the essential conditions of work and of employment, between temporary workers and workers recruited by the user company.

Social dumping has also been under discussion in the context of undeclared work. Mid-2016, following a [proposal](#) of the European Commission, a [European platform against undeclared work](#) was set up, tasked with supporting and coordinating Member States' efforts in preventing, deterring, and fighting undeclared work. The platform's aim is to improve technical and administrative cooperation between different Member States' enforcement authorities at EU level to prevent and deter undeclared work, including falsely declared work and bogus self-employment, more efficiently and effectively. Another aim is to avoid the deterioration in the quality of work, to ensure health and safety at work, and to facilitate the exchange of best practices.

### European Parliament

On 14 September 2016, the Parliament adopted a [resolution](#) on social dumping in the European Union which calls for a number of actions to limit social dumping, such as:

- reinforced controls, cross-border cooperation, and coordination between EU Member States to ensure a level playing field, fair competition and mutual assistance between Member States across the EU;
- addressing regulatory gaps in enforcing the principles of equal pay and equal social protection, amongst others by eliminating legal shortcomings identified in the current rules and addressing risks related to long subcontracting chains;
- combating social dumping for mobile workers in the transport industry, for instance through increased monitoring of the implementation of working time and rest time rules in the road transport industry, by revising the working conditions in the aviation and the shipping services, as well as via the creation of a European Road Transport Agency; and
- promoting social convergence, amongst other things, through specific measures to help women affected by social dumping; by encouraging respect for, and the promotion of, collective bargaining; and by further controlling temporary agencies sending domestic workers to other Member States.

In other cases, Parliament adopted resolutions and decisions on the working conditions of transport workers, such as [Directive 2013/54/EU](#) of the European Parliament and of the Council of 20 November 2013 concerning certain flag State responsibilities for compliance with and enforcement of the Maritime Labour Convention, 2006. With this directive, the Parliament aims to bring the Maritime Labour Convention closer to EU law, with the aim being to reduce social dumping for seafarers.



## Stakeholders' views

Social dumping is a major concern for trade unions. In 2011, the European Trade Union Confederation (ETUC) launched a [consultation](#), to prepare a pan-European drive against wage and social dumping. Amongst other things, they intended to publish a 'black book' revealing instances of social dumping in the Member States.

In the automotive industry, actors try to end social dumping by putting [Transnational Company Agreements](#) (TCAs) in place, an instrument guaranteeing minimum social standards, as well as information and consultation rights. Other social partner organisations, including those in construction, the food industry and transport sectors, have also been developing initiatives in this field.

The business community and employer organisations are also concerned about the issue. In its [2012 Annual Report](#) the European Construction Industry Federation (FIEC) emphasised that prevention of social dumping was decisive for the sector's competitiveness.

## Main references

Bernaciak, M., et al.: [Market Expansion and Social Dumping in Europe](#), 2015.

Buelens, J., Rigaux, M., et al.: [From Social Competition to Social Dumping](#), 2016.

## Endnotes

<sup>1</sup> D. Vaughan-Whitehead, *EU Enlargement versus Social Europe? The Uncertain Future of the European Social Model*, Edward Elgar Publications, Cheltenham, 2003.

<sup>2</sup> Member States which joined the EU in 2004 and after: Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, Slovenia.

<sup>3</sup> L. Berentsen and N. Lillie, *Varieties of social dumping in a pan-European labour market*, in: M. Bernaciak: *Market Expansion and Social Dumping in Europe*, 2015.

<sup>4</sup> Ibid.

<sup>5</sup> The [hospitality sector](#) includes hotel and restaurant industries, as well as art and entertainment services.

<sup>6</sup> A European Commission [proposal](#) for the revision of the existing social security coordination was published on 13 December 2016, as a part of the labour mobility package.

<sup>7</sup> There are already problems at Member State level: the 2014 Posting of Workers Enforcement Directive had been implemented by only 15 Member States by the deadline of 18 June 2016.

<sup>8</sup> A [posted worker](#) is legally employed in a given Member State and is sent by their employer to work temporarily in another EU Member State (where the employer is providing a service).

<sup>9</sup> Bulgaria, the Czech Republic, Denmark, Estonia, Croatia, Latvia, Lithuania, Hungary, Poland, Romania and Slovakia.

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**United States Trade Representative  
February 2023**

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## ABBREVIATIONS

ACFTU	All China Federation of Trade Unions
CBIRC	China Banking and Insurance Regulatory Commission
CED	U.S.-China Comprehensive Economic Dialogue
CFDA	China Food and Drug Administration
CNIPA	China's National Intellectual Property Administration
GACC	General Administration of Customs of China
ISO	International Organization for Standardization
JCCT	U.S.-China Joint Commission on Commerce and Trade
MIIT	Ministry of Industry and Information Technology
MARA	Ministry of Agriculture and Rural Affairs
MOF	Ministry of Finance
MOFCOM	Ministry of Commerce
MOST	Ministry of Science and Technology
MPS	Ministry of Public Security
NBC	National Biosafety Committee
NDRC	National Development and Reform Commission
NMPA	National Medical Products Administration
PBOC	People's Bank of China
SAC	Standardization Administration of China
SAIC	State Administration for Industry and Commerce
SAMR	State Administration for Market Regulation
SASAC	State-owned Assets Supervision and Administration Commission
SAT	State Administration of Taxation
SCLAO	State Council's Legislative Affairs Office
SED	U.S.-China Strategic Economic Dialogue
S&ED	U.S.-China Strategic and Economic Dialogue
SPB	State Postal Bureau
SPC	Supreme People's Court
SPP	Supreme People's Procuratorate
WTO	World Trade Organization

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### FOREWORD

This is the 21st report prepared pursuant to section 421 of the U.S.-China Relations Act of 2000 (P.L. 106-286), 22 U.S.C. § 6951 (the Act), which requires the United States Trade Representative (USTR) to report annually to Congress on compliance by the People's Republic of China (China) with commitments made in connection with its accession to the World Trade Organization (WTO), including both multilateral commitments and any bilateral commitments made to the United States. The report covers calendar year 2022. It also incorporates the findings of the Overseas Compliance Program, as required by section 413(b)(2) of the Act, 22 U.S.C. § 6943(b)(2).

In preparing this report, USTR drew on its experience in overseeing the U.S. Government's monitoring of China's WTO compliance efforts. USTR chairs the Trade Policy Staff Committee (TPSC) Subcommittee on China, an inter-agency body whose mandate is, *inter alia*, to assess China's efforts to comply with its WTO commitments. This TPSC subcommittee is composed of experts from USTR, the Departments of Agriculture, Commerce, Labor, Justice, State and Treasury, the Environmental Protection Agency, the Federal Trade Commission and the U.S. Patent and Trademark Office, among other agencies. Members

of the TPSC subcommittee work closely with State Department economic officers, Foreign Commercial Service officers, Enforcement and Compliance officers and Intellectual Property Attachés from the Commerce Department, Foreign Agricultural Service officers, Customs and Border Protection attachés and Immigration and Customs Enforcement attachés at the U.S. Embassy and Consulates General in China, who are active in gathering and analyzing information, maintaining regular contacts with U.S. industries operating in China and maintaining a regular dialogue with Chinese government officials at key ministries and agencies. The TPSC subcommittee meets in order to evaluate and coordinate U.S. engagement with China in the trade context.

To aid in its preparation of this report, USTR as chair of the TPSC published a notice in the Federal Register on August 29, 2022. The notice asked interested parties to submit written comments. A number of written comments were received from interested parties. In lieu of a public hearing, the TPSC then posed written questions to certain of the interested parties, and the interested parties subsequently responded to those questions in writing. All of these written materials are available at [www.regulations.gov](http://www.regulations.gov) under docket no. USTR-2022-0012.

## EXECUTIVE SUMMARY

### OVERVIEW

In this report, we provide an updated assessment of China's WTO membership. This assessment reveals the unique and very serious challenges that China's state-led, non-market approach to the economy and trade continues to pose for the multilateral trading system. While the United States and other like-minded WTO Members have pursued various WTO-focused strategies over the years to address the unique problems posed by China, it has become clear that new and more effective strategies – including strategies that involve taking actions outside the WTO where necessary – are critically needed to address those problems.

### CHINA'S WTO RECORD

When China acceded to the WTO in 2001, it voluntarily agreed to embrace the WTO's open, market-oriented approach and to embed it in China's trading system and institutions. China also agreed to take on the obligations set forth in existing WTO rules, while also making numerous China-specific commitments. As we previously documented, and as remains true today, China's record of compliance with these terms has been poor.

After more than 20 years of WTO membership, China still embraces a state-led, non-market approach to the economy and trade, despite other WTO Members' expectations – and China's own representations – that China would transform its economy and pursue the open, market-oriented policies endorsed by the WTO. In fact, China's embrace of a state-led, non-market approach to the economy and trade has increased rather than decreased over time, and the mercantilism that it generates has harmed and disadvantaged U.S.

workers and companies, as well as workers and companies of other WTO Members, often severely. China also has a long record of violating, disregarding and evading WTO rules to achieve its industrial policy objectives. China continues to use numerous and constantly evolving unfair, non-market and distortive trade policies and practices in pursuit of harmful and anticompetitive industrial policy objectives. At the same time, China has sought to frustrate WTO oversight mechanisms, such as through its poor record of adhering to its WTO transparency obligations.

### WTO-FOCUSED STRATEGIES

For many years following China's accession to the WTO, a variety of bilateral and multilateral efforts were pursued by the United States and other WTO Members to address the unique challenges presented by China's WTO membership. However, even though these efforts were persistent, they did not result in meaningful changes in China's state-led, non-market approach to the economy and trade.

For example, the United States pursued a dual track approach in an effort to resolve the many concerns that arose in our trade relationship with China. One track involved using high-level bilateral dialogues, and the other track focused on enforcement at the WTO.

The United States approached its bilateral dialogues with China in good faith and put a great deal of effort into them. These dialogues were intended to push China toward complying with and internalizing WTO rules and norms and making other market-oriented changes. However, they only achieved isolated, incremental progress. At times, the United States did secure broad commitments from China for fundamental shifts in the direction of Chinese policies and practices, but these commitments were unenforceable and China repeatedly failed to follow through on them. Moreover, over time, commitments from China became more difficult to secure.

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Meanwhile, at the WTO, the United States brought 27 cases against China, often in collaboration with like-minded WTO Members. The United States secured victories in every one of its cases that was decided. Other WTO Members were also successful in many cases that they brought against China. Still, even when China changed the specific practices that had been challenged, it did not typically change the underlying policies, and meaningful reforms by China remained elusive.

As has become clear, the WTO's dispute settlement mechanism is of only limited value in addressing a situation where a WTO Member is dedicated to a state-led economic and trade regime that prevails over market forces. The WTO's dispute settlement mechanism is designed to address good faith disputes in which one member believes that another member has adopted a measure or taken an action that breaches a WTO obligation. This mechanism is not designed to address a trade regime that broadly conflicts with the fundamental underpinnings of the WTO system. No amount of WTO dispute settlement by other WTO Members would be sufficient to remedy this systemic problem. Indeed, many of the most harmful policies and practices being pursued by China are not even directly disciplined by WTO rules.

In addition to pursuing WTO dispute settlement cases, the United States has actively participated in meetings at the WTO addressing China's adherence to its WTO obligations over the years. For example, the United States took on a leading role in the numerous China-specific Transitional Review Mechanism meetings from 2002 through 2011. However, China consistently approached these meetings in ways that frustrated WTO Members' efforts to secure a meaningful assessment of China's compliance efforts. The United States also raised, and continues to raise, China-related issues at regular meetings of WTO committees and councils, including the WTO's General Council. Among other things, the United States sought to highlight how

China's trade-disruptive economic model works, the costs that it exacts from other WTO Members and the benefits that China receives from it. While these efforts raised awareness among WTO Members, they did not lead to meaningful changes in China's approach to the economy and trade.

In theory, the WTO membership could have adopted new rules expressly requiring members like China to abandon non-market economic systems and state-led, mercantilist trade regimes. For two basic reasons, however, members have not pursued any negotiation of new WTO rules that would change China's current approach to the economy and trade in a meaningful way.

First, new WTO rules disciplining China would require agreement among all WTO Members, including China. China has shown no willingness at the WTO to consider fundamental changes to its economic system or trade regime. Given the extent to which China has benefited and continues to benefit from the current state of affairs, it was not realistic to expect that China would agree to effective new WTO disciplines on its behavior. Indeed, China has been using its WTO membership to develop rapidly – but in an anticompetitive manner that comes at the expense of others. In 2001, when China acceded to the WTO, China's economy was the sixth largest in the world. China's economy is now four times larger than it was in 2001, and it is the second largest economy in the world. China also has risen to become the largest goods trader among WTO Members. It is therefore highly unlikely that China would agree to new WTO disciplines targeted at its policies and practices. In fact, in connection with ongoing discussions at the WTO relating to needed WTO reform, China has stated that it would not alter its state-led, non-market approach to the economy and trade.

Second, China has a long record of not pursuing ambitious outcomes at the WTO. Past agreements, even relatively narrow ones, have been difficult to



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achieve, and even when an agreement is achieved, it is significantly less ambitious because of China's participation.

As these experiences make clear, it is unrealistic to believe that actions at the WTO alone will be sufficient to force or persuade China to make fundamental changes to its economic and trade regime. The WTO system was designed for countries that are truly committed to market principles, not for an economically powerful country determined to maintain a state-led, non-market system, and China has demonstrated no willingness to change its approach in any meaningful way.

### STRATEGIES OUTSIDE THE WTO

In recent years, it became evident to the United States that new strategies were needed to deal with the many problems posed by China's state-led, non-market approach to the economy and trade, including solutions independent of the WTO. For example, the United States launched an investigation into China's acts, policies and practices relating to technology transfer, intellectual property and innovation under Section 301 of the Trade Act of 1974. The findings made in this investigation led to substantial U.S. tariffs on imports from China as well as corresponding retaliation by China. Against this backdrop of rising tensions, in January 2020, the two sides signed what is commonly referred to as the "Phase One Agreement." This Agreement included commitments from China to improve market access for the agriculture and financial services sectors, along with commitments relating to intellectual property and technology transfer and a commitment by China to increase its purchases of U.S. goods and services.

Many of the commitments in the Phase One Agreement reflected changes that China had already been planning or pursuing for its own benefit or that otherwise served China's interests, such as the changes involving intellectual property protection and the opening up of more financial services

sectors. Other commitments to which China agreed reflected a political calculation, as evidenced by the attention paid to the agriculture sector in the Phase One Agreement and the novel commitments relating to China's purchases of U.S. goods and services ostensibly as a means to reduce the bilateral trade deficit.

Given these dynamics, and given China's interest in a more stable relationship with the United States, China followed through in implementing some provisions of the Phase One Agreement. At the same time, China has not yet implemented some of the more significant commitments that it made in the Phase One Agreement, such as commitments in the area of agricultural biotechnology and the required risk assessment that China is to conduct relating to the use of ractopamine in cattle and swine. China has also fallen far short of implementing its commitments to purchase U.S. goods and services in 2020 and 2021.

The reality is that this Agreement did not meaningfully address the more fundamental concerns that the United States has with China's state-led, non-market policies and practices and their harmful impact on the U.S. economy and U.S. workers and businesses. China's government continues to employ a wide array of interventionist industrial policies and supporting measures, which provide substantial government guidance, massive financial resources and favorable regulatory support to domestic industries across the economy, often in pursuit of specific targets for capacity and production levels and market shares. In furtherance of its industrial policy objectives, China has also limited market access for imported goods and services and restricted the ability of foreign manufacturers and services suppliers to do business in China. It has also used various, often illicit, means to secure foreign intellectual property and technology to further its industrial policy objectives.

The principal beneficiaries of these non-market policies and practices are China's state-owned and

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state-invested enterprises and numerous nominally private domestic companies. The benefits that Chinese industries receive largely come at the expense of China's trading partners, including their workers and businesses. As a result, markets all over the world have faced distorted signals, and the playing field is heavily skewed against foreign businesses that seek to compete against Chinese enterprises, whether in China, in the United States or globally.

The industrial policies that flow from China's non-market economic system have systematically distorted critical sectors of the global economy such as steel, aluminum, solar and fisheries, devastating markets in the United States and other countries. At the same time, as is their design, China's industrial policies are increasingly responsible for displacing companies in new, emerging sectors of the global economy, as the Chinese government and the Chinese Communist Party (the CCP or the Party) powerfully intervene in these sectors on behalf of Chinese companies. Companies in economies disciplined by the market cannot effectively compete with both China's domestic companies and the Chinese state.

### NEW STRATEGIES

In the United States' view, new strategies are needed to deal with the many problems posed by China's state-led, non-market approach to the economy and trade, including solutions independent of the WTO. These strategies also need to be based on a realistic assessment of China's economic and trade regime and need to be calibrated not only for the near-term but also for the longer term. Accordingly, as first explained in last year's report, the United States is now pursuing a multi-faceted strategic approach that accounts for the current realities in the U.S.-China trade relationship and the many challenges that China poses for the United

States and other trading partners, both now and likely in the future.

The U.S. Trade Representative announced the initial steps of the United States' strategic approach one year ago. This approach includes several components, which the United States has begun to implement.

First, it is critical that the United States take steps domestically to invest in, and build policies supportive of, the industries of today and tomorrow. Important steps taken to date include the passage of the CHIPS and Science Act, the Inflation Reduction Act and the Infrastructure Investment and Jobs Act.

Second, the United States is continuing to pursue bilateral engagement with China. China is an important trading partner, and every avenue for obtaining real change in its economic and trade regime must be utilized. We are focused on the United States' most fundamental concerns with China's state-led, non-market approach to the economy and trade, which includes China's industrial policies. At the same time, the United States will work to hold China accountable for its existing commitments, including under the Phase One Agreement.

Third, it is clear that domestic trade tools – including updated or new domestic trade tools reflecting today's realities – will be necessary to secure a more level playing field for U.S. workers and businesses. The United States is exploring how best to use and improve domestic trade tools to achieve that end.

Finally, it is equally critical for the United States to work more intensely and broadly with allies and like-minded partners in order to build support for solutions to the many significant problems that China's state-led, non-market approach to the economy and trade has created for the global trading system. This work is taking place in bilateral, regional and multilateral fora, including the WTO.

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### INTRODUCTION

In this report, we first provide a broad assessment of China's WTO membership to date. We then discuss U.S. strategies for addressing the many unique challenges that China's state-led, non-market trade regime continues to pose for the United States and other WTO Members. Finally, we catalogue the many specific trade concerns generated by that trade regime.

### ASSESSMENT OF CHINA'S WTO MEMBERSHIP

In assessing China's WTO membership below, we first recall the terms of China's accession to the WTO. As we have previously explained, these terms included not only commitments to adhere to the rules and principles set forth in the WTO agreements but also an unprecedented number of China-specific commitments intended to address the unique challenges posed by a state-led, non-market economy that appeared to be transitioning toward a market economy. We then review China's record of compliance as a WTO member, which has been poor. Finally, we describe the numerous challenges that still must be confronted in light of China's continued adherence to a state-led, non-market approach to the economy and trade.

### CHINA'S WTO ACCESSION

In July of 1986, China applied for admission to the WTO's predecessor, the General Agreement on Tariffs and Trade (GATT). The GATT formed a Working Party in March of 1987, composed of all interested GATT contracting parties, to examine China's application and negotiate terms for China's accession. For the next eight years, negotiations were conducted under the auspices of the GATT Working Party. Following the formation of the WTO on January 1, 1995, pursuant to the Marrakesh Agreement Establishing the World Trade

Organization (WTO Agreement), a successor WTO Working Party, composed of all interested WTO Members, took over the negotiations.

Like all WTO accession negotiations, the negotiations with China had three basic aspects. First, China provided information to the Working Party regarding its trade regime. China also updated this information periodically during the 15 years of negotiations to reflect changes in its trade regime. Second, each interested WTO Member negotiated bilaterally with China regarding market access concessions and commitments in the goods and services areas, including, for example, the tariffs that would apply on industrial and agricultural goods and the commitments that China would make to open up its market to foreign services suppliers. The most trade liberalizing of the concessions and commitments obtained through these bilateral negotiations were consolidated into China's Goods and Services Schedules and apply to all WTO Members. Third, overlapping in time with these bilateral negotiations, China engaged in multilateral negotiations with Working Party members on the rules that would govern trade with China. Throughout these multilateral negotiations, U.S. leadership in working with China was critical to removing obstacles to China's WTO accession and achieving a consensus on appropriate rules commitments. These commitments are set forth in China's Protocol of Accession and an accompanying Report of the Working Party.

WTO Members formally approved an agreement on the terms of accession for China on November 10, 2001, at the WTO's Fourth Ministerial Conference, held in Doha, Qatar. One day later, China signed the agreement and deposited its instrument of ratification with the Director-General of the WTO. China became the 143rd member of the WTO on December 11, 2001.

China's Protocol of Accession, accompanying Working Party Report and Goods and Services Schedules are available on the WTO's website ([www.wto.org](http://www.wto.org)).

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To accede to the WTO, China agreed to take concrete steps to remove trade barriers and open its markets to foreign companies and their exports from the first day of accession in virtually every product sector and for a wide range of services. Supporting these steps, China also agreed to undertake important changes to its legal framework, designed to add transparency and predictability to business dealings.

Like all acceding WTO Members, China also agreed to assume the obligations of more than 20 existing multilateral WTO agreements. Areas of principal concern to the United States and China's other trading partners, as evidenced by the accession negotiations, included core principles of the WTO, such as most-favored nation treatment, national treatment, transparency and the availability of independent review of administrative decisions. Other key concerns arose in the areas of agriculture, sanitary and phytosanitary measures, technical barriers to trade, trade-related investment measures, customs valuation, rules of origin, import licensing, antidumping, subsidies and countervailing measures, trade-related aspects of intellectual property rights and services. For some of its obligations, China was allowed minimal transition periods, where it was considered necessary.

Through its membership in the WTO, China also became subject to the same expectations as other WTO Members, as set forth in the Marrakesh Declaration issued in April 1994 at the conclusion of the Uruguay Round negotiations. There, among other things, WTO Members expressly affirmed their view that the WTO Member economies would participate in the international trading system based on "open, market-oriented policies."

Even though the terms of China's accession agreement are directed at the opening of China's market to WTO Members, China's accession agreement also includes provisions designed to address issues related to any injury that U.S. or other WTO Members' industries and workers might experience based on import surges or unfair trade

practices, particularly during what was envisioned to be a time of transition for China from a non-market economy to a market economy. These mechanisms include: (1) a special textile safeguard mechanism (which expired on December 11, 2008, seven years after China's WTO accession); (2) a unique, China-specific safeguard mechanism allowing a WTO Member to take action against increasing Chinese imports that disrupt its market (which expired on December 11, 2013, 12 years after China's WTO accession); (3) an expression of the ability of WTO Members to use an antidumping methodology that is not based on a strict comparison with domestic prices or costs in China if the producers under investigation cannot clearly show that market economy conditions prevail in the industry producing the like product with regard to the manufacture, production and sale of that product; and (4) an expression of the ability to use methodologies for identifying and measuring subsidy benefits to Chinese enterprises that are not based on terms and conditions prevailing in China.

With China's consent, the WTO also created a special multilateral mechanism for reviewing China's compliance on an annual basis. Known as the Transitional Review Mechanism, this mechanism operated annually for eight years after China's accession. A final review, looking back over the first 10 years of China's WTO membership, took place in 2011.

### EXPECTATIONS OF WTO MEMBERSHIP

For all WTO Members, the expectations of WTO membership are clearly set forth in the Marrakesh Declaration issued in April 1994 at the conclusion of the Uruguay Round negotiations. There, WTO Members expressly affirmed their view that the establishment of the WTO ushers in a "new era of global economic cooperation" that "reflect[s] the widespread desire to operate in a fairer and more open multilateral trading system." WTO Members further made clear their determination that their economies would participate in the international trading system, based on both "open, market-

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oriented policies” and “the commitments set out in the Uruguay Round Agreements and Decisions.”

As this language makes clear, it was not contemplated that any WTO Member would reject market-based policies in favor of a state-led trade regime. It also was not contemplated that any WTO Member would pursue mercantilist outcomes instead of policies promoting a fairer and more open multilateral trading system. Rather, it was expected that each WTO Member would pursue open, market-oriented policies designed to achieve more efficient outcomes. The pursuit of open, market-oriented policies means not only adhering to the agreed rules but also observing in good faith the fundamental principles that run throughout the many WTO agreements, which include non-discrimination, openness, reciprocity, fairness and transparency.

When China acceded to the WTO in 2001, it agreed to embrace the WTO's open, market-oriented approach and embed it in its trading system and institutions. Through China's commitments and representations, WTO Members understood that China intended to dismantle existing state-led, mercantilist policies and practices, and they expected China to continue on its then-existing path of economic reform and successfully complete a transformation to a market-oriented economy and trade regime.

China's protocol of accession to the WTO sets out China's obligations under the WTO agreements as well as numerous additional China-specific commitments made necessary because of the need for China to transform its approach to the economy and trade. China itself acknowledged “the evolving nature of its economy,” and it confirmed that “a socialist market economy system was applied” in China. Similarly, WTO Members highlighted that “China was continuing the process of transition towards a full market economy.” WTO Members noted, for example, that “the special features of China's economy, in its present state of reform, still

created the potential for a certain level of trade-distorting subsidization.”

For these reasons, it was agreed that special safeguard-like provisions would be included among the terms of China's protocol of accession as protective measures while China completed its transformation into a market economy. As noted above, for example, China's protocol of accession included a China-specific safeguard mechanism, special antidumping rules and special methodologies for identifying and measuring subsidy benefits. It also created a unique, 10-year review mechanism designed to monitor China's progress in implementing its many WTO commitments and to secure updated information on the use of industrial plans by China.

### CHINA'S WTO COMPLIANCE RECORD

As has been catalogued in prior reports, China has a poor record when it comes to complying with WTO rules and observing the fundamental principles on which the WTO agreements are based – non-discrimination, openness, reciprocity, fairness and transparency. Too often, China flouts the rules to achieve industrial policy objectives. In addition, and of more serious concern to the United States and other WTO Members, China has not made sufficient progress in transitioning toward a market economy. China continues to embrace a state-led, non-market and mercantilist approach to the economy and trade. This approach results in sophisticated and expansive policies and practices that often evade WTO disciplines and cause serious harm to markets, workers and industries in the United States and other WTO Members. At the same time, China has used the benefits of WTO membership – including its guarantee of open, non-discriminatory access to the markets of other WTO Members – to become the WTO's largest trader, while resisting calls for further liberalization of its trade regime by claiming to be a “developing” country.

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### Adoption of Market-Oriented Policies

Since last year's report, our assessment of China's record in terms of transitioning to a market economy has not changed. More than 20 years after its accession to the WTO, China has still not embraced open, market-oriented policies. The state remains in control of China's economy, and it heavily intervenes in the market to achieve anticompetitive industrial policy objectives. Indeed, the state's role continues to grow, not recede.

As we detailed in prior reports, China pursues a wide array of continually evolving interventionist policies and practices. It offers substantial government guidance, resources and regulatory support to domestic industries, including China's state-owned enterprises and numerous other domestic companies. At the same time, it also seeks to limit market access for imported goods and services and restrict the ability of foreign manufacturers and services suppliers to do business in China in various ways. The benefits that China's industries realize from these non-market policies and practices largely come at the expense of China's trading partners and their workers and companies, as markets all over the world are distorted, and the playing field is heavily skewed against foreign companies that seek to compete against Chinese companies, whether in China's market or markets outside of China.

This situation has worsened in recent years. Since new leaders assumed power in China in 2013, the state's role in the economy – effectuated by the Chinese government and, increasingly, the CCP – has grown. While China has repeatedly signaled in recent years that it is pursuing “economic reform,” China's concept of “economic reform” differs from the type of change that a country would be pursuing if it were embracing open, market-oriented principles. For China, “economic reform” appears to mean perfecting the management of the economy by the government and the Party and strengthening the state sector, particularly state-owned and state-invested enterprises. Meanwhile, as the state's role

in the economy has increased in recent years, the depth and breadth of challenges facing U.S. and other foreign companies doing business in China – or competing with favored Chinese companies in markets outside of China – have similarly increased.

To fully appreciate the challenges presented by China's non-market economy, it is vital to understand the extent to which the state still maintains control over economic decision-making in China. As we catalogued in prior reports, a thorough examination of China's Constitution, relevant directives and pronouncements by China's leadership, legislative and regulatory measures issued by the Chinese government, China's industrial plans and the actions of the Chinese government and the CCP leave no doubt that the state maintains a tight grip on virtually all economic activity. Indeed, the government and the Party have constitutional mandates to develop a “socialist market economy with Chinese characteristics.” To fulfill these mandates, the framework of China's economy is set by the government and the Party, which exercise control directly and indirectly over the allocation of resources through instruments such as government ownership and control of key economic actors and innumerable government directives. The government and the Party also direct and channel economic actors to meet the state's planning targets. The government and the Party permit market forces to operate only to the extent that they accord with the objectives of national economic and industrial policies. When there is conflict between market outcomes and state objectives, the government and the Party intervene to ensure that the state's objectives prevail.

Aside from the role of the government and the Party in managing the economy, there are also serious concerns over how the government and the Party exercise influence over the operations and investment decisions of both state-owned and state-invested enterprises and private companies, including foreign-invested enterprises. This influence appears to be growing, as the Party is



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increasing its control over key actors in China's economy and not, as had been hoped, enabling China's transition to a market economy.

China claims that its state-owned and state-invested enterprises make business decisions independently of the state and based on market principles. However, the government and the Party continue to exercise control over state-owned and state-invested enterprises. Among other things, they appoint and control key executives through the Chinese Communist Party Organization Department. They also provide state-owned and state-invested enterprises with preferential access to important inputs (such as land and capital) and other competitive advantages unavailable to private Chinese companies. State-owned and state-invested enterprises, in turn, play an outsized role in China's economy. For example, state-owned and state-invested enterprises outstrip private Chinese companies in terms of their share of total credit, their market dominance in key industries and their share of total market capitalization on China's stock market.

Both state-owned and state-invested enterprises and private Chinese companies also host internal Party committees capable of exercising government and Party influence over their corporate governance and business decisions. This arrangement is codified in Chinese law under Article 19 of the *Company Law*, which applies to both state-owned and state-invested enterprises and private Chinese companies. In recent years, moreover, the Party has taken steps to increase the strength and presence of Party committees within all of these companies. For example, state-owned and state-invested enterprises and private Chinese companies are being pressured to amend their articles of association to ensure Party representation on their boards of directors, usually as the Chairman of the Board, and to ensure that important company decisions are made in consultation with Party cells.

Increasingly in recent years, China has also taken "golden shares" in large private Chinese companies.

Under this type of arrangement, the Chinese government via a government guidance fund or other state-backed entity purchases a small stake in the company in exchange for a seat on the board of directors or veto rights. The result is stronger Chinese government oversight and control of the company's operations.

As we explained in prior reports, U.S. industry associations report that the Party is also taking steps to influence the managerial and investment decisions of foreign-invested enterprises in China through the insertion of Party cells. According to these reports, these efforts, in some cases, are beginning to affect the decision-making processes of some Chinese-foreign joint ventures in China.

Further reinforcing the Party's influence over enterprises in China is the *Social Credit System*, a tool endorsed by the Party that the government will increasingly be using to monitor, rate and condition not only the conduct of all individuals in China, but also all domestic and foreign companies in China. This system has become operational, but so far there is no fully integrated national system for assigning comprehensive social credit scores for companies, and the social credit system remains highly fragmented, as local governments experiment with their own pilot social credit schemes. In any event, it appears that the government will use the threat of poor ratings and corresponding adverse consequences under the *Social Credit System*, among other things, to ensure that all economic actors in China operate in accordance with China's industrial policy objectives and do not cross political redlines on sensitive matters like human rights.

Separate from these various mechanisms used to control company behavior, the government and the Party continue to control or otherwise influence the prices of key factors of production. The result is that the means of production in China are not allocated or priced according to market principles. For example, all land in China is property of the state, as either state-owned urban land or collectively owned rural land. The state also exerts a high degree of

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control over energy and other input prices. In addition, there are significant institutional constraints on the extent to which wage rates are determined through free bargaining between labor and management, contrary to International Labor Organization principles. China denies workers the right of association and the right to organize and collectively bargain. China prohibits the formation of independent trade unions to represent workers, and workers do not have the legal right to strike, which is an important lever in collective action and negotiation with management over wages in market economies. In addition, government restrictions on labor mobility continue to inhibit and guide labor flows, causing distortions on the supply side of the labor market.

The government and the Party also exercise strong control over the financial sector. Five large commercial banks that are majority state-owned entities operate large branch networks on a nationwide basis and account for nearly half of total commercial bank assets. There are also three large state-owned policy banks, as well as scores of city commercial banks and credit unions under local government control. In addition to the ownership of these banks by the government, the state exercises other forms of influence over banking decisions. The Party, through its Organization Department, appoints executives in state-owned banks and other state-owned financial institutions. China's central bank, the People's Bank of China (PBOC), also meets frequently with large banks in China to ensure that their lending decisions align with PBOC and government objectives. In addition, the *Law on Commercial Banks* provides that "commercial banks are to conduct their business of lending in accordance with the needs of national economic and social development and under the guidance of the industrial policies of the state."

Similarly, China's legal system continues to function as an instrument by which the government and the Party can secure discrete economic outcomes, channel broader economic policy and pursue industrial policy objectives. Key legal institutions,

such as the courts, are structured to respond to the Party's direction, both broadly and on a case-specific basis. As a general matter, to the extent that companies and individuals seek to act independently of government or Party direction, the legal system does not provide a venue for them to achieve these objectives on a systemic or consistent basis. In addition, companies and individuals continue to face challenges in obtaining impartial outcomes, either because of local protectionism or corruption.

The larger issue of China's restrictions on the freedom of information also impacts China's economic system. For example, while China's Internet firewall and the Party's regular censorship of audio-visual and print media have many negative effects outside China's economic system, they also create distortions in China's economy, and these distortions affect the ability of foreign companies to operate and compete effectively in China's market.

In March 2021, China finalized and issued the *14th Five-Year Plan (2021-2025) for National Economic and Social Development*, which runs from 2021 through 2025. Like its predecessor, the *14th Five-year Plan* covers all sectors of China's economy and is not limited to one overarching plan, but instead will include hundreds of sub-plans. In this regard, various institutions participate in plan formulation and execution, including central government bodies with legislative and regulatory authority, thousands of provincial and local government authorities, various organs of the Party and key Chinese companies.

When compared to the industrial plans of other WTO Members, China's industrial plans are fundamentally different. In several significant ways, China's industrial plans go well beyond traditional approaches to guiding and supporting domestic industries. First, adherence to the objectives of China's industrial plans is effectively mandatory. Chinese companies have little discretion to ignore them, even when market forces would dictate different commercial behavior. Second, the financial support that the state provides to domestic

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industries in support of China's industrial plans is significantly larger than in other countries. The state also provides massive, market-distorting financial support to the ongoing operations of China's domestic industries. This support often leads to severe excess capacity in China – followed by China's widespread dumping of the inevitable excess production into the markets of other WTO Members. This assault on global markets causes serious harm to other WTO Members' industries and workers. The WTO does not provide effective mechanisms for addressing this problem. Third, China's industrial planning is more complex than in any other country, as it is made up of hundreds of plans across industries and at all levels of government. Fourth, China actively seeks to help its domestic producers through myriad additional policies and practices that impede, disadvantage and harm the foreign competition and skew the playing field against imported goods and services and foreign manufacturers and services suppliers.

When combined with the large size of China's economy and China's large share of global trade, the policies and practices that China pursues in support of its industrial plans transform China into a unique and pressing problem for the United States and other market economies as well as for the WTO and the multilateral trading system. Moreover, this troubling situation is not static. New mechanisms to maintain and enhance the state's control over the economy in China continue to emerge.

### Compliance with WTO Rules

Since last year's report, our assessment of China's record in terms of complying with WTO rules and observing the fundamental principles on which the WTO agreements are based has not changed. China's record remains poor.

As we detailed in prior reports, China's economic and trade regime has generated many WTO compliance concerns over the years. Too often,

WTO Members have had to resort to the WTO's dispute settlement mechanism to change problematic Chinese policies and practices. The United States, for example, has brought 27 cases against China at the WTO covering a wide range of important policies and practices, such as: (1) local content requirements in the automobile sector; (2) discriminatory taxes in the integrated circuit sector; (3) hundreds of prohibited subsidies in a wide range of manufacturing sectors; (4) inadequate intellectual property rights enforcement in the copyright area; (5) significant market access barriers in copyright-intensive industries; (6) severe restrictions on foreign suppliers of financial information services; (7) export restraints on numerous raw materials; (8) a denial of market access for foreign suppliers of electronic payment services; (9) repeated abusive use of trade remedies; (10) excessive domestic support for key agricultural commodities; (11) the opaque and protectionist administration of tariff-rate quotas for key agricultural commodities; and (12) discriminatory regulations on technology licensing. Even though the United States has routinely prevailed in these WTO disputes, as have other WTO Members in their disputes against China, they take years to litigate, consume significant resources and often require further efforts when China fails to comply with WTO rules.

In addition, China has often taken steps to obscure its actions to make it more difficult for trading partners to even challenge them in the WTO's adjudicative system. The WTO's dispute settlement mechanism was designed to facilitate the resolution of disagreements over whether an action breaches a WTO obligation, but where the action is so obscured that it is difficult to demonstrate it as a factual matter, the dispute settlement mechanism can fail to be an effective disciplinary tool. In this regard, as USTR has explained in prior reports, China disregards many of its WTO transparency obligations, which places its trading partners at a disadvantage and often serves as a cloak for China to conceal unfair, non-market and distortive trade policies and practices from scrutiny.

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For example, during the first 15 years of its WTO membership, China failed to notify any sub-central government subsidies to the WTO, despite the fact that most subsidies in China are provided by provincial and local governments. The magnitude and significance of this problem is illustrated by the five WTO cases that the United States has brought challenging prohibited subsidies maintained by China. While those cases involved hundreds of subsidies, most of the subsidies were provided by sub-central governments. The United States was able to bring those cases only because of its own extensive investigatory efforts to uncover China's opaque subsidization practices. Most other WTO Members lack the resources to conduct the same types of investigations.

Today, China continues to shield massive sub-central government subsidies from the scrutiny of other WTO Members, while also obscuring massive central government subsidies provided through a newer vehicle known as "government guidance funds." While China claims that the government has no role in these government guidance funds, the facts plainly reveal that these government guidance funds are run by government agencies and state-owned enterprises and provide state capital to Chinese companies. Together with other non-market practices, the massive subsidies provided by China's central government and sub-central governments contribute to the serious excess capacity problems that have been plaguing industries like steel, aluminum, solar panels and fishing and have been devastating global markets and foreign competitors, and similar results can be expected in other industries now being targeted by China for dominance.

As has become clear, the WTO's dispute settlement mechanism has not been effective in addressing the serious issues that arise from a WTO Member's state-led, non-market approach to the economy and trade that systematically disadvantages that Member's trading partners and broadly conflicts with the fundamental, market-oriented underpinnings of the WTO system. The value of the

dispute settlement mechanism is also undermined where a WTO Member does not operate in good faith. As a result, over time, despite the enforcement efforts of the United States and other WTO Members, China has been able to reinforce its state-led, non-market policies and practices, which WTO rules and the dispute settlement mechanism have so far proven unable to discipline effectively.

### UNRESOLVED PROBLEMS

A long list of problems with China's state-led, non-market trade regime persist. Because China is the largest trader among WTO Members, the harm caused by these problems is significantly magnified.

Most importantly, fundamental structural issues remain unaddressed. These include, for example, China's heavy reliance on market-distorting industrial policies covering virtually every sector of the economy, preferential treatment of state enterprises, massive subsidization of domestic industries (including financial support to and through state-owned enterprises and other state entities at multiple levels of government and a banking system dominated by state-owned banks favoring state-owned enterprises and targeted industries), forced technology transfer, state-sponsored theft of intellectual property and severe and persistent non-market excess capacity in key industries.

A host of other serious issues also remain outstanding. Key examples include significant market access restrictions, unjustified non-tariff barriers, import substitution, violations of internationally recognized labor rights (including forced labor), lax or unenforced environmental standards, increased adoption of unique Chinese national standards (including reportedly through the China Standards 2035 plan, which seeks to set the global standards for next-generation technologies), continued gaps in intellectual property protection and enforcement, overly broad cybersecurity regulation designed to favor domestic companies, unwarranted data localization requirements and cross-border data transfer restrictions, the misuse of

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competition policy for industrial policy objectives, purposeful obfuscation of trade and economic policies, especially with regard to China's subsidies practices, and inadequate regulatory transparency.

Overlaying all of these problematic policies and practices is China's economic system. Unlike the U.S. system, China's economic system is state-led, and it facilitates control and direction of all aspects of the economy by the Chinese government and the CCP, along with a reliance on rule *by* law rather than rule *of* law. The very fact that decisions in the marketplace are made based on the goals of the state, rather than based on commercial considerations, distorts the global economy in ways that can weaken and damage trading partners' economies. As has become evident to China's trading partners, one significant result of China's non-market economic system is the creation of excess capacity – that is, capacity that would not have been created and would not persist if market forces were operating properly.

In the past, China itself has acknowledged excess capacity in several industries, including steel, cement, electrolytic aluminum, flat glass and shipbuilding. Numerous other excess capacity industries have been identified by industry associations in the United States and other countries. Some of the Chinese industries most likely to inflict the disastrous consequences of severe excess capacity on the world in the future can be found in the *Made in China 2025* industrial plan. Through that plan, the Chinese government is seeking to create dominant Chinese companies in 10 sectors, including advanced information technology, robotics and automated machine tools, aircraft and aircraft components, maritime vessels and marine engineering equipment, advanced rail equipment, new energy vehicles, electrical generation and transmission equipment, agricultural machinery, new materials and pharmaceuticals and medical devices. By some estimates, the Chinese government is making available more than \$500 billion of financial support to these sectors, often using large government guidance funds that China

attempts to shield from scrutiny by claiming that they are wholly private. Based on the recent history of the steel and aluminum industries, China's non-market distortions in these newer sectors will likely result in oversupply, leading to loss of jobs and production in market economies.

Another example of the harm that can be caused by China's non-market economic system involves forced technology transfer. In USTR's Section 301 investigation into China's unfair acts, policies and practices related to technology transfer, intellectual property and innovation, USTR issued two extensive factual reports that detailed how the Chinese government uses foreign ownership restrictions, such as formal and informal joint venture requirements, to require or pressure technology transfer from U.S. companies to Chinese entities. The reports also explained how China imposes substantial restrictions on, and intervenes in, U.S. companies' investments and activities, including through restrictions on technology licensing terms. In addition, the reports analyzed how the Chinese government directs and unfairly facilitates the systematic investment in, and acquisition of, U.S. companies and assets by Chinese entities to obtain cutting-edge technologies and intellectual property and to generate large-scale technology transfer in industries deemed important by state industrial plans. Finally, the reports illustrated how the Chinese government has conducted or supported cyber intrusions into U.S. commercial networks, with the targets being intellectual property and sensitive commercial information held by U.S. firms. While these reports focused on the harm caused to U.S. interests, it is not a problem borne solely by the United States. As in the case of excess capacity, China's unfair policies and practices relating to forced technology transfer also affect other WTO Members whose companies have developed or are developing advanced technologies.

In addition to severe and persistent excess capacity and forced technology transfer, China's non-market economic system causes other serious harm to industries and workers in the United States and

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other WTO Members. This harm occurs because Chinese companies use the artificial competitive advantages provided to them by the extensive interventionist policies and practices of the Chinese state to undersell their foreign competition around the world. To some extent, the harm to foreign manufacturers is reflected in the very large number of antidumping and countervailing duty investigations that have been initiated against China by the investigating authorities of WTO Members. Since China joined the WTO in 2001, it has been the number one target for both antidumping and countervailing duty investigations. At the same time, many types of interventionist policies and practices are not capable of being addressed by antidumping and countervailing duty regimes, so the harm caused by China's interventionist policies and practices is only partially reflected in those antidumping and countervailing duty investigations.

### U.S. TRADE POLICY TOWARD CHINA

Below, we first summarize the various challenges that the United States and other WTO Members face as a result of China's continued pursuit of a state-led, non-market approach to the economy and trade. We then outline the multi-faceted strategic approach that forms the foundation of the United States' trade policy toward China.

#### CURRENT CHALLENGES

The United States expects, and is seeking to ensure, that its trading partners' economic and trade regimes promote fair, market-oriented conditions for competition. Market orientation implies the freedom for enterprises and individuals to pursue their interests and goals on a level playing field. Indeed, in establishing the WTO, members agreed that "open, market-oriented policies" were at the foundation of the multilateral trading system.

In the case of China, more than 20 years after its accession to the WTO, it has still not embraced market-oriented policies. The state remains in control of China's economy, and it heavily intervenes in the market to achieve national industrial policy objectives. It subsidizes industries that would not otherwise form or thrive, funds acquisitions for the purpose of accessing technologies and directs activities that a private business would not choose to undertake. The evidence is clear, moreover, that when a trading partner with China's size – China is the largest goods trader among WTO Members and the second largest economy in the world – pursues non-market policies and practices, the distortions that it creates impose substantial costs on its trading partners. The Chinese state's decisions in the marketplace are not driven by market factors, but their effects on markets push U.S. and international companies out of sectors, such as steel, aluminum, solar panels and fisheries. Once China's dominance is established, barriers to entry can lock-in China's dominance over the long term. As a result, markets all over the world are less fair and well-functioning than they should be, and the playing field is heavily skewed against U.S. and other foreign companies that seek to compete against Chinese companies, whether in China's market or markets outside of China.

This view is also held by many other WTO Members, particularly the democratic market economies that participated in the Summit for Democracy in December 2021. It has become widely accepted that China's approach to the economy and trade has not moved toward a stronger embrace of open, market-oriented principles and instead has seen a doubling-down on state capitalism "with Chinese characteristics." It has become equally evident that China's approach to the economy and trade has severely harmed workers and businesses in the United States and in many other countries.

In the United States, it has also become widely accepted that the existing WTO rules do not, and cannot, effectively discipline many of China's most



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harmful policies and practices. It is similarly evident to us that China has become quite adept at circumventing the existing rules, as well as the attempted enforcement of those rules, by obscuring state involvement in the economy in ways that the WTO rules did not anticipate at the time of their negotiation.

As a result, while the WTO still has a significant role to play, enforcement of WTO rules has become less significant and solutions independent of the WTO are necessary, including solutions pursued through bilateral engagement and the use of domestic trade tools. It was in large part from that perspective that, in August 2017, the United States launched an investigation under Section 301 of the Trade Act of 1974 into China's unfair acts, policies and practices related to technology transfer, intellectual property and innovation. As reported previously, USTR subsequently issued a detailed report, finding that China had engaged in a range of unfair and harmful conduct. USTR then began the process of imposing tariffs on imports from China and pursued a bilateral negotiation with China that resulted in an economic and trade agreement, commonly referred to as the "Phase One Agreement," which was signed in January 2020.

While substantial Section 301 tariffs remain in place on imports from China, we are not seeking to build a wall between the United States and China. Indeed, even if that were possible, it would not address the problems posed by China. It would also ignore China's importance to, and integration into, the world economy.

Over the last few years, as changes have taken place in how the United States and U.S. stakeholders view the United States' trade relationship with China, it has become apparent that the views of other WTO Members have also been evolving toward this view. More and more trading partners appear to understand that China's state-led, non-market approach to the economy and trade has been severely harming their workers and businesses. While each trading partner is impacted differently by

China, there is also a growing consensus that this situation will not change unless new strategies are pursued.

While the WTO remains a strong focus for the United States and many of the United States' trading partners, there is a growing awareness that it may be necessary to pursue some solutions outside the WTO in order to avoid the severe harm that will likely continue to result from China's state-led, non-market economic and trade regime. For example, some of the United States' trading partners are now exploring possible new domestic trade tools to address the challenges posed by China's state-led trade regime. These and other like-minded trading partners have also begun working with the United States — sometimes confidentially — in pursuit of new joint strategies to address China's harmful non-market policies and practices, including China's increasing use of economic coercion.

At the same time, still other trading partners appear to be replicating some of China's unfair trade practices, or at least accepting them as a result of China's tactics to coerce or entice countries to acquiesce to its practices. Consequently, addressing these practices in China could have the additional benefit of dissuading these countries from following China's example.

Meanwhile, many of China's trading partners are increasingly skeptical of China's rhetoric. For example, China often touts its strong commitment to win-win outcomes in international trade matters, but its actions plainly belie its words. Through state-led industrial plans like *Made in China 2025*, which targets 10 strategic emerging sectors, China pursues a zero-sum approach. It first seeks to develop and dominate its domestic markets. Once China develops, acquires or steals new technologies and Chinese enterprises become capable of producing the same quality products in those industries as the foreign competition, the state suppresses the foreign competition domestically and then supports Chinese enterprises as they "go out" and seek dominant positions in global markets. Based on the

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world's past experiences with industries like steel, aluminum, solar panels and fisheries, a new wave of severe and persistent non-market excess capacity can be expected in industries like those targeted by *Made in China 2025*, to the detriment of China's trading partners.

It has also not gone unnoticed among China's trading partners — particularly the democratic market economies — that China's leadership appears confident in its state-led, non-market approach to the economy and trade and feels no need to conform to global norms. China's leadership demonstrates confidence in its ability to quiet dissenting voices. Indeed, it has become increasingly evident that China's leadership is seeking to establish new global norms that better reflect and support China's approach to the economy and trade and China's governance model, providing a potentially attractive alternative for other authoritarian regimes around the world.

China has also regularly used its economic clout in a coercive way if it perceives that a foreign company or a foreign country has spoken or acted in a way that undermines China's economic and trade interests. This economic coercion can mute international objections to China's non-market policies and practices, even when China flouts the WTO's rules-based international trading system. In recent years, China has increasingly expanded its use of economic coercion to take on foreign governments whose policies or practices are perceived to undermine not only China's economic and trade interests but also China's political interests. China's coercive economic measures in this context have taken a variety of forms, including, for example, import restrictions, export restrictions, restrictions on bilateral investment, regulatory actions, state-led and state-encouraged boycotts, and travel bans. Many countries have been subjected to this economic coercion.

In sum, the reality confronting the United States and other market economies — especially the

democratic market economies — is not simply that China has a different economic system from ours. China plainly does not hold the same core values held by democratic market economies like the United States, China's state-led, non-market approach to the economy and trade conflicts in significant and harmful ways with our market-oriented approaches, to the detriment of our workers and businesses.

### U.S. STRATEGIC APPROACH

As a starting point, any U.S. trade policy toward China must account for current realities in the U.S.-China trade relationship and the many challenges that China poses for the United States and other trading partners, both now and in the future. Given that China's approach to the economy and trade has evolved and become more sophisticated, our strategies also need to evolve and become more sophisticated. We also need to find ways to address — and to protect ourselves against — China's many harmful, non-market policies and practices. Those policies and practices directly harm American workers, farmers and businesses, threaten our technological edge, weaken the resiliency of our supply chains and undermine our national interest. They also inflict similar harm on many of our trading partners.

Given these circumstances, it is clear that any strategic approach pursued by the United States must focus not only on the near-term, but also on the longer term, if the United States is to compete effectively with China. Any strategic approach should also be pursued in coordination with our many important, like-minded trading partners around the world.

Looking back over the first 20 years of China's WTO membership, and observing China's current leadership and clear policy direction, it would be appropriate to assume that the problems currently posed by China will be with us for some time. We

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cannot expect that China will willingly make fundamental changes to its state-led, non-market approach to the economy and trade in the near-term or even the medium-term.

It is also clear that effective strategies for dealing with China need to be flexible. The United States must be prepared to adapt and adjust its strategic approach over time as China's non-market policies and practices evolve and as global trade patterns shift and alliances and interests change.

For all of these reasons, the United States is now pursuing a multi-faceted strategic approach as it seeks to address the unique challenges posed by China and its state-led, non-market approach to the economy and trade. This approach involves the pursuit of strategic domestic investment, bilateral engagement of China, enforcement actions, the deployment of domestic trade tools and close coordination with allies and partners.

### Domestic Investment

The United States has been working to ensure that we are taking the steps domestically to invest in, and build policies supportive of, the industries of today and tomorrow. We therefore have been working to strengthen our economy, our supply chains, our infrastructure, our workers, our farmers and our businesses and to lay a solid foundation for us to continue to innovate and maintain our technological edge. Important steps taken to date include the passage of the CHIPS and Science Act, the Inflation Reduction Act and the Infrastructure Investment and Jobs Act.

### Bilateral Engagement

The United States remains intent on pursuing bilateral engagement with China and is seeking to find areas where some progress can be achieved. China is an important trading partner, and every avenue for obtaining real change in its trade regime must be utilized.

At the same time, it is clear that prior U.S. efforts have not led to fundamental changes in China's trade regime, and many serious challenges remain, including in the wake of the Phase One Agreement. Priority concerns currently include state-led industrial plans that target specific industries for dominance, massive subsidization, the non-market activities of state-owned and state-invested enterprises, severe and persistent excess capacity, discriminatory regulation, forced technology transfer, state-sponsored theft of intellectual property, market access restrictions, repression of internationally recognized labor rights, including the use of forced labor, and economic coercion.

Ultimately, it will be up to China to decide whether and to what extent it is willing to work constructively with the United States to address these significant concerns.

### Enforcement

It is important for the bilateral relationship to demonstrate that China must honor its promises. We therefore have been working to ensure that China lives up to its existing trade commitments, including the ones that China made in the Phase One Agreement.

### Domestic Trade Tools

The use of domestic trade tools is also a key focus of U.S. trade policy toward China. To the extent that China's unfair, non-market and distortive policies and practices persist, the United States is prepared to use domestic trade tools strategically as needed in order to achieve a more level playing field with China for U.S. workers and businesses.

It is also apparent that existing trade tools need to be strengthened, and new trade tools need to be forged. China pursues unfair policies and practices that were not contemplated when many of the U.S. trade statutes were drafted decades ago, and we are

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therefore exploring ways in which to work with the Congress to update our trade tools to counter them.

In one significant action to date, as previously discussed, USTR pursued an investigation under the authority of Section 301 of the Trade Act of 1974 into China's unfair acts, policies and practices related to technology transfer, intellectual property and innovation. In March 2018, after a thorough review and analysis of the evidence, USTR issued a detailed report, finding that China had engaged in a range of unfair and harmful conduct. First, USTR found that China uses foreign ownership restrictions, including joint venture requirements, equity limitations and other investment restrictions, to require or pressure technology transfer from U.S. companies to Chinese entities. USTR also found that China uses administrative review and licensing procedures to require or pressure technology transfer, which, *inter alia*, undermines the value of U.S. investments and technology and weakens the global competitiveness of U.S. companies. Second, USTR found that China imposes substantial restrictions on, and intervenes in, U.S. companies' investments and activities, including through restrictions on technology licensing terms. These restrictions deprive U.S. technology owners of the ability to bargain and set market-based terms for technology transfer. As a result, U.S. companies seeking to license technologies must do so on terms that unfairly favor Chinese recipients. Third, USTR found that China directs and facilitates the systematic investment in, and acquisition of, U.S. companies and assets by Chinese companies to obtain cutting-edge technologies and intellectual property and to generate large-scale technology transfer in industries deemed important by Chinese government industrial plans. Fourth, USTR found that China conducts and supports unauthorized intrusions into, and theft from, the computer networks of U.S. companies. These actions provide the Chinese government with unauthorized access to intellectual property, trade secrets and confidential business information, such as technical data, negotiating positions and sensitive and

proprietary internal business communications. The purpose of these actions is to support China's strategic development goals, including its science and technology advancement, military modernization and economic development.

Based on these findings, the United States took a range of responsive actions. These actions included the successful prosecution of a WTO dispute settlement case challenging Chinese measures that deny foreign patent holders the ability to enforce their patent rights against a Chinese joint venture partner after a technology transfer contract ends and that impose mandatory adverse contract terms that discriminate against and are less favorable for imported foreign technology as compared to Chinese technology, as well as the imposition of substantial additional tariffs on imports of Chinese goods. Over time, as has been previously reported, these tariffs eventually covered \$370 billion of Chinese imports, with additional tariffs of 25 percent on \$250 billion of Chinese imports and additional tariffs of 15 percent on a further \$120 billion of Chinese imports, while China responded through the imposition of retaliatory tariffs on various imports of U.S. goods.

In December 2019, after one year of negotiations, the United States announced that the two sides had finalized the text of an economic and trade agreement, which was later signed in January 2020. This agreement, commonly referred to as the "Phase One Agreement," included commitments from China on intellectual property, technology transfer, agriculture, financial services, currency and foreign exchange, and the purchase of U.S. goods and services. The commitments varied in ambition, and in effectiveness. For example, some commitments related to financial services reflected reforms that China was already contemplating or pursuing, as China had begun easing foreign investment restrictions in some financial services sectors in 2017. In addition, in the area of intellectual property rights, while China committed to make a number of changes to its laws and regulations, China saw many of these changes as now needed by its domestic

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businesses, given their own increasing efforts at innovation. It also remains unclear how faithfully and fairly China will actually enforce the changes to its laws and regulations. Meanwhile, other commitments that China made, such as in the area of technology transfer, are difficult to verify given the tactics that China takes to obscure its activities.

Notably, the Phase One Agreement did not address many of the U.S. concerns that the United States had been seeking to address in its negotiations with China. The unresolved issues included critical concerns in areas such as industrial plans, subsidies, state-owned enterprises, excess capacity, state-sponsored cyber-enabled theft of intellectual property, standards, cybersecurity, data localization requirements, restrictions on cross-border data transfers, competition law enforcement and regulatory transparency as well as certain issues in the areas of intellectual property, technology transfer and services market access that were not addressed in the Phase One Agreement.

In light of the limited progress represented by the Phase One Agreement, the United States did not make major changes to the existing Section 301 tariffs. After some minor adjustments, the United States kept in place tariffs on \$370 billion of Chinese imports, which included 25 percent tariffs on \$250 billion of Chinese imports and 7.5 percent tariffs on \$120 billion of Chinese imports. The United States also decided not to move forward with plans to raise the tariff rate for some of the existing Section 301 tariffs or to impose new tariffs on additional Chinese imports.

Since the Phase One Agreement entered into force in February 2020, the United States has been closely monitoring China's progress in implementing its commitments. The United States has also been utilizing the consultation arrangements set forth in the agreement, including regular meetings required by the agreement between the two sides. Through these many engagements, the United States has raised various concerns that have arisen regarding China's implementation progress. In addition,

official trade data appears to show that China fell far short of implementing its commitments to purchase U.S. goods and services in calendar years 2020 and 2021. Serious concerns with China's implementation efforts have also arisen in other areas, including agriculture, particularly with regard to China's commitments relating to agricultural biotechnology and the risk assessment that China is required to conduct relating to the use of ractopamine in cattle and swine.

### Allies and Partners

The United States cannot do it alone. There are limits to bilateral engagement and the impact of enforcement actions and domestic trade tools. That is why the United States is working more intensely and broadly with allies and like-minded trading partners. Just as we are reassessing our domestic trade tools, we are also re-thinking how the United States engages with its trading partners to address the challenges that China poses for the global economy.

As more and more U.S. allies and like-minded trading partners come to understand the need for new approaches to China, the United States is working more intensely and broadly with them, both in existing international trade fora and initiatives and in new ones. The COVID-19 pandemic, and its impacts on supply chains and global economic conditions, have laid bare the vulnerabilities and interdependencies of global economies and have underscored the need for new coalitions to build up economic security and resiliency. There is a strong need for new thinking and new coalitions of allies and like-minded partners, including not only on a bilateral basis — especially with major trading partners — but also regionally and multilaterally, to find global solutions to the many serious problems posed by China's state-led, non-market approach to the economy and trade.

As part of this effort, the United States is continuing to work directly with allies and like-minded trading

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partners outside of a multilateral organization context in pursuit of new initiatives to explore strategies for addressing the unique problems posed by non-market policies and practices.

For example, the United States and the European Union (EU) have established a Trade and Technology Council, and the United States and Japan have established a Partnership for Trade. In both venues, one important component of the engagement focuses on better understanding and developing strategies for addressing non-market policies and practices.

Notably, as a result of meetings of the Trade and Technology Council held in 2022, the United States and the EU have started to exchange information on China's non-market policies and practices in the medical devices sector and China's extensive use of government guidance funds that provide financial support to domestic companies. The two sides have also expressed serious concerns regarding China's use of economic coercion, including against allies and partners of the United States and the EU, and resolved to cooperate on strategies for addressing this problem.

Separately, the United States and the EU also held the first Ministerial Meeting of the Working Group on Large Civil Aircraft in 2022. The two sides agreed to continue the Working Group's efforts to confront the challenges posed by China's non-market policies and practices.

Over the past year, the United States, the EU and Japan have also begun to deepen their trilateral work, focusing on the identification of problems arising from non-market policies and practices, the identification of gaps in existing trade tools and where further work is needed to develop new tools to address non-market policies and practices, and possible cooperation in utilizing existing tools. The three trading partners have also highlighted the importance of WTO reform in an effort to build a

free and fair rules-based multilateral trading system that benefits all its members and helps secure shared prosperity for all.

The United States is also holding discussions with many other like-minded trading partners, including in the Indo-Pacific region, on how to strengthen our existing trade relationships. Given that trade with China poses so many serious risks and potential harms, the United States believes that market economies should enhance their trade with each other.

As part of its discussions with like-minded trading partners, the United States is also working to make critical supply chains less vulnerable and more secure, sustainable and resilient. The United States recognizes the need to cooperate with trading partners to diversify international suppliers and reduce geographic concentration risk, especially in China, and to address vulnerabilities that can result in shortages of key goods. This joint work can also enable more effective responses to non-market policies and practices that have eroded critical supply chains.

At the same time, the United States is continuing to pursue initiatives at the WTO. For example, the U.S. agenda at the WTO includes pushing for and building support for meaningful WTO reforms to update the organization and respond to contemporary challenges, including China's accession to the WTO. One U.S. proposal relates to "special and differential treatment," where certain WTO Members rely on self-declared developing country status to inappropriately seek "special and differential treatment" to avoid making meaningful commitments in WTO negotiations. The United States has also offered, and will continue to pursue, proposals to respond to certain policies and practices of China and other non-market economies. They include a proposal intended to increase consequences for WTO Members who fail to adequately notify industrial subsidies.



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Similar work is taking place in fora such as the Group of Seven (G7), the Group of Twenty and the Organization for Economic Cooperation and Development. For example, at the G7 Leaders Meeting, held in June 2022, the United States and the other members of the G7 discussed the challenges that China's non-market policies and practices pose to the multilateral trading system. They agreed to continue to build a shared understanding of this problem and to consult on collective approaches for addressing it. They also specifically committed to work together to develop coordinated actions to ensure a level playing field, to counter economic coercion and to reduce strategic dependencies.

### SPECIFIC TRADE CONCERNS

At present, China pursues numerous unfair, non-market and distortive policies and practices that cause particular concern for the United States and U.S. stakeholders. The key concerns are summarized below.

#### STATE-LED, NON-MARKET TRADE REGIME

##### Industrial Plans

China continues to pursue a wide array of industrial plans and related policies that seek to limit market access for imported goods, foreign manufacturers and foreign services suppliers, while offering substantial government guidance, resources and regulatory support to Chinese companies. The beneficiaries of these constantly evolving policies are not only state-owned enterprises but also other domestic Chinese companies.

One of the more far-reaching and harmful industrial plans is *Made in China 2025*. China's State Council released this industrial plan in May 2015. It is a 10-year plan targeting 10 strategic sectors, including advanced information technology, automated machine tools and robotics, aviation and spaceflight

equipment, maritime engineering equipment and high-tech vessels, advanced rail transit equipment, new energy vehicles (NEVs), power equipment, farm machinery, new materials, biopharmaceuticals and advanced medical device products. While ostensibly intended simply to raise industrial productivity through more advanced and flexible manufacturing techniques, *Made in China 2025* is emblematic of China's evolving and increasingly sophisticated approach to "indigenous innovation," which is evident in numerous supporting and related industrial plans. Under China's harmful and anticompetitive approach to indigenous innovation, the common, overriding aim is to replace foreign technologies, products and services with Chinese technologies, products and services in the China market through any means possible so as to enable Chinese companies to dominate international markets.

*Made in China 2025*, which represents the first 10 years of a 30-year strategy known as the "Strong Manufacturing Nation Strategy," seeks to build up Chinese companies in the 10 targeted, strategic sectors at the expense of, and to the detriment of, foreign companies and their technologies, products and services through a multi-step process over 10 years. The initial goal of *Made in China 2025* is to ensure, through various means, that Chinese companies develop, extract or acquire their own technology, intellectual property and know-how and their own brands. The next goal of *Made in China 2025* is to substitute domestic technologies, products and services for foreign technologies, products and services in the China market. The final goal of *Made in China 2025* is to capture much larger worldwide market shares in the 10 targeted, strategic sectors.

In pursuit of these goals, subsequently released documents set specific targets for capacity and production levels and market shares for the dozens of industries that comprise the 10 broad sectors targeted in *Made in China 2025*. In October 2015, China's National Manufacturing Strategic Advisory Committee published the *Made in China 2025 Key*

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*Area Technology Roadmap*, and since then it has published two updated editions of this document. The first update took place in February 2018, with the issuance of the *Made in China 2025 Key Area Technology and Innovation Greenbook – Technology Roadmap (2017)*. Like its predecessor, the updated document sets explicit market share and other targets to be attained by Chinese companies in dozens of high-technology industries, often both in the China market and globally. For example, it calls for “indigenous new energy vehicle annual production” to have a “supplying capacity that can satisfy more than 80 percent of the market” in China by 2020, up from a 70 percent target set in the 2015 document. In November 2020, the 2017 document was updated with the issuance of the *Made in China Key Area Technology Innovation Greenbook – Technology Roadmap (2019)*.

Many of the policy tools being used by the Chinese government to achieve the goals of *Made in China 2025* raise serious concerns. Several of these tools are unprecedented and include a wide array of state intervention and support designed to promote the development of Chinese industry in large part by restricting, taking advantage of, discriminating against or otherwise creating disadvantages for foreign enterprises and their technologies, products and services. Indeed, even facially neutral measures can be applied in favor of domestic enterprises, as past experience has shown, especially at sub-central levels of government.

*Made in China 2025* also differs from industry support pursued by other WTO Members in its level of ambition and, perhaps more importantly, in the scale of resources the government is investing in the pursuit of its industrial policy goals. Indeed, by some estimates, the Chinese government is making available more than \$500 billion of financial support to the *Made in China 2025* sectors, often using large government guidance funds, which China attempts to shield from scrutiny by claiming that they are wholly private. Even if China fails to fully achieve the industrial policy goals set forth in *Made in China 2025*, it is still likely to create or exacerbate market

distortions and create severe excess capacity in many of the targeted sectors. It is also likely to do long-lasting damage to U.S. interests, as well as the interests of the United States’ allies and partners, as China-backed companies increase their market share at the expense of foreign companies operating in these sectors.

While public references to *Made in China 2025* subsided after June 2018 reportedly in response to an order from the central government, it is clear that China remains committed to achieving the underlying goals of *Made in China 2025* and continues to seek dominance for Chinese firms in the sectors that it views as strategic, both in China’s market and globally. For example, in September 2020, the central government issued a guiding opinion encouraging investment in “strategic emerging industries,” a term used to describe an earlier initiative from which *Made in China 2025* evolved. Among other things, the guiding opinion called for the support and creation of industrial clusters for strategic emerging industries, along with the use of various types of government support and funding. The guiding opinion specifically encouraged provincial and local governments to support industries such as advanced information technology, NEVs and biopharmaceuticals.

In March 2021, the National People’s Congress passed the *14th Five-Year Plan (2021-2025) for National Economic and Social Development (the 14th Five-Year Plan)*, together with a document titled *Long-Range Objectives Through Year 2035*. The *14th Five-Year Plan* and subsequently issued sector-specific five-year plans, along with five-year plans issued by sub-central governments, make clear that China will continue to pursue its industrial policy objectives. While industrial plans like *Made in China 2025* were not named in the *14th Five-Year Plan*, there continues to be overlap between the industries identified in China’s five-year plans with both *Made in China 2025* industries and strategic emerging industries. In addition, other longer-ranging industrial plans, such as the *New Energy Vehicle Industry Development Plan (2021-2035)* and

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*China Standards 2035*, continue to demonstrate China's commitment to a state-led, non-market approach to the economy and trade.

### Technology Transfer

For years, longstanding and serious U.S. concerns regarding technology transfer remained unresolved, despite repeated, high-level bilateral commitments by China to remove or no longer pursue problematic policies and practices. In August 2017, USTR sought to address these concerns by initiating an investigation under Section 301 focused on policies and practices of the Government of China related to technology transfer, intellectual property and innovation. Specifically, in its initiation notice, USTR identified four categories of reported Chinese government conduct that would be the subject of its inquiry: (1) the use of a variety of tools to require or pressure the transfer of technologies and intellectual property to Chinese companies; (2) depriving U.S. companies of the ability to set market-based terms in technology licensing negotiations with Chinese companies; (3) intervention in markets by directing or unfairly facilitating the acquisition of U.S. companies and assets by Chinese companies to obtain cutting-edge technologies and intellectual property; and (4) conducting or supporting cyber-enabled theft and unauthorized intrusions into U.S. commercial computer networks for commercial gains. In March 2018, USTR issued a report supporting findings that the four categories of acts, policies and practices covered in the investigation are unreasonable or discriminatory and burden and/or restrict U.S. commerce. In November 2018, USTR issued an updated report that found that China had not taken any steps to change its problematic policies and practices. Based on the findings in USTR's Section 301 investigation, the United States took a range of responsive actions, including the pursuit of a successful WTO case challenging certain discriminatory technology licensing measures maintained by China in addition to the imposition of additional tariffs on Chinese imports.

The Phase One Agreement, signed in January 2020, addresses certain aspects of the unfair trade practices of China that were identified in USTR's Section 301 report. In the agreement, China committed to end its longstanding practice of forcing or pressuring foreign companies to transfer their technology to Chinese companies as a condition for obtaining market access, securing administrative approvals or receiving advantages from the Chinese government. China also committed to provide transparency, fairness and due process in administrative proceedings and to ensure that technology transfer and licensing take place on market terms that are voluntary and reflect mutual agreement. Separately, China committed to refrain from directing or supporting outbound investments aimed at acquiring foreign technology pursuant to its distortive industrial plans.

Since the entry into force of the Phase One Agreement in February 2020, the United States has continually engaged with the U.S. business community, which has expressed concern about China's informal, unwritten actions that force or pressure U.S. companies to transfer their technology to Chinese entities, including as a condition for obtaining market access. The United States has engaged China as issues arise and will continue to monitor developments closely.

### Indigenous Innovation

Policies aimed at promoting China's so-called "indigenous innovation" continue to represent an important component of China's industrialization efforts. Through intensive, high-level bilateral engagement with China since 2009, the United States has attempted to address these policies, which provide various preferences when intellectual property is owned or developed in China, both broadly across sectors of China's economy and specifically in the government procurement context.

For example, at the May 2012 meeting of the U.S.-China Strategic and Economic Dialogue (S&ED),

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China committed to treat intellectual property owned or developed in other countries the same as intellectual property owned or developed in China. The United States also used the U.S.-China Joint Commission on Commerce and Trade (JCCT) process in 2012 and subsequent discussions to press China to revise or eliminate specific measures that appeared to be inconsistent with this commitment. At the December 2014 JCCT meeting, China clarified and underscored that it will treat intellectual property owned or developed in other countries in the same manner as domestically owned or developed intellectual property. Once again, however, these commitments were not fulfilled. China continues to pursue myriad policies that require or favor the ownership or development of intellectual property in China.

The United States secured a series of similar commitments from China in the government procurement context, where China agreed to de-link indigenous innovation policies at all levels of the Chinese government from government procurement preferences, including through the issuance of a State Council measure mandating that provincial and local governments eliminate any remaining linkages by December 2011. Many years later, however, this promise had not been fulfilled. At the November 2016 JCCT meeting, in response to U.S. concerns regarding the continued issuance of scores of inconsistent measures, China announced that its State Council had issued a document requiring all agencies and all sub-central governments to “further clean up related measures linking indigenous innovation policy to the provision of government procurement preference.”

Over the years, the underlying thrust of China's indigenous innovation policies has remained unchanged, as China's leadership has continued to emphasize the necessity of advancing indigenous innovation capabilities. Through plans such as the *14th Five-Year Plan for the Protection and Utilization of National Intellectual Property Rights*, China has continued to implement discriminatory policies encouraging “indigenous intellectual property

rights” and “core technologies” that are owned or developed in China. Accordingly, USTR has been using mechanisms like a Section 301 investigation to seek to address, among other things, China's use of indigenous innovation policies to force or pressure foreigners to own or develop their intellectual property in China.

### STATE-OWNED ENTERPRISES

While many provisions in China's WTO accession agreement indirectly discipline the activities of state-owned and state-invested enterprises, China also agreed to some specific disciplines. In particular, it agreed that laws, regulations and other measures relating to the purchase of goods or services for commercial sale by state-owned and state-invested enterprises, or relating to the production of goods or supply of services for commercial sale or for non-governmental purposes by state-owned and state-invested enterprises, would be subject to WTO rules. China also affirmatively agreed that state-owned and state-invested enterprises would have to make purchases and sales based solely on commercial considerations, such as price, quality, marketability and availability, and that the government would not directly or indirectly influence the commercial decisions of state-owned and state-invested enterprises.

In subsequent bilateral dialogues with the United States, China made further commitments. In particular, China committed to develop a market environment of fair competition for enterprises of all kinds of ownership and to provide them with non-discriminatory treatment in terms of credit provision, taxation incentives and regulatory policies.

However, instead of adopting measures giving effect to its commitments, China instead took steps intended to strengthen the role of state-owned and state-invested enterprises in the economy and to protect them against foreign competition. China established the State-owned Asset Supervision and Administration Commission (SASAC) and adopted

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the *Law on State-owned Assets of Enterprises* in addition to numerous other measures that mandate state ownership and control of many important industrial sectors. The CCP also ensured itself a decisive role in state-owned and state-invested enterprises' major business decisions, personnel changes, project arrangements and movement of funds. The fundamental premise of these measures was to enable the government and the Party to intervene in the business strategies, management and investments of these enterprises in order to ensure that they play a dominant role in the national economy in line with the overall objective of developing China's "socialist market economy" and China's industrial plans. Over the past few years, Party leadership in state-owned and state-invested enterprises has been strengthened through practices such as appointing a person as both the chairman of the board and the Party secretary for a state-owned enterprise.

Separately, the Chinese government also has issued a number of measures that restrict the ability of state-owned and state-invested enterprises to accept foreign investment, particularly in key sectors. Some of these measures are discussed below in the Investment section.

In its 2013 *Third Plenum Decision*, China endorsed a number of far-reaching economic reform pronouncements, which called for making the market "decisive" in allocating resources, reducing Chinese government intervention in the economy, accelerating China's opening up to foreign goods and services and improving transparency and the rule of law to allow fair competition in China's market. It also called for "reforming" China's state-owned and state-invested enterprises.

However, rather than actually embrace the role of the market, China sought to strengthen the role of the state in the economy. Statements by China's President also made clear that China continues to view the role of the state very differently from the United States and other democratic market

economies. In October 2016, he called for strengthening the role of the CCP in state-owned enterprises and emphasized that state-owned enterprises should be "important forces" to implement national strategies and enhance national power. In February 2019, in an article in a CCP journal, he further called for the strengthening of the Party's "leadership over the rule of law," and he vowed that China "must never copy the models or practices of other countries" and "we must never follow the path of Western 'constitutionalism,' 'separation of powers' or 'judicial independence.'"

With regard to the reform of China's state-owned enterprises, one example of China's efforts included an announcement that China would classify these enterprises into commercial, strategic or public interest categories and require commercial state-owned and state-invested enterprises to garner reasonable returns on capital. However, this plan also allowed for divergence from commercially driven results to meet broadly construed national security interests, including energy and resource interests and cyber and information security interests. Similarly, in recent years, China has pursued reforms through efforts to realize "mixed ownership." These efforts included pressuring private companies to invest in, or merge with, state-owned and state-invested enterprises as a way to inject innovative practices into and create new opportunities for inefficient state-owned and state-invested enterprises.

China has also previously indicated that it would consider adopting the principle of "competitive neutrality" for state-owned enterprises. However, China has continued to pursue policies that further enshrine the dominant role of the state and its industrial plans when it comes to the operation of state-owned and state-invested enterprises. For example, China has adopted rules ensuring that the government continues to have full authority over how state-owned and state-invested enterprises use allocations of state capital and over the projects that state-owned enterprises pursue.

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Overall, while China's efforts at times have appeared to signal a high-level determination to accelerate needed economic reforms, those reforms have not materialized. Indeed, the Chinese state's role in the economy has increased rather than decreased. It also seems clear that China's past policy initiatives were not designed to reduce the presence of state-owned and state-invested enterprises in China's economy or to force them to compete on the same terms as private commercial operators. Rather, the reform objectives were to strengthen state-owned and state-invested enterprises and to place them on a more competitive footing, both in China and globally, through consolidation, increased access to state capital, preferential access to goods and services and the use of other policies and practices designed to give these enterprises artificial advantages over their private competitors.

This unfair situation is made worse for foreign companies. Like China's state-owned and state-invested enterprises, China's private companies also benefit from a wide array of state intervention and support designed to promote the development of China's domestic industries in accordance with China's industrial plans. These interventions and support are deployed in concert with other policies and practices that restrict, take advantage of, discriminate against or otherwise create disadvantages for foreign companies and their technologies, products and services.

### SUBSIDIES

#### Industrial Subsidies

China continues to provide massive subsidies to its domestic industries, which have caused injury to U.S. industries. Some of these subsidies also appear to be prohibited under WTO rules. To the extent possible, the United States has sought to address these subsidies through countervailing duty proceedings conducted by the Commerce

Department and dispute settlement cases at the WTO.

The United States and other WTO Members also have continued to press China to notify all of its subsidies to the WTO in accordance with its WTO obligations while also submitting counter notifications listing hundreds of subsidy programs that China has failed to notify. China's WTO subsidy notifications have marginally improved over the years in terms of timeliness and completeness. Nevertheless, since joining the WTO more than 20 years ago, China has not yet submitted to the WTO a complete notification of subsidies maintained by the central government, and it did not notify a single sub-central government subsidy until July 2016, when it provided information largely only on sub-central government subsidies that the United States had challenged as prohibited subsidies in a WTO case.

The United States began working with the EU and Japan in 2018 to identify further effective action and potential rules that could address problematic subsidies practices not currently covered by existing obligations. In January 2020, the trade ministers of the United States, the EU and Japan issued a statement agreeing to strengthen the WTO subsidy rules by: (1) prohibiting certain egregious types of subsidies; (2) requiring the subsidizing country to demonstrate for other distortive subsidy types that the subsidy provided did not cause adverse effects; (3) building upon the existing "serious prejudice" rules; (4) putting some teeth into the notification rules; and (5) developing a new definition of what constitutes a "public body." In November 2021, the trade ministers of the United States, the EU and Japan renewed their commitment to work together, including with regard to the identification of areas where further work is needed to develop new tools and other measures to address non-market policies and practices. Since then, the United States, the EU and Japan have also been working together at the staff level to uncover China's subsidies practices in specific sectors, such as the semiconductors sector.



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### Excess Capacity

Because of its state-led approach to the economy, China is the world's leading offender in creating non-market capacity, as evidenced by the severe and persistent excess capacity situations in several industries. China is also well on its way to creating severe excess capacity in other industries through its pursuit of industrial plans such as *Made in China 2025*, pursuant to which the Chinese government is doling out hundreds of billions of dollars to support Chinese companies and requiring them to achieve preset targets for domestic market share – at the expense of imports – and global market share in each of 10 advanced manufacturing industries.

In manufacturing industries such as steel and aluminum, China's economic planners have contributed to massive excess capacity in China through various government support measures. For steel, the resulting over-production has distorted global markets, harming U.S. workers and manufacturers in both the U.S. market and third country markets, where U.S. exports of steel products compete with exports from China. This over-production has similarly harmed the workers and manufacturers of many of the United States' allies and partners. While China has publicly acknowledged excess capacity in these industries, among others, it has yet to take meaningful steps to address the root causes of this problem in a sustainable way.

From 2000 to 2021, China accounted for 71 percent of global steelmaking capacity growth, an increase well in excess of the increase in global and Chinese demand over the same period. Currently, China's capacity represents about one-half of global capacity and more than twice the combined steelmaking capacity of the EU, Japan, the United States and Brazil.

At the same time, China's steel production is continually reaching new highs, eclipsing demand. In 2020, China's steel production climbed above one billion metric tons for the first time, reaching 1,065

million metric tons, a seven percent increase from 2019, and remained high at 1,033 million metric tons in 2021, despite a significant contraction in domestic steel demand. This sustained ballooning of greenhouse gas (GHG) emissions-intensive steel production, combined with weakening economic growth and a slowdown in the Chinese construction sector, has flooded the global market with excess steel supply at a time when the steel sector outside of China is still recovering from the severe demand shock brought on by the COVID-19 pandemic and the ongoing effects of Russia's war of aggression against Ukraine. In 2021, China exported more steel than the world's second and third largest steel producers, India and Japan, combined. Today, China remains by far the world's largest exporter of steel.

Similarly, primary aluminum production capacity in China increased by more than 1,400 percent between 2000 and 2021, with China accounting for more than 80 percent of global capacity growth during that period. Much of this capacity addition has been built with government support, has taken place during periods of decline in global aluminum prices and relies on GHG emissions-intensive sources of electricity. China's primary aluminum capacity now accounts for more than 57 percent of global capacity and is more than double the capacity of the next ten aluminum-producing countries combined. As in the steel sector, China's aluminum production has also ballooned in recent years, as China's aluminum production has continued to increase despite global demand shocks. China's capacity and production continue to contribute to major imbalances and price distortions in global markets, harming U.S. aluminum producers and workers.

Excess capacity in China hurts various U.S. workers and industries not only through direct exports from China to the United States, but also through its impact on global prices and supply, which makes it difficult for competitive manufacturers throughout the world to remain viable. Indeed, domestic industries in many of China's trading partners continue to petition their governments to impose trade measures to respond to the trade-distortive

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effects of China's excess capacity. In addition, the United States has acted under Section 232 of the Trade Expansion Act of 1962 to increase import duties on steel and aluminum products after finding that excessive imports are a threat to U.S. national security.

### Agricultural Domestic Support

For several years, China has been significantly increasing domestic subsidies and other support measures for its agricultural sector. China maintains direct payment programs, minimum support prices for basic commodities and input subsidies. China has implemented a cotton reserve system, based on minimum purchase prices, and cotton target price programs. In 2016, China established subsidies for starch and ethanol producers to incentivize the purchase of domestic corn, resulting in higher volumes of exports of processed corn products from China in 2017 and 2018. In addition, in 2022, China began encouraging soybean production through various support programs, such as through increased subsidies for crop rotations, awards to counties with high oilseed production, incentives to promote the intercropping of corn and soybeans, and subsidies for "demonstration farming" of soybeans on alkali and salty land.

China submitted a notification concerning domestic support measures to the WTO in May 2015, but it only provided information up to 2010. In December 2018, China notified domestic support measures for the period 2011-2016. This notification showed that China had exceeded its *de minimis* level of domestic support for soybeans (in 2012, 2014 and 2015), cotton (from 2011 to 2016), corn (from 2013 to 2016), rapeseed (from 2011 to 2013) and sugar (2012). The situation was likely even worse, as the methodologies used by China to calculate domestic support levels result in underestimates. Moreover, the support programs notified by China seemingly failed to account for support given at the sub-national level by provincial and local governments and, possibly, support administered through state-owned enterprises.

In September 2016, the United States launched a WTO case challenging China's government support for the production of wheat, corn and rice as being in excess of China's commitments. Like other WTO Members, China committed to limit its support for producers of agricultural commodities. China's market price support programs for wheat, corn and rice appear to provide support far exceeding the agreed levels. This excessive support creates price distortions and skews the playing field against U.S. farmers. In October 2016, consultations took place. In January 2017, a WTO panel was established to hear the case. Hearings before the panel took place in January and April 2018, and the panel issued its decision in February 2019, ruling that China's domestic support for wheat and rice was WTO-inconsistent. China originally agreed to come into compliance with the panel's recommendations by March 31, 2020. The United States subsequently agreed to extend this deadline to June 30, 2020. In July 2020, the United States submitted a request for authorization to suspend concessions and other obligations pursuant to Article 22 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) on the ground that China had failed to bring its measures into compliance with its WTO obligations. After China objected to this request, the matter was referred to arbitration in accordance with Article 22 of the DSU. The arbitration is currently suspended, and the United States continues to closely monitor the operation of China's market price support programs for wheat and rice.

### Fisheries Subsidies

It is estimated that China is the world's largest provider of harmful fisheries subsidies, with support exceeding \$4 billion annually. These subsidies contribute to overfishing and overcapacity that threatens global fish stocks. Indeed, China is the world's largest producer of marine capture fisheries and, in the years since its WTO accession, has continued to support its fishing fleet through subsidies and other market-distorting means. China's annual fisheries harvest is nearly double that

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of the next largest producer in the world in terms of marine capture and triple that of other top producers, like the United States, India and Japan. At the same time, reports continue to emerge about Chinese-flagged fishing vessels engaging in illegal, unreported and unregulated (IUU) fishing in distant waters, including in areas under the jurisdiction of other WTO Members. While China has made some progress in reducing subsidies to domestic fisheries, it continues to shift its overcapacity to international fisheries by providing a much higher rate of subsidy support to Chinese distant water fishery enterprises.

For several years, the United States has been raising its long-standing concerns over China's fisheries subsidies programs. In 2015, the United States submitted a written request for information pursuant to Article 25.8 of the WTO Agreement on Subsidies and Countervailing Measures (Subsidies Agreement). This submission addressed fisheries subsidies provided by China at central and sub-central levels of government. The subsidies at issue were set forth in nearly 40 measures and included a wide range of subsidies, including fishing vessel acquisition and renovation grants, grants for new fishing equipment, subsidies for insurance, subsidized loans for processing facilities, fuel subsidies and the preferential provision of water, electricity and land. When China did not respond to this request, the United States submitted an Article 25.10 counter notification covering these same measures. More recent subsidy notifications by China have been more fulsome, but still incomplete.

In addition, the United States has long been an active and constructive participant in the WTO fisheries subsidies negotiations, pressing for a meaningful outcome to prohibit the most harmful types of fisheries subsidies. The United States and various like-minded WTO Members have put forward several proposals designed to achieve an ambitious outcome for those negotiations. Notably, in June 2022, WTO Members adopted the text of the WTO Agreement on Fisheries Subsidies, which includes several important disciplines, including prohibitions on subsidies to vessels or operators

engaged in IUU fishing, subsidies to fishing regarding stocks that are overfished and subsidies to fishing on the unregulated high seas. This agreement also contains robust transparency provisions to strengthen WTO Members' subsidy notifications and to enable effective monitoring of WTO Members' implementation of their obligations. The agreement will enter into force when it has been accepted by two-thirds of WTO Members.

Going forward, the United States will continue to investigate the full extent of China's fisheries subsidies and will continue to press China to fully comply with its relevant WTO subsidy obligations. The United States also will urge WTO Members to support additional, ambitious disciplines on harmful fisheries subsidies as part of the further WTO negotiations on fisheries subsidies.

## IMPORT POLICIES

### Trade Remedies

As of December 2022, China had in place 121 antidumping measures, affecting imports from 17 countries or regions. China also had in place seven countervailing duty measures, affecting imports from five countries or regions. The greatest systemic shortcomings in China's antidumping and countervailing duty practice continue to be in the areas of transparency and procedural fairness. Over the years, China has often utilized antidumping and countervailing duty investigations as more of a retaliatory tool than as a mechanism to nullify the effects of dumping or unfair subsidization within its domestic market. In response, the United States has pressed China bilaterally, in WTO meetings and through written comments submitted in connection with pending antidumping and countervailing duty proceedings to adhere strictly to WTO rules in the conduct of its trade remedy investigations.

The conduct of antidumping investigations by China's Ministry of Commerce (MOFCOM) continues to fall short of full commitment to the fundamental

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tenets of transparency and procedural fairness embodied in the WTO's Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994, commonly known as the Antidumping Agreement. The United States and other WTO Members accordingly have expressed concerns about key lapses in transparency and procedural fairness in China's conduct of antidumping investigations. The principal areas of concern include: MOFCOM's inadequate disclosure of key documents placed on the record by domestic Chinese producers; insufficient disclosures of the essential facts underlying MOFCOM decisions, such as dumping margin calculations and evidence supporting injury and dumping conclusions; MOFCOM's failure to issue supplemental questionnaires in instances where MOFCOM identifies information deficiencies; the improper rejection of U.S. respondents' reported cost and sales data; the unjustified use of facts available; and MOFCOM's failure to adequately address critical arguments or evidence put forward by interested parties. These aspects of China's antidumping practice have been raised with MOFCOM in numerous proceedings over the past several years.

A review of China's conduct of countervailing duty investigations makes clear that, as in the antidumping area, China needs to improve its transparency and procedural fairness when conducting these investigations. In addition, the United States has noted procedural concerns specific to China's conduct of countervailing duty investigations. For example, China initiated investigations of alleged subsidies that raised concerns, given the requirements regarding "sufficient evidence" in Article 11.2 of the Subsidies Agreement. The United States is also concerned about China's application of facts available under Article 12.7 of the Subsidies Agreement.

On several occasions in the past, the United States has expressed serious concerns about China's pursuit of antidumping and countervailing duty remedies that appear to be retaliatory and intended to discourage the United States and other trading

partners from the legitimate exercise of their rights under WTO antidumping and countervailing duty rules and the trade remedy provisions of China's accession agreement. More recently, it also appears that China has used arbitrary economic and trade measures, including antidumping and countervailing duty investigations, as a form of economic coercion designed to achieve China's political goals. Obvious examples include MOFCOM's antidumping and countervailing duty investigations of imports of Australian barley and Australian wine.

In certain recent investigations of U.S. imports, China has determined — without legal or factual support — that costs and prices in certain U.S. markets are distorted, and therefore unusable, because of so-called "non-market situations." For example, in four final antidumping determinations on imports of n-propanol, polyphenylene sulfide, ethylene propylene diene monomer and polyvinyl chloride from the United States in 2020 and 2021, China found a "non-market situation" in certain energy sectors in the United States. However, these findings were made without defining the term "non-market situation" or identifying any legal basis in China's law to make these findings. Separately, in the final countervailing duty determination on imports of n-propanol from the United States, China also found that alleged subsidies to the U.S. oil and gas sector automatically passed through to petrochemical products without providing the analysis required by the Subsidies Agreement.

### Tariff-Rate Quota Administration for Agricultural Commodities

Market access promised through the tariff-rate quota (TRQ) system set up pursuant to China's WTO accession agreement has yet to be fully realized as of December 2022. Due to China's poorly defined criteria for applicants, unclear procedures for distributing TRQ allocations and failure to announce quota allocation and reallocation results, traders are unsure of available import opportunities and producers worldwide have reduced market access opportunities. As a result, China's TRQs for wheat,

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corn and rice seldom fill even when they are oversubscribed. For example, from 2020 to 2022, China's corn imports significantly exceeded TRQ levels, but the TRQ issuance, application and allocation processes lacked transparency, and large state-owned enterprises in China appear to have been the only beneficiaries of the increased imports.

In December 2016, the United States launched a WTO case challenging China's administration of TRQs for wheat, corn and rice. Consultations took place in February 2017. A WTO panel was established to hear the case at the United States' request in September 2017, and 17 other WTO Members joined as third parties. The panel issued its decision in April 2019, ruling that China's administration of tariff-rate quotas for wheat, corn and rice was WTO-inconsistent. In July 2021, the United States submitted a request for authorization to suspend concessions and other obligations pursuant to Article 22 of the DSU on the ground that China had failed to bring its measures into compliance with its WTO obligations. After China objected to this request, the matter was referred to arbitration in accordance with Article 22 of the DSU. The arbitration is currently suspended, and the United States continues to closely monitor China's ongoing administration of the tariff-rate quotas for wheat, corn and rice.

As part of the Phase One Agreement, China agreed that, from December 31, 2019, its administration of TRQs for wheat, corn and rice would conform to its WTO obligations. In addition, China agreed to make specific improvements to its administration of the wheat, corn and rice TRQs, including with regard to the allocation methodology, and to the treatment of non-state trading quota applicants. China also committed to greater transparency. To date, however, China has not demonstrated full implementation of these commitments.

### VAT Rebates for Agricultural Commodities

The Chinese government attempted to manage imports of primary agricultural commodities by

raising or lowering the value-added tax (VAT) rebate to manage domestic supplies. China sometimes reinforces its domestic objectives by imposing or retracting VATs. These practices have caused tremendous distortion and uncertainty in the global markets for wheat, corn and soybeans, as well as intermediate processed products of these commodities.

## ENVIRONMENTAL POLICIES

### Import Ban on Scrap Materials

Currently, China restricts almost all imports of unprocessed scrap materials. China only allows imports of certain processed scrap materials, including "recycled raw materials" such as copper, steel, aluminum and brass that meet purity standards, pelletized scrap plastic and pulped scrap paper.

Since 2017, China has issued numerous measures that limit or ban imports of most scrap and recovered materials, such as certain types of plastic, paper and metals. China has also employed import licensing and inspection measures to restrict imports of scrap materials contrary to international standards and practices. Notably, China does not universally apply similar restrictions to domestic processors of domestically sourced scrap and recovered materials.

In 2020, China amended the *Law on the Prevention and Control of Environmental Pollution by Solid Waste*. This amended law is designed to "basically realize zero imports of solid waste."

U.S. exports to China of the unprocessed scrap and recovered materials covered by China's restrictive measures totaled \$479 million in 2016, the year before China started to pursue its more restrictive policies. U.S. exports of these materials to China have been significantly reduced.

In addition to impacting the global market for scrap and recovered materials, the tightened restrictions

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have raised the costs of recycling in the United States, leading some communities to end recycling programs. While markets for U.S. scrap and recovered materials have shifted, taking up some of the lost exports to China, significant amounts of U.S. scrap materials have not found new buyers, leading to increased landfilling and incineration and increased demand for virgin materials globally.

### Import Ban on Remanufactured Products

China prohibits the importation of remanufactured products, which it typically classifies as used goods. China also maintains restrictions that prevent remanufacturing process inputs (known as cores) from being imported into China's customs territory, except special economic zones. These import prohibitions and restrictions undermine the development of industries in many sectors in China, including mining, agriculture, healthcare, transportation and communications, because companies in these industries are unable to purchase high-quality, lower-cost remanufactured products produced outside of China. Nevertheless, China is apparently prepared to pay this price in order to limit imports of remanufactured goods.

### LABOR

The Chinese government represses internationally recognized labor rights and does not adequately enforce existing prohibitions on forced labor. China has been the subject of international attention for its forced labor practices, especially in the Xinjiang Uyghur Autonomous Region (Xinjiang), where China has arbitrarily detained more than one million Uyghurs and other mostly Muslim minorities. Victims, news media and think tanks report that factories, including factories producing cotton and tomato products, frequently engage in coercive recruitment, limit workers' freedom of movement and communication and subject workers to constant surveillance, retribution for religious beliefs, exclusion from community and social life, and isolation. It is currently estimated that hundreds of thousands of Uyghurs, ethnic Kazakhs and members

of other Muslim minority groups are being subjected to forced labor in China following detention. Based on the U.S. Government's independent analysis of these sources, the U.S. Government has taken several actions to address forced labor and other human rights abuses in Xinjiang.

U.S. Customs and Border Protection has issued several withhold release orders (WROs) pursuant to section 307 of the Tariff Act of 1930 based on information that reasonably indicates the use of detainee or prison labor and situations of forced labor in Xinjiang, including a region-wide WRO on cotton and tomato products from Xinjiang in January 2021. The scope of this WRO includes cotton and tomatoes and downstream products that incorporate these products as inputs.

In July 2021, the United States issued an updated Xinjiang Supply Chain Business Advisory for U.S. businesses whose supply chains run through Xinjiang, China. The advisory calls urgent attention to U.S. businesses' supply chain risks and identifies serious investing and sourcing considerations for businesses and individuals with exposure to entities engaged in forced labor and other human rights abuses linked to Xinjiang. The advisory also describes U.S. government actions taken to date to counter the use of forced labor in Xinjiang and to prohibit the importation of goods produced in whole or in part with forced labor or convict labor.

In December 2021, President Biden signed into law the Uyghur Forced Labor Prevention Act (UFLPA), which, among other things, establishes a rebuttable presumption that the importation of goods from Xinjiang is prohibited under section 307 of the Tariff Act of 1930. This rebuttable presumption took effect in June 2022.

In advance of the rebuttable presumption taking effect, several U.S. agencies hosted a public hearing on the use of forced labor in China. Witnesses, included private individuals, industry associations, consultancy and risk-management companies, civil society organizations, non-governmental



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organizations (NGOs), labor unions and others who shared their views on potential measures to prevent the importation of goods mined, produced or manufactured wholly or in part with forced labor in China into the United States. The UFLPA's Strategy, which was published in June 2022, takes this witness testimony into account. The main components of the Enforcement Strategy include (1) an assessment of the risk of importing goods made with forced labor in China, (2) the development of the UFLPA Entity List and descriptions of forced-labor schemes, (3) the consideration of efforts, initiatives and tools to identify and trace the origin of goods, (4) a description of relevant legal authorities and tools to prevent entry of violative goods, (5) a description of resources, (6) the development of importer guidance and (7) the development of a coordination plan with NGOs and the private sector.

In June 2022, President Biden issued the Memorandum on Combating Illegal, Unreported, and Unregulated Fishing and Associated Labor Abuses. The Memorandum notes that, if left unchecked, IUU fishing and associated labor abuses threaten the livelihoods and human rights of fishers around the world and will undermine U.S. economic competitiveness, national security and fishery sustainability. It also notes that this behavior will exacerbate the environmental and socioeconomic effects of climate change. In December 2022, the Treasury Department sanctioned individuals associated with China's distant water fishing vessels for serious human rights abuse, including forced labor, of workers aboard these vessels.

It also remains concerning that China does not adhere to certain other internationally recognized labor standards, including the freedom of association and effective recognition of the right to collective bargaining. Chinese law provides for the right to associate and form a union, but does not allow workers to form or join an independent union of their own choosing. Unions must affiliate with the official All-China Federation of Trade Unions (ACFTU), which is under the direction of the CCP. Workers at enterprises in China are required to

accept the ACFTU as their representative. They cannot instead select another union or decide not to have any union representation. Only collective bargaining through the ACFTU is permitted, and there is no legal obligation for an employer to bargain in good faith. Striking is also prohibited.

## SANITARY AND PHYTOSANITARY MEASURES

### Overview

China remains a difficult and unpredictable market for U.S. agricultural exporters, largely because of inconsistent enforcement of regulations and selective intervention in the market by China's regulatory authorities. China's unwillingness to routinely follow science-based, international standards and guidelines and to apply regulatory enforcement in a transparent and rules-based manner further complicates and impedes agricultural trade.

### Agricultural Biotechnology Approvals

The Chinese regulatory approval process for agricultural biotechnology products creates significant uncertainty among developers and traders, slowing commercialization of products and creating adverse trade impacts, particularly for U.S. exports of corn, soy and alfalfa. It continues to be inordinately lengthy, causing uncertainty among traders and limiting trade, particularly for U.S. exports of corn and alfalfa. In addition, the asynchrony between China's biotechnology product approvals and the product approvals made by other countries has widened considerably in recent years.

For many years, biotechnology product approvals by China's regulatory authorities mainly materialized only after high-level political intervention. In the Phase One Agreement, the United States was able to secure China's commitment to implement a transparent, predictable, efficient and science- and risk-based system for the review of products of agricultural biotechnology. The agreement also called for China to improve its regulatory

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authorization process for agricultural biotechnology products, including by completing reviews of products for use as animal feed or further processing within an average of no more than 24 months and by improving the transparency of its review process. China also agreed to work with importers and the U.S. government to address situations involving low-level presence of genetically engineered (GE) materials in shipments. In addition, China agreed to establish a regulatory approval process for all food ingredients derived from genetically modified microorganisms (GMMs), rather than continue to restrict market access to GMM-derived enzymes only.

In 2021, China held two meetings of the National Biosafety Committee (NBC), the body responsible for biosafety approval of GE products. In total, China issued new biosafety certificates for only two GE crops for import, both of which were cotton products. China also renewed existing biosafety certificates that were due to expire for 32 GE crops for import. In 2022, China held an NBC meeting in March that led only to one new biosafety certificate for a crop for import, a soybean product, while renewing existing certificates for 10 GE crops for import. The NBC also held a meeting in December resulting in the issuance of new biosafety certificates for six products that had been developed by U.S. companies. Three of them were cotton products, two of them were alfalfa products, and one of them was a canola product. All of the companies' applications had been pending for well over 24 months, including three for more than 10 years and two others for more than five years.

Meanwhile, since 2021, China has issued numerous approvals and renewals for Chinese developers. China has issued approximately 165 new biosafety certificates for products intended for domestic cultivation, including 126 new GE cotton products, eight new GE corn products and two new GE soybean product.

China's approach to agricultural biotechnology remains among the most significant commitments

under the Phase One Agreement for which China has not demonstrated full implementation. There remains a significant lack of transparency regarding the procedures for convening meetings of the NBC, including regarding dates and agenda items for these meetings and the process for notifying applicants of outcomes and for soliciting additional information to support product applications. While the NBC is required to meet at least two times each year, the meetings are not held pursuant to a regular schedule, and information about the meetings is not widely shared with the public in a transparent and predictable manner. In addition, in conducting its approval process, China continues to ask for information that is not relevant to a product's intended use or information that applicants have previously provided. For this and other reasons, China has not reduced the average time for its approval process for agricultural biotechnology products for feed or further processing to no more than 24 months, as it had committed to do, even when taking into account the approvals issued following the December 2022 NBC meeting.

### Food Safety Law

China's ongoing implementation of its 2015 *Food Safety Law* has led to the introduction of myriad new measures. These measures include exporter facility and product registration requirements for almost all food and agricultural products. Overall, China's notification of these measures to the WTO TBT Committee and the WTO Sanitary and Phytosanitary Committee (SPS Committee) has been uneven.

Despite facing strong international opposition and agreeing to a two-year implementation delay of an official certification requirement for all food products, China's regulatory authorities issued draft measures for public comment in November 2019 that would require the registration of all foreign food manufacturers. The United States submitted comprehensive written comments on the draft measures to China's regulatory authorities. The United States also raised concerns about them before the WTO TBT Committee and the WTO SPS

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Committee. More than 15 WTO Members supported the concerns raised by the United States.

In April 2021, China's regulatory authorities issued final versions of these measures, now known as Decrees 248 and 249, with an implementation date of January 1, 2022. In correspondence delivered to foreign missions in Beijing in September 2021, China's regulatory authorities laid out a non-transparent, multi-tier system where producers of certain products are required to be registered by foreign regulatory authorities, while producers of other products are eligible to self-register. Decrees 248 and 249 also establish new labeling and conformity assessment requirements.

These Decrees and similar prior measures continue to place excessive strain on food producers, traders and exporting countries' regulatory authorities, with no apparent added benefit to food safety. They instead provide China with a tool to control food imports, as decided by China's state planners, and to retaliate against food producers from countries whose governments challenge Chinese government policies or practices in non-trade areas.

According to China's customs authorities, by July 1, 2023, certain foreign food producers will be required to upload additional detailed information to China's online facility registration portal, and foreign regulatory authorities will be required to review and certify the uploaded information. These tasks are fundamentally beyond the traditional roles of regulatory authorities. If implemented, these new requirements will impose even greater burdens on food manufacturers and food safety regulatory authorities and will therefore pose a new threat to food trade with China.

In the Phase One Agreement, China committed that it would not implement food safety regulations that are not science- or risk-based and that it would only apply food safety regulations to the extent necessary to protect human life or health. China also agreed to certain procedures for registering U.S. facilities that produce various food products. Despite repeated

U.S. requests for clarification regarding the relationship between the facility registration procedures set forth in the Phase One Agreement and the requirements of Decrees 248 and 249, China has not provided sufficient information.

### Poultry

Starting in February 2022, the United States notified China of detections of high pathogenicity avian influenza (HPAI) in multiple U.S. states. In the ensuing months, several states recovered from these detections, and they were deemed HPAI-free by the United States. The United States submitted reports to China for these states and requested approval to resume exporting poultry from these states to China. China has yet to confirm the restoration of market access.

In the Phase One Agreement, China agreed to maintain measures consistent with the World Organization for Animal Health (WOAH) guidelines for future outbreaks of avian influenza. China also agreed to sign a regionalization protocol within 30 days of entry into force of the agreement, which it did, to help avoid unwarranted nationwide animal disease restrictions in the future. This protocol requires that China resume acceptance of poultry imports from states with HPAI detections within five days of receiving a U.S. report that the states are HPAI-free.

### Beef

In May 2017, China committed to allow the resumption of U.S. beef shipments into its market consistent with international food safety and animal health standards. However, China back-tracked one month later and insisted that it would retain certain conditions relating to veterinary drugs, growth promotants and animal health that were inconsistent with international food safety and animal health standards. For example, China insisted on maintaining a zero-tolerance ban on the use of beta-agonists and synthetic hormones commonly used by global cattle producers under

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strict veterinary controls and following Codex Alimentarius (Codex) guidelines. Beef from only about three percent of U.S. cattle qualified for importation into China under these conditions.

In the Phase One Agreement, China agreed to expand the scope of U.S. beef products allowed to be imported, to eliminate age restrictions on cattle slaughtered for export to China and to recognize the U.S. beef and beef products' traceability system. China also agreed to establish maximum residue levels (MRLs) for three synthetic hormones legally used for decades in the United States consistent with Codex standards and guidelines. Where Codex standards and guidelines do not yet exist, China agreed to use MRLs established by other countries that have performed science-based risk assessments.

While China confirmed to the United States that it had adopted Codex-consistent MRLs for use of the three synthetic hormones in beef, China still has not published the MRLs. The lack of publication contributes to regulatory ambiguity for U.S. beef producers and traders, who remain uncertain regarding which products will be allowed for import into China. China's failure to publish the MRLs is another example of China's inadequate implementation of the Phase One Agreement.

### Pork

China maintains an approach to U.S. pork that is inconsistent with international standards, limiting the potential of an important export market given China's growing meat consumption and major shortages of domestic pork due to African swine fever. Specifically, China bans the use of certain veterinary drugs and growth promotants instead of accepting the MRLs set by Codex.

As part of the Phase One Agreement, China agreed to broaden the list of pork products that are eligible for importation, including processed products such as ham and certain types of offal that are inspected by the U.S. Department of Agriculture's Food Safety

and Inspection Service for both domestic and international trade. China also agreed to conduct a risk assessment for ractopamine in swine and cattle as soon as possible and to establish a joint working group with the United States to discuss next steps based on the risk assessment. To date, China has not completed the risk assessment and therefore has not yet made any progress on next steps based on the risk assessment, which will need to include the establishment of MRLs or import tolerances.

## TECHNICAL BARRIERS TO TRADE

### Standards

The Chinese government continues to pursue improvements in its standards system, including by moving from a government-led system to one that incorporates both government guidance and "bottom up" input from the marketplace. At the same time, the Chinese government also continues to limit foreign participation in standards setting and, at times, pursue unique national standards for strategic reasons.

In January 2018, China's revised *Standardization Law* entered into force. Since then, China has issued numerous implementing measures, some of which contain positive references to the ability of foreign-invested enterprises to participate in China's standardization activities and purport to recognize the value of international standards. Unfortunately, many of these implementing measures cause concern for U.S. industry as they appear to focus on the development of Chinese standards without sufficient consideration being given to existing, internationally developed standards. In addition, they do not explicitly provide that all foreign stakeholders may participate on equal terms with domestic competitors in all aspects of the standardization process, and they fall short of explicitly endorsing internationally accepted best practices.

As these implementing measures have been issued, China's existing technical committees have

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continued to develop standards. U.S. and other foreign companies have reported that they are often not permitted to participate in these domestic standards-setting processes, and even in technical committees where participation has been possible for some foreign stakeholders, it has typically been on terms less favorable than those applicable to their domestic competitors. For example, the technical committee for cybersecurity standards (known as TC-260) allows foreign companies to participate in standards development and setting, with several U.S. and other foreign companies being allowed to participate in some of the TC-260 working groups. However, foreign companies are not universally allowed to participate as voting members, and they report challenges to participating in key aspects of the standardization process, such as drafting. They also remain prohibited from participating in certain TC-260 working groups, such as the working group on encryption standards.

Over the years, U.S. stakeholders have also reported that, in some cases, Chinese government officials have pressured foreign companies seeking to participate in the standards-setting process to license their technology or intellectual property on unfavorable terms. In addition, China has continued to pursue unique national standards in a number of high technology areas where international standards already exist. The United States continues to press China to address these specific concerns, but to date this bilateral engagement has yielded minimal progress.

Notably, U.S. concerns about China's standards regime are not limited to the implications for U.S. companies' access to China's market. China's ongoing efforts to develop unique national standards aims eventually to serve the interests of Chinese companies seeking to compete globally, as the Chinese government's vision is to use the power of its large domestic market to influence the development of international standards. The United States remains very concerned about China's policies with regard to standards and has expressed, and will

continue to express, concerns to China bilaterally and multilaterally as China continues to develop and issue implementing measures for its revised *Standardization Law*.

In October 2021, the Central Committee of the Chinese Communist Party and the State Council issued the *Outline for the Development of National Standardization*, which set targets for China's standardization system. It reiterates the desire for China's standardization system to be both guided by the government and driven by the market. It also calls for China's standardization system to refocus from quantity to quality and to shift from a domestic focus to an equal domestic and international focus. In addition, it calls for standards to support not just a particular industry, but also the economy and society as a whole.

The October 2021 *Outline for the Development of National Standardization* is partly based on an initiative that China announced in 2019, known as *China Standards 2035*. A lack of transparency with regard to the initiative's findings is troubling, particularly given longstanding global concerns about inadequate foreign participation in China's standards-setting processes, China's use of standards that differ from international standards without basis and certain licensing practices in China's standards-setting processes.

### Cosmetics

Over the past several years, the United States and U.S. industry have engaged with China's Food and Drug Administration (CFDA) and its successor, the National Medical Products Administration (NMPA), to highlight serious concerns with China's regulation of cosmetics. Currently, the regulation of cosmetics in China is governed by the Cosmetics Supervision and Administration Regulation (CSAR), which was issued in June 2020 and entered into effect in January 2021. The United States has repeatedly raised serious concerns with the CSAR and its numerous implementing measures, both bilaterally and in meetings of the WTO TBT Committee and the

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Council for Trade in Goods, as have several other WTO Members.

The CSAR implementing measures contain provisions that would require companies to disclose full product formulations, ingredient suppliers, manufacturing methods, claims and safety data to both NMPA and local agents in China when products are registered or notified. In addition, these measures require companies to publish claims abstracts that may contain trade secrets and confidential business information on NMPA's website. The United States has expressed concern to China that its regulators are applying the same approach to general and special cosmetics as is used with drugs and medical devices, despite the generally lower risk in cosmetics. China's filing and registration requirements for cosmetics also significantly diverge from those in other major markets and do not align with international standards, making compliance very burdensome for importers.

The United States is particularly concerned that the CSAR implementing measures do not provide adequate assurances as to how undisclosed information, trade secrets and confidential business information will be protected from unauthorized disclosure. China also has not addressed requests from the United States and cosmetics right holders that NMPA provide a legally enforceable mechanism to monitor and protect the trade secrets and confidential business information typically identified by companies in their cosmetics filings.

In addition, China continues to require duplicative in-country testing to assess many product and ingredient safety and performance claims, without considering the applicability of international data or other means of establishing conformity. In response to U.S. concerns, China indicated that it would allow foreign laboratories with facilities in China to conduct its required testing. However, this change does not address the burden of China's requirement, which does not consider the applicability of testing conducted via internationally recognized

laboratories outside of China, as well as other means used by foreign regulators and industries to assess the conformity of product and ingredient safety and performance claims.

The United States also questions China's assertion that its cosmetics good manufacturing practices (GMP) requirements provide equal treatment for imported and domestic general and special cosmetics. If the government of a cosmetics importer does not issue GMP or manufacturing export certificates, the only means that China provides to establish conformity with China's GMP for general cosmetics is animal testing. The United States and other WTO Members have made repeated requests that China consider the many alternative means available to establish GMP conformity, including utilizing second party or third party certificates based upon the ISO 22716 Cosmetics GMP Guidelines. China also provides no means for exemptions regarding GMP for imported special cosmetics.

In sum, after years of the United States engaging with China bilaterally and via the International Cooperation on Cosmetics Regulation, the WTO and other fora to share views and expertise regarding the regulation of cosmetics, China has not yet addressed key U.S. concerns, including the use of international standards and good regulatory practices to facilitate cosmetics conformity assessment and avoid discriminatory treatment, nor has it provided confidence that U.S. intellectual property will be protected. Until China addresses these concerns, many U.S. companies will be impeded in accessing, or simply unable to access, the China market.

### INVESTMENT RESTRICTIONS

China seeks to protect many domestic industries through a restrictive investment regime. Many aspects of China's current investment regime continue to cause serious concerns for foreign investors. For example, China's *Foreign Investment Law* and implementing regulations, both of which



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entered into force in January 2020, perpetuate separate regimes for domestic investors and investments and foreign investors and investments and invite opportunities for discriminatory treatment.

There has also been a lack of substantial liberalization of China's investment regime, evidenced by the continued application of prohibitions, foreign equity caps and joint venture requirements and other restrictions in certain sectors. China's most recent version of its *Foreign Investment Negative List*, which entered into force in January 2022, leaves in place significant investment restrictions in a number of areas important to foreign investors, such as key services sectors, agriculture, certain extractive industries and certain manufacturing industries. With regard to services sectors in particular, China maintains prohibitions or restrictions in key sectors such as cloud computing services and other Internet-related services, telecommunications services, film production and film distribution services, and video and entertainment software services.

China's *Foreign Investment Law*, implementing regulations and other related measures suggest that China is pursuing the objective of replacing its case-by-case administrative approval system for a broad range of investments with a system that would only be applied to "restricted" sectors. However, it currently remains unclear whether China is fully achieving that objective in practice. Moreover, even for sectors that have been liberalized, the potential for discriminatory licensing requirements or the discriminatory application of licensing processes could make it difficult to achieve meaningful market access. In addition, the potential for a new and overly broad national security review mechanism, and the increasingly adverse impact of China's *Cybersecurity Law*, *Data Security Law* and *Personal Information Protection Law* and related implementing measures, including ones that unduly restrict cross-border data flows and impose data localization requirements, have serious negative implications for foreign investors and investments.

Foreign companies also continue to report that Chinese government officials may condition investment approval on a requirement that a foreign company transfer technology, conduct research and development (R&D) in China, satisfy performance requirements relating to exportation or the use of local content or make valuable, deal-specific commercial concessions.

Over the years, the United States has repeatedly raised concerns with China about its restrictive investment regime. Given that China's investment restrictions place pressure on U.S. companies to transfer technology to Chinese companies, they were a focus of USTR's Section 301 investigation. The responsive actions taken by the United States in that investigation are intended in part to address this concern.

### COMPETITION POLICIES

In March 2018, as part of a major government reorganization, China announced the creation of the State Administration for Market Regulation (SAMR), a new agency that incorporated the former anti-monopoly enforcement authorities from the National Development and Reform Commission (NDRC), MOFCOM and the State Administration of Industry and Commerce (SAIC) into one of its bureaus. It had been hoped that more centralized anti-monopoly enforcement would lead to policy adjustments that address the serious concerns raised by the United States and other WTO Members in this area, but to date it does not appear to have led to significant policy adjustments.

In November 2021, China elevated the status of SAMR's anti-monopoly bureau, by designating a vice minister as its official-in-charge and re-naming it the National Anti-monopoly Bureau. It remains to be seen how this elevated status will impact anti-monopoly policy enforcement in China.

In June 2022, the National People's Congress Standing Committee passed amendments to the *Anti-Monopoly Law*. These amendments gave SAMR

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expanded authority to evaluate and investigate potential anti-competitive behavior, as well as the authority to impose higher fines, up to 50 percent of an alleged violator's annual sales, in order to punish actions determined to be anti-competitive.

As previously reported, China's implementation of the *Anti-monopoly Law* has generated various concerns. A key concern is the extent to which the *Anti-monopoly Law* is applied to foreign companies as opposed to state-owned enterprises. While Chinese regulatory authorities have clarified that the *Anti-monopoly Law* does apply to state-owned enterprises, to date they have brought enforcement actions primarily against provincial government-level state-owned enterprises, rather than central government-level state-owned enterprises under the supervision of SASAC. In addition, provisions in the *Anti-monopoly Law* protect the lawful operations of state-owned enterprises and government monopolies in industries deemed nationally important. Many U.S. companies have cited selective enforcement of the *Anti-monopoly Law* against foreign companies seeking to do business in China as a major concern, and they have highlighted the comparatively limited enforcement of this law against state-owned enterprises.

Another concern expressed by U.S. industry is that remedies imposed on U.S. and other foreign-owned companies in merger cases do not always appear to be aimed at restoring competition. Instead, these remedies seem to be designed to further China's industrial policy goals, such as when the regulatory authorities seek to require the transfer of technology or a reduction in licensing fees for intellectual property.

U.S. industry has also expressed concern about insufficient predictability, procedural fairness and transparency in *Anti-monopoly Law* investigative processes of foreign companies. For example, U.S. industry reports that, through the threat of steep fines and other penalties, China's regulatory authorities have pressured foreign companies to "cooperate" in the face of unspecified allegations

and have discouraged or prevented foreign companies from bringing counsel to meetings. In addition, U.S. companies continue to report that the Chinese regulatory authorities sometimes make "informal" suggestions regarding appropriate company behavior, including how a company is to behave outside China, strongly suggesting that a failure to comply may result in investigations and possible punishment. More recently, high-level policy statements suggest increased *Anti-monopoly Law* enforcement where technology owned or controlled by foreign companies allegedly implicates national security concerns or implicates technology being prioritized for indigenous innovation in China.

In 2021, a local intermediate court in China issued a decision finding that certain intellectual property developed by a foreign company was an "essential facility" and that the foreign company's failure to license this intellectual property to particular Chinese companies, the plaintiffs in a series of related cases, constituted an abuse of dominance exposing the foreign company to civil liability and mandatory licensing requirements – notwithstanding the foreign company's existing licenses to other Chinese companies. This legal decision, currently on appeal to China's Supreme People's Court, raises concerns that China's regulatory authorities may target foreign patent holders for *Anti-monopoly Law* enforcement, especially in areas of technology being prioritized for indigenous innovation in China.

State-directed mergers of state-owned enterprises are also a concern. SAMR does not provide sufficient information about decisions made regarding these "administrative mergers," so it is not clear how SAMR evaluates them. It is possible for these transactions to provide the merged company with excessive market power that can be used anti-competitively in China and in markets around the world.

Given the state-led nature of China's economy, the need for careful scrutiny of anti-competitive government restraints and regulation is high. The *Anti-monopoly Law's* provisions on the abuse of

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administrative (i.e., government) power are potentially important instruments for reducing the government's interference in markets and for promoting the establishment and maintenance of increasingly competitive markets in China. The State Council's adoption of the *Opinions on Establishing a Fair Competition Review System* in 2016 reflects a useful widening of oversight by China's anti-monopoly enforcement agencies over undue government restraints on competition and anti-competitive regulation of competition. However, implementing measures contain a broad list of exemptions, including for national economic security, cultural security, national defense construction, poverty alleviation, disaster relief and general "public interest" considerations. It appears unlikely that the Fair Competition Review System established by the *Opinions on Establishing a Fair Competition Review System* will be able to achieve its stated goals, given China's continuing efforts to ensure a strong role for the state in China's economy.

### EXPORT POLICIES

#### Export Restraints

Over the years, China has deployed a combination of export restraints, including export quotas, export licensing, minimum export prices, export duties and other restrictions, on a number of raw material inputs where it holds the leverage of being among the world's leading producers. In many instances, through these export restraints, it appears that China has been able to provide substantial economic advantages to a wide range of downstream producers in China at the expense of foreign downstream producers, while creating pressure on foreign downstream producers to move their operations, technologies and jobs to China.

In 2013, China removed its export quotas and duties on several raw material inputs of key interest to the U.S. steel, aluminum and chemicals industries after the United States won a dispute settlement case

against China at the WTO. In 2014, the United States won a second WTO case, focusing on China's export restraints on rare earths, tungsten and molybdenum, which are key inputs for a multitude of U.S.-made products, including hybrid automobile batteries, wind turbines, energy-efficient lighting, steel, advanced electronics, automobiles, petroleum and chemicals. China removed those export restraints in 2015. In 2016, the United States launched a third WTO case challenging export restraints maintained by China. The challenged export restraints include export quotas and export duties maintained by China on various forms of 11 raw materials, including antimony, chromium, cobalt, copper, graphite, indium, lead, magnesia, talc, tantalum and tin. These raw materials are key inputs in important U.S. manufacturing industries, including aerospace, automotive, construction and electronics. While China appears to have removed the challenged export restraints, the United States continues to monitor the situation. In the United States' view, it is deeply concerning that the United States was forced to bring multiple cases to address the same obvious WTO compliance issues.

A more recent concern involves China's potential regulation of rare earth exports under its export controls regime. In this regard, the Ministry of Industry and Information Technology issued the draft *Regulations on the Administration of Rare Earths* for public comment in January 2021, and one of the provisions in the draft measure provides that rare earth exporters need to abide by laws and regulations in the area of export controls.

In November 2021, China announced an export ban on certain fertilizers. Despite repeated requests from its trading partners to lift this export ban and help address growing international concern over rising commodity prices and disrupted global supply chains, China continues to impose this export ban.

Meanwhile, U.S. companies report that China has also instituted export restrictions on corn starch. To date, however, the Chinese government still has not published an official notice.

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### VAT Rebates and Related Policies

As in prior years, in 2021, the Chinese government attempted to manage the export of many primary, intermediate and downstream products by raising or lowering the VAT rebate available upon export. China sometimes reinforces its objectives by imposing or retracting export duties. These practices have caused tremendous disruption, uncertainty and unfairness in the global markets for some products, particularly downstream products for which China is a leading world producer or exporter, such as products made by the steel, aluminum and soda ash industries. These practices, together with other policies, such as excessive government subsidization, have also contributed to severe excess capacity in these same industries.

An apparently positive development took place at the July 2014 S&ED meeting, when China committed to improve its VAT rebate system, including by actively studying international best practices, and to deepen communication with the United States on this matter, including regarding its impact on trade. Once more, however, this promise remains unfulfilled. To date, China has not made any movement toward the adoption of international best practices.

### INTELLECTUAL PROPERTY PROTECTION

#### Overview

After its accession to the WTO, China undertook a wide-ranging revision of its framework of laws and regulations aimed at protecting the intellectual property rights of domestic and foreign right holders, as required by the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (the TRIPS Agreement). Despite various plans and directives issued by the State Council, inadequacies in China's intellectual property protection and enforcement regime continue to present serious barriers to U.S. exports and investment. As a result, China was again placed on the Priority Watch List in USTR's 2022 Special 301 Report. In addition, in

February 2022, USTR announced the results of its 2021 Review of Notorious Markets, which identifies online and physical markets that exemplify key challenges in the global struggle against piracy and counterfeiting and explains the harm not only to U.S. businesses, but also to U.S. workers. Several markets in China were among those named as notorious markets.

The Phase One Agreement addresses numerous longstanding U.S. concerns relating to China's inadequate intellectual property protection and enforcement. Specifically, the agreement requires China to revise its legal and regulatory regimes in a number of ways in the areas of trade secrets, pharmaceutical-related intellectual property, patents, trademarks and geographical indications. In addition, the agreement requires China to make numerous changes to its judicial procedures and to establish deterrent-level penalties. China must also take a number of steps to strengthen enforcement against pirated and counterfeit goods, including in the online environment, at physical markets and at the border.

China has published a number of draft measures for comment and issued some final measures relating to implementation of the intellectual property chapter of the Phase One Agreement. Notably, China amended the *Patent Law*, the *Copyright Law* and the *Criminal Law*. China has also reported increased enforcement actions against counterfeit medicines and increased customs actions against pirated and counterfeit goods. At the same time, China has outstanding work to finalize the draft measures that it has published and to publish other draft measures in accordance with the Intellectual Property Action Plan that it released in April 2020, such as certain patent, geographical indications and trade secret measures. In addition, China has yet to demonstrate that it has published data on enforcement actions online on a regular basis, increased enforcement actions against counterfeits with health and safety risks and at physical markets, increased training of customs personnel or ensured the use of only licensed software in government agencies and state-

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owned enterprises. The United States continues to monitor China's implementation of the intellectual property chapter of the Phase One Agreement, including the impact of the final measures that have been issued.

### Trade Secrets

Serious inadequacies in the protection and enforcement of trade secrets in China have been the subject of high-profile engagement between the United States and China in recent years. Several instances of trade secret theft for the benefit of Chinese companies have occurred both within China and outside of China. Offenders in many cases continue to operate with impunity. Particularly troubling are reports that actors affiliated with the Chinese government and the Chinese military have infiltrated the computer systems of U.S. companies, stealing terabytes of data, including the companies' proprietary information and intellectual property, for the purpose of providing commercial advantages to Chinese enterprises.

In high-level bilateral dialogues with the United States over the years, China has committed to issue judicial guidance to strengthen its trade secrets regime. China has also committed not to condone state-sponsored misappropriation of trade secrets for commercial use. In addition, the United States has urged China to make certain key amendments to its trade secrets-related laws and regulations, particularly with regard to a draft revision of the *Anti-unfair Competition Law*. The United States has also urged China to take actions to address inadequacies across the range of state-sponsored actors and to promote public awareness of trade secrets disciplines.

At the November 2016 JCCT meeting, China claimed that it was strengthening its trade secrets regime and bolstering several areas of importance, including the availability of evidence preservation orders and damages based on market value as well as the issuance of a judicial interpretation on preliminary injunctions and other matters. In 2016 and 2017,

China circulated proposed revisions to the *Anti-unfair Competition Law* for public comment. China issued the revised law in November 2017, effective January 2018. Despite improvements in the protection of trade secrets relative to prior law, the final measure reflects a number of missed opportunities for the promotion of effective trade secrets protection. China subsequently amended the *Anti-unfair Competition Law*, the *Foreign Investment Law* and the *Administrative Licensing Law*, but the amendments still do not fully address critical shortcomings in the scope of protections and obstacles to enforcement. In 2022, China published additional draft amendments to the *Anti-Unfair Competition Law*, but they contain few changes to the law's trade secrets provisions.

The Phase One Agreement significantly strengthens protections for trade secrets and enforcement against trade secret theft in China. In particular, the chapter on intellectual property requires China to expand the scope of civil liability for misappropriation beyond entities directly involved in the manufacture or sale of goods and services, to cover acts such as electronic intrusions as prohibited acts of trade secret theft and to shift the burden of proof in civil cases to the defendants when there is a reasonable indication of trade secret theft. It also requires China to make it easier to obtain preliminary injunctions to prevent the use of stolen trade secrets, to allow for initiation of criminal investigations without the need to show actual losses, to ensure that criminal enforcement is available for willful trade secret misappropriation and to prohibit government personnel and third party experts and advisors from engaging in the unauthorized disclosure of undisclosed information, trade secrets and confidential business information submitted to the government.

In 2020, China published various measures relating to civil, criminal and administrative enforcement of trade secrets. In September 2020, the Supreme People's Court issued the *Provisions on Several Issues Concerning the Application of Law in Civil Cases of Trade Secret Infringement and the*

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*Interpretation III on Several Issues Concerning the Application of Law in Handling Criminal Cases of Infringement of Intellectual Property Rights.* In September 2020, the Supreme People's Procuratorate (SPP) and the Ministry of Public Security (MPS) also issued the *Decision on Amendment of Docketing for Prosecution of Criminal Trade Secrets Infringement Cases Standards*. These measures relate to issues such as the scope of liability for trade secret misappropriation, prohibited acts of trade secret theft, preliminary injunctions and thresholds for initiations of criminal investigations for trade secret theft. In December 2020, the National People's Congress passed amendments to the *Criminal Law* that included changes to the thresholds for criminal investigation and prosecution and the scope of criminal acts of trade secret theft. The *Criminal Law* amendments require revisions to certain previously issued judicial interpretations and prosecution standards. However, two years after the passage of the *Criminal Law* amendments, these other measures remain unchanged, and implementation of the *Criminal Law* amendments therefore remains incomplete. The United States will continue to monitor the effectiveness of all of these measures.

### Bad Faith Trademark Registration

The continuing registration of trademarks in bad faith in China remains a significant concern. For example, so-called "trademark squatters" have attempted to take advantage of the fact that a genuine trademark owner has not yet registered its trademark in China by registering that trademark and then trying to sell it to the genuine trademark owner. Bad faith trademark registration also occurs when trademarks intending to deceive or confuse consumers are registered.

At the November 2016 JCCT meeting, China publicly noted the harm that can be caused by bad faith trademarks and asserted that it was taking further steps to combat bad faith trademark filings. Amendments to the *Trademark Law* made in 2019 and subsequent implementing measures require the

disallowance of bad faith trademark applications. However, implementation by China to date suggests that right holders remain insufficiently protected, as bad faith trademarks remain widespread and problems persist with the large number of inconsistent decisions and low rate of success for oppositions. As a result of these deficiencies, U.S. companies across industry sectors continue to face Chinese applicants registering their marks and "holding them for ransom" or seeking to establish a business building off of U.S. companies' global reputations. The Phase One Agreement requires China to address longstanding U.S. concerns regarding bad-faith trademark registration, such as by invalidating or refusing bad faith trademark applications. The United States will continue to monitor developments in this area of long-standing concern closely.

### Online Infringement

Online piracy continues on a large scale in China, affecting a wide range of industries, including those involved in distributing legitimate music, motion pictures, books and journals, software and video games. While increased enforcement activities have helped stem the flow of online sales of some pirated offerings, much more sustained action and attention is needed to make a meaningful difference for content creators and right holders, particularly small and medium-sized enterprises. In response to the COVID-19 pandemic, reports indicate that many infringers have moved online to distribute their pirated and counterfeit goods, which further increases the need for targeted and sustained enforcement measures in the online environment.

The United States has urged China to consider ways to create a broader policy environment to help foster the growth of healthy markets for licensed and legitimate content. The United States has also urged China to revise existing rules that have proven to be counterproductive.

At the November 2016 JCCT meeting, China agreed to actively promote electronic commerce-related



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legislation, strengthen supervision over online infringement and counterfeiting, and work with the United States to explore the use of new approaches to enhance online enforcement capacity. In December 2016 and November 2017, China published drafts of a new *E-Commerce Law* for public comment. In written comments, the United States stressed that the final version of this law should not undermine the existing notice-and-takedown system and should promote effective cooperation in deterring online infringement. In August 2018, China adopted its new *E-Commerce Law*, which entered into force in January 2019. This law was an opportunity for China to institute strong provisions on intellectual property protection and enforcement for its electronic commerce market, which is now the largest in the world. However, as finalized, the law instead introduced provisions that weaken the ability of right holders to protect their rights online and that alleviate the liability of China-based electronic commerce platforms for selling counterfeit and other infringing goods.

The Phase One Agreement requires China to provide effective and expeditious action against infringement in the online environment, including by requiring expeditious takedowns and by ensuring the validity of notices and counter-notifications. It also requires China to take effective action against electronic commerce platforms that fail to take necessary measures against infringement.

In May 2020, the National People's Congress issued the *Civil Code*, which included updated notice-and-takedown provisions. In September 2020, the SPC issued *Guiding Opinions on Hearing Intellectual Property Disputes Involving E-Commerce Platform* and the *Official Reply on the Application of Law in Network-Related Intellectual Property Infringement Disputes*. These measures relate to issues such as expeditious takedowns and the validity of notices and counter-notifications, but have only recently taken effect. In November 2020, the National People's Congress adopted long-pending amendments to the *Copyright Law*, including

provisions relating to increasing civil remedies for copyright infringement, new rights of public performance and broadcasting for producers of sound recordings, and protections against circumvention of technological protection measures. Right holders have welcomed these developments but have noted the need for effective implementation as well as new measures to address online piracy. The United States will closely monitor the impact of these measures going forward.

More recently, in August 2021, SAMR issued draft amendments to the *E-Commerce Law* for public comment. These draft amendments further attempt to address concerns that have been raised about procedures and penalties under China's notice-and-takedown system.

### Counterfeit Goods

Counterfeiting in China remains widespread and affects a wide range of goods. In April 2019, China amended its *Trademark Law*, effective November 2019, to require civil courts to order the destruction of counterfeit goods, but these amendments still do not provide the full scope of civil remedies for right holders. One of many areas of particular U.S. concern involves medications. Despite years of sustained engagement by the United States, China still needs to improve its regulation of the manufacture of active pharmaceutical ingredients to prevent their use in counterfeit and substandard medications. At the July 2014 S&ED meeting, China committed to develop and seriously consider amendments to the *Drug Administration Law* that will require regulatory control of the manufacturers of bulk chemicals that can be used as active pharmaceutical ingredients. At the June 2015 S&ED meeting, China further committed to publish revisions to the *Drug Administration Law* in draft form for public comment and to consider the views of the United States and other relevant stakeholders. In October 2017, China published limited draft revisions to the *Drug Administration Law* and stated that future proposed revisions to the

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remainder of this law would be forthcoming. Although the final *Drug Administration Law*, issued in August 2019, requires pharmaceuticals products and active pharmaceutical ingredients to meet manufacturing standards, it remains unclear how these requirements will be implemented or enforced.

The Phase One Agreement requires China to take effective enforcement action against counterfeit pharmaceuticals and related products, including active pharmaceutical ingredients, and to significantly increase actions to stop the manufacture and distribution of counterfeits with significant health or safety risks. The agreement also requires China to provide that its judicial authorities shall order the forfeiture and destruction of pirated and counterfeit goods, along with the materials and implements predominantly used in their manufacture. In addition, the agreement requires China to significantly increase the number of enforcement actions at physical markets in China and against goods that are exported or in transit. It further requires China to ensure, through third party audits, that government agencies and state-owned enterprises only use licensed software.

In August 2020, SAMR issued the *Opinions on Strengthening the Destruction of Infringing and Counterfeit Goods*, and the State Council amended the *Provisions on the Transfer of Suspected Criminal Cases by Administrative Organs for Law Enforcement*, which relate to the transfer of intellectual property cases from administrative authorities to criminal authorities. China has reported increased enforcement actions against counterfeit medicines and increased customs actions against pirated and counterfeit goods, but it also needs to show that it has increased enforcement actions against counterfeits with health and safety risks and at physical markets, increased training of customs personnel and ensured the use of only licensed software in government agencies and state-owned enterprises.

## PHARMACEUTICALS AND MEDICAL DEVICES

### Pharmaceuticals

For several years, the United States has pressed China on a range of pharmaceuticals issues. These issues have related to matters such as overly restrictive patent application examination practices, regulatory approvals that are delayed or linked to extraneous criteria, weak protections against the unfair commercial use and unauthorized disclosure of regulatory data, issues with the implementation of an efficient mechanism to resolve patent infringement disputes, and restrictions on receiving patent term extensions for unreasonable marketing approval delays. In particular, China's narrow definition of "new drug" as a drug that has not been marketed anywhere else before it is launched in China continues to have negative implications for China's provision of patent term extensions for unreasonable marketing approval delays and China's potential implementation of regulatory data protection, and it may indirectly pressure foreign companies to bring their products to China first regardless of patient demand or other important factors. While China has implemented some helpful reforms, the United States still has many of the same concerns with China's pharmaceutical market, especially as it pertains to treatment of foreign companies.

CFDA also issued several draft notices in 2017 setting out a conceptual framework to protect against the unfair commercial use and unauthorized disclosure of undisclosed test or other data generated to obtain marketing approval for pharmaceutical products. In addition, this proposed framework sought to promote the efficient resolution of patent disputes between right holders and the producers of generic pharmaceuticals. However, in 2018, CFDA's successor agency, NMPA, issued draft *Drug Registration Regulations* and draft implementing measures on drug trial data that would preclude or condition the duration of regulatory data protection

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on whether clinical trials and first marketing approval occur in China. Subsequently, China issued a revised *Drug Administration Law* in 2019, followed by NMPA's revised draft *Drug Registration Regulations* in 2020 and NMPA's revised draft *Drug Administration Law Implementing Regulations* in 2021. Despite the opportunities that these revised draft measures afforded China's regulatory authorities, the concerning limitations on regulatory data protection have not been removed.

Since 2018, volume-based procurement has presented a new market access complication for foreign suppliers of pharmaceuticals, largely because of the opaque and unpredictable nature of the bidding processes. In November 2018, a National Drug Centralized Procurement Pilot Scheme was launched. Then, in January 2019, the State Council issued a Pilot Plan for National Centralized Drug Procurement and Use. In December 2021, the National Healthcare Security Administration published the 2021 edition of its annual National Reimbursement Drug List, which became effective on January 1, 2022. U.S. industry also cites the need for increased transparency and greater harmony between national and provincial bidding processes as well as a greater emphasis on a competitive, market-based approach to evaluating a product's value and relevant bids.

As part of the Phase One Agreement, the two sides agreed that China would establish a nationwide mechanism for the early resolution of potential pharmaceutical patent disputes that covers both small molecule drugs and biologics, including a cause of action to allow a patent holder to seek expeditious remedies before the marketing of an allegedly infringing product. The United States has been working closely with U.S. industry to monitor developments and to ensure that China's new system works as contemplated. Separately, the agreement also provides for patent term extensions to compensate for unreasonable patent and marketing approval delays that cut into the effective patent term as well as for the use of supplemental data to meet relevant patentability criteria for

pharmaceutical patent applications. The United States and China agreed to address data protection for pharmaceuticals in future negotiations.

In October 2020, China amended the *Patent Law* to provide for patent term extensions for unreasonable patent and marketing approval delays, and it also added a mechanism for the early resolution of potential patent disputes, known as patent linkage. Implementing measures for the patent linkage mechanism were issued in July 2021, as NMPA and CNIPA jointly issued the *Trial Implementation Measures for the Mechanism for Early Resolution of Drug Patent Disputes* and the Supreme People's Court issued the *Regulations on Several Issues Concerning the Application of Law in the Trial of Civil Patent Disputes Related to Drug Registration Application*. In 2021 and 2022, CNIPA issued draft implementing rules for the amended *Patent Law* and drafts of amendments to the *Patent Examination Guidelines*. Among other things, U.S. right holders have expressed concern about China's implementation of patent term extensions for unreasonable marketing approval delays, including China's use of unfair localization requirements and limits on the type of protection provided. Going forward, the United States will continue to monitor closely China's progress in implementing its commitments, with regard to both patent term extensions for unreasonable patent and marketing approval delays and the patent linkage mechanism.

### Medical Devices

For many years, working closely with U.S. industry, the United States has raised concerns about China's pricing and tendering procedures for medical devices and its discriminatory treatment of imported medical devices. At the November 2015 JCCT meeting, China did commit that, in terms of accessing the market, it will give imported medical devices the same treatment as medical devices manufactured or developed domestically. Unfortunately, this promise has not been fulfilled. China continues to pursue a wide range of policies that direct China's purchasing authorities to

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prioritize the procurement of domestic medical device manufacturers over imported medical device manufacturers.

In recent years, the United States has continued to press China's regulatory authorities to develop sound payment systems that are transparent, predictable and competitive. The United States has also urged China to adequately recognize quality, safety and the costs of R&D in its approach to procurement policy.

In 2019, China's State Council launched a volume-based procurement (VBP) approach for medical devices in a few provinces and municipalities in an attempt to cut healthcare costs. Since then, the VBP approach has become further engrained in China's system, with the formation of multi-province and municipal alliances to conduct joint procurements under VBP. In 2020, China implemented its first national VBP tender, which has been followed by additional national tenders in 2021 and 2022. In practice, implementation of China's VBP prioritizes cost over the product's value or quality. With China perceiving the resulting price cuts as successes, U.S. industry expects that China will continue to expand the categories of medical devices subject to VBP in the future.

According to U.S. industry, if China continues to pursue VBP without significant changes, it could lead to the creation of a low-cost, low-quality medical devices sector and low-quality monopolies in China, which would operate to the disadvantage of innovative medical device companies, many of which are foreign companies, and the patients who rely on advanced medical technologies. Currently, medical device companies that are successful at winning bids often have very thin profit margins or even lose money. Reportedly, some medical device companies are reducing training to healthcare providers in order to offer the expected price cuts. In addition, given the size of China's medical device market, low-quality monopolies from China could expand and then prioritize exports of their medical devices to third countries. With the choice between a higher

cost but more effective product or a lower cost, lower quality product, countries with greater budget constraints, and greater vulnerability to Chinese influence, may be more inclined to procure China's offerings. Overall, China's VBP approach poses a risk to the medical device sector and the provision of high-quality medical treatment worldwide.

In July 2022, China's Ministry of Finance issued a revised *Government Procurement Law*. While China has a history of distributing unofficial, non-public guidance to give preference to domestic over foreign medical devices companies, China's revisions to the *Government Procurement Law* also officially expands the coverage of products for which domestic alternatives should be given preference.

Meanwhile, the *Made in China 2025* industrial plan announced by the State Council in 2015 seeks to prop up China's domestic medical device sector through a series of support policies, including targeted funds and procurement policies. The goal of these policies is to significantly increase the market share of domestically owned and domestically manufactured medical devices, and correspondingly decrease market share of foreign medical devices, by 2025. At the same time, some provincial governments directly subsidize the purchase of domestically manufactured medical devices. In addition, some provincial governments have issued guidelines urging medical institutions to prioritize the procurement of local medical equipment over imported equipment. In at least one province, the guidelines suggest that only imported medical devices for which there is not a domestic replacement will be eligible for procurement. Going forward, the United States will continue to urge China to provide foreign medical devices with fair and equal access to China's market.

U.S. industry also reports that while sub-central governments in China have always provided some financial support to domestic medical devices companies, their support appears to have increased between 2020 and 2022. U.S. industry notes that this trend could be attributed to either the COVID-19

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pandemic or China's five-year industrial plan for medical equipment covering the years 2021 to 2025, or perhaps both. The United States will monitor this situation closely and will encourage China to be transparent in its approach.

### SERVICES

#### Overview

The prospects for U.S. service suppliers in China should be promising, given the size of China's market. Nevertheless, the U.S. share of China's services market remains well below the U.S. share of the global services market, and the Organization for Economic Cooperation and Development continues to rate China's services regime as one of the most restrictive among the world's major economies.

In 2022, numerous challenges persisted in a number of services sectors. As in past years, Chinese regulators continued to use discriminatory regulatory processes, informal bans on entry and expansion, case-by-case approvals in some services sectors, overly burdensome licensing and operating requirements, and other means to frustrate the efforts of U.S. suppliers of services to achieve their full market potential in China. These policies and practices affect U.S. service suppliers across a wide range of sectors, including cloud computing, telecommunications, film production and distribution, online video and entertainment services, express delivery and legal services. In addition, China's *Cybersecurity Law* and related implementing measures include mandates to purchase domestic information and communications technology (ICT) products and services, while China's *Cybersecurity Law*, *Data Security Law* and *Personal Information Protection Law* and related implementing measures include excessive restrictions on cross-border data flows, and requirements to store and process data locally. These types of data measures undermine U.S. services suppliers' ability to take advantage of market access opportunities in China by prohibiting

or severely restricting cross-border transfers of information that are routine in the ordinary course of business and are fundamental to any business activity. China also has failed to fully address U.S. concerns in areas that have been the subject of WTO dispute settlement, including electronic payment services and theatrical film importation and distribution.

The Phase One Agreement, signed in January 2020, addresses a number of longstanding trade and investment barriers to U.S. providers of a wide range of financial services, including banking, insurance, securities, asset management, credit rating and electronic payment services, among others. The barriers addressed in the agreement include joint venture requirements, foreign equity limitations and various discriminatory regulatory requirements. Removal of these barriers should allow U.S. financial service providers to compete on a more level playing field and expand their services export offerings in the China market. Nevertheless, China's excessive restrictions on cross-border data flows could continue to create significant challenges for U.S. financial service providers in China.

#### Banking Services

Although China has opened its banking sector to foreign competition in the form of wholly foreign-owned banks, China has maintained restrictions on market access in other ways that have kept foreign banks from establishing, expanding and obtaining significant market share in China. Recently, however, China has taken some steps to ease or remove market access restrictions.

For example, China has removed a number of longstanding barriers for foreign banks, including the \$10 billion minimum asset requirement for establishing a foreign bank in China and the \$20 billion minimum asset requirement for setting up a Chinese branch of a foreign bank. China has also removed the cap on the equity interest that a single foreign investor can hold in a Chinese-owned bank.

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In the Phase One Agreement, China committed to remove some of these barriers and to expand opportunities for U.S. financial institutions, including bank branches, to supply securities investment fund custody services by considering their global assets when they seek licenses. China also agreed to review and approve qualified applications by U.S. financial institutions for securities investment fund custody licenses on an expeditious basis. One U.S. bank was approved for this license in 2021. In addition, China committed to consider the international qualifications of U.S. financial institutions when evaluating license applications for Type-A lead underwriting services for all types of non-financial debt instruments in China.

### **Securities, Asset Management and Futures Services**

In the Phase One Agreement, China committed to remove the foreign equity caps in the securities, asset management and futures sectors by no later than April 1, 2020. It also committed to ensure that U.S. suppliers of securities, asset management and futures services are able to access China's market on a non-discriminatory basis, including with regard to the review and approval of license applications.

Consistent with its commitments in the Phase One Agreement, China announced that it would allow wholly foreign-owned companies for the securities and asset (i.e., fund) management sectors as of April 1, 2020, and that it would allow wholly foreign-owned companies for the futures sector as of January 1, 2020. Prior to these announcements, China had maintained a foreign equity cap of 51 percent for these sectors. Over the past three years, some U.S. financial institutions have applied for and received licenses to operate as wholly foreign-owned enterprises in these sectors. The United States is monitoring these and other developments as U.S. companies continue to seek to obtain licenses and undertake operations in these sectors.

### **Insurance Services**

In the Phase One Agreement, China committed to accelerate the removal of the foreign equity caps for life, pension and health insurance so that they are removed no later than April 1, 2020. In addition, it confirmed the removal of the 30-year operating requirement, known as a "seasoning" requirement, which had been applied to foreign insurers seeking to establish operations in China in all insurance sectors. China also committed to remove all other discriminatory regulatory requirements and processes and to expeditiously review and approve license applications.

Consistent with China's commitments in the Phase One Agreement, the China Banking and Insurance Regulatory Commission (CBIRC) announced that China would allow wholly foreign-owned companies for the life, pension and health insurance sectors as of January 1, 2020. Prior to this announcement, China had maintained foreign equity caps and only permitted foreign companies to establish as Chinese-foreign joint ventures in these sectors. In December 2020, CBIRC issued a measure that provided further transparency regarding its intention to allow foreign-invested companies to take advantage of this opening.

In other insurance sectors, the United States continues to encourage China to establish more transparent procedures so as to better enable foreign participation in China's market. Sectors in need of more transparency include export credit insurance and political risk insurance.

Finally, some U.S. insurance companies established in China have encountered difficulties in getting the CBIRC to issue timely approvals of their requests to open up new internal branches to expand their operations. The United States continues to urge CBIRC to issue timely approvals when U.S. insurance companies seek to expand their branch networks in China.



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### Electronic Payment Services

In a WTO case that it launched in 2010, the United States challenged China's restrictions on foreign companies, including major U.S. credit and debit card processing companies, which had been seeking to supply electronic payment services to banks and other businesses that issue or accept credit and debit cards in China. The United States argued that China had committed in its WTO accession agreement to open up this sector in 2006, and a WTO panel agreed with the United States in a decision issued in 2012. China subsequently agreed to comply with the WTO panel's rulings in 2013, but China did not allow foreign suppliers to apply for licenses until June 2017, when China's regulator – PBOC – finalized the establishment of a two-step licensing process in which a supplier must first complete one year of preparatory work before being able to apply for a license.

As of January 2020, when the United States and China entered into the Phase One Agreement, no foreign supplier of electronic payment services had been able to secure the license needed to operate in China's market due largely to delays caused by PBOC. At times, PBOC had refused even to accept applications to begin preparatory work from U.S. suppliers, the first of two required steps in the licensing process. Meanwhile, throughout the years that China actively delayed opening up its market to foreign suppliers, China's national champion, China Union Pay, has used its exclusive access to domestic currency transactions in the China market, and the revenues that come with it, to support its efforts to build out its electronic payment services network abroad, including in the United States. In other words, China consciously decided to maintain market-distorting practices that benefit its own companies, even in the face of adverse rulings at the WTO.

In the Phase One Agreement, China committed to ensure that PBOC operates an improved and timely licensing process for U.S. suppliers of electronic

payment services so as to facilitate their access to China's market.

In June 2020, four months after the entry into force of the Phase One Agreement, American Express became the first foreign supplier of electronic payment services to secure a license to operate in China's market. Meanwhile, the United States continues to closely monitor developments as applications from two other U.S. suppliers, Visa and MasterCard, are progressing slowly through PBOC's licensing process.

### Internet-Enabled Payment Services

PBOC first issued regulations for non-bank suppliers of online payment services in 2010, and it subsequently began processing applications for licensees. Regulations were further strengthened in 2015, with additional provisions aimed at increasing security and traceability of transactions. According to a U.S. industry report, of more than 200 licenses issued as of June 2014, only two had been issued to foreign-invested suppliers, and those two were for very limited services. This report provided clear evidence supporting stakeholder concerns about the difficulties they faced entering China's market and the slow process foreign firms face in getting licensed. In 2018, PBOC announced that it would allow foreign suppliers, on a nondiscriminatory basis, to supply Internet-enabled payment services. At the same time, as in many other sectors, PBOC requires suppliers to localize their data and facilities in China. In January 2021, PayPal became the first foreign company to obtain full ownership of a payment platform in China, along with a license to supply payment services. The United States will continue to closely monitor developments in this area.

### Telecommunications Services

China's restrictions on basic telecommunications services, such as informal bans on new entry, a 49-percent foreign equity cap, a requirement that foreign suppliers can only enter into joint ventures

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with state-owned enterprises and exceedingly high capital requirements, have blocked foreign suppliers from accessing China's basic telecommunications services market. Since China acceded to the WTO almost two decades ago, not a single foreign firm has succeeded in establishing a new joint venture to enter this sector.

Restrictions maintained by China on less highly regulated value-added telecommunications services also have created serious barriers to market entry for foreign suppliers seeking to enter this sector. These restrictions include opaque and arbitrary licensing procedures, foreign equity caps and periodic, unjustified moratoria on the issuance of new licenses. As a result, only a few dozen foreign-invested suppliers have secured licenses to provide value-added telecommunications services, while there are thousands of licensed domestic suppliers.

### Internet Regulatory Regime

China's Internet regulatory regime is restrictive and non-transparent, affecting a broad range of commercial services activities conducted via the Internet, and is overseen by multiple agencies without clear lines of jurisdiction. China's Internet economy has boomed over the past decade and is second in size only to that of the United States. Growth in China has been marked in service sectors similar to those found in the United States, including retail websites, search engines, vocational and adult online education, travel, advertising, audio-visual and computer gaming services, electronic mail and text, online job searches, Internet consulting, mapping services, applications, web domain registration and electronic trading. However, in the China market, Chinese companies dominate due in large part to restrictions imposed on foreign companies by the Chinese government. At the same time, foreign companies continue to encounter major difficulties in attempting to offer these and other Internet-based services on a cross-border basis.

China continues to engage in extensive blocking of legitimate websites, imposing significant costs on both suppliers and users of web-based services and products. According to the latest data, China currently blocks most of the largest global sites, and U.S. industry research has calculated that more than 10,000 sites are blocked, affecting billions of dollars in business, including communications, networking, app stores, news and other sites. Even when sites are not permanently blocked, the often arbitrary implementation of blocking, and the performance-degrading effect of filtering all traffic into and outside of China, significantly impair the supply of many cross-border services, often to the point of making them unviable.

### Voice-Over-Internet Protocol Services

While computer-to-computer voice-over-Internet (VOIP) services are permitted in China, China's regulatory authorities have restricted the ability to offer VOIP services interconnected to the public switched telecommunications network (i.e., to call a traditional phone number) to basic telecommunications service licensees. There is no obvious rationale for such a restriction, which deprives consumers of a useful communication option, and the United States continues to advocate for eliminating it.

### Cloud Computing Services

Especially troubling is China's treatment of foreign companies seeking to participate in the development of cloud computing services, including computer data processing and storage services and software application services provided over the Internet. China prohibits foreign companies established in China from directly providing any of these services. Given the difficulty in providing these services on a cross-border basis (largely due to restrictive Chinese policies), the only option that a foreign company has to access the China market is to establish a contractual partnership with a Chinese company, which is the holder of the necessary

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Internet data center license, and turn over its valuable technology, intellectual property, know-how and branding as part of this arrangement. While the foreign service supplier earns a licensing fee from the arrangement, it has no direct relationship with customers in China and no ability to independently develop its business. It has essentially handed over its business to a Chinese company that may well become a global competitor. This treatment has generated serious concerns in the United States and among other WTO Members as well as U.S. and other foreign companies.

In major markets, including China, cloud computing services are typically offered through commercial presence in one of two ways. They are offered as an integrated service in which the owner and operator of a telecommunication network also offers computing services, including data storage and processing function, over that network, or they are offered as a stand-alone computer service, with connectivity to the computing service site provided separately by a telecommunications service supplier. Although China's commitments under the WTO's General Agreement on Trade in Services (GATS) include services relevant to both of these approaches, neither one is currently open to foreign-invested companies in China.

### Audio-Visual and Related Services

China prohibits foreign companies from providing film production and distribution services in China. In addition, China's restrictions in the area of theater services have wholly discouraged investment by foreign companies in cinemas in China.

China's restrictions on services associated with television and radio greatly limit participation by foreign suppliers. For example, China prohibits retransmission of foreign TV channels, foreign investment in TV production and foreign investment in TV stations and channels. China also imposes quotas on the amount of foreign programming that can be shown on a Chinese TV channel each day. In addition, in September 2018, the National Radio and

Television Administration's (NRTA) issued a problematic draft measure that would impose new restrictions in China's already highly restricted market for foreign creative content. It would require that spending on foreign content account for no more than 30 percent of available total programs in each of several categories, including foreign movies, TV shows, cartoons, documentaries and other foreign TV programs, made available for display via broadcasting institutions and online audio-visual content platforms. It also would prohibit foreign TV shows in prime time. Although this measure has not yet been issued in final form, it continues to raise serious concerns, as it appears that, as a matter of practice, it is already being implemented in China, including by online audio-visual content platforms.

### Theatrical Films

In February 2012, the United States and China reached an alternative resolution with regard to certain rulings relating to the importation and distribution of theatrical films in a WTO case that the United States had won. The two sides signed a memorandum of understanding (MOU) providing for substantial increases in the number of foreign films imported and distributed in China each year, along with substantial additional revenue for U.S. film producers. However, China has not yet fully implemented its MOU commitments, including with regard to critical commitments to open up film distribution opportunities for imported films. As a result, the United States has been pressing China for full implementation of the MOU.

In 2017, in accordance with the terms of the MOU, the two sides began discussions regarding the provision of further meaningful compensation to the United States in an updated MOU. These discussions continued until March 2018, before stalling when China embarked on a major government reorganization that involved significant changes for China's Film Bureau. Discussions resumed in 2019 as part of the broader U.S.-China trade negotiations that began following a meeting between the two countries' Presidents on the margins of the Group of

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20 Heads of State and Government Summit in Buenos Aires in December 2018. To date, no agreement has been reached on the further meaningful compensation that China owes to the United States. The United States will continue pressing China to fulfill its obligations.

### Online Video and Entertainment Services

China restricts the online supply of foreign video and entertainment services through measures affecting both content and distribution platforms. China requires foreign companies to license their content to Chinese companies and also imposes burdensome restrictions on content, which are implemented through exhaustive content review requirements that are based on vague and otherwise non-transparent criteria. With respect to distribution platforms, NRTA has required Chinese online platform suppliers to spend no more than 30 percent of their acquisition budget on foreign content. NRTA has also instituted numerous measures that prevent foreign suppliers from qualifying for a license, such as requirements that video platforms all be Chinese-owned. NRTA and other Chinese regulatory authorities have also taken actions to prevent the cross-border supply of online video services, which may implicate China's GATS commitments relating to video distribution.

### Legal Services

China restricts the types of legal services that can be provided by foreign law firms, including through a prohibition on foreign law firms hiring lawyers qualified to practice Chinese law. It also restricts the ability of foreign law firms to represent their clients before Chinese government agencies and imposes lengthy delays on foreign law firms seeking to establish new offices. In addition, beginning with the version of China's *Foreign Investment Negative List* that entered into force in July 2020, China has added an explicit prohibition on the ability of a foreign lawyer to become a partner in a domestic law firm. Reportedly, China is also considering draft

regulatory measures that would even further restrict the ability of foreign law firms to operate in China.

### Express Delivery Services

The United States continues to have concerns regarding China's implementation of the 2009 *Postal Law* and related regulations through which China prevents foreign service suppliers from participating in the document segment of its domestic express delivery market. In the package segment, China applies overly burdensome and inconsistent regulatory approaches, including with regard to security inspections, and reportedly has provided more favorable treatment to Chinese service suppliers when awarding business permits.

## DIGITAL TRADE AND ELECTRONIC COMMERCE POLICIES

### Data Restrictions

In 2022, China continued to build out its expansive regulation of the collection, storage, processing and sharing of data. China's *Data Security Law* entered into force in September 2021, and China's *Personal Information Protection Law* entered into force in November 2021. These laws operate together with the *Cybersecurity Law*, which took effect in June 2017, the *National Security Law*, which has been in effect since 2015, and various implementing measures, including the *Security Assessment Measures for Outbound Transfers of Data*, which took effect in September 2022, to prohibit or severely restrict cross-border transfers of "important data," a broadly and vaguely defined term, and, in certain cases, personal information collected by companies through their operations in China. These laws and implementing measures also impose local data storage and processing requirements on companies operating in China that collect "important data" and, in certain cases, personal information. Cross-border transfers of data are routine in the ordinary course of business and are fundamental to any business activity. Given the

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wide range of businesses and business activities that are dependent on cross-border transfers of data and flexible access to global computing facilities, these developments continue to generate serious concerns in the United States and many other countries.

### Secure and Controllable ICT Policies

Implementing measures for China's *Cybersecurity Law* remain a continued source of serious concern for U.S. companies since the law's enactment in 2016. Of particular concern are the *Measures for Cybersecurity Review*, first issued in 2016 and later updated in 2020 and 2021. This measure implements one element of the cybersecurity regime created by the *Cybersecurity Law*. Specifically, the measure puts in place a review process to regulate the purchase of ICT products and services by critical information infrastructure operators and online platform operators in China. The review process is to consider, among other things, potential national security risks related to interruption of service, data leakage and reliability of supply chains. In addition, in September 2022, China published a draft revision of the *Cybersecurity Law* with a 15-day public comment period. The draft revision would introduce penalties on operators of critical information infrastructure who use products or services that have not undergone the required security review, and it would also raise fines for certain violations of the *Cybersecurity Law*.

As demonstrated in implementing measures for the *Cybersecurity Law*, China's approach is to impose severe restrictions on a wide range of U.S. and other foreign ICT products and services with an apparent goal of supporting China's technology localization policies by encouraging the replacement of foreign ICT products and services with domestic ones. U.S. and other foreign stakeholders and governments around the world expressed serious concerns about requirements that ICT equipment and other ICT products and services in critical sectors be "secure and controllable," as these requirements are used by

the Chinese government to disadvantage non-Chinese firms.

In addition to the *Cybersecurity Law*, China has referenced its "secure and controllable" requirements in a variety of measures dating back to 2013. Through these measures, China has mandated that Chinese information technology users purchase Chinese products and favor Chinese service suppliers, imposed local content requirements, imposed domestic R&D requirements, considered the location of R&D as a cybersecurity risk factor and required the transfer or disclosure of source code or other intellectual property. In the 2019 update of the *Measures for Cybersecurity Review*, China added political, diplomatic and other "non-market" developments as potential risk factors to be considered.

In addition, in 2015, China enacted a *National Security Law* and a *Counterterrorism Law*, which include provisions citing not only national security and counterterrorism objectives but also economic and industrial policies. The State Council also published a plan in 2015 that sets a timetable for adopting "secure and controllable" products and services in critical government ministries by 2020.

Meanwhile, sector-specific policies under this broad framework continue to be proposed and deployed across China's economy. A high-profile example from December 2014 was a proposed measure drafted by the China Banking Regulatory Commission that called for 75 percent of ICT products used in the banking system to be "secure and controllable" by 2019 and that would have imposed a series of criteria that would shut out foreign ICT providers from China's banking sector. Not long afterwards, a similar measure was proposed for the insurance sector.

In 2015, the United States, in concert with other governments and stakeholders around the world, raised serious concerns about China's "secure and controllable" regime at the highest levels of government within China. During a state visit in

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September 2015 in Washington, D.C., the U.S. and Chinese Presidents committed to a set of principles for trade in information technologies. The issue also was raised in connection with the June 2015 S&ED meeting and the November 2015 JCCT meeting, with China making a series of additional important commitments with regard to technology policy. China reiterated many of these commitments at the November 2016 JCCT meeting, where it affirmed that its “secure and controllable” policies are not to unnecessarily limit or prevent commercial sales opportunities for foreign ICT suppliers or unnecessarily impose nationality-based conditions and restrictions on commercial ICT purchases, sales or uses. China also agreed that it would notify relevant technical regulations to the WTO Committee on Technical Barriers to Trade (TBT Committee).

Again, however, China has not honored its promises. The numerous draft and final implementation measures issued by China from 2017 through 2022 in the area of cybersecurity raise serious questions about China's approach to cybersecurity regulation. China's measures do not appear to be in line with the non-discriminatory, non-trade restrictive approach to which China has committed, and global stakeholders have grown even more concerned about the implications of China's ICT security measures across the many economic sectors that employ digital technologies. Accordingly, throughout the past year, the United States conveyed its serious concerns about China's approach to cybersecurity regulation through bilateral engagement and multilateral engagement, including at WTO committee and council meetings, in an effort to persuade China to revise its policies in this area in light of its WTO obligations and bilateral commitments. These efforts are currently ongoing.

### Encryption

Use of ICT products and services is increasingly dependent on robust encryption, an essential functionality for protecting privacy and safeguarding sensitive commercial information. Onerous

requirements on the use of encryption, including intrusive approval processes and, in many cases, mandatory use of indigenous encryption algorithms (e.g., for WiFi and 4G cellular products), continue to be cited by stakeholders as a significant trade barrier.

In October 2019, China adopted a *Cryptography Law* that includes restrictive requirements for commercial encryption products that “involve national security, the national economy and people's lives, and public interest,” which must undergo a security assessment. This broad definition of commercial encryption products that must undergo a security assessment raises concerns that the new *Cryptography Law* will lead to unnecessary restrictions on foreign ICT products and services. In August 2020, the State Cryptography Administration issued the draft *Commercial Cryptography Administrative Regulations* to implement the *Cryptography Law*. This draft measure did not address the concerns that the United States and numerous other stakeholders had raised regarding the *Cryptography Law*.

Going forward, the United States will continue to monitor implementation of the *Cryptography Law* and related measures. The United States will remain vigilant toward the introduction of any new requirements hindering technologically neutral use of robust, internationally standardized encryption.

### GOVERNMENT PROCUREMENT

In its WTO accession agreement, China made a commitment to accede to the WTO Agreement on Government Procurement (GPA) and to open up its vast government procurement market to the United States and other GPA parties. More than two decades later, this commitment remains unfulfilled, while China's government procurement has continued to grow exponentially. Indeed, government procurement at the central level of government alone now exceeds \$500 billion, even without considering procurement by state-owned enterprises.



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The United States, the EU and other GPA parties have viewed China's GPA offers over the years as highly disappointing in scope and coverage. China submitted its sixth revised offer in October 2019. This offer showed progress in a number of areas, including thresholds, coverage at the sub-central level of government, entity coverage and services coverage. Nonetheless, it fell short of U.S. expectations and remains far from acceptable to the United States and other GPA parties as significant deficiencies remain in a number of critical areas, including thresholds, entity coverage, services coverage and exclusions. Although China has since stated that it will "speed up the process of joining" the GPA, it has not submitted a new offer since October 2019. China's most recent submission, made in June 2021, was only an update of its checklist of issues, which informs GPA parties of changes to China's existing government procurement regime since its last update.

China's current government procurement regime is governed by two important laws. The *Government Procurement Law*, administered by the Ministry of Finance, governs purchasing activities conducted with fiscal funds by state organs and other organizations at all levels of government in China, but does not apply to procurements by state-owned enterprises. The *Tendering and Bidding Law* falls under the jurisdiction of NDRC and imposes uniform tendering and bidding procedures for certain classes of procurement projects in China, notably construction and works projects, without regard for the type of entity (e.g., a government agency or a state-owned enterprise) that conducts the procurement. Both laws cover important procurements that GPA parties would consider to be government procurement eligible for coverage under the GPA.

China's *Foreign Investment Law*, which entered into force in January 2020, and a related October 2021 Ministry of Finance measure state that China will provide equal treatment to foreign companies invested in China and to domestic Chinese companies with regard to government procurement

opportunities. However, it is not yet clear how these measures may be impacting government procurement in China.

Under both its government procurement regime and its tendering and bidding regime, China continues to implement policies favoring products, services and technologies made or developed by Chinese-owned and Chinese-controlled companies through explicit and implicit requirements that hamper foreign companies from fairly competing in China. For example, notwithstanding China's commitment to equal treatment, foreign companies continue to report cases in which "domestic brands" and "indigenous designs" are required in tendering documents. China also has proposed but has not yet adopted clear rules on what constitutes a domestic product. As a result, there are no specific metrics, such as a percentage of value-added within China, for foreign products to qualify for many procurements and tenders, which often works to the disadvantage of foreign companies.

### ADMINISTRATIVE PROCESS

#### Administrative Licensing

U.S. companies continue to encounter significant problems with a variety of administrative licensing processes in China, including processes to secure product approvals, investment approvals, business expansion approvals, business license renewals and even approvals for routine business activities. While there has been an overall reduction in license approval requirements and a focus on decentralizing licensing approval processes, U.S. companies continue to report that one of their key concerns involves China's problematic licensing approval processes.

#### Transparency

##### Overview

One of the core principles reflected throughout China's WTO accession agreement is transparency.

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Unfortunately, after more than 20 years of WTO membership, China still has a poor record when it comes to adherence to its transparency obligations.

### Publication of Trade-Related Measures

In its WTO accession agreement, China committed to adopt a single official journal for the publication of all trade-related laws, regulations and other measures. China adopted a single official journal, to be administered by MOFCOM, in 2006. However, it appears that China only publishes trade-related measures from some, but not all, central-government entities in this journal. It also appears that China does not publish any trade-related measures from sub-central governments in the journal.

At the central government level, moreover, China tends to take a narrow view of the types of trade-related measures that need to be published in the official journal. For those government entities whose trade-related measures are published in the official journal, China more commonly (but still not regularly) publishes trade-related administrative regulations and departmental rules in the journal, but it is rare for China to publish other measures such as opinions, circulars, orders, directives and notices, which are known as “normative documents” in China’s legal system. Normative documents are regulatory documents that do not fall into the category of administrative regulations or departmental rules, but still impose binding obligations on enterprises and individuals. Although the State Council introduced a definition for “administrative normative documents” in 2014, this definition is narrow and does not appear to encompass all normative documents, nor has it resulted in their regular publication as required by China’s WTO commitments.

Meanwhile, China rarely publishes certain types of trade-related measures from either the central level or the sub-central level of government in the official

journal. As discussed above in the Industrial Subsidies section, an important example involves subsidy measures.

### Notice-and-Comment Procedures

In its WTO accession agreement, China committed to provide a reasonable period for public comment before implementing new trade-related laws, regulations and other measures. While little progress has been made in implementing this commitment at the sub-central government level, the National People’s Congress instituted notice-and-comment procedures for draft laws in 2008, and shortly thereafter China indicated that it would also publish proposed trade- and economic-related administrative regulations and departmental rules for public comment. Subsequently, the National People’s Congress began regularly publishing draft laws for public comment. China’s State Council often (but not regularly) published draft administrative regulations for public comment, but many of China’s ministries were not consistent in publishing draft departmental rules or normative documents for public comment.

At the May 2011 S&ED meeting, China committed to issue a measure implementing the requirement to publish all proposed trade- and economic-related administrative regulations and departmental rules on the website of the State Council’s Legislative Affairs Office (SCLAO) for a public comment period of not less than 30 days. In April 2012, the SCLAO issued two measures that appear to address this requirement.

Currently, the process for issuing new regulatory measures in China can be opaque and unpredictable and implemented without adequate notice. China still needs to improve its practices relating to the publication of administrative regulations and departmental rules for public comment. China also needs to formalize its use of notice-and-comment procedures for all normative documents.

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In the Phase One Agreement, China committed to provide no less than 45 days for public comment on all proposed laws, regulations and other measures implementing the Phase One Agreement. Since the entry into force of this commitment in February 2020, China has generally been providing the required 45-day public comment period and working constructively with the United States whenever it has raised questions or concerns regarding provisions in proposed implementing measures.

### Translations

In its WTO accession agreement, China committed to make available translations of all of its trade-related laws, regulations and other measures at all levels of government in one or more of the WTO languages, i.e., English, French and Spanish. Prior to 2014, China had only compiled translations of trade-related laws and administrative regulations (into English), but not other types of measures, such as departmental rules, normative documents and sub-central government measures. Even for trade-related laws and administrative regulations, China was years behind in publishing these translations. At the July 2014 S&ED meeting, China committed that it would extend its translation efforts to include not only trade-related laws and administrative regulations but also trade-related departmental rules. Subsequently, in March 2015, China issued a measure requiring trade-related departmental rules to be translated into English. This measure also provides that the translation of a departmental rule normally must be published before implementation.

Notably, however, even if China were to fully implement its existing measures requiring translations, they would not be sufficient to bring China into full WTO compliance in this area. China does not consistently publish translations of trade-related laws, administrative regulations and departmental rules in a timely manner (i.e., before implementation), nor does it publish any translations of trade-related normative documents or trade-related measures issued by sub-central governments.

### Inquiry Point

In its WTO accession agreement, China committed to establish an inquiry point that would respond to requests for information relating to legal measures required to be published in its official journal. At times, however, China has refused to provide copies of legal measures in response to legitimate requests directed to its inquiry point.

In April 2020, for example, the United States submitted a request concerning five Chinese legal measures covering semiconductors and fisheries subsidy programs that had not been published in China's official journal and were not otherwise available online, nor had they been notified to the WTO. Despite the obligation in its WTO accession agreement to either provide the documents or respond in writing within 45 days, China did not meet this deadline. The United States made repeated follow-up requests, to no avail. Five months after the United States submitted its request to China's inquiry point, MOFCOM orally informed the U.S. Embassy in Beijing that it would not be providing any of the requested legal measures because two of the measures would soon be replaced and the other three measures, in China's view, were not relevant to China's WTO obligations. USTR promptly responded to MOFCOM in writing, countering its assertions and urging it to provide the requested documents. Since then, China has continued to refuse to provide a written response to the United States' request or to provide any of the requested legal measures, even though the United States and other WTO Members have repeatedly raised this matter before the WTO's Subsidies Committee and Council for Trade in Goods.

### Corporate Social Credit System

Since 2014, China has been working to implement a national "social credit" system for both individuals and companies. The implementation of this system is at a more advanced stage for companies versus individuals, as "unified social credit codes" are assigned to every domestic and foreign company in

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China. These 18-digit codes will provide a way for the Chinese government to track a company's record of administrative and regulatory compliance and generate public credit information. Over the past year, China has been increasingly focused on making the social credit system fully functional. Indeed, in his report to the 20th National Party Congress in October 2022, Xi Jinping in his capacity as the General Secretary of the Chinese Communist Party emphasized the need to refine the social credit system.

Under the corporate social credit system, government records and market-generated corporate compliance data are collected on every legal entity in China. The collected information contains regulatory and administrative records contributed by at least 44 state agencies and their branch offices across every province in China. Previously disparate information relating to a company's financial records, regulatory compliance, inspection results and other administrative enforcement activities is being consolidated under a company's unified social credit code. All of this data will be aggregated and shared between regulatory agencies via the National Credit Information Sharing Platform. Reportedly, approximately 75 percent of the records collected on companies is intended to be designated as "open to the public," while the remaining 25 percent that is intended to be withheld will include potentially sensitive information, such as approval records related to national development projects and details of any criminal cases.

Nationwide data collection under the corporate social credit system provides mechanisms to penalize companies with poor corporate and legal compliance records by, among other things, subjecting them to public censure via what China calls "blacklists," while rewarding compliant companies with positive incentives via so-called "redlists." Negative ratings or placement on a government agency's censure list can lead to various restrictions on a company's business activities. A company could face increased inspections, reduced access to loans and tax incentives, restrictions on

government procurement, reduced land-use rights, monetary fines or permit denials, among other possible penalties.

However, currently, there is no fully integrated national system for assigning comprehensive social credit scores for companies, and the social credit system remains highly fragmented. Certain central government agencies and sub-central government agencies maintain their own rating systems, with each agency making its own decisions about the types of transgressions that warrant negative ratings or placing a company on a censure list.

In November 2022, NDRC and PBOC jointly published a draft law that would give the social credit system a legal basis, further embedding it into China's regulatory network. The draft law seeks to establish NDRC and PBOC as the main government agencies for construction of the social credit system. Their responsibilities would include overall coordination, supervision and guidance of the construction of the social credit system and taking the lead in organizing the formulation and implementation of relevant policies and standards. The draft law also seeks to provide formal legal definitions for certain terms used in implementing the social credit system, such as "untrustworthy," "credit supervision" and "credit information." In addition, the draft law seeks to codify the protection of certain rights, as it calls for the establishment of a social credit system that maintains the security of social credit information and strictly protects state secrets, business secrets and personal privacy, while also protecting the lawful rights and interests of natural persons, legal persons and unincorporated organizations.

Earlier in 2022, prior to the publication of the draft law, NDRC issued a draft update of the 2021 *National Basic Catalogue of Public Credit Information* and a draft update of the 2021 *National Basic List of Disciplinary Measures against Dishonest Acts*. The draft Catalogue compiles the scope and types of credit information that can be collected by government agencies. It also stipulates that certain categories of information are exempt from

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collection, including state secrets and trade secrets. The draft List includes a range of punitive actions that may be applied to violators of trust, such as duties, fees, restrictions on market activity, prohibitions or limitations on occupations and bans from government procurement bidding.

The corporate social credit system has been tied to larger policy objectives as well. For example, the General Office of the State Council and the General Office of the Chinese Communist Party issued a joint opinion on promoting a high-quality credit system in order to further China's "dual circulation" objectives. In addition, in November 2022, the Ministry of Science and Technology (MOST) announced a new pilot project for evaluating STEM talent. Under MOST's new pilot project, evaluation of scientists' performance is to incorporate metrics related to their moral character, which includes their social credit record, in order to ensure that scientific researchers have no history of plagiarism or academic fraud. This pilot project appears to reflect China's struggle to improve the quality of its scientific research talent.

Foreign companies are concerned that the corporate social credit system will be used by the Chinese government to pressure them to act in furtherance of China's industrial policies or other state priorities or otherwise to make investments or conduct their business operations in ways that run counter to market principles or their own business strategies. Foreign companies are also concerned that the Chinese government will use the corporate social credit system as another tool to ensure that they do not cross political redlines on sensitive matters like human rights. In addition, foreign companies are concerned about the opaque nature of the corporate social credit system. Currently, for example, a company sometimes only learns about its negative ratings when, for example, it requests a permit and receives a denial, even though the *Measures for Administration of the List of Serious Violators of Trust and Law* includes a requirement that companies be informed of their being censured in advance. Other times, a company learns for the

first time that it has been censured when a Chinese government agency posts its name on the agency's website, even though the censuring of a company can cause severe harm to the company's reputation and adversely impact its efforts to attract customers, secure needed financing or make new investments. When Chinese government agencies begin to pursue joint punishment in the way that NDRC envisions, it will mean that an infraction in one regulatory context could have wider consequences across the company's entire business operations.

Another key concern regarding the corporate social credit system involves its links to individual social credit. In addition, the Chinese government could also potentially use corporate social credit in the future to exert extraterritorial influence by threatening the social credit standing of foreign multinationals or citizens for behavior or speech outside of China.

To date, the corporate social credit system does not appear to explicitly disadvantage U.S. or other foreign companies or provide favorable treatment to domestic companies. Nevertheless, concerns remain regarding how this system will be applied in practice, and the need to comply with an increasingly complex and expansive social credit system may impose barriers to entry into China's market for foreign companies that are unfamiliar with the legal and regulatory requirements associated with corporate social credit compliance and reporting.

### OTHER NON-TARIFF MEASURES

A number of other non-tariff measures can adversely affect the ability of U.S. industry to access or invest in China's market. Key areas of concern include laws governing land use in China, commercial dispute resolution and the treatment of non-governmental organizations. Corruption among Chinese government officials, enabled in part by China's incomplete adoption of the rule of law, is also a key area of concern.

**REGLAMENTO DE EJECUCIÓN (UE) 2022/2068 DE LA COMISIÓN**  
**de 26 de octubre de 2022**

**por el que se establece un derecho antidumping definitivo sobre las importaciones de determinados productos planos de acero laminados en frío originarios de la República Popular China y de la Federación de Rusia, tras una reconsideración por expiración de conformidad con el artículo 11, apartado 2, del Reglamento (UE) 2016/1036 del Parlamento Europeo y del Consejo**

LA COMISIÓN EUROPEA,

Visto el Tratado de Funcionamiento de la Unión Europea,

Visto el Reglamento (UE) 2016/1036 del Parlamento Europeo y del Consejo, de 8 de junio de 2016, relativo a la defensa contra las importaciones que sean objeto de dumping por parte de países no miembros de la Unión Europea <sup>(1)</sup> («Reglamento de base»), y en particular su artículo 11, apartado 2,

Visto el Reglamento (UE) 2015/477 del Parlamento Europeo y del Consejo, de 11 de marzo de 2015, sobre las medidas que podrá tomar la Unión en relación con el efecto combinado de las medidas antidumping o antisubvenciones y las medidas de salvaguardia <sup>(2)</sup>, y en particular su artículo 1,

Considerando lo siguiente:

**1. PROCEDIMIENTO**

**1.1. Investigaciones anteriores y medidas en vigor**

- (1) Mediante el Reglamento (UE) 2016/1328 <sup>(3)</sup>, la Comisión Europea estableció derechos antidumping sobre las importaciones de determinados productos planos de acero laminados en frío originarios de la República Popular China («RPC» o «China») y de la Federación de Rusia («Rusia») («medidas originales»). En adelante, la investigación que condujo a la aplicación de las medidas originales se denominará «la investigación original».
- (2) Los derechos antidumping actualmente en vigor para la RPC son del 19,7 % sobre las importaciones de los productores exportadores incluidos en la muestra, del 20,5 % sobre las empresas cooperantes no incluidas en la muestra y del 22,1 % para todas las demás empresas; en el caso de Rusia, oscilan entre el 18,7 y el 34 % para los productores exportadores incluidos en la muestra, con un tipo de derecho del 36,1 % para todas las demás empresas.

**1.2. Solicitud de reconsideración por expiración**

- (3) A raíz de la publicación de un anuncio de expiración inminente <sup>(4)</sup>, la Comisión Europea (en lo sucesivo, «Comisión») recibió una solicitud de reconsideración de conformidad con el artículo 11, apartado 2, del Reglamento de base.

<sup>(1)</sup> DO L 176 de 30.6.2016, p. 21.

<sup>(2)</sup> DO L 83 de 27.3.2015, p. 11.

<sup>(3)</sup> Reglamento de Ejecución (UE) 2016/1328 de la Comisión, de 29 de julio de 2016, por el que se impone un derecho antidumping definitivo y se percibe definitivamente el derecho provisional impuesto sobre las importaciones de determinados productos planos de acero laminados en frío originarios de la República Popular China y de la Federación de Rusia (DO L 210 de 4.8.2016, p. 1).

<sup>(4)</sup> DO C 389 de 16.11.2020, p. 4.



- (4) La solicitud de reconsideración fue presentada el 3 de mayo de 2021 por la Asociación Europea del Acero («Eurofer» o «solicitante») en nombre de la industria de la Unión de productos planos de acero laminados en frío, en el sentido del artículo 5, apartado 4, del Reglamento de base. El motivo en el que se basó la solicitud fue que la expiración de las medidas probablemente acarrearía la reaparición del dumping y la continuación o reaparición del perjuicio para la industria de la Unión.

### 1.3. Inicio de una reconsideración por expiración

- (5) Tras determinar, previa consulta al comité establecido por el artículo 15, apartado 1, del Reglamento de base, que existían pruebas suficientes para iniciar una reconsideración por expiración, la Comisión inició el 3 de agosto de 2021 una reconsideración por expiración relativa a las importaciones a la Unión de productos planos de acero laminados en frío originarios de la RPC y de Rusia («países afectados») de conformidad con el artículo 11, apartado 2, del Reglamento de base. La Comisión publicó un anuncio de inicio en el *Diario Oficial de la Unión Europea* <sup>(5)</sup> (en lo sucesivo, «anuncio de inicio»).

### 1.4. Período de investigación de la reconsideración y período considerado

- (6) La investigación de la continuación o reaparición del dumping abarcó el período comprendido entre el 1 de julio de 2020 y el 30 de junio de 2021 («período de investigación de la reconsideración»). El análisis de las tendencias pertinentes para evaluar la probabilidad de continuación o reaparición del perjuicio abarcó el período comprendido entre el 1 de enero de 2017 y el final del período de investigación de la reconsideración («período considerado»).

### 1.5. Partes interesadas

- (7) En el anuncio de inicio se invitó a las partes interesadas a ponerse en contacto con la Comisión para participar en la investigación. Además, la Comisión informó específicamente al solicitante, a todos los productores conocidos de la Unión, a los productores conocidos y a las autoridades de la RPC y de Rusia, así como a los importadores, usuarios y comerciantes conocidos, sobre el inicio de la reconsideración por expiración y les invitó a participar.

### 1.6. Observaciones sobre el inicio

- (8) Se brindó a las partes interesadas la oportunidad de formular observaciones sobre el inicio de la reconsideración por expiración y de solicitar una audiencia con la Comisión o con el consejero auditor en los procedimientos comerciales. La Comisión recibió observaciones de tres productores exportadores de Rusia, del Gobierno ruso, de un importador no vinculado y de un usuario.
- (9) En sus observaciones sobre el inicio, los tres productores exportadores rusos alegaron que el solicitante no había presentado pruebas suficientes y fiables de que era probable que el dumping perjudicial de las importaciones procedentes de Rusia continuara o reapareciera. Además, el Gobierno ruso, los productores exportadores rusos, el importador no vinculado y un usuario alegaron que no existía un nexo causal entre la situación de perjuicio de la industria de la Unión y las importaciones de productos planos de acero laminados en frío originarios de China y de Rusia. El razonamiento de las distintas partes era que el perjuicio para la industria de la Unión, si existía, se debía a factores distintos de las importaciones perjudiciales procedentes de Rusia y China, dados los volúmenes insignificantes de importaciones de productos planos de acero laminados en frío desde los países afectados.
- (10) Además, como también se indica en el anuncio de inicio, el solicitante alegó que «la desaparición del perjuicio inicialmente establecido se ha debido principalmente a la existencia de medidas y que, si se deja que estas expiren, la reanudación de importaciones en cantidades sustanciales a precios objeto de dumping desde los países afectados probablemente acarrearía una reaparición del perjuicio para la industria de la Unión» <sup>(6)</sup>. El objetivo de la investigación de reconsideración era determinar si es probable que la expiración de las medidas dé lugar a la continuación o reaparición del perjuicio causado por las importaciones objeto de dumping desde los países afectados. La información facilitada por el solicitante en la fase de inicio era suficiente para demostrar que el perjuicio causado por las importaciones objeto de dumping reaparecería si dichas importaciones se reanudaran en volúmenes más elevados. Por consiguiente, la Comisión rechazó las alegaciones de las partes sobre la causalidad.

<sup>(5)</sup> Anuncio de inicio de una reconsideración por expiración de las medidas antidumping aplicables a las importaciones de determinados productos planos de acero laminados en frío originarios de la República Popular China y la Federación de Rusia (DO C 311 de 3.8.2021, p. 6).

<sup>(6)</sup> DO C 311 de 3.8.2021, p. 8, punto 4.2.

- (11) El Gobierno ruso alegó que el solicitante no presentó pruebas suficientes del aumento del dumping, como se indica en el artículo 5, apartado 2, del Acuerdo Antidumping, al calcular el valor normal. Además, alegó que la información facilitada en la versión abierta de la solicitud de reconsideración por expiración no era lo suficientemente detallada y no mostraba las cifras exactas utilizadas para calcular el margen, ya que los costes de transporte, los costes de exportación y los precios en el mercado ruso de productos planos de acero laminados en frío y los propios cálculos se habían facilitado en cifras aproximadas. El Gobierno ruso pidió a la Comisión que examinara los cálculos presentados en la solicitud y que aportara pruebas de que dichos cálculos eran fiables. Por otra parte, el Gobierno ruso se refirió al artículo 6, apartado 2, del Acuerdo Antidumping, afirmando que, sin una oportunidad de comprender razonablemente el contenido de la información facilitada con carácter confidencial, el solicitante estaba impidiendo tanto al Gobierno ruso como a los productores rusos, así como a otras partes interesadas, tener la oportunidad de defender plenamente sus intereses, y pidió a la Comisión y a Eurofer que facilitaran datos más detallados sobre los cálculos del margen de dumping.
- (12) En cuanto a la alegación sobre la suficiencia de las pruebas, la solicitud de reconsideración reconoció que las exportaciones rusas del producto afectado a la Unión disminuyeron considerablemente en comparación con el período de investigación de la investigación original. Por lo tanto, la solicitud evaluó la probabilidad de reaparición del dumping tomando como referencia los precios de exportación a terceros países distintos de la Unión. El análisis de las pruebas puso de manifiesto que la solicitud contenía pruebas suficientes de la probabilidad de reaparición del dumping.
- (13) El margen de dumping calculado en la solicitud reflejaba el comportamiento en materia de fijación de precios de los productores exportadores rusos en los mercados de terceros países y no reflejaba necesariamente el grado exacto de dumping calculado en la investigación. Sin embargo, el solicitante aportó pruebas suficientes en la solicitud sobre el precio de exportación y el valor normal que mostraban la probabilidad de reaparición del dumping. El solicitante presentó también una descripción suficientemente detallada de la metodología utilizada en su cálculo del dumping para permitir una comprensión razonable del contenido de la información facilitada con carácter confidencial.
- (14) A fin de evaluar el valor normal de los productos planos de acero laminados en frío para los productores exportadores rusos, el solicitante había recopilado información públicamente disponible y de pago sobre los precios de venta de una tonelada de productos planos de acero laminados en frío por parte de los principales exportadores en su mercado nacional durante el período de referencia. La Comisión verificó y confirmó el precio de exportación mediante la base de datos Global Trade Atlas («GTA»).
- (15) Dado que las importaciones a la Unión del producto objeto de reconsideración procedentes de Rusia han sido insignificantes tras la imposición de los derechos antidumping en 2016, el solicitante basó el precio de exportación en varias fuentes de información sobre los precios de las ventas de exportación de productos planos de acero laminados en frío rusos a cualquier tercer país en 2020. Los precios de exportación para una tonelada de dichos productos se establecieron sobre la base de información de mercado acerca de los precios de exportación de Rusia. El precio de exportación se verificó y confirmó con el precio medio de los tres principales destinos de las exportaciones rusas recogido en la base de datos GTA.
- (16) Así pues, el solicitante había comparado el precio medio de exportación franco fábrica de los productos en cuestión originarios de Rusia con un valor normal basado en los precios nacionales rusos.
- (17) En su análisis reglamentario, la Comisión solo tuvo en cuenta los elementos de prueba suficientemente adecuados y precisos.
- (18) Por lo tanto, se rechazaron las alegaciones del Gobierno ruso.
- (19) La Comisión consideró que la versión no confidencial de la solicitud disponible en el expediente para inspección por las partes interesadas contenía todas las pruebas esenciales y resúmenes no confidenciales de los datos confidenciales que permitían a las partes interesadas ejercer adecuadamente sus derechos de defensa. En consecuencia, se rechazó esta alegación.

#### 1.7. Muestreo

- (20) En el anuncio de inicio, la Comisión indicó que podría realizar un muestreo de las partes interesadas con arreglo al artículo 17 del Reglamento de base.

### 1.7.1. Muestreo de los productores de la Unión

- (21) En el anuncio de inicio, la Comisión declaró que había seleccionado provisionalmente una muestra de tres productores de la Unión. La Comisión seleccionó la muestra en función de los volúmenes de producción y venta del producto similar. La muestra estaba compuesta por tres productores de la Unión, que representaban más del 30 % del volumen total estimado de producción del producto similar en la Unión y más del 20 % del volumen total estimado de ventas.
- (22) De conformidad con el artículo 17, apartado 2, del Reglamento de base, la Comisión invitó a las partes interesadas a presentar sus observaciones sobre la muestra provisional. No se recibió ninguna observación, por lo que se confirmó la muestra provisional y se la consideró representativa de la industria de la Unión.

### 1.7.2. Muestreo de los importadores

- (23) Para decidir si era necesario el muestreo y, en caso afirmativo, seleccionar una muestra, la Comisión pidió a los importadores no vinculados que facilitaran la información especificada en el anexo del anuncio de inicio.
- (24) Ningún importador no vinculado respondió al formulario de muestreo. En consecuencia, la Comisión concluyó que no era necesario un muestreo.

### 1.7.3. Muestreo de los productores exportadores de Rusia y China

- (25) Para decidir si era necesario un muestreo y, en caso afirmativo, seleccionar una muestra, la Comisión pidió a todos los productores exportadores de Rusia y China que facilitaran la información especificada en el anuncio de inicio. Además, pidió a las autoridades de ambos países que, si había otros productores exportadores que pudieran estar interesados en participar en la investigación, los identificara o se pusiera en contacto con ellos.
- (26) En el inicio de la reconsideración por expiración, la Comisión puso a disposición de los interesados, para su inspección, una copia de los cuestionarios del expediente y la publicó en el sitio web de la Dirección General de Comercio.
- (27) Ningún productor exportador chino facilitó la información solicitada ni accedió a ser incluido en la muestra. La Comisión informó a la Misión de la República Popular China ante la Unión Europea de su intención de aplicar los datos disponibles de conformidad con el artículo 18 del Reglamento de base. No se recibieron observaciones.
- (28) Por lo tanto, dado que los productores chinos no cooperaron, las conclusiones relativas a las importaciones procedentes de la RPC se formularon sobre la base de los datos disponibles de conformidad con el artículo 18 del Reglamento de base, en particular utilizando estadísticas comerciales sobre importaciones y exportaciones [Eurostat, Global Trade Atlas (GTA) <sup>(7)</sup> y Organización de Cooperación y Desarrollo Económicos (OCDE) <sup>(8)</sup>].
- (29) Tres productores exportadores rusos, a saber, PJSC Magnitogorsk Iron and Steel Works (MMK) y sus empresas vinculadas (grupo MMK), PJSC Novolipetsk Steel (NLMK) y sus empresas vinculadas (grupo NLMK) y PJSC Severstal (Severstal) y sus empresas vinculadas (grupo SEVERSTAL), facilitaron la información solicitada y aceptaron ser incluidos en la muestra. Sin embargo, el 6 de septiembre de 2021, estos tres productores exportadores informaron a la Comisión de que habían decidido no presentar respuestas individuales al cuestionario antidumping, pero que cooperarían con la Comisión en todos los demás aspectos de la reconsideración por expiración, como las observaciones sobre la solicitud de reconsideración, la probabilidad de continuación o reaparición del perjuicio y el interés de la Unión. Posteriormente, el 13 de septiembre de 2021, los tres productores exportadores rusos presentaron observaciones sobre la solicitud de reconsideración por expiración, la supuesta continuación y la probabilidad de reaparición del dumping perjudicial y el interés de la Unión. Invitaron a la Comisión a llevar a cabo una verificación selectiva de los datos específicos de las empresas pertinentes, como la producción, la capacidad y la utilización de la capacidad, presentados junto con las observaciones.

<sup>(7)</sup> <https://www.gtis.com/gta/>.

<sup>(8)</sup> [https://qdd.oecd.org/subject.aspx?Subject=ExportRestrictions\\_IndustrialRawMaterials](https://qdd.oecd.org/subject.aspx?Subject=ExportRestrictions_IndustrialRawMaterials).

- (30) Tras esta comunicación, el 21 de septiembre y el 19 de noviembre de 2021, la Comisión informó a los productores exportadores mencionados de que los consideraba partes no cooperantes y les informó de su intención de aplicar el artículo 18 del Reglamento de base y utilizar los datos disponibles para determinar sus conclusiones en la investigación. La Comisión informó asimismo a las autoridades rusas de su intención de utilizar los datos disponibles de conformidad con el artículo 18 del Reglamento de base.
- (31) El 30 de septiembre y el 29 de noviembre de 2021, la Comisión recibió observaciones de los tres productores exportadores rusos sobre la aplicación del artículo 18 del Reglamento de base. No estaban de acuerdo con la evaluación de la Comisión sobre su situación de cooperación y reiteraron su intención de cooperar en otros aspectos de la reconsideración, como la continuación o reaparición del perjuicio, la probabilidad de un mayor dumping perjudicial y el interés de la Unión. Invitaron de nuevo a la Comisión a verificar los datos sobre producción, capacidad y utilización de la capacidad que habían presentado.
- (32) A este respecto, los productores exportadores rusos no presentaron la información necesaria solicitada en sus respuestas al cuestionario. La Comisión consideró que los productores exportadores rusos solo proporcionaron información fragmentada que se limitaba a la producción, la capacidad y el volumen de producción, sin aportar pruebas justificativas. Por consiguiente, dado que los productores exportadores no proporcionaron información suficiente y fiable para que la Comisión llegara a una conclusión razonablemente precisa, la Comisión utilizó la información disponible en el expediente, como se explica en el considerando 30. En cualquier caso, la Comisión utilizó la información facilitada por los tres productores rusos en la medida de lo posible a este respecto.
- (33) La Comisión remitió al Gobierno de la República Popular China un cuestionario sobre la existencia en la RPC de distorsiones significativas a efectos del artículo 2, apartado 6 bis, letra b), del Reglamento de base.
- (34) La Comisión también envió cuestionarios a los productores de la Unión incluidos en la muestra. Los mismos cuestionarios también se habían publicado en línea <sup>(9)</sup> el día del inicio de la investigación. Además, la Comisión envió un cuestionario a la asociación de productores de la Unión, Eurofer.
- (35) Se recibieron respuestas al cuestionario de los tres productores de la Unión incluidos en la muestra y de Eurofer.

#### 1.7.4. Verificación

- (36) La Comisión recabó y verificó toda la información que consideró necesaria para determinar la probabilidad de la continuación o reaparición del dumping y del perjuicio, así como el interés de la Unión. Sin embargo, debido al brote de la pandemia de COVID-19 y a las consiguientes medidas adoptadas para hacerle frente («comunicación sobre la COVID-19») <sup>(10)</sup>, la Comisión no pudo llevar a cabo las inspecciones *in situ* en las instalaciones de las empresas incluidas en la muestra. En su lugar, la Comisión realizó verificaciones a distancia de la información facilitada por las siguientes empresas por videoconferencia:

#### **Productores de la Unión**

- Voestalpine Stahl GmbH, Austria,
- ThyssenKrupp Steel Europe AG, Alemania,
- ArcelorMittal Belgium, Bélgica.

#### 1.8. Procedimiento posterior

- (37) El 19 de agosto de 2022, la Comisión comunicó los hechos y consideraciones esenciales en los que se basaba su intención de mantener los derechos antidumping en vigor en relación con las importaciones procedentes de la RPC y de Rusia. Se concedió a todas las partes la oportunidad de formular observaciones acerca de la información comunicada.

<sup>(9)</sup> [https://trade.ec.europa.eu/tdi/case\\_details.cfm?id=2538](https://trade.ec.europa.eu/tdi/case_details.cfm?id=2538).

<sup>(10)</sup> Comunicación sobre las consecuencias del brote de COVID-19 para las investigaciones antidumping y antisubvenciones (2020/C 86/06) (DO C 86 de 16.3.2020, p. 6).

- (38) La Comisión examinó las observaciones de las partes interesadas y las tuvo en cuenta, en su caso. Se concedió audiencia a las partes que lo solicitaron.

## 2. PRODUCTO OBJETO DE RECONSIDERACIÓN, PRODUCTO AFECTADO Y PRODUCTO SIMILAR

### 2.1. Producto objeto de reconsideración

- (39) El producto objeto de reconsideración es el mismo que en la investigación original, a saber, productos laminados planos de hierro o acero sin alear, o de otro tipo de acero aleado, excepto de acero inoxidable, de cualquier anchura, sin chapar ni revestir, simplemente laminados en frío (reducidos en frío), clasificados actualmente en los códigos NC ex 7209 15 00 (código TARIC 7209 15 00 90), 7209 16 90, 7209 17 90, 7209 18 91, ex 7209 18 99 (código TARIC 7209 18 99 90), ex 7209 25 00 (código TARIC 7209 25 00 90), 7209 26 90, 7209 27 90, 7209 28 90, 7211 23 30, ex 7211 23 80 (códigos TARIC 7211 23 80 19, 7211 23 80 95 y 7211 23 80 99), ex 7211 29 00 (códigos TARIC 7211 29 00 19 y 7211 29 00 99), 7225 50 80 y 7226 92 00 («producto objeto de reconsideración»).
- (40) Están excluidos de la definición del producto objeto de reconsideración los siguientes tipos de productos:
- los productos eléctricos planos de hierro o de acero sin alear, de cualquier anchura, sin chapar ni revestir, simplemente laminados en frío (reducidos en frío), enrollados o sin enrollar, de cualquier espesor,
  - los productos recocidos (denominados «chapa negra») planos de hierro o de acero sin alear, de cualquier anchura, laminados en frío (reducidos en frío), sin chapar ni revestir, enrollados, de un espesor inferior a 0,35 mm,
  - los productos laminados planos de los demás aceros aleados, de cualquier anchura, de acero magnético al silicio, y
  - los productos laminados planos de acero aleado, simplemente laminados en frío (reducidos en frío), de acero rápido.
- (41) Los productos planos de acero laminados en frío se fabrican a partir de bobinas laminadas en caliente. El proceso de laminado en frío se define mediante el paso de una chapa o fleje (que se haya laminado y decapado en caliente) a través de las bobinas frías, es decir, por debajo de la temperatura de reblandecimiento del metal. Los productos planos de acero laminados en frío se fabrican para cumplir ciertas especificaciones, o las del usuario final patentadas. Pueden entregarse en diversas formas: en bobinas (engrasadas o sin engrasar), en longitudes a medida (chapa) o flejes estrechos. Los productos planos de acero laminados en frío son insumos industriales adquiridos por usuarios finales para diversas aplicaciones, principalmente en la manufactura (industria en general, envases y embalajes, automoción, etc.), pero también en la construcción.

### 2.2. Producto afectado

- (42) El producto afectado por la presente investigación es el producto objeto de reconsideración originario de la RPC y de Rusia.

### 2.3. Producto similar

- (43) Según lo establecido en la investigación original, la presente investigación de reconsideración por expiración confirmó que los siguientes productos tienen las mismas características físicas básicas, así como los mismos usos básicos:
- el producto afectado cuando se exporte a la Unión,
  - el producto objeto de reconsideración vendido en los mercados interiores de China y Rusia, así como
  - el producto objeto de reconsideración fabricado y vendido en la Unión por la industria de la Unión.
- (44) Se considera, por tanto, que son productos similares a tenor del artículo 1, apartado 4, del Reglamento de base.

### 3. DUMPING

#### 3.1. República Popular China

##### 3.1.1. Observaciones preliminares

- (45) Durante el período de investigación de la reconsideración se siguieron realizando importaciones de determinados productos planos de acero laminados en frío desde China, si bien a niveles inferiores a los del período de investigación de la investigación original (es decir, entre el 1 de abril de 2014 y el 31 de marzo de 2015). Según los datos de Eurostat, las importaciones de determinados productos planos de acero laminados en frío originarios de China representaron menos del 1 % del mercado de la Unión en el período de investigación de la reconsideración, frente a una cuota de mercado del 10,3 % <sup>(11)</sup> durante la investigación original. En términos absolutos, China exportó a la Unión unas 32 000 toneladas durante el período de investigación de la reconsideración, lo que supone una disminución significativa en comparación con las aproximadamente 732 000 toneladas <sup>(12)</sup> que exportó a la Unión durante el período de investigación de la investigación original.
- (46) Durante la investigación original, la Comisión constató que las exportaciones del producto afectado procedentes de China eran objeto de dumping a un nivel significativo en el mercado de la Unión. Los márgenes de dumping de los exportadores chinos que cooperaron oscilaban entre el 52,7 y el 59,2 %. Debido a la aplicación de la regla del derecho inferior, los derechos antidumping impuestos a las importaciones chinas se fijaron en un nivel mucho más bajo, que oscilaba entre el 19,7 y el 22,1 %.
- (47) Tal como se menciona en el considerando 27, ninguno de los productores exportadores chinos cooperó en la investigación. Por lo tanto, se informó a las autoridades chinas de que, debido a la falta de cooperación, la Comisión podría aplicar el artículo 18 del Reglamento de base en cuanto a las conclusiones con respecto a la RPC. La Comisión no recibió ninguna observación ni solicitud de intervención del consejero auditor a este respecto.
- (48) Por tanto, de conformidad con el artículo 18, apartado 1, del Reglamento de base, las conclusiones relativas a la probabilidad de continuación o reaparición del dumping con respecto a China se basaron en los datos disponibles, en particular la información contenida en la solicitud de reconsideración por expiración y en la información comunicada por las partes interesadas, junto con otras fuentes de información, como las estadísticas comerciales sobre importaciones y exportaciones [Eurostat, base de datos GTA <sup>(13)</sup> y OCDE <sup>(14)</sup>] y proveedores independientes de datos financieros, como las estadísticas Global Financials que publica Dunn & Bradstreet <sup>(15)</sup>.

##### 3.1.2. Dumping

###### 3.1.2.1. Procedimiento para la determinación del valor normal con arreglo al artículo 2, apartado 6 bis, del Reglamento de base para las importaciones de determinados productos planos de acero laminados en frío originarios de China.

- (49) Dado que al inicio de la investigación había datos disponibles suficientes que tendían a demostrar, con respecto a la RPC, la existencia de distorsiones significativas a efectos del artículo 2, apartado 6 bis, letra b), del Reglamento de base, la Comisión inició la investigación con arreglo al artículo 2, apartado 6 bis, del Reglamento de base.
- (50) A fin de obtener la información que consideró necesaria para su investigación en relación con las supuestas distorsiones significativas, la Comisión envió un cuestionario al Gobierno de la República Popular China. Además, en el punto 5.3.2 del anuncio de inicio, la Comisión invitó a todas las partes interesadas a exponer sus puntos de vista, presentar la información oportuna y aportar pruebas justificativas con respecto a la aplicación del artículo 2, apartado 6 bis, del Reglamento de base en los treinta y siete días siguientes a la fecha de publicación del anuncio de inicio en el *Diario Oficial de la Unión Europea*. No se recibió ninguna respuesta del Gobierno de la República Popular China al cuestionario ni ningún documento sobre la aplicación del artículo 2, apartado 6 bis, del Reglamento de base dentro del plazo. Posteriormente, mediante nota verbal de 13 de septiembre de 2021, la Comisión informó al Gobierno de la República Popular China de que utilizaría los datos disponibles a tenor del artículo 18 del Reglamento de base para determinar la existencia de distorsiones significativas en la RPC.

<sup>(11)</sup> Reglamento de Ejecución (UE) 2016/181 de la Comisión, de 10 de febrero de 2016, que impone un derecho antidumping provisional sobre las importaciones de determinados productos planos de acero laminados en frío originarios de la República Popular China y de la Federación de Rusia (DO L 37 de 12.2.2016, p. 17), considerando 113.

<sup>(12)</sup> Véase la nota anterior.

<sup>(13)</sup> <https://www.gtis.com/gta/>.

<sup>(14)</sup> [https://qdd.oecd.org/subject.aspx?Subject=ExportRestrictions\\_IndustrialRawMaterials](https://qdd.oecd.org/subject.aspx?Subject=ExportRestrictions_IndustrialRawMaterials).

<sup>(15)</sup> <https://ec.altares.eu/>.



- (51) En el punto 5.3.2 del anuncio de inicio, la Comisión también especificó que, a la vista de las pruebas disponibles, un posible tercer país representativo de China era en este caso Brasil, de conformidad con el artículo 2, apartado 6 bis, letra a), del Reglamento de base, a fin de determinar el valor normal basado en precios o valores de referencia no distorsionados. La Comisión también señaló que analizaría otros países posiblemente adecuados de conformidad con los criterios establecidos en el artículo 2, apartado 6 bis, letra a), primer guion, del Reglamento de base.
- (52) El 24 de noviembre de 2020, la Comisión informó a las partes interesadas mediante una nota (en lo sucesivo, «primera nota») de las fuentes pertinentes que tenía previsto utilizar para determinar el valor normal. En dicha nota, la Comisión facilitó una lista de todos los factores de producción, como las materias primas, la mano de obra y la energía utilizados en la producción de determinados productos planos de acero laminados en frío. Además, basándose en los criterios que rigen la elección de precios o valores de referencia no distorsionados, la Comisión identificó posibles países representativos, a saber, Brasil, México, Rusia y Turquía. La Comisión no recibió observaciones sobre la primera nota.
- (53) El 17 de marzo de 2022, la Comisión informó a las partes interesadas mediante una segunda nota (en lo sucesivo, «segunda nota») sobre las fuentes pertinentes que tenía previsto utilizar para determinar el valor normal, con Brasil como país representativo. No se recibieron observaciones.

### 3.1.2.2. Valor normal

- (54) Con arreglo al artículo 2, apartado 1, del Reglamento de base, «el valor normal se basará en principio en los precios pagados o por pagar, en el curso de operaciones comerciales normales, por clientes independientes en el país de exportación».
- (55) Sin embargo, de conformidad con el artículo 2, apartado 6 bis, letra a), de ese mismo Reglamento, «si [...] se determina que no es adecuado utilizar los precios y costes internos del país exportador debido a la existencia en ese país de distorsiones significativas a tenor de la letra b), el valor normal se calculará exclusivamente a partir de costes de producción y venta que reflejen precios o valores de referencia no distorsionados» e «incluirá una cantidad no distorsionada y razonable en concepto de gastos administrativos, de venta y generales y en concepto de beneficios» (los «gastos administrativos, de venta y generales» se denominarán en lo sucesivo «gastos VGA»).
- (56) Como se explica con más detalle en las subsecciones siguientes, la Comisión concluyó en la presente investigación que, con arreglo a las pruebas disponibles, y teniendo en cuenta la falta de cooperación del Gobierno de la República Popular China y de los productores exportadores chinos, procedía aplicar el artículo 2, apartado 6 bis, del Reglamento de base.

### 3.1.3. Existencia de distorsiones significativas

- (57) En recientes investigaciones relativas al sector siderúrgico de China <sup>(16)</sup>, la Comisión constató la existencia de distorsiones significativas en el sentido del artículo 2, apartado 6 bis, letra b), del Reglamento de base.
- (58) En estas investigaciones, la Comisión constató que existe una intervención sustancial de los poderes públicos en China que da lugar a una alteración de la asignación efectiva de recursos en consonancia con los principios del mercado <sup>(17)</sup>. En particular, la Comisión concluyó que el sector del acero, que es la principal materia prima para producir el producto objeto de reconsideración, no solo sigue estando en gran medida en manos del Gobierno de la República Popular China, en el sentido del artículo 2, apartado 6 bis, letra b), primer guion, del Reglamento de

<sup>(16)</sup> Reglamento de Ejecución (UE) 2022/191 de la Comisión, de 16 de febrero de 2022, por el que se impone un derecho antidumping definitivo sobre las importaciones de determinados elementos de fijación de hierro o acero originarios de la República Popular China (DO L 36 de 17.2.2022, p. 1); Reglamento de Ejecución (UE) 2021/2239 de la Comisión, de 15 de diciembre de 2021, por el que se establece un derecho antidumping definitivo sobre las importaciones de determinadas torres eólicas industriales de acero originarias de la República Popular China (DO L 450 de 16.12.2021, p. 59); Reglamento de Ejecución (UE) 2021/635 de la Comisión, de 16 de abril de 2021, por el que se establece un derecho antidumping definitivo sobre las importaciones de determinados tubos soldados de hierro o de acero sin alear originarios de Bielorrusia, la República Popular China y Rusia, tras una reconsideración por expiración en virtud del artículo 11, apartado 2, del Reglamento (UE) 2016/1036 del Parlamento Europeo y del Consejo (DO L 132 de 19.4.2021, p. 145), y Reglamento de Ejecución (UE) 2020/508 de la Comisión, de 7 de abril de 2020, por el que se impone un derecho antidumping provisional a las importaciones de determinadas chapas y bobinas de acero inoxidable laminadas en caliente originarias de Indonesia, República Popular China y Taiwán (DO L 110 de 8.4.2020, p. 3).

<sup>(17)</sup> Véanse el Reglamento de Ejecución (UE) 2022/191, considerandos 195 a 201, el Reglamento de Ejecución (UE) 2021/2239, considerandos 67 a 74, el Reglamento de Ejecución (UE) 2021/635, considerandos 149 y 150, y el Reglamento de Ejecución (UE) 2020/508, considerandos 158 y 159.

base <sup>(18)</sup>, sino que dicho Gobierno también está en condiciones de interferir en los precios y los costes gracias a la presencia del Estado en las empresas en el sentido del artículo 2, apartado 6 bis, letra b), segundo guion, del Reglamento de base <sup>(19)</sup>. La Comisión también constató que la presencia e intervención del Estado en los mercados financieros, así como en el suministro de materias primas e insumos, tienen un efecto distorsionador adicional en el mercado. En efecto, por lo general, el sistema de planificación de la RPC hace que los recursos se destinen a los sectores que el Gobierno de la República Popular China considera estratégicos o políticamente importantes, en lugar de asignarse en consonancia con las fuerzas del mercado <sup>(20)</sup>. Además, la Comisión llegó a la conclusión de que la legislación en materia de propiedad y el Derecho concursal chinos no funcionan de manera adecuada, en el sentido del artículo 2, apartado 6 bis, letra b), cuarto guion, del Reglamento de base, lo que genera distorsiones en particular para mantener a flote las empresas insolventes y asignar los derechos de uso del suelo en la RPC <sup>(21)</sup>. En la misma línea, la Comisión constató distorsiones de los costes salariales en el sector siderúrgico en el sentido del artículo 2, apartado 6 bis, letra b), quinto guion, del Reglamento de base <sup>(22)</sup>, así como distorsiones en los mercados financieros en el sentido del artículo 2, apartado 6 bis, letra b), sexto guion, del Reglamento de base, en particular en lo que se refiere al acceso al capital del sector empresarial de la RPC <sup>(23)</sup>.

- (59) Al igual que en investigaciones previas relativas al sector siderúrgico en China, la Comisión analizó en la presente investigación si procedía o no utilizar los precios y costes internos de China, debido a la existencia de distorsiones significativas a tenor del artículo 2, apartado 6 bis, letra b), del Reglamento de base. Para ello, tomó como base los datos disponibles en el expediente, incluidos los contenidos en la solicitud, así como en el documento de trabajo de los servicios de la Comisión sobre distorsiones significativas en la economía de la República Popular China a efectos de las investigaciones de defensa comercial <sup>(24)</sup> («Informe»), que proceden de fuentes públicamente disponibles. Este análisis examinó las intervenciones sustanciales del Estado en la economía china en general, así como la situación específica del mercado en el sector en cuestión, incluido el producto objeto de reconsideración. La Comisión completó estos elementos probatorios con sus propias investigaciones sobre los diferentes criterios pertinentes para confirmar la existencia de distorsiones significativas en China, como también constataron sus anteriores investigaciones al respecto.

<sup>(18)</sup> Véanse el Reglamento de Ejecución (UE) 2022/191, considerandos 195 a 201, el Reglamento de Ejecución (UE) 2021/2239, considerandos 67 a 74, el Reglamento de Ejecución (UE) 2021/635, considerandos 115 a 118, y el Reglamento de Ejecución (UE) 2020/508, considerandos 122 a 127.

<sup>(19)</sup> Véanse el Reglamento de Ejecución (UE) 2022/191, considerandos 195 a 201, el Reglamento de Ejecución (UE) 2021/2239, considerandos 67 a 74, el Reglamento de Ejecución (UE) 2021/635, considerandos 119 a 122, y el Reglamento de Ejecución (UE) 2020/508, considerandos 128 a 132: si bien se puede considerar que el derecho de las autoridades estatales pertinentes a designar y destituir a los altos directivos de las empresas públicas, conforme a lo dispuesto en la legislación china, refleja los correspondientes derechos de propiedad, las células del Partido Comunista Chino («PCC») en las empresas, tanto públicas como privadas, representan otro canal importante a través del cual el Estado puede interferir en las decisiones empresariales. Con arreglo al Derecho de sociedades chino, en todas las empresas debe establecerse una organización del PCC (con al menos tres miembros del partido, según se especifica en la Constitución del PCC) y la empresa debe ofrecer las condiciones necesarias para las actividades de dicha organización. Aparentemente, en el pasado este requisito no siempre se aplicaba ni se imponía de forma estricta. Sin embargo, al menos desde 2016, el PCC ha reforzado sus exigencias de control de las decisiones empresariales de las empresas públicas como una cuestión de principio político. También se ha informado de las presiones que ejerce el PCC en las empresas privadas para que den prioridad al «patriotismo» y sigan la disciplina de partido. En 2017 se informó de que existían células del Partido en el 70 % de los aproximadamente 1,86 millones de empresas de propiedad privada, así como de que había una presión creciente para que las organizaciones del PCC tuvieran la última palabra sobre las decisiones empresariales en sus respectivas empresas. Estas normas se aplican de manera general a toda la economía china y a todos los sectores, en particular a los productores de acero inoxidable laminado en frío y a los proveedores de sus insumos.

<sup>(20)</sup> Véanse el Reglamento de Ejecución (UE) 2022/191, considerandos 195 a 201, el Reglamento de Ejecución (UE) 2021/2239, considerandos 67 a 74, el Reglamento de Ejecución (UE) 2021/635, considerandos 123 a 129, y el Reglamento de Ejecución (UE) 2020/508, considerandos 133 a 138.

<sup>(21)</sup> Véanse el Reglamento de Ejecución (UE) 2022/191, considerandos 195 a 201, el Reglamento de Ejecución (UE) 2021/2239, considerandos 67 a 74, el Reglamento de Ejecución (UE) 2021/635, considerandos 130 a 133, y el Reglamento de Ejecución (UE) 2020/508, considerandos 139 a 142.

<sup>(22)</sup> Véanse el Reglamento de Ejecución (UE) 2022/191, considerandos 195 a 201, el Reglamento de Ejecución (UE) 2021/2239, considerandos 67 a 74, el Reglamento de Ejecución (UE) 2021/635, considerandos 134 y 135, y el Reglamento de Ejecución (UE) 2020/508, considerandos 143 y 144.

<sup>(23)</sup> Véanse el Reglamento de Ejecución (UE) 2022/191, considerandos 195 a 201, el Reglamento de Ejecución (UE) 2021/2239, considerandos 67 a 74, el Reglamento de Ejecución (UE) 2021/635, considerandos 136 a 145, y el Reglamento de Ejecución (UE) 2020/508, considerandos 145 a 154.

<sup>(24)</sup> Documento de trabajo de los servicios de la Comisión SWD(2017) 483 final/2, 20. 12. 2017, disponible en [https://trade.ec.europa.eu/doclib/docs/2017/december/tradoc\\_156474.pdf](https://trade.ec.europa.eu/doclib/docs/2017/december/tradoc_156474.pdf).

- (60) En la solicitud se alegaba que la economía china en su conjunto está ampliamente influida y afectada por diversas intervenciones globales del Gobierno de la República Popular China u otras autoridades públicas en diversos niveles de gobierno, en vista de las cuales los precios y costes internos de la industria siderúrgica china no pueden utilizarse en la presente investigación. Para respaldar su posición, la solicitud se refería a las recientes investigaciones de la Comisión sobre el sector siderúrgico chino <sup>(25)</sup> o a las conclusiones del Foro Mundial del G-20 sobre el exceso de capacidad de la siderurgia <sup>(26)</sup>.
- (61) Más concretamente, la solicitud señalaba que, en el contexto de la doctrina de la «economía de mercado socialista» consagrada en la Constitución de la República Popular China, la omnipresencia del Partido Comunista Chino (PCC) y la influencia gubernamental sobre la economía a través de iniciativas de planificación estratégica —como los planes quinquenales 13.º y 14.º—, el intervencionismo del Gobierno de la República Popular China adopta diversas formas, a saber, administrativa, financiera y reglamentaria.
- (62) La solicitud ofrecía ejemplos de elementos que apuntaban a la existencia de distorsiones, tal como se enumeran en el artículo 2, apartado 6 bis, letra b), guiones primero a sexto, del Reglamento de base. En particular, refiriéndose a investigaciones anteriores de la Comisión en el sector siderúrgico, al Informe y a los informes de las autoridades de terceros países (representante de Comercio de los Estados Unidos) y de otras instituciones (Fondo Monetario Internacional), el solicitante alegó que:
- El mercado de productos planos de acero laminados en frío está abastecido en gran medida por empresas que operan bajo la propiedad, el control o la supervisión política o dirección de las autoridades chinas, habida cuenta, en particular, de la influencia del PCC tanto en empresas privadas como públicas mediante nombramientos del PCC en las empresas, así como en vista de la confusión sistemática entre las oficinas del Estado y del PCC. El solicitante alegó además que, si bien el sector siderúrgico representa aproximadamente la mitad de las empresas estatales y la mitad de las empresas privadas en términos de producción y capacidad de producción, cuatro de los cinco mayores productores de acero son empresas públicas, entre ellas Baowu, el segundo mayor productor de acero bruto del mundo, cuyo capital es íntegramente estatal y que está en estrecha consonancia con la política siderúrgica de Gobierno de la República Popular China. El solicitante señaló a este respecto que Gobierno de la República Popular China ha venido aplicando el plan de consolidar el 70 % de la producción de hierro y acero en diez empresas promotoras de aquí a 2025, una estrategia que afecta también a la industria de productos planos de acero laminados en frío, por ejemplo, mediante la adquisición por Baowu del productor Maanshan Iron Steel en 2019.
  - La presencia del Estado en las empresas le permite influir en los precios o los costes, en particular ejerciendo un control reglamentario y de gestión sobre las empresas públicas, así como a través de un papel cada vez más importante del PCC tanto en las empresas públicas como en las privadas, a las que se ha instado en los últimos años a dejar las decisiones importantes en manos del PCC. El solicitante se refirió además a los solapamientos personales entre la asociación CISA controlada por el Estado y el mayor productor privado de acero, el grupo Shagang, así como a la presencia del Estado en empresas del sector en sentido ascendente para las que se han fijado objetivos que dan lugar a costes anormalmente bajos para la industria siderúrgica.
  - Las políticas o medidas públicas son discriminatorias en favor de los proveedores nacionales o influyen de otro modo en las fuerzas del libre mercado, habida cuenta, en particular, del sistema de planificación que canaliza los recursos hacia determinadas industrias, como el sector siderúrgico. El solicitante lo ilustró citando el proyecto del Decimocuarto Plan Quinquenal para la Industria Siderúrgica, que reitera su importancia para la economía china, así como remitiéndose a otros documentos estratégicos y de planificación que prevén un apoyo al sector siderúrgico, como «Made in China 2025». El solicitante se refirió además a otras políticas públicas que afectan a las fuerzas del libre mercado, como el hecho de que el Gobierno de la República Popular China dirija los precios de las materias primas a través de numerosas medidas, como cuotas de exportación, requisitos de licencias de exportación, derechos de exportación o reducciones del IVA, mediante la diferenciación de los precios de la energía. Además, la solicitud describe los incentivos que ofrecen las autoridades chinas a los productores de acero que participen en la Iniciativa de la Franja y la Ruta, destinada a fomentar la presencia de empresas chinas en los mercados extranjeros.

<sup>(25)</sup> Reglamento de Ejecución (UE) 2017/649 de la Comisión, de 5 de abril de 2017, por el que se impone un derecho antidumping definitivo a las importaciones de determinados productos planos laminados en caliente de hierro, de acero sin alear o de los demás aceros aleados, originarios de la República Popular China (DO L 92 de 6.4.2017, p. 68); Reglamento de Ejecución (UE) 2017/969 de la Comisión, de 8 de junio de 2017, por el que se establecen derechos compensatorios definitivos sobre las importaciones de determinados productos planos laminados en caliente de hierro, de acero sin alear o de los demás aceros aleados, originarios de la República Popular China, y se modifica el Reglamento de Ejecución (UE) 2017/649, por el que se impone un derecho antidumping definitivo a las importaciones de determinados productos planos laminados en caliente de hierro, de acero sin alear o de los demás aceros aleados, originarios de la República Popular China (DO L 146 de 9.6.2017, p. 17), y Reglamento de Ejecución (UE) 2019/688 de la Comisión, de 2 de mayo de 2019, por el que se establece un derecho compensatorio definitivo sobre las importaciones de determinados productos siderúrgicos revestidos de materia orgánica originarios de la República Popular China a raíz de una reconsideración por expiración con arreglo al artículo 18 del Reglamento (UE) 2016/1037 del Parlamento Europeo y del Consejo (DO L 116 de 3.5.2019, p. 39).

<sup>(26)</sup> Foro mundial sobre el exceso de capacidad de la siderurgia, Informe ministerial, 20 de septiembre de 2018.

- La falta de aplicación, la aplicación discriminatoria o la ejecución inadecuada de las leyes en materia de propiedad, sociedades y Derecho concursal dan lugar a la supervivencia de un gran número de «empresas zombis» que contribuyen a la persistencia de capacidades no utilizadas, un problema especialmente grave en el sector siderúrgico y que repercute en los mercados financieros y de empréstito chinos. El solicitante señaló además que, dado que en China no existe propiedad privada de la tierra, el Estado chino interviene en el uso del suelo por parte del sector siderúrgico, como ya constató la Comisión en investigaciones anteriores <sup>(27)</sup>.
  - Los costes salariales están distorsionados, en la medida en que no existe una libre negociación y el único sindicato legalmente reconocido, el ACFTU, está sometido a las directrices del PCC. El solicitante indicó asimismo que China todavía no ha ratificado varios convenios fundamentales de la Organización Internacional del Trabajo (OIT) y que la mano de obra china se ve afectada por el sistema de registro de hogares.
  - La concesión de acceso a la financiación compete a instituciones que aplican objetivos de política pública, o que por cualquier otro motivo no actúan con independencia del Estado, debido a la presencia dominante de bancos de propiedad y control estatal en los que el Estado y el PCC tienen influencia en las decisiones sobre personal y empresariales y que se ajustan a los objetivos de política industrial del país. Según la solicitud, los productores chinos de productos planos de acero laminados en frío se benefician masivamente de préstamos en condiciones preferentes por parte de esos bancos. El solicitante señaló que los bancos privados también deben tener en cuenta la política nacional en el ejercicio de sus actividades. De forma similar a las distorsiones en el sector bancario, la solicitud describe el papel dominante de los agentes gubernamentales en el mercado de obligaciones y el papel distorsionador de las agencias de calificación crediticia de propiedad estatal o de las agencias privadas sujetas a una poderosa influencia del Estado, lo que abre el camino, para las industrias fomentadas, a una financiación a tipos más favorables que los que habrían estado disponibles en los mercados financieros que operan con arreglo a los principios de mercado.
- (63) Como se indica en el considerando 50, el Gobierno de la República Popular China no presentó observaciones ni pruebas que respaldaran o refutaran los datos contenidos en el expediente del caso, en particular el Informe y las pruebas adicionales aportadas por el solicitante, sobre la existencia de distorsiones significativas o sobre si procedía aplicar el artículo 2, apartado 6 bis, del Reglamento de base en relación con este asunto.
- (64) En concreto, el sector al que pertenece el producto objeto de reconsideración, a saber, el siderúrgico, sigue estando en gran medida en manos del Gobierno de la República Popular China. Muchos de los mayores productores de productos planos de acero laminados en frío son propiedad del Estado, como Hebei Iron and Steel, Handan Iron and Steel, Baoshan Iron and Steel, Shanghai Meishan Iron and Steel, BX Steel Posco Cold Rolled Sheet, WISCO International Economic and Trading, Maanshan Iron and Steel, Tianjin Rolling One Steel o Inner Mongolia Baotou Steel Union. Baosteel, otra importante empresa china que se dedica a la fabricación de acero, forma parte de China Baowu Steel Group Co., Ltd (anteriormente, Baosteel Group y Wuhan Iron & Steel), el mayor productor de acero del mundo <sup>(28)</sup> cuyo capital, en última instancia, está íntegramente en manos de la Comisión Estatal para la Supervisión y Administración de los Activos del Estado (SASAC) <sup>(29)</sup>. Si bien se calcula que la división nominal entre el número de empresas públicas y el número de empresas privadas está prácticamente equilibrada, de los cinco productores chinos de acero clasificados entre los diez principales productores de acero del mundo, cuatro son empresas públicas <sup>(30)</sup>. Al mismo tiempo, mientras que los diez principales productores solo abarcaron alrededor del 36 % de la producción total de la industria en 2016, ese mismo año el Gobierno de la República Popular China estableció el objetivo de consolidar entre el 60 y el 70 % de la producción de acero en alrededor de diez grandes empresas para el año 2025 <sup>(31)</sup>. En abril de 2019, Gobierno de la República Popular China insistió en esta intención y anunció la publicación de unas directrices sobre la consolidación de la industria del acero <sup>(32)</sup>. Esta consolidación puede dar lugar a fusiones forzosas de empresas privadas rentables con empresas públicas con un rendimiento insuficiente <sup>(33)</sup>. Puesto que no hubo cooperación alguna por parte de los exportadores chinos del producto objeto de reconsideración, no fue posible determinar la proporción exacta de productores privados y de propiedad estatal de productos planos de acero laminados en frío. Sin embargo, si bien es posible que no se disponga de información específica para el sector dedicado a la fabricación de estos productos, el sector representa un subsector de la industria siderúrgica y, por lo tanto, las conclusiones relativas al sector siderúrgico se consideran también indicativas para el producto objeto de reconsideración.

<sup>(27)</sup> Reglamento de Ejecución (UE) 2019/688, considerando 86.

<sup>(28)</sup> Véase: <https://worldsteel.org/steel-topics/statistics/top-producers/> (consultado el 4 de agosto de 2022).

<sup>(29)</sup> Véase, por ejemplo: [www.fitchratings.com/research/corporate-finance/china-baowu-steel-group-corporation-limited-05-03-2021](http://www.fitchratings.com/research/corporate-finance/china-baowu-steel-group-corporation-limited-05-03-2021) (consultado el 4 de agosto de 2022).

<sup>(30)</sup> Informe, capítulo 14, p. 358: el 51 % son empresas privadas y el 49 % son empresas públicas en términos de producción, mientras que el 44 % son empresas públicas y el 56 % son empresas privadas en términos de capacidad.

<sup>(31)</sup> Disponible en [www.gov.cn/zhengce/content/2016-02/04/content\\_5039353.htm](http://www.gov.cn/zhengce/content/2016-02/04/content_5039353.htm), [https://policyn.com/policy\\_ticker/higher-expectations-for-large-scale-steel-enterprise?iframe=1&secret=c8uthafuthetra4e](https://policyn.com/policy_ticker/higher-expectations-for-large-scale-steel-enterprise?iframe=1&secret=c8uthafuthetra4e) y [www.xinhuanet.com/english/2019-04/23/c\\_138001574.htm](http://www.xinhuanet.com/english/2019-04/23/c_138001574.htm) (consultado el 4 de agosto de 2022).

<sup>(32)</sup> Disponible en [http://www.jjckb.cn/2019-04/23/c\\_137999653.htm](http://www.jjckb.cn/2019-04/23/c_137999653.htm) (consultado el 4 de agosto de 2022).

<sup>(33)</sup> Como sucedió con la fusión entre la empresa privada Rizhao y la empresa pública Shandong Iron and Steel en 2009. Véase el *Beijing steel report* [«Informe sobre el acero de Pekín», documento en inglés], p. 58, y la adquisición de la participación mayoritaria de China Baowu Steel Group en Magang Steel en junio de 2019; véase <https://www.ft.com/content/a7c93fae-85bc-11e9-a028-86cea8523dc2> (consultado el 4 de agosto de 2022).



- (65) Los últimos documentos de política chinos relativos al sector siderúrgico confirman la importancia que el Gobierno de la República Popular China sigue atribuyendo al sector, incluida la intención de intervenir en él para configurarlo en consonancia con las políticas gubernamentales. Esto queda ilustrado por el proyecto de dictamen orientativo del Ministerio de Industria y Tecnología de la Información sobre el fomento de un desarrollo de alta calidad de la industria siderúrgica, que aboga por una mayor consolidación de la base industrial y una mejora significativa en el nivel de modernización de la cadena industrial <sup>(34)</sup>, o por el Decimocuarto Plan Quinquenal para el Desarrollo de la Industria de las Materias Primas, según el cual el sector «se adherirá a la combinación de liderazgo del mercado y promoción gubernamental» y «cultivará un grupo de empresas líderes con liderazgo ecológico y competitividad fundamental» <sup>(35)</sup>. Pueden observarse ejemplos similares de la intención de las autoridades chinas de supervisar y orientar la evolución del sector a nivel provincial, como en Shandong, que no solo prevé «la construcción de una ecología de la industria siderúrgica [...], la creación de parques de fabricación, la ampliación de la cadena industrial y la creación de agrupaciones industriales», sino que también desea que la industria siderúrgica «aporte una demostración para la transformación y modernización [...] en nuestra provincia e incluso en todo el país» <sup>(36)</sup>.
- (66) En cuanto a si el Gobierno de la República Popular China está en condiciones de interferir en los precios y los costes a través de la presencia del Estado en las empresas en el sentido del artículo 2, apartado 6 bis, letra b), segundo guion, del Reglamento de base, debido a la falta de cooperación de los productores de productos planos de acero laminados en frío, no fue posible establecer de manera sistemática la existencia de conexiones personales entre los fabricantes del producto objeto de reconsideración y el PCC. Sin embargo, dado que los productos planos de acero laminados en frío representan un subsector del sector siderúrgico, la información disponible con respecto a los productores de acero también es pertinente para dichos productos. A modo de ejemplo, el presidente del Consejo de Administración de Baowu ostenta al mismo tiempo el cargo de secretario del Comité del Partido, y el director general es simultáneamente vicesecretario del Comité del Partido <sup>(37)</sup>. Asimismo, el presidente del Consejo de Administración de Baosteel ocupa el cargo de secretario del Comité del Partido, mientras que el director ejecutivo es vicesecretario del Comité del Partido <sup>(38)</sup>. En términos más generales, teniendo en cuenta la aplicabilidad general de la legislación sobre la presencia del PCC en las empresas, no cabe suponer que la capacidad del Gobierno de la República Popular China para interferir en los precios y los costes mediante la presencia del Estado en las empresas sea diferente en el sector siderúrgico en general.
- (67) Tanto las empresas públicas como las privadas del sector de los productos planos de acero laminados en frío están sujetas a supervisión y orientación política. Los ejemplos siguientes ilustran la citada tendencia a una creciente intervención del Gobierno de la República Popular China en este sector. Gran parte de los productores de productos planos de acero laminados en frío destacan explícitamente las actividades de construcción del Partido en sus sitios web, cuentan con miembros del Partido en la dirección de la empresa y subrayan su afiliación al PCC. Por ejemplo, Baowu indica que existen 301 comités del Partido dentro del grupo, y entre el personal de Baowu hay 84 571 miembros del PCC <sup>(39)</sup>. Además, el grupo indica lo siguiente en relación con la construcción del Partido en la empresa: «Reforzar la dirección del Partido y mejorar el buen gobierno de la empresa, mejorar el sistema empresarial moderno. China Baowu aplica plenamente los requisitos de las “Opiniones sobre el fortalecimiento del liderazgo del Partido en la mejora del buen gobierno de las empresas centrales” [...]. El sistema de toma de decisiones revisado y mejorado para los asuntos importantes mejoró aún más la autoridad de toma de decisiones del comité del Partido, el Consejo de Administración, los gerentes y otros órganos de gobierno, los asuntos de toma de decisiones y las formas autorizadas por el Consejo de Administración [...]. [...] Baowu se adhiere y aplica la planificación simultánea de la construcción del Partido y la reforma empresarial, el establecimiento simultáneo de organizaciones y entidades operativas del Partido, la asignación simultánea de personas encargadas de la organización del Partido y del personal encargado de los asuntos del Partido» <sup>(40)</sup>.
- (68) Asimismo, el sector de los productos planos de acero laminados en frío cuenta con políticas que discriminan en favor de productores nacionales o que influyen de otro modo en el mercado en el sentido del artículo 2, apartado 6 bis, letra b), tercer guion, del Reglamento de base. A pesar de que los productos planos de acero laminados en frío constituyen una industria especializada y durante la investigación no se pudo identificar ningún documento de política concreto para orientar específicamente el desarrollo de dicha industria, este sector se beneficia de la orientación e intervención de los poderes públicos en el sector del acero, ya que los productos planos de acero laminados en frío representan uno de sus subsectores.

<sup>(34)</sup> Véase: [https://www.miit.gov.cn/gzcy/yjzj/art/2020/art\\_af1bef04b9624997956b2bff6cdb7383.html](https://www.miit.gov.cn/gzcy/yjzj/art/2020/art_af1bef04b9624997956b2bff6cdb7383.html) (consultado el 13 de enero de 2022).

<sup>(35)</sup> Véase la sección IV, subsección 3, del Plan, disponible en [https://www.miit.gov.cn/zwgk/zcwj/wjfb/tz/art/2021/art\\_2960538d19e34c66a5eb8d01b74cbb20.html](https://www.miit.gov.cn/zwgk/zcwj/wjfb/tz/art/2021/art_2960538d19e34c66a5eb8d01b74cbb20.html) (consultado el 13 de enero de 2022).

<sup>(36)</sup> Véase el prólogo del Decimocuarto Plan Quinquenal para el Desarrollo de la Industria Siderúrgica.

<sup>(37)</sup> Véase el sitio web del grupo, disponible en [http://www.baowugroup.com/about/board\\_of\\_directors](http://www.baowugroup.com/about/board_of_directors) (consultado el 28 de marzo de 2022).

<sup>(38)</sup> Véase el sitio web de la empresa, disponible en <https://www.baosteel.com/about/manager> (consultado el 28 de marzo de 2022).

<sup>(39)</sup> Véase el sitio web del grupo, disponible en [http://www.baowugroup.com/party\\_building/overview](http://www.baowugroup.com/party_building/overview) (consultado el 28 de marzo de 2022).

<sup>(40)</sup> *Ibidem*.

- (69) El Gobierno de la República Popular China considera que la industria siderúrgica es esencial <sup>(41)</sup>. Así lo confirman los numerosos planes, directrices y otros documentos centrados en el acero, que se emiten a nivel nacional, regional y municipal, como el «Plan de ajuste y modernización de la industria siderúrgica para 2016-2020», vigente durante una parte significativa del período de investigación de la reconsideración. En dicho Plan se afirmaba que la industria siderúrgica es «un sector importante y fundamental de la economía china, una piedra angular nacional» <sup>(42)</sup>. Las principales tareas y objetivos establecidos en dicho Plan abarcan todos los aspectos del desarrollo de la industria <sup>(43)</sup>. El Decimotercer Plan Quinquenal para el Desarrollo Económico y Social <sup>(44)</sup>, de aplicación durante el período de investigación de la reconsideración, preveía apoyar a las empresas que fabricaban tipos de productos de acero de gama alta <sup>(45)</sup>. También se centraba en el logro de la calidad, durabilidad y fiabilidad de los productos apoyando a las empresas que utilizaban tecnologías relacionadas con la producción de acero limpio, el laminado de precisión y la mejora de la calidad <sup>(46)</sup>. Del mismo modo, en el marco del Decimocuarto Plan Quinquenal, adoptado en marzo de 2021, el Gobierno de la República Popular China ha centrado la industria siderúrgica en la transformación y modernización, así como en la optimización y el ajuste estructural <sup>(47)</sup>.
- (70) En el *Guiding Catalogue for Industry Restructuring* [«Catálogo de directrices para la reestructuración de la industria», versión de 2019, documento en inglés] <sup>(48)</sup> («el Catálogo»), el acero figura en la lista de industrias fomentadas. El hierro es la otra materia prima importante utilizada para la producción de productos de acero planos laminados en frío. El mineral de hierro estuvo cubierto por el Plan Nacional de Recursos Minerales 2016-2020 durante gran parte del período de investigación de la reconsideración. El Plan preveía, entre otras cosas, «velar por la concentración de empresas y desarrollar minas de tamaño grande y mediano que sean competitivas en el mercado», «garantizar la orientación de los recursos locales para concentrarlos en grupos mineros de gran tamaño», «reducir la carga que soportan las empresas de mineral de hierro, aumentar la competitividad de las empresas nacionales de mineral de hierro», «controlar adecuadamente el desarrollo de minas de 1 000 metros de profundidad y minas de mineral de hierro de baja calidad a pequeña escala».
- (71) El mineral de hierro también se menciona en el Decimotercer Plan Quinquenal sobre el Acero 2016-2020, que estuvo en vigor durante una parte significativa del período de investigación de la reconsideración. El Plan prevé para el mineral de hierro: «seguir contribuyendo a las obras de exploración en zonas minerales clave, [...], apoyar una serie de empresas nacionales de mineral de hierro existentes y especialmente competitivas, gracias a un desarrollo más amplio e intensificado [...], e intensificar el papel de las bases nacionales de recursos minerales en lo que respecta a la seguridad (de los suministros)».
- (72) El mineral de hierro está clasificado como un sector estratégico emergente y, por lo tanto, está cubierto por el Decimotercer Plan Quinquenal relativo a los Sectores Estratégicos Emergentes. El mineral de hierro y las ferroaleaciones también figuran en el Catálogo. Las ferroaleaciones se mencionan, además, en el documento *Guiding Catalogue for Industry Development and Transfer 2018* [«Catálogo para orientar el desarrollo y la transferencia industrial de 2018», documento en inglés] del Ministerio de Industria y Tecnología de la Información («el MIIT»). Los ejemplos anteriores relativos al sector siderúrgico en general y al sector del mineral de hierro en particular, dado que este último es una materia prima importante para fabricar productos planos de acero laminados en frío, demuestran la importancia que el Gobierno de la República Popular China está concediendo a estos sectores. Por lo tanto, dicho Gobierno también orienta el desarrollo del sector de los productos planos de acero laminados en frío con arreglo a una gran variedad de instrumentos y directrices políticas y controlan prácticamente todos los aspectos de la evolución y el funcionamiento del sector. Así pues, la industria de los productos planos de acero laminados en frío se beneficia de la orientación e intervención de los poderes públicos en relación con las principales materias primas utilizadas para fabricar dichos productos, a saber, el hierro.
- (73) Resumiendo, el Gobierno de la República Popular China ha adoptado medidas para inducir a los operadores a cumplir los objetivos de las políticas públicas de apoyar a las industrias fomentadas, en particular la producción de la principal materia prima utilizada en la fabricación de estos productos. Tales medidas impiden el libre funcionamiento de las fuerzas del mercado.

<sup>(41)</sup> Informe, parte III, capítulo 14, p. 346 y siguientes.

<sup>(42)</sup> Introducción al Plan de Ajuste y Modernización de la Industria Siderúrgica.

<sup>(43)</sup> Informe, capítulo 14, p. 347.

<sup>(44)</sup> Decimotercer Plan Quinquenal para el Desarrollo Económico y Social de la República Popular China (2016-2020), disponible en <https://en.ndrc.gov.cn/policies/202105/P020210527785800103339.pdf> (consultado el 4 de agosto de 2022).

<sup>(45)</sup> Informe, capítulo 14, p. 349.

<sup>(46)</sup> Informe, capítulo 14, p. 352.

<sup>(47)</sup> Véase el Decimocuarto Plan Quinquenal para el Desarrollo Económico y Social Nacional y los Objetivos a Largo Plazo de la República Popular China para 2035, parte III, artículo VIII, disponible en <https://cset.georgetown.edu/publication/china-14th-five-year-plan/> (consultado el 4 de agosto de 2022).

<sup>(48)</sup> *Guiding Catalogue for Industry Restructuring* [«Guía para la reestructuración de la industria», versión de 2019, documento en inglés], aprobada mediante el Decreto n.º 29 de la Comisión Nacional de Desarrollo y Reforma de la República Popular China, de 27 de agosto de 2019; disponible en <http://www.gov.cn/xinwen/2019-11/06/5449193/files/26c9d25f713f4ed5b8dc51ae40ef37af.pdf> (consultado el 27 de junio de 2022).



- (74) La presente investigación no ha revelado ninguna prueba de que la aplicación discriminatoria o inadecuada de las leyes en materia de propiedad y Derecho concursal, con arreglo al artículo 2, apartado 6 bis, letra b), cuarto guion, del Reglamento de base en el sector de los productos planos de acero laminados en frío a que se refiere el considerando 55, no vaya a afectar a los fabricantes del producto objeto de reconsideración.
- (75) El sector de los productos de acero planos laminados en frío se ve también afectado por las distorsiones de los costes salariales en el sentido del artículo 2, apartado 6 bis, letra b), quinto guion, del Reglamento de base, como también se ha mencionado en el considerando 55. Estas distorsiones afectan al sector tanto de forma directa (en la fabricación del producto objeto de reconsideración o de los principales insumos) como de forma indirecta (en el acceso al capital o a los insumos de empresas sujetas al mismo sistema laboral en China) <sup>(49)</sup>.
- (76) Por otro lado, en la presente investigación no se han presentado pruebas que demuestren que el sector de los productos planos de acero laminados en frío no se ve afectado por la intervención de los poderes públicos en el sistema financiero a efectos del artículo 2, apartado 6 bis, letra b), sexto guion, del Reglamento de base, como también se ha mencionado en el considerando 55. Por lo tanto, la intervención sustancial de los poderes públicos en el sistema financiero afecta gravemente a las condiciones del mercado a todos los niveles.
- (77) Por último, la Comisión recuerda que, para producir productos planos de acero laminados en frío, se necesitan una serie de insumos. Cuando los fabricantes de estos productos compran o contratan dichos insumos, los precios que pagan (y que se registran como costes) están claramente expuestos a las distorsiones sistémicas antes mencionadas. Por ejemplo, los proveedores de insumos emplean mano de obra que está sujeta a las distorsiones. Los posibles préstamos que reciban estarán sujetos a las distorsiones del sector financiero o de la asignación de capital. Además, se rigen por el mismo sistema de planificación que se aplica a todos los niveles de la administración pública y a todos los sectores.
- (78) Como consecuencia de ello, no solo no es apropiado utilizar los precios de venta internos de los productos planos de acero laminados en frío a efectos del artículo 2, apartado 6 bis, letra a), del Reglamento de base, sino que también se ven afectados todos los costes de los insumos (incluidas las materias primas, la energía, los terrenos, la financiación, la mano de obra, etc.), ya que la intervención sustancial de los poderes públicos incide en la formación de sus precios, tal como se describe en las partes I y II del Informe. De hecho, las intervenciones de los poderes públicos descritas en relación con la asignación de capital, el suelo, la mano de obra, la energía y las materias primas están presentes en toda China. Esto significa, por ejemplo, que un insumo producido en China mediante la combinación de una serie de factores de producción está expuesto a distorsiones significativas. Lo mismo se aplica al insumo del insumo, y así sucesivamente.
- (79) En la presente investigación, ni el Gobierno de la República Popular China ni los productores exportadores han presentado pruebas ni argumentos en sentido contrario.
- (80) En resumen, las pruebas disponibles mostraron que los precios o costes del producto objeto de reconsideración (incluidos los costes de las materias primas, la energía y la mano de obra) no son fruto de la libre interacción de las fuerzas del mercado, ya que se ven afectados por una intervención sustancial de los poderes públicos en el sentido del artículo 2, apartado 6 bis, letra b), del Reglamento de base, tal como demuestra el impacto real o posible de uno o más de los elementos pertinentes en ella enumerados. Sobre esta base, y ante la falta de cooperación del Gobierno de la República Popular China, la Comisión llegó a la conclusión de que, en este caso, no era adecuado utilizar los precios y los costes internos para determinar el valor normal. Por consiguiente, la Comisión procedió a calcular el valor normal basándose exclusivamente en costes de producción y venta que reflejaran precios o valores de referencia no distorsionados, es decir, en este caso concreto, basándose en los costes correspondientes de producción y venta de un país representativo apropiado, de conformidad con el artículo 2, apartado 6 bis, letra a), del Reglamento de base, tal como se explica en la sección siguiente.

#### 3.1.4. País representativo

##### 3.1.4.1. Observaciones generales

- (81) La elección del país representativo, de conformidad con el artículo 2, apartado 6 bis, del Reglamento de base, se basó en los criterios siguientes:
- un nivel de desarrollo económico similar al de China. Con este fin, la Comisión utilizó países con una renta nacional bruta per cápita similar a la de China con arreglo a la base de datos del Banco Mundial <sup>(50)</sup>,

<sup>(49)</sup> Véanse el Reglamento de Ejecución (UE) 2021/635, considerandos 134 y 135, y el Reglamento de Ejecución (UE) 2020/508, considerandos 143 y 144.

<sup>(50)</sup> Datos abiertos del Banco Mundial: ingreso mediano alto, <https://datos.bancomundial.org/nivel-de-ingresos/ingreso-mediano-alto>.

- fabricación del producto objeto de reconsideración en dicho país <sup>(81)</sup>,
- disponibilidad de los datos públicos pertinentes en el país representativo,
- en caso de que haya más de un tercer país representativo posible, debe darse preferencia, en su caso, al país con un nivel adecuado de protección social y medioambiental.

(82) Como se explica en los considerandos 52 y 53, la Comisión emitió dos notas para el expediente sobre las fuentes para la determinación del valor normal. Dichas notas describen los hechos y las pruebas utilizadas para sustentar los criterios pertinentes. No se recibieron observaciones de las partes sobre estos elementos ni sobre las fuentes pertinentes, tal como se establece en las dos notas antes mencionadas. En la segunda nota, la Comisión informó a las partes interesadas de su intención de considerar Brasil como país representativo adecuado en el presente caso si se confirmaba la existencia de distorsiones significativas con arreglo al artículo 2, apartado 6 bis, del Reglamento de base.

#### 3.1.4.2. Un nivel de desarrollo económico similar al de China

- (83) En la primera nota relativa a los factores de producción, la Comisión determinó que Brasil, México, Rusia y Turquía eran países con un nivel de desarrollo económico similar al de China según el Banco Mundial (todos ellos están clasificados por el Banco Mundial como países de «ingreso mediano alto» sobre la base de la renta nacional bruta) en los que se fabricaba el producto objeto de reconsideración.
- (84) El solicitante había propuesto a Brasil como país representativo supuestamente adecuado en su solicitud, ya que Brasil albergaba varios productores de acero integrados y era un excelente ejemplo de un mercado interior competitivo para los principales productos siderúrgicos, incluido el producto objeto de reconsideración. El solicitante también indicó en su solicitud que todos los insumos utilizados en la producción del producto investigado en Brasil suelen importarse de múltiples orígenes y, en gran medida, de fuentes no distorsionadas.
- (85) No se recibió ninguna observación relativa a los países señalados en dicha nota.

#### 3.1.4.3. Disponibilidad de los datos públicos pertinentes en el país representativo

- (86) En la primera nota, la Comisión indicó que, en el caso de los países en los que se había determinado que se fabrica el producto objeto de reconsideración, a saber, Brasil, México, Rusia y Turquía, debía verificarse la disponibilidad de los datos públicos, en particular en lo relativo a los datos financieros públicos procedentes de fabricantes del producto objeto de reconsideración.
- (87) Por lo que respecta a México, la Comisión identificó dos empresas que se refirieron en la primera nota como productores. Sin embargo, una de estas dos empresas registró pérdidas a partir de 2016, también en 2020. En cuanto a la otra empresa, resultó que sus estados financieros para el ejercicio 2020 no eran coherentes con los estados financieros del ejercicio anterior (2019): por ejemplo, se constató que las ventas netas eran aproximadamente siete veces más bajas en 2020 que en 2019. No se encontró ninguna información que justificara esta diferencia en las ventas netas (que también afectó a los beneficios netos) entre los años 2020 y 2019. Por lo tanto, se consideró que ninguna de las dos empresas era una candidata adecuada para la determinación de los gastos generales de fabricación, los gastos VGA y los beneficios. Puesto que la información que obraba en el expediente no ofrecía a la Comisión más datos sobre la presencia de otras empresas que fabricaran el producto objeto de reconsideración en México para las que se dispusiera fácilmente de información financiera, la Comisión concluyó que México no podía considerarse un país representativo adecuado.
- (88) Por lo que se refiere a Rusia, la Comisión identificó a dos empresas referidas en la primera nota como productores y para las que existían datos financieros públicamente disponibles. Ambas empresas fueron rentables en 2020 y en los años anteriores. Sin embargo, como se indica en el considerando 91, la Comisión detectó una serie de problemas con los datos disponibles para Rusia, ya que no importó una serie de materias primas importantes, como el gas natural licuado, utilizadas para la producción del producto investigado. Además, los precios del gas natural parecían estar distorsionados en Rusia. Por consiguiente, la Comisión concluyó que Rusia no podía considerarse un país representativo adecuado para esta investigación.

<sup>(81)</sup> Si no se fabrica el producto objeto de reconsideración en ningún país con un nivel de desarrollo similar, podrá tenerse en cuenta la fabricación de un producto perteneciente a la misma categoría general o al mismo sector del producto objeto de reconsideración.

- (89) Por lo que se refiere a Turquía, la Comisión identificó a dos empresas en la primera nota como productores. Sin embargo, para una de ellas no se disponía de estados financieros recientes y fácilmente disponibles. Para la otra empresa, a pesar de que fue rentable en 2020 y en los años anteriores, la Comisión consideró que el nivel de los gastos generales y de venta («VGA») de esa empresa no era razonable porque dichos gastos, expresados como porcentaje de su coste de fabricación, eran bajos (menos del 2 % en 2020) o incluso negativos. Por lo tanto, la Comisión concluyó que no podía utilizar los datos de estas empresas como una cantidad no distorsionada y razonable para los gastos VGA de cara a determinar el valor normal no distorsionado. Como resultado de ello, la Comisión concluyó que Turquía no podía considerarse un país representativo adecuado para esta investigación.
- (90) Por último, por lo que se refiere a Brasil, la Comisión identificó en la primera nota a cinco empresas productoras de productos planos de acero laminados en frío. Sin embargo, dos de estas cinco empresas tenían unos gastos de venta y generales («VGA») negativos expresados como porcentaje de su coste de fabricación, por lo que sus datos no podían utilizarse para establecer el valor normal no distorsionado. Las otras tres empresas brasileñas disponían de datos financieros públicos recientes que mostraban los beneficios y el importe razonable de los gastos VGA para el año 2020.
- (91) La Comisión analizó también las importaciones de los principales factores de producción en Brasil, México, Rusia y Turquía. El análisis de los datos sobre importaciones mostró que Rusia no importaba algunos factores de producción importantes. Además, los precios del gas natural parecían estar distorsionados en Rusia. Además, el análisis de los datos de importación mostró que Turquía no importaba gas natural licuado (HS 2711 11, gas natural licuado) y solo importaba una cantidad limitada de oxígeno (HS 2804 40, oxígeno). Por lo tanto, ni Rusia ni Turquía podían considerarse países representativos adecuados.
- (92) En vista de las consideraciones anteriores, la Comisión informó a las partes interesadas mediante la segunda nota de que, con arreglo a lo previsto en el artículo 2, apartado 6 bis, letra a), primer guion, del Reglamento de base, tenía intención de utilizar a Brasil como país representativo adecuado y a tres empresas brasileñas (ArcelorMittal Brazil, CSN y Usiminas) para obtener los precios o los valores de referencia no distorsionados a fin de calcular el valor normal.
- (93) Se invitó a las partes interesadas a dar su opinión sobre la idoneidad de Brasil como país representativo y de las tres empresas citadas (ArcelorMittal Brazil, CSN y Usiminas) como productores en el país representativo. No se recibieron observaciones tras la segunda nota.

#### 3.1.4.4. Nivel de protección social y medioambiental

- (94) Tras determinarse que Brasil era el único país representativo adecuado con arreglo a los elementos expuestos anteriormente, no fue necesario realizar una evaluación del nivel de protección social y medioambiental de conformidad con la última frase del artículo 2, apartado 6 bis, letra a), primer guion, del Reglamento de base.

#### 3.1.4.5. Conclusión

- (95) Habida cuenta del análisis anterior, Brasil cumplía todos los criterios establecidos en el artículo 2, apartado 6 bis, letra a), primer guion, del Reglamento de base para ser considerado país representativo adecuado.

#### 3.1.5. Fuentes utilizadas para determinar los costes no distorsionados

- (96) En la primera nota, la Comisión había enumerado los factores de producción (tales como los materiales, la energía y la mano de obra) utilizados por los productores exportadores para fabricar el producto objeto de reconsideración, y había invitado a las partes interesadas a presentar observaciones y a proponer información públicamente disponible sobre valores no distorsionados correspondiente a cada uno de los factores de producción mencionados en dicha nota.

- (97) Posteriormente, en la segunda nota, la Comisión declaró que, con el fin de calcular el valor normal de conformidad con el artículo 2, apartado 6 bis, letra a), del Reglamento de base, utilizaría la base de datos GTA para determinar el coste no distorsionado de la mayoría de los factores de producción, especialmente de las materias primas. Además, la Comisión afirmó que utilizaría las siguientes fuentes para determinar los costes no distorsionados de la energía: el precio de la electricidad aplicado por uno de los mayores proveedores de electricidad de Brasil, la empresa EDP Brasil <sup>(52)</sup>, mientras que utilizaría los datos —como se explica con más detalle en el considerando 109— para el precio del gas natural en Brasil. Además, la Comisión declaró que, para establecer los costes no distorsionados de la mano de obra, utilizaría las estadísticas de la OIT para determinar los salarios en Brasil. Las estadísticas de la OIT <sup>(53)</sup> proporcionan información sobre los salarios mensuales de los empleados <sup>(54)</sup> y la media de horas semanales trabajadas en Brasil, en el sector manufacturero <sup>(55)</sup>, en 2020.
- (98) En la segunda nota, la Comisión también informó a las partes interesadas de que, dada la falta de cooperación de los productores exportadores chinos, agruparía el peso insignificante de algunas de las materias primas en el coste total de producción en «bienes fungibles», sobre la base de la información presentada en la solicitud por el solicitante. Además, la Comisión informó de que aplicaría el porcentaje al coste recalculado de las materias primas sobre la base de la información facilitada por el solicitante en su solicitud para determinar los bienes fungibles al utilizar los valores de referencia no distorsionados establecidos en el país representativo adecuado.
- (99) No se recibieron observaciones.

### 3.1.6. Costes y valores de referencia no distorsionados

#### 3.1.6.1. Factores de producción

- (100) La Comisión pidió al solicitante que facilitara aclaraciones sobre los factores de producción pertinentes utilizados para los procesos de producción a partir de productos laminados en caliente semiacabados y que presentara una actualización del nivel de los costes de transporte que abarcara todo el período de investigación de la reconsideración. El solicitante facilitó dicha información el 17 de febrero de 2022.
- (101) Teniendo en cuenta toda la información basada en la solicitud y la información posterior presentada por el solicitante, se identificaron los siguientes factores de producción y sus fuentes con el fin de determinar el valor normal de conformidad con el artículo 2, apartado 6 bis, letra a), del Reglamento de base:

Cuadro 1

#### Factores de producción de determinados productos planos laminados en frío

Factor de producción	Código de la mercancía	Valor no distorsionado en CNY	Unidad de medida
<b>Materias primas</b>			
Dolomita	251810, 251820 y 251830	169,9	Tonelada
Piedra caliza	252100	160,8	Tonelada
Cal viva	252210	852,8	Tonelada
Minerales de hierro y sus concentrados	260111 y 260112	1 206,8	Tonelada
Productos férreos	720310 y 720390	453 671	Tonelada

<sup>(52)</sup> [https://www.edp.com.br/distribuicao-es/saiba-mais/informativos/tarifas-aplicadas-a-clientes-atendidos-em-alta-e-media-tensao-\(grupo-a\)](https://www.edp.com.br/distribuicao-es/saiba-mais/informativos/tarifas-aplicadas-a-clientes-atendidos-em-alta-e-media-tensao-(grupo-a)) y <https://www.edp.com.br/distribuicao-es/saiba-mais/informativos/bandeira-tarifaria>.

<sup>(53)</sup> <https://ilostat.ilo.org/es/>.

<sup>(54)</sup> <https://ilostat.ilo.org/es/data/> [https://www.ilo.org/shinyapps/bulkexplorer36/?lang=es&segment=indicator&id=EAR\\_4MTH\\_SEX\\_ECO\\_CUR\\_NB\\_A](https://www.ilo.org/shinyapps/bulkexplorer36/?lang=es&segment=indicator&id=EAR_4MTH_SEX_ECO_CUR_NB_A).

<sup>(55)</sup> [https://www.ilo.org/shinyapps/bulkexplorer38/?lang=es&segment=indicator&id=HOW\\_TEMP\\_SEX\\_ECO\\_NB\\_A](https://www.ilo.org/shinyapps/bulkexplorer38/?lang=es&segment=indicator&id=HOW_TEMP_SEX_ECO_NB_A).

Antracita y hulla bituminosa	270111 y 270112	662	Tonelada
Coques y semicoques de hulla	270400	2 027,6	Tonelada
Oxígeno	280440	8 796,3	Metro cúbico
Ferromanganeso	720211 y 720219	9 388,2	Tonelada
Ferrocromo	720241 y 720249	9 470,6	Tonelada
Productos intermedios de hierro o acero sin alear	7207	4 256,3	Tonelada
Productos laminados planos de hierro o acero sin alear	72081000, 72082500, 72082610, 72082690, 72082710, 72082790, 72083610, 72083690, 72083700, 72083810, 72083890, 72083910, 72083990, 72084000, 72085100, 72085200, 72085300, 72085400, 72089000, 72111300, 72111400, 72111900	4 637,9	Tonelada
Productos laminados planos de los demás aceros aleados, de anchura superior o igual a 600 mm	72253000, 72254010, 72254090	8 539,6	Tonelada
Productos laminados planos de los demás aceros aleados, de anchura inferior a 600 mm	72269100	9 081,8	Tonelada
<b>Producto derivado: residuos</b>			
Desperdicios y desechos de hierro o acero	720430 y 720449	2 383,3	Tonelada
Torneaduras, virutas, esquirlas, limaduras (de amolado, aserrado, limado) y recortes de estampado o de corte de hierro o de acero	720441	3 269,1	Tonelada
<b>Mano de obra</b>			
Mano de obra		24,8	Precio por hora de la mano de obra
<b>Energía</b>			
Electricidad		547,7	kWh
Gas natural	271111 y 271112	1 638	Tonelada

## 3.1.6.2. Materias primas

- (102) Sobre la base de la información facilitada por el solicitante en su solicitud, existen dos procesos principales de producción para producir determinados productos planos de acero laminados en frío:

- El primer proceso de producción, a partir de materias primas con uso de un alto horno de oxígeno. En este proceso de producción, el primer paso es la producción del «plano laminado en frío sin soldadura» a partir de materias primas (principalmente mineral de hierro y carbón de coque), es decir, el producto obtenido inmediatamente después de que el material laminado en caliente pase por el laminador en frío para reducir el espesor. El segundo paso es el recocido y el recalentamiento del plano laminado en frío sin soldadura para restablecer las propiedades del acero.
- El segundo proceso de producción comienza por los productos semiacabados, es decir, los productos planos de acero laminados en caliente. La producción de productos planos de acero laminados en frío empieza con las bobinas de acero plano laminado en caliente adquiridas («bobinas decapadas»), que constituirán la mayor parte de los costes de los insumos.
- (103) Con el fin de establecer el precio no distorsionado de las materias primas (en el caso del primer proceso de producción) y de los productos planos de acero laminados en caliente (en el caso del segundo proceso de producción) tal como fueron entregadas a pie de fábrica a un productor del país representativo, la Comisión utilizó como base el precio de importación medio ponderado de dicho país según figuraba en la base de datos GTA y le añadió los derechos de importación y los costes de transporte. Se estableció un precio de importación al país representativo utilizando una media ponderada de los precios unitarios de las importaciones procedentes de todos los terceros países, excepto China y los países que no son miembros de la OMC, enumerados en el anexo I del Reglamento (UE) 2015/755 del Parlamento Europeo y del Consejo<sup>(56)</sup>. La Comisión decidió excluir las importaciones al país representativo procedentes de China al llegar a la conclusión, presentada en el considerando 80, de que no procedía utilizar los precios y costes internos de China debido a la existencia de distorsiones significativas de conformidad con el artículo 2, apartado 6 bis, letra b), del Reglamento de base. Dado que no pudo demostrarse que esas mismas distorsiones no afectaban por igual a los productos destinados a la exportación, la Comisión consideró que las mismas distorsiones afectaban a los precios de exportación. Tras excluir las importaciones al país representativo procedentes de China, el volumen de las importaciones procedentes de otros terceros países seguía siendo representativo.
- (104) Varios de los factores de producción representaban un porcentaje insignificante de los costes totales de las materias primas durante el período de investigación de la reconsideración. Puesto que el valor utilizado para ellos no repercutió de manera considerable en el cálculo del margen de dumping, independientemente de la fuente utilizada, la Comisión decidió incluir estos costes en la categoría de bienes fungibles. Como se explica en el considerando 98, la Comisión aplicó el porcentaje facilitado por el solicitante en su solicitud para determinar la cantidad de bienes fungibles al utilizar los valores de referencia no distorsionados establecidos en el país representativo adecuado.
- (105) Por lo que se refiere a los derechos de importación, la Comisión observó que Brasil importaba sus materias primas más importantes (mineral de hierro de más de cinco países y carbón y coque de más de diez países). Dado que en una reconsideración por expiración no es necesario calcular un margen de dumping exacto, sino más bien determinar la probabilidad de continuación o reaparición del dumping, la Comisión calculó los derechos de importación de cada materia prima sobre la base de volúmenes representativos de importaciones procedentes de un número limitado de países, que representaban al menos el 80 % de las importaciones totales de las materias primas más importantes (mineral de hierro, carbón y coque).
- (106) Por lo que se refiere a los costes de transporte, en ausencia de cooperación, la Comisión pidió al solicitante que presentara una actualización del nivel de los costes de transporte nacionales que abarcara todo el período de investigación de la reconsideración. El solicitante presentó la información solicitada el 4 y el 17 de febrero de 2022, respectivamente. La Comisión expresó el coste del transporte nacional para el suministro de materias primas como un porcentaje del coste real de estas y, a continuación, aplicó el mismo porcentaje al coste no distorsionado de las mismas materias primas con vistas a obtener el coste de transporte no distorsionado. Asimismo, consideró que la relación entre las materias primas del productor exportador y los costes de transporte notificados podía utilizarse razonablemente como una indicación para calcular los costes de transporte no distorsionados de las materias primas cuando se entregan a la fábrica de la empresa.

### 3.1.6.3. Mano de obra

- (107) La Comisión utilizó estadísticas de la OIT para determinar los salarios en Brasil. Las estadísticas de la OIT<sup>(57)</sup> proporcionan información sobre los salarios mensuales de los empleados<sup>(58)</sup> y la media de horas semanales trabajadas en Brasil, en el sector manufacturero<sup>(59)</sup>, en 2020.

<sup>(56)</sup> Reglamento (UE) 2015/755 del Parlamento Europeo y del Consejo, de 29 de abril de 2015, sobre el régimen común aplicable a las importaciones de determinados terceros países (DO L 123 de 19.5.2015, p. 33). El artículo 2, apartado 7, del Reglamento de base considera que los precios internos de esos países no pueden utilizarse para determinar el valor normal y, en cualquier caso, dichos datos relativos a las importaciones eran insignificantes.

<sup>(57)</sup> <https://ilostat.ilo.org/es/>.

<sup>(58)</sup> <https://ilostat.ilo.org/es/data/> [https://www.ilo.org/shinyapps/bulkexplorer36/?lang=es&segment=indicator&id=EAR\\_4MTH\\_SEX\\_CO\\_CUR\\_NB\\_A](https://www.ilo.org/shinyapps/bulkexplorer36/?lang=es&segment=indicator&id=EAR_4MTH_SEX_CO_CUR_NB_A).

<sup>(59)</sup> [https://www.ilo.org/shinyapps/bulkexplorer38/?lang=es&segment=indicator&id=HOW\\_TEMP\\_SEX\\_ECO\\_NB\\_A](https://www.ilo.org/shinyapps/bulkexplorer38/?lang=es&segment=indicator&id=HOW_TEMP_SEX_ECO_NB_A).



#### 3.1.6.4. Electricidad

- (108) La Comisión utilizó la tarifa de precios de la electricidad comunicada por uno de los mayores proveedores de electricidad de Brasil <sup>(60)</sup>, la empresa EDP Brasil, para determinar el valor no distorsionado del coste de la electricidad.

#### 3.1.6.5. Gas natural

- (109) El precio del gas natural en Brasil se basó en datos que proporcionan precios de importación con derechos de aduana para el gas importado combinando las cantidades importadas y los valores extraídos de la base de datos GTA con los datos arancelarios obtenidos de MacMap <sup>(61)</sup>.

#### 3.1.6.6. Gastos generales de fabricación, gastos administrativos, de venta y generales, beneficios y depreciación

- (110) De conformidad con el artículo 2, apartado 6 bis, letra a), del Reglamento de base, «el valor normal calculado incluirá una cantidad no distorsionada y razonable en concepto de gastos administrativos, de venta y generales y en concepto de beneficios». Además, debe establecerse un valor para los gastos generales de fabricación que cubra los costes no incluidos en los factores de producción mencionados anteriormente.
- (111) La Comisión utilizó los datos financieros de tres empresas brasileñas (ArcelorMittal Brasil, CSN y Usiminas), productores del país representativo, tal como se menciona en el considerando 90.
- (112) Para establecer un valor no distorsionado de los gastos generales de fabricación y dada la falta de cooperación de los productores exportadores chinos, la Comisión utilizó los datos disponibles de conformidad con el artículo 18 del Reglamento de base. Por consiguiente, a partir de los datos aportados por el solicitante en su solicitud, la Comisión estableció la relación entre los gastos generales de fabricación y los costes de fabricación y laborales totales. A continuación, se aplicó este porcentaje al valor no distorsionado del coste de fabricación para obtener el valor no distorsionado de los gastos generales de fabricación.

#### 3.1.7. Cálculo del valor normal

- (113) Sobre la base de lo anterior, la Comisión calculó el valor normal franco fábrica por tipo de producto, de conformidad con el artículo 2, apartado 6 bis, letra a), del Reglamento de base.
- (114) En primer lugar, la Comisión determinó los costes de fabricación no distorsionados. Ante la falta de cooperación por parte de los productores exportadores, la Comisión se basó en la información facilitada por el solicitante en la solicitud de reconsideración sobre la utilización de cada factor (materiales y mano de obra) para la fabricación del producto objeto de reconsideración.
- (115) Una vez que se determinó el coste de fabricación no distorsionado, la Comisión añadió los gastos generales de fabricación, los gastos VGA y los beneficios, como se indica en el considerando 112. Los gastos generales de fabricación se determinaron a partir de los datos facilitados por el solicitante. Los gastos VGA y los beneficios se determinaron sobre la base de los datos financieros de tres empresas brasileñas (ArcelorMittal Brasil, CSN y Usiminas), como se indica en el considerando 111. La Comisión añadió los siguientes elementos a los costes de fabricación no distorsionados:
- los gastos generales de fabricación, que representaban en total el 10 % de los costes directos de fabricación a partir del primer proceso de producción y el 2 % de los costes directos de fabricación a partir del segundo proceso de producción,

<sup>(60)</sup> <https://www.edp.com.br/distribuicao-es/saiba-mais/informativos/tarifas-aplicadas-a-clientes-atendidos-em-alta-e-media-tensao-grupo-a> y <https://www.edp.com.br/distribuicao-es/saiba-mais/informativos/bandeira-tarifaria>.

<sup>(61)</sup> [www.macmap.org](http://www.macmap.org).

- los gastos VGA y otros costes, que representaban el 18,5 % de los costes de las mercancías vendidas («COGS») de las tres empresas brasileñas mencionadas anteriormente, y
- los beneficios, que suponían el 14,7 % de los costes de las mercancías vendidas por las tres empresas brasileñas mencionadas anteriormente, se aplicaron a los costes totales de fabricación no distorsionados.

(116) Partiendo de esta base, la Comisión calculó el valor normal franco fábrica por tipo de producto, de conformidad con el artículo 2, apartado 6 bis, letra a), del Reglamento de base. El valor normal calculado osciló entre 1 200 y 1 400 EUR/tonelada o entre 1 500 y 1 700 EUR/tonelada, dependiendo del proceso de producción (véase al respecto el considerando 102) durante el período de investigación de la reconsideración.

#### 3.1.8. Precio de exportación

(117) En ausencia de cooperación por parte de los productores exportadores de China, el precio de exportación se determinó utilizando datos de la base de datos creada conforme al artículo 14, apartado 6 <sup>(62)</sup>, a nivel CIF.

#### 3.1.9. Comparación

(118) La Comisión comparó el valor normal calculado con arreglo al artículo 2, apartado 6 bis, letra a), del Reglamento de base con el precio de exportación establecido anteriormente.

(119) Cuando la necesidad de garantizar una comparación ecuaníme lo justificaba, la Comisión ajustó el valor normal o el precio de exportación para tener en cuenta las diferencias que afectaban a los precios y a la comparabilidad de estos, de conformidad con el artículo 2, apartado 10, del Reglamento de base. Se realizaron ajustes basados en la información facilitada por el solicitante para tener en cuenta los gastos de flete marítimo y nacional y los gastos de descarga, por un importe de 140,44 EUR/tonelada, en el precio de exportación, con el fin de situarlo en el precio franco fábrica.

#### 3.1.10. Continuación del dumping

(120) Sobre esta base, la Comisión determinó que el precio de exportación era un 29,7 % inferior al valor normal para el primer proceso de producción a partir de las materias primas, como se explica en el considerando 102, y un 8,83 % para el segundo proceso de producción a partir de los productos semiacabados.

(121) Sin embargo, dado que el volumen de las importaciones en cuestión era muy limitado, en concreto inferior al 0,5 % de las importaciones totales en la Unión e inferior al 1 % de la cuota de mercado en el mercado de la Unión, los precios se consideraron no representativos. Por consiguiente, la Comisión concluyó que estos volúmenes bajos no proporcionan una base suficiente para llegar a una conclusión respecto a la continuación del dumping. Por lo tanto, la Comisión investigó la probabilidad de reaparición del dumping.

#### 3.1.11. Probabilidad de reaparición del dumping

(122) Para analizar la probabilidad de reaparición del dumping, se analizaron los siguientes elementos adicionales: las exportaciones a terceros países, la capacidad de producción y la capacidad excedentaria de China, así como el atractivo del mercado de la Unión.

##### 3.1.11.1. Comparación entre los precios de exportación a terceros países y los precios de exportación a la Unión

(123) La Comisión analizó el patrón de precios de las exportaciones chinas a terceros países durante el período de investigación de la reconsideración. Por lo tanto, consultó información públicamente disponible, como las estadísticas chinas de exportación, tal como figuran en la base de datos Global Trade Atlas («GTA») y extrajo las cantidades y valores de las exportaciones de determinados productos planos de acero laminados en frío de los códigos SA 7209 15 90, 7209 16 90, 7209 17 90, 7209 18 90, 7209 25 00, 7209 26 00, 7209 27 00, 7209 28 00, 7211 23 00, 7211 29 00, 7225 50 00 y 7226 92 00 para el período de investigación de la reconsideración. Las cantidades de exportación (en toneladas) a todos los países (incluida la UE) ascienden a 3 253 368 toneladas, de las cuales se exportaron 31 602 a la Unión (alrededor del 1 %).

<sup>(62)</sup> La base de datos creada conforme al artículo 14, apartado 6, proporciona datos sobre las importaciones de productos que ya están sujetos a registro o a medidas antidumping o antisubvenciones, procedentes de los países afectados por el procedimiento y de otros terceros países, al nivel de los códigos TARIC de 10 dígitos.

- (124) Las estadísticas de exportación chinas proporcionadas en la base de datos GTA informaron de un precio de exportación CIF medio de China a otros países de 629 EUR/tonelada, que se ajustó a un precio franco fábrica (tras los ajustes por flete marítimo y nacional, y gastos de descarga) que ascendía a 585 EUR/tonelada. Este último precio fue incluso inferior al precio de exportación a la UE en el período de investigación de la reconsideración.
- (125) Así pues, se estimó que era probable que, si se derogasen las medidas vigentes, los productores exportadores chinos empezaran a vender a la Unión a niveles inferiores al valor normal calculado.

#### 3.1.11.2. Capacidad de producción y capacidad excedentaria de China

- (126) Según la solicitud del solicitante, hay más de cincuenta productores exportadores del producto objeto de reconsideración en China. Según las estadísticas de exportación chinas, tal como figuran en la base de datos GTA, los productores exportadores chinos también exportaron al resto del mundo.
- (127) Ante la falta de cooperación de los productores exportadores chinos en China, la Comisión basó sus conclusiones con respecto a la capacidad de los demás productores exportadores en los datos disponibles y se basó en la información contenida en la solicitud de reconsideración por expiración, así como en otras fuentes disponibles, como el Reglamento de Ejecución (UE) 2021/1029 de la Comisión <sup>(63)</sup>, un documento de la OCDE sobre la evolución más reciente <sup>(64)</sup> de las capacidades de fabricación de acero en 2021, publicado en septiembre de 2021, y los datos de la Asociación Mundial del Acero relativos al año 2021 <sup>(65)</sup>.
- (128) En primer lugar, la información contenida en la solicitud de reconsideración por expiración estimaba la capacidad china total en más de 120 millones de toneladas, mientras que tanto la producción como el consumo chinos se estimaban en 100 millones de toneladas en 2020. Sobre esta base, la capacidad excedentaria de China se estimó en 20 millones de toneladas en 2020, lo que es indicativo de la capacidad excedentaria en el período de investigación de la reconsideración y que supera significativamente el consumo total de la Unión en el mercado libre (alrededor de 9,7 millones de toneladas) en el período de investigación de la reconsideración. En segundo lugar, el Reglamento de Ejecución (UE) 2021/1029 disponía que, a pesar del «excepcional aumento en el consumo experimentado en China» [véase el considerando 36 del Reglamento (UE) 2021/1029], el informe ministerial del Foro Mundial sobre el exceso de capacidad de la siderurgia de 2020, basado en datos de hasta 2019, establecía que «la consecuencia inmediata de las perspectivas de la demanda es que la brecha global entre la capacidad y la demanda, un indicador de los riesgos del exceso de oferta para el mercado del acero, va a aumentar significativamente hasta al menos 606 millones de toneladas en 2020». Señalaba, asimismo que «este cambio en el exceso de capacidad puede provocar perturbaciones comerciales, desencadenar precios considerablemente inferiores del acero y dañar la sostenibilidad económica de la industria siderúrgica». En tercer lugar, esta situación también se confirmó en el documento de la OCDE titulado *Latest development in steelmaking capacities in 2021* [«Evolución reciente de las capacidades de fabricación de acero en 2021», documento en inglés]. El documento se refería no solo a «una serie de nuevas inversiones relacionadas con las medidas de China para sustituir a pequeñas plantas siderúrgicas obsoletas, especialmente en las zonas costeras orientales y meridionales de China», sino también al hecho de que el Gobierno chino «ha encontrado casos en los que algunas acerías han ampliado su capacidad de producción en el marco del régimen de intercambio de capacidad». Además, el documento de la OCDE hacía referencia a las inversiones de empresas siderúrgicas chinas en países del sur de Asia, como Filipinas e Indonesia. Por último, aunque los datos de la Asociación Mundial del Acero correspondientes al año 2021 se refieren únicamente al acero bruto, pueden considerarse indicativos del producto afectado, ya que la producción de acero laminado en frío es básicamente el segundo proceso de producción de acero, después de la producción de acero laminado en caliente. A este respecto, los datos de 2021 relativos a la producción de acero bruto mostraron que China era responsable del 52,9 % de la producción mundial de acero, lo que también pone de manifiesto la enorme capacidad de producción del producto afectado en China durante el año 2021.
- (129) Además, algunos de los principales mercados, como los de los Estados Unidos y la India, están protegidos por medidas antidumping sobre el producto objeto de reconsideración, lo que reduce el acceso de los productores exportadores chinos.

- (130) Por tanto, es probable que, en caso de expiración de las medidas, los productores chinos dirijan sus capacidades excedentarias al mercado de la Unión en grandes cantidades a precios objeto de dumping.

#### 3.1.11.3. Atractivo del mercado de la Unión

- (131) El mercado de la Unión se encuentra entre los mayores mercados de determinados productos planos de acero laminados en frío de todo el mundo.

<sup>(63)</sup> Reglamento de Ejecución (UE) 2021/1029 de la Comisión, de 24 de junio de 2021, por el que se modifica el Reglamento de Ejecución (UE) 2019/159 de la Comisión para prolongar la medida de salvaguardia impuesta a las importaciones de determinados productos siderúrgicos (DO L 225 I de 25.6.2021, p. 1).

<sup>(64)</sup> <https://www.oecd.org/industry/ind/latest-developments-in-steelmaking-capacity-2021.pdf>.

<sup>(65)</sup> <https://worldsteel.org/steel-topics/statistics/world-steel-in-figures-2022/>.

- (132) En su solicitud, el solicitante alegó que las medidas de salvaguardia del acero de la Unión que se aplican al producto objeto de reconsideración no serían suficientes por sí solas para proteger el mercado de la Unión frente a importaciones en cantidades significativas a precios objeto de dumping. Dado que China no recibió ningún contingente específico por país para el producto objeto de reconsideración, los productores exportadores chinos tienen acceso a una gran cantidad de volúmenes de contingentes residuales por debajo de los cuales podrían dirigir sus exportaciones al mercado de la Unión si las medidas antidumping dejaran de tener efecto. Como consecuencia de ello, si se derogaran las medidas antidumping, es probable que los volúmenes de exportación chinos aumentaran significativamente dentro del contingente residual y, por tanto, inundaran el mercado de la Unión antes de que fuera aplicable cualquier derecho fuera del contingente en virtud de la medida de salvaguardia.
- (133) El importador Duferco SA declaró <sup>(66)</sup> que las autoridades chinas cancelaron la reducción del 13 % del impuesto sobre el valor añadido sobre las exportaciones de acero, incluidas las importaciones del producto objeto de reconsideración, con el fin de restringir la producción de acero en China (para hacer frente a sus emisiones de carbono), garantizando al mismo tiempo el suministro interno chino. Duferco SA declaró que, como consecuencia de ello, se espera que los precios de las importaciones chinas aumenten y socaven así el atractivo del mercado de la Unión. Sin embargo, la Comisión no pudo confirmar esta alegación, ya que la evolución de los volúmenes y los precios depende también de muchos otros elementos, como el exceso de capacidad existente y el atractivo del mercado de la Unión en comparación con otros terceros países.

#### 3.1.11.4. Conclusión sobre la probabilidad de reaparición del dumping

- (134) El mercado de la Unión presenta un gran atractivo, ya que se encuentra entre los más grandes del mundo. Además, como se establece en el cuadro 7 del considerando 202, la media ponderada de los precios de venta unitarios de los productores de la Unión incluidos en la muestra a clientes no vinculados en el mercado libre de la Unión ascendió a 622 EUR/tonelada durante el período de investigación de la reconsideración, es decir, por encima del precio medio de exportación desde China ajustado a un precio franco fábrica que ascendía a 585 EUR/tonelada (véase el considerando 124). Así pues, sería probable que, en caso de expirar las actuales medidas antidumping, los productores chinos utilizaran su capacidad excedentaria y, además, desviarán algunas de sus ventas de exportación menos rentables de terceros países al mercado de la Unión.
- (135) Con arreglo a las consideraciones anteriores, se concluyó que existía una probabilidad de reaparición del dumping si se dejaran expirar las medidas.

## 3.2. RUSIA

### 3.2.1. Observaciones preliminares

- (136) Durante el período de investigación de la reconsideración, las importaciones del producto objeto de reconsideración procedentes de Rusia continuaron, aunque a niveles significativamente inferiores en comparación con el período de investigación de la investigación original (es decir, entre el 1 de abril de 2014 y el 31 de marzo de 2015). Según las estadísticas de Comext (Eurostat), las importaciones de productos planos de acero laminados en frío procedentes de Rusia representaron menos de 3 000 toneladas en el período de investigación de la reconsideración, frente a aproximadamente 700 000 toneladas durante el período de investigación original. Las importaciones de productos planos de acero laminados en frío procedentes de Rusia representaron una cuota de mercado cercana al 0 % tanto del mercado total de la Unión como del mercado libre de la Unión en el período de investigación de la reconsideración, frente a una cuota de mercado del 9,8 % durante el período de investigación original.
- (137) Como se explica en el considerando 29, los tres productores exportadores rusos se dieron a conocer al inicio y expresaron su disposición a cooperar. No obstante, posteriormente informaron a la Comisión de su intención de no responder al cuestionario destinado a los productores exportadores.
- (138) En consecuencia, de conformidad con el artículo 18 del Reglamento de base, las conclusiones relativas a la continuación del dumping y a la probabilidad de reaparición del dumping se basaron en los datos disponibles.

<sup>(66)</sup> Anuncio de inicio de una reconsideración por expiración de las medidas antidumping aplicables a las importaciones de determinados productos planos de acero laminados en frío originarios de la República Popular China y la Federación de Rusia, información presentada en nombre de Duferco SA, 27.8.2021, sección 4.1. China, páginas 6 y 7.

### 3.2.2. Continuación del dumping en las importaciones durante el período de investigación de la reconsideración

#### 3.2.2.1. Valor normal

- (139) Como se ha mencionado en el considerando 138, debido a la falta de cooperación de los productores exportadores de Rusia, la Comisión utilizó los datos disponibles para establecer el valor normal. A tal fin, la Comisión utilizó los datos facilitados por el solicitante para el período de investigación de la reconsideración basados en las referencias de precios internos internacionales de MEPS International <sup>(67)</sup> para los productos planos de acero laminados en frío en la región rusa de Volga. Sobre esta base, el valor normal fue de 702,97 EUR/tonelada durante el período de investigación de la reconsideración.

#### 3.2.2.2. Precio de exportación

- (140) Como consecuencia de la falta de cooperación de los productores exportadores de Rusia, la Comisión se vio obligada a utilizar los datos disponibles para establecer el precio de exportación.
- (141) El precio de exportación se determinó sobre la base de datos CIF de Eurostat. Así pues, el precio de exportación fue de 755,65 EUR/tonelada.

#### 3.2.2.3. Comparación

- (142) La Comisión comparó el valor normal y el precio de exportación del producto objeto de reconsideración sobre la base del precio franco fábrica. Sobre la base de la información facilitada por el solicitante, se realizaron ajustes por un importe de 127,84 EUR/tonelada en el precio de exportación para tener en cuenta el flete marítimo y nacional y los gastos de descarga, con el fin de situarlo en el nivel franco fábrica. Sobre esta base, el precio de exportación franco fábrica a la Unión ajustado fue de 627,81 EUR/tonelada.

#### 3.2.2.4. Continuación del dumping

- (143) La comparación anterior mostró que los precios de exportación a la Unión, expresados como porcentaje del valor CIF, eran un 10 % inferiores al valor normal establecido.
- (144) No obstante, puesto que el volumen de las importaciones en cuestión fue muy limitado, ya que representaban menos del 1 % de las importaciones totales a la UE y cerca del 0 % de la cuota del mercado de la Unión, la Comisión también investigó la probabilidad de reaparición del dumping.

### 3.2.3. Probabilidad de reaparición del dumping en caso de que se deroguen las medidas

- (145) La Comisión investigó, de conformidad con el artículo 11, apartado 2, del Reglamento de base, la probabilidad de reaparición del dumping en caso de que se derogaran las medidas. A este respecto, se analizaron los siguientes elementos adicionales: las exportaciones a terceros países, la capacidad de producción y la capacidad excedentaria de Rusia, así como el atractivo del mercado de la Unión.

#### 3.2.3.1. Exportaciones a terceros países

##### a) **Valor normal**

- (146) El valor normal se calculó según se explica en la sección 3.2.2.1 anterior.

##### b) **Precio de exportación**

- (147) El precio de exportación se determinó sobre la base de los precios de exportación del producto objeto de reconsideración a otros terceros países. A este respecto, debido a la falta de cooperación de los productores exportadores, la Comisión utilizó la base de datos GTA. El precio medio de exportación CIF a terceros países fue de 536 EUR/tonelada en el período de investigación de la reconsideración. El precio CIF de exportación a terceros países se redujo al nivel franco fábrica deduciendo los costes de flete y seguro y el coste del transporte nacional en Rusia, que ascendían a 127,84 EUR/tonelada, como se indica en el considerando 141. Sobre esta base, el precio de exportación franco fábrica ajustado a terceros países fue de 408,72 EUR/tonelada.

<sup>(67)</sup> Global Steel Prices, Indexes & Forecasts | MEPS International.

c) *Comparación de precios*

- (148) La Comisión comparó el valor normal establecido en la sección 3.2.2.1 y el precio medio de exportación a terceros países con arreglo al precio franco fábrica.
- (149) La comparación anterior mostró que las exportaciones rusas del producto objeto de reconsideración a terceros países, expresadas como porcentaje del valor CIF, eran un 55 % inferiores al valor normal establecido.
- (150) En sus observaciones sobre el inicio de la investigación, los tres productores exportadores rusos alegaron que los precios de exportación a terceros mercados no son más representativos que los precios de exportación a la Unión, ya que estas exportaciones, principalmente a Turquía, se componen de tipos de productos planos de acero laminados en frío más económicos, lo que explicaría sus precios más bajos. Sugirieron que los elevados precios de las exportaciones rusas comunicados por Eurostat son representativos y debían utilizarse en la evaluación.
- (151) A este respecto, la Comisión señaló que no se aportaron pruebas que justificaran el argumento relativo a las diferencias en los tipos de producto. De hecho, ninguno de los tres productores exportadores rusos proporcionó una respuesta al cuestionario que permitiera a la Comisión evaluar los tipos de productos exportados a la Unión. Por lo tanto, como se explica en el considerando 138, la Comisión basó su evaluación en los datos disponibles. Utilizó la base de datos GTA para establecer el precio de exportación ruso a terceros países como la fuente más adecuada. En cualquier caso, incluso si se utilizaran los precios de las exportaciones rusas a la Unión, como sugerían los tres exportadores rusos, la Comisión determinó en la sección 3.2.2.4 que los precios de las exportaciones rusas a la Unión proporcionados por Eurostat, expresados como porcentaje del valor CIF, eran un 10 % inferiores al valor normal establecido. En consecuencia, se rechazó la alegación.

3.2.3.2. Capacidad de producción y capacidad excedentaria de Rusia

- (152) Dada la falta de cooperación por parte de los productores exportadores rusos, la capacidad de producción y la capacidad excedentaria de Rusia se determinaron sobre la base de los datos disponibles y, en particular, de la información facilitada por el solicitante referente al período de investigación de la reconsideración.
- (153) Según la información facilitada por el solicitante, la capacidad de producción total del producto objeto de reconsideración en Rusia superó los 12 millones de toneladas en el período de investigación de la reconsideración. El solicitante estimó que los productores rusos cuentan con una capacidad excedentaria de aproximadamente dos millones de toneladas que el mercado interno no puede absorber. Además, el solicitante alegó que los productores rusos aumentaron la capacidad de producción de acero laminado en frío en aproximadamente 1 150 000 toneladas entre 2016 y 2021.
- (154) Los productores exportadores rusos cuestionaron la estimación de la capacidad excedentaria de Rusia facilitada por el solicitante. En sus observaciones sobre el inicio de la investigación, proporcionaron datos sobre la capacidad de producción total de la industria rusa de productos planos de acero laminados en frío, el volumen de producción global y el índice de utilización de la capacidad. Alegaron que, en 2020, la industria rusa de productos planos de acero laminados en frío tenía una capacidad excedentaria de [1,8-2,3] millones de toneladas, que representaba tan solo el [4-8] % del consumo total de la Unión (32,4 millones de toneladas). Asimismo, afirmaron que, teniendo en cuenta el crecimiento estimado del consumo y la producción de estos productos en Rusia y la Unión Económica Euroasiática (UEE), se prevé que la capacidad libre de la industria rusa de productos planos de acero laminados en frío disminuya aún más.
- (155) A este respecto, como se explica en el considerando 32, los productores exportadores rusos no enviaron respuestas al cuestionario y la Comisión consideró que solo proporcionaron información fragmentada sobre la producción, la capacidad y el volumen de producción sin aportar pruebas, una información que la Comisión no pudo verificar. Por consiguiente, dado que los productores exportadores no proporcionaron información suficiente y fiable sobre la capacidad de producción y los volúmenes de producción, la Comisión utilizó la información disponible en el expediente.



- (156) Además, los productores exportadores rusos facilitaron los datos sobre la producción, la capacidad y la utilización de la capacidad únicamente en una versión confidencial, sin incluir un resumen no confidencial. Como se indica en el anuncio de inicio, si una parte que facilita información confidencial no justifica suficientemente la solicitud de trato confidencial, o no proporciona un resumen no confidencial de esa información en el formato y con la calidad exigidos, la Comisión podrá no tener en cuenta dicha información, salvo que se demuestre de manera convincente, a partir de fuentes apropiadas, que es exacta. Dado que la información sobre la producción, la capacidad y la utilización de la capacidad solo se facilitó en versión confidencial y, por tanto, no pudo recibir observaciones de otras partes interesadas, no pudo demostrarse satisfactoriamente que la información fuera correcta.
- (157) En cualquier caso, los datos en cuestión facilitados por los productores exportadores rusos y los facilitados por el solicitante no diferían en gran medida. Por lo tanto, la Comisión consideró que una evaluación basada en los datos facilitados por los productores exportadores rusos no habría llevado a una conclusión diferente. En consecuencia, la Comisión rechazó esta alegación.
- (158) Tras la comunicación de la información, el Gobierno ruso y los productores exportadores cuestionaron las conclusiones de la Comisión de que los productores exportadores no habían cooperado plenamente en la investigación y de que no se había presentado ninguna versión abierta significativa (como se explica en el considerando 156). Así pues, los productores exportadores alegaron que la Comisión incurrió en un abuso de su poder discrecional a este respecto.
- (159) En primer lugar, la Comisión observó que la información sobre la capacidad por empresa solo fue facilitada por los productores exportadores de una forma indexada que no permitía a las partes formular observaciones sobre la capacidad exacta instalada (no se facilitaron intervalos). En la versión abierta no se facilitaron datos ni de producción ni de utilización de la capacidad. Por consiguiente, la Comisión reiteró su conclusión de que la versión abierta de la información sobre producción, capacidad y utilización de la capacidad no podía ser examinada por las demás partes interesadas. En segundo lugar, esta información no se facilitó como parte de las respuestas al cuestionario y no pudo cotejarse con otras partes de los cuestionarios ni con los documentos justificativos que las empresas deben presentar como pruebas para respaldar la información presentada en la respuesta al cuestionario. Por último, como se explica en el considerando 157 anterior, la Comisión estableció que, incluso si se tuvieran en cuenta los datos facilitados, sus conclusiones sobre la capacidad excedentaria habrían sido las mismas. Por consiguiente, la Comisión rechazó estas alegaciones.
- (160) La capacidad excedentaria del producto objeto de reconsideración disponible en Rusia representa aproximadamente el 21 % del consumo total de la Unión en el mercado libre en el período de investigación de la reconsideración, según la solicitud, y aproximadamente un 20 % de acuerdo con la información presentada por los productores exportadores rusos.
- (161) En vista de lo anterior, la Comisión concluyó que los productores exportadores rusos cuentan con una importante capacidad excedentaria que podrían utilizar para fabricar productos planos de acero laminados en frío para su exportación a la Unión si se dejaran expirar las medidas.

### 3.2.3.3. Atractivo del mercado de la Unión

- (162) La Comisión determinó que los productores exportadores rusos exportaron el producto objeto de reconsideración a terceros mercados a unos precios aproximadamente un 14 % inferiores a los precios medios de venta de los productores de la Unión en el mercado de la UE. Teniendo en cuenta este nivel de precios, exportar a la Unión resulta potencialmente más atractivo para los exportadores rusos que exportar a todos los demás países.
- (163) El mercado de la Unión también es atractivo debido a su proximidad geográfica y su tamaño, con un consumo total de 33 579 173 toneladas, incluido un consumo en el mercado libre de 9 677 020 toneladas en el período de investigación de la reconsideración.

- (164) El volumen de las exportaciones a terceros países fue de 580 000 toneladas durante el período de investigación de la reconsideración, lo que representaba el 6 % del consumo en el mercado libre de la Unión. Esto representa un volumen adicional de productos planos de acero laminados en frío que, dado su atractivo, podría desviarse al mercado de la Unión si expiraran las medidas.
- (165) Tras la comunicación de la información, los productores exportadores y el Gobierno ruso alegaron que el mercado de la Unión había dejado de ser atractivo para los productores exportadores debido a las sanciones y que, incluso en el período previo a las sanciones, «los flujos comerciales, las infraestructuras y las cadenas de suministro ya se [habían] destruido» y tardarían años en restablecerse.
- (166) Si bien la alegación relativa a las sanciones se aborda en los considerandos 167 y 172 siguientes, la Comisión observó que no se había aportado ninguna prueba con respecto a la alegación de que tendrían que pasar años para restablecer las exportaciones a la Unión. Al mismo tiempo, dados los precios considerablemente más bajos a los que los productores exportadores rusos siguen exportando al resto del mundo, la proximidad geográfica y el tamaño del mercado de la Unión, así como el importante volumen de exportaciones a terceros países que podrían desviarse a la Unión, la Comisión reiteró sus conclusiones de que el mercado de la Unión es atractivo para los productores exportadores rusos.
- (167) Los acontecimientos recientes no desvirtúan esta conclusión. La Comisión señaló al respecto que, tras el inicio de la investigación, debido a la agresión militar de la Federación de Rusia contra Ucrania, la Unión impuso sucesivos paquetes de sanciones contra Rusia que también afectaban a productos siderúrgicos o a las empresas siderúrgicas que producían y exportaban el producto objeto de reconsideración tras el período de investigación de la reconsideración. El último paquete de sanciones relativas al producto objeto de reconsideración o a los productores exportadores contiene una importante prohibición de importación de productos planos de acero laminados en frío. Dicha prohibición entró en vigor el 16 de marzo de 2022 <sup>(68)</sup>. Dado que estas sanciones están vinculadas a la agresión militar y a la situación geopolítica subyacente, su alcance, modulación o duración son imprevisibles. Además, las medidas antidumping tienen una duración de cinco años. Teniendo en cuenta las incertidumbres antes mencionadas y el hecho de que el Consejo puede modificar aún más el alcance exacto y la duración de las sanciones en cualquier momento, la Comisión consideró que no pueden influir en sus conclusiones en este procedimiento.

#### 3.2.3.4. Conclusión sobre la probabilidad de reaparición del dumping

- (168) La Comisión estableció que los productores exportadores rusos venden a terceros países a precios inferiores al valor normal.
- (169) Como se explica en el considerando 161, la capacidad excedentaria de Rusia fue significativa en el período de investigación de la reconsideración, ya que representaba aproximadamente el 21 % del consumo total de la Unión en el mercado libre en el período de investigación de la reconsideración, y aumentó entre 2016 y 2021.
- (170) Por último, el atractivo del mercado de la Unión en términos de tamaño, de proximidad geográfica y de precios apunta a que sea probable que las exportaciones rusas y su capacidad excedentaria se (re)dirijan hacia el mercado de la Unión si se dejan expirar las medidas.
- (171) Tras la comunicación de la información, el Gobierno ruso alegó que no hay ninguna probabilidad de reaparición del dumping, ya que las importaciones han sido insignificantes y, debido a las sanciones, los fabricantes rusos han interrumpido completamente las exportaciones a la Unión por un período de tiempo largo e indefinido.
- (172) Por lo que se refiere a las exportaciones a la Unión, la Comisión recordó que estableció la probabilidad de reaparición del dumping sobre la base de los elementos descritos anteriormente, entre los que no se encuentra el nivel actual de las exportaciones a la Unión, que se considera una situación temporal que puede cambiar en cualquier momento. En cuanto a las sanciones en vigor, como se explica en el considerando 167, dado que su alcance, modulación o

<sup>(68)</sup> Reglamento (UE) n.º 833/2014 del Consejo, de 31 de julio de 2014, relativo a medidas restrictivas motivadas por acciones de Rusia que desestabilizan la situación en Ucrania (DO L 229 de 31.7.2014, p. 1), modificado por el Reglamento (UE) 2022/428 (DO L 87 I de 15.3.2022, p. 13). Véase <https://eur-lex.europa.eu/legal-content/ES/TXT/?uri=CELEX%3A02014R0833-20220413> para consultar la versión consolidada del Reglamento (UE) n.º 833/2014, que contiene todas las modificaciones relativas al paquete de sanciones.

duración son imprevisibles y pueden modificarse en cualquier momento, la Comisión consideró que no pueden influir en las conclusiones de este procedimiento. Por lo tanto, los recientes acontecimientos que afectaron temporalmente a las importaciones a la Unión procedentes de Rusia no pueden modificar las conclusiones sobre la reaparición del dumping en este caso y se rechazaron estas alegaciones.

- (173) En consecuencia, la Comisión concluyó que era probable que reapareciese el dumping en caso de no prorrogarse las medidas.

#### 4. PERJUICIO

##### 4.1. Definición de la industria de la Unión y producción de la Unión

- (174) Durante el período considerado, veintiún productores fabricaron el producto similar en la Unión. Estos productores constituyen «la industria de la Unión» a tenor del artículo 4, apartado 1, del Reglamento de base.
- (175) La producción total de la Unión durante el período de investigación de la reconsideración se estableció en torno a los 30,5 millones de toneladas. Para calcular esa cifra, la Comisión utilizó toda la información disponible sobre la industria de la Unión, incluida la información facilitada por el solicitante. Como se indica en el considerando 21, se seleccionó una muestra compuesta por tres productores de la Unión que representaban más del 30 % de la producción total de la Unión del producto similar.
- (176) Dado que la industria de la Unión se encuentra en su mayoría integrada verticalmente y los productos planos de acero laminados en frío se consideran una materia prima para la producción en una fase posterior de diversos productos transformados de valor añadido, el consumo del mercado cautivo y del mercado libre se analizaron por separado.
- (177) La distinción entre el mercado cautivo y libre es pertinente para la evaluación del perjuicio porque los productos destinados a un uso cautivo no están expuestos a la competencia directa de las importaciones, y los precios de transferencia se fijan dentro de los grupos con arreglo a diversas políticas de precios y, por tanto, no son fiables. Por el contrario, la producción destinada al mercado libre entra en competencia directa con las importaciones del producto afectado, y los precios son los del libre mercado.
- (178) Para poder ofrecer un panorama de la industria de la Unión lo más completo posible, y de manera similar a lo que se hizo en el marco de la investigación original, la Comisión obtuvo datos de toda la actividad relacionada con los productos planos de acero laminados en frío y determinó si la producción estaba destinada a un uso cautivo o al mercado libre. La Comisión determinó que en torno al 78 % de la producción total de los productores de la Unión se destinaba a un uso cautivo.
- (179) La Comisión examinó determinados indicadores económicos relativos a la industria de la Unión basándose únicamente en los datos del mercado libre. Estos indicadores son los siguientes: el volumen de ventas y los precios de venta en el mercado de la Unión; la cuota de mercado; volumen y precios de exportación y rentabilidad. En relación con otros indicadores, como producción, capacidad, productividad, empleo y salarios, las cifras que se valoran más adelante se refieren a toda la actividad y, por ese motivo, no se garantizó su desglose.

##### 4.2. Consumo de la Unión

- (180) La Comisión estableció el consumo de la Unión sobre la base de a) los datos proporcionados por Eurofer relativos a las ventas del producto similar de la industria de la Unión en este territorio, cotejados con los productores de la Unión incluidos en la muestra; y b) las importaciones del producto objeto de reconsideración procedentes de todos los terceros países, según datos de Eurostat.
- (181) El consumo de la Unión evolucionó de la manera siguiente:

Cuadro 2

## Consumo de la Unión (toneladas)

	2018	2019	2020	Período de investigación de la reconsideración
Consumo total de la Unión	39 389 717	38 484 642	31 808 880	33 579 173
<i>Índice</i> (2018 = 100)	100	98	81	85
Mercado cautivo	28 207 944	28 129 434	22 651 025	23 902 153
<i>Índice</i> (2018 = 100)	100	100	80	85
Mercado libre	11 181 772	10 355 209	9 157 856	9 677 020
<i>Índice</i> (2018 = 100)	100	93	82	87

Fuente: Datos facilitados por Eurofer y cotejados con las respuestas al cuestionario de los productores incluidos en la muestra; Eurostat.

- (182) El consumo en el mercado libre ha aumentado en comparación con las 7 122 682 toneladas consumidas durante el período de investigación de la investigación original (del 1 de abril de 2014 al 31 de marzo de 2015). Sin embargo, durante el período considerado, el consumo cautivo de la Unión disminuyó alrededor de un 15 %, mientras que el consumo en el mercado libre de la Unión disminuyó alrededor del 13 %. Entre los años 2018 y 2019, el consumo en el mercado cautivo se mantuvo estable, mientras que el consumo en el mercado libre disminuyó un 7 %. El principal descenso se produjo entre los años 2019 y 2020, cuando tanto el consumo libre como el cautivo disminuyeron de manera sustancial, un 11 % y un 20 %, respectivamente. Esta disminución comenzó en 2019 debido a una desaceleración general del crecimiento de la Unión, pero se agudizó como consecuencia de la desaceleración económica general causada por la pandemia de COVID-19. La desaceleración del crecimiento económico en general, y en el sector manufacturero en particular, ha afectado a la demanda global de acero. Esto afectó especialmente a la industria automovilística, que constituye una parte significativa de los usuarios de productos planos de acero laminados en frío. Entre 2020 y el período de investigación de la reconsideración, tanto el consumo cautivo como el libre aumentaron un 5 %, aunque no lograron recuperar los niveles de 2018.

#### 4.3. Importaciones procedentes de los países afectados y del resto del mundo

##### 4.3.1. Volumen y cuota de mercado de las importaciones procedentes de los países afectados y del resto del mundo

- (183) La Comisión determinó el volumen de las importaciones a partir de los datos de Eurostat. La cuota de mercado de las importaciones se determinó comparando los volúmenes de importación con el consumo en el mercado libre de la Unión, consignado en el cuadro 2 anterior.
- (184) Las importaciones en la Unión procedentes de los países afectados y del resto del mundo evolucionaron como sigue:

Cuadro 3

## Volumen de las importaciones (toneladas) y cuota de mercado

	2018	2019	2020	Período de investigación de la reconsideración
Volumen de las importaciones procedentes de los países afectados	14 367	4 286	1 435	9 713
Índice (2018 = 100)	100	30	10	68
Cuota de mercado	0,1 %	0,0 %	0,0 %	0,1 %
Volumen de las importaciones procedentes de China	2 305	1 275	423	7 065
Índice (2018 = 100)	100	55	18	307
Cuota de mercado de China	0,0 %	0,0 %	0,0 %	0,1 %
Volumen de las importaciones procedentes de Rusia	12 062	3 011	1 012	2 648
Índice (2018 = 100)	100	25	8	22
Cuota de mercado de Rusia	0,0 %	0,0 %	0,0 %	0,0 %
Volumen de las importaciones procedentes del resto del mundo	2 279 706	2 113 190	1 876 491	2 154 420
Índice (2018 = 100)	100	93	82	95
Cuota de mercado del resto del mundo	20,39 %	20,41 %	20,49 %	22,26 %

Fuente: Eurostat.

- (185) Pese a que las importaciones procedentes de los países afectados representaban una cuota de mercado del 20 % durante el período de investigación original (1,4 millones de toneladas), han desaparecido prácticamente del mercado de la Unión, según la información de Eurostat. De hecho, las importaciones procedentes de los países afectados siguieron disminuyendo —de 14 367 a 9 713 toneladas— durante el período considerado. Aunque los volúmenes de importación procedentes de ambos países afectados volvieron a aumentar ligeramente entre 2020 y el período de investigación de la reconsideración, en consonancia con el aumento de los volúmenes de consumo en el mismo período, continuaron representando una cuota de mercado de tan solo un 0,1 % durante el período de investigación de la reconsideración.

- (186) Las importaciones totales del producto objeto de reconsideración procedentes de terceros países distintos de los países afectados disminuyeron un 5 % (de 2,28 a 2,15 millones de toneladas) durante el período considerado. Esto sigue la misma tendencia a la baja del consumo en el mercado libre de la Unión que se menciona en el cuadro 2, pero en menor medida. Además, los terceros países mantuvieron (e incluso aumentaron casi dos puntos porcentuales) su cuota de mercado en el mercado libre durante el período considerado, mientras que la industria de la Unión perdió casi un 2 % de cuota de mercado. Sin embargo, la oferta de productos planos de acero laminados en frío en el mercado libre estaba fragmentada, y ninguno de los demás terceros países poseía una cuota de mercado superior al 4 % en el mercado de la Unión <sup>(69)</sup>.

#### 4.4. Situación económica de la industria de la Unión

##### 4.4.1. Observaciones generales

- (187) El examen de la situación económica de la industria de la Unión incluyó una evaluación de todos los indicadores económicos que influyeron en el estado de la industria de la Unión durante el período considerado.
- (188) Para determinar el perjuicio, la Comisión distinguió entre indicadores de perjuicio macroeconómicos y microeconómicos. La Comisión evaluó los indicadores macroeconómicos basándose en los datos recogidos en la respuesta al cuestionario presentada por Eurofer en relación con las ventas del producto similar de la industria de la Unión, cotejados con los datos facilitados por los productores de la Unión incluidos en la muestra. La Comisión evaluó los indicadores microeconómicos a partir de los datos contenidos en las respuestas al cuestionario de los productores de la Unión incluidos en la muestra. Se consideró que estos dos conjuntos de datos eran representativos de la situación económica de la industria de la Unión.
- (189) Los indicadores macroeconómicos son los siguientes: producción, capacidad de producción, utilización de la capacidad, volumen de ventas, cuota de mercado, crecimiento, empleo, productividad, magnitud del margen de dumping y recuperación con respecto a prácticas de dumping anteriores.
- (190) Los indicadores microeconómicos son: precios medios unitarios, coste unitario, costes laborales, existencias, rentabilidad, flujo de caja, inversiones, rendimiento de las inversiones y capacidad para reunir capital.

##### 4.4.2. Indicadores macroeconómicos

###### 4.4.2.1. Producción, capacidad de producción y utilización de la capacidad

- (191) Las cifras totales de producción, capacidad de producción y utilización de la capacidad en la Unión evolucionaron del siguiente modo durante el período considerado:

Cuadro 4

#### Producción, capacidad de producción y utilización de la capacidad

	2018	2019	2020	Período de investigación de la reconsideración
Volumen de producción (toneladas)	36 298 267	35 686 689	29 229 520	30 520 404
Índice (2018 = 100)	100	98	81	84
Capacidad de producción (toneladas)	45 912 036	45 976 102	48 542 510	44 909 450
Índice (2018 = 100)	100	100	106	98

<sup>(69)</sup> La India, Turquía, Ucrania y la República de Corea fueron los únicos países con una cuota de mercado superior al 3 % durante el período de investigación de la reconsideración, mientras que solo Taiwán y el Reino Unido tenían una cuota de mercado superior al 2 %.



Utilización de la capacidad (%)	79	78	60	68
<i>Índice</i> (2018 = 100)	100	98	76	86

Fuente: Eurofer, productores de la Unión incluidos en la muestra.

- (192) Los volúmenes de producción han disminuido significativamente desde el inicio del período considerado. La disminución presenta una tendencia y una magnitud muy similares a las observadas en el caso de la disminución del consumo total de la Unión. Los volúmenes de producción se redujeron un 16 % durante el período de investigación de reconsideración.
- (193) La capacidad de producción también disminuyó ligeramente durante el período considerado y se sitúa a un nivel mucho más bajo que durante la investigación original. Esto se debe en parte a que el Reino Unido seguía siendo miembro de la Unión durante la investigación original, mientras que su capacidad de producción ya no se tuvo en cuenta en la presente investigación de reconsideración. Además, la industria de la Unión ha tomado medidas para adaptar y racionalizar su capacidad en consonancia con el consumo en el mercado. Por lo tanto, los índices de utilización de la capacidad mejoraron inicialmente en comparación con la investigación original. Sin embargo, desde la ralentización del crecimiento de la Unión en 2019 y, en particular, el inicio de la pandemia de COVID-19, volvieron a disminuir de manera significativa durante el período considerado, aunque se recuperaron ligeramente en el período de investigación de la reconsideración (mientras que la disminución fue de casi 20 puntos porcentuales en 2020 en comparación con 2018, en el período de investigación de la reconsideración la caída fue de 11 puntos porcentuales con respecto a 2018).

#### 4.4.2.2. Volumen de ventas y cuota de mercado

- (194) Durante el período considerado, el volumen de ventas y la cuota de mercado de la industria de la Unión evolucionaron como sigue:

Cuadro 5

#### Volumen de ventas (toneladas) y cuota de mercado

	2018	2019	2020	Período de investigación de la reconsideración
Volumen total de ventas en el mercado de la Unión, tanto libre como cautivo	37 095 644	36 367 167	29 930 954	31 415 040
<i>Índice</i> (2018 = 100)	100	98	81	85
Ventas y uso en el mercado cautivo	28 207 944	28 129 434	22 651 025	23 902 153
<i>Índice</i> (2018 = 100)	100	100	80	85
Ventas en el mercado libre	8 887 699	8 237 733	7 279 930	7 512 887
<i>Índice</i> (2018 = 100)	100	93	82	85
Cuota de mercado de las ventas en el mercado libre	79 %	80 %	79 %	78 %

Fuente: Eurofer, productores de la Unión incluidos en la muestra.

- (195) Las ventas totales en la Unión siguieron una tendencia descendente durante el período considerado, con una reducción global del 15 %. La misma tendencia se observa con una magnitud similar para los mercados cautivo y libre, en consonancia con la disminución del consumo que se muestra en el cuadro 2.
- (196) La cuota de mercado de la industria de la Unión en el mercado libre se mantuvo bastante estable durante el período considerado, pero disminuyó casi un 2 % durante el período de investigación de la reconsideración. Esto coincide con el aumento de la cuota de mercado de terceros países en el período de investigación de la reconsideración, como se muestra en el cuadro 3.

#### 4.4.2.3. Crecimiento

- (197) En un contexto de disminución del consumo, la industria de la Unión no solo experimentó una caída del volumen de ventas en la Unión, sino también una reducción de la cuota de mercado en el mercado libre. Por consiguiente, no se produjo crecimiento alguno de la industria de la Unión durante el período considerado.

#### 4.4.2.4. Empleo y productividad

- (198) En el período considerado, el empleo y la productividad evolucionaron de la manera siguiente:

Cuadro 6

#### Empleo y productividad

	2018	2019	2020	Período de investigación de la reconsideración
Número de empleados	9 634	9 137	9 773	9 321
<i>Índice</i> (2018 = 100)	100	95	101	97
Productividad (toneladas/empleado)	3 768	3 906	2 991	3 274
<i>Índice</i> (2018 = 100)	100	104	79	87

Fuente: Eurofer, productores de la Unión incluidos en la muestra.

- (199) La industria de la Unión no consiguió mantener el número de empleados dedicados a la producción del producto objeto de reconsideración, que experimentó una caída global del 3 % entre 2018 y el período de investigación de la reconsideración.
- (200) La productividad de la mano de obra de la industria de la Unión, medida como producción (toneladas) por persona empleada, siguió una tendencia descendente durante el período considerado (- 13 %). La considerable disminución de la productividad se explica por la mayor reducción del volumen de producción, que también está relacionada con la disminución de las ventas y la demanda de productos de la industria de la Unión, tanto en los mercados interno como de exportación, en comparación con la menor reducción del número de empleados.

#### 4.4.2.5. Magnitud del margen de dumping y recuperación con respecto a prácticas de dumping anteriores

- (201) Todos los márgenes de dumping establecidos durante el período de investigación de la reconsideración se situaron significativamente por encima del nivel mínimo. Al mismo tiempo, el nivel de importaciones durante el período de investigación de la reconsideración fue muy limitado, ya que representó tan solo el 0,1 % del consumo de la Unión. Las medidas antidumping impuestas a raíz de la investigación original habían permitido a la industria de la Unión recuperarse de prácticas de dumping anteriores, como demuestran los datos de 2018 y confirmaron las declaraciones del solicitante en la solicitud de reconsideración.

## 4.4.3. Indicadores microeconómicos

## 4.4.3.1. Precios y factores que inciden en los precios

- (202) Durante el período considerado, los precios de venta unitarios medios ponderados y los costes de producción de los productores de la Unión incluidos en la muestra aplicados a clientes no vinculados en la Unión evolucionaron de la manera siguiente:

Cuadro 7

**Precios de venta y coste de la producción en la Unión (EUR/tonelada)**

	2018	2019	2020	Período de investigación de la reconsideración
Precio de venta unitario medio en el mercado libre de la Unión	654	613	553	622
<i>Índice</i> (2018 = 100)	100	94	85	95
Coste unitario de producción	592	617	573	643
<i>Índice</i> (2018 = 100)	100	104	97	109

Fuente: Productores de la Unión incluidos en la muestra.

- (203) Durante el período considerado, los precios de venta en el mercado de la Unión a partes no vinculadas (el mercado libre) disminuyeron un 5 %. Un análisis detallado muestra que, entre 2018 y 2020, los precios de venta disminuyeron un 15 %, pero volvieron a aumentar un 12 % en el período de investigación de la reconsideración. Durante el mismo período, el coste de producción fluctuó, pero fue casi un 10 % superior en el período de investigación de la reconsideración que en 2018. El coste medio de producción fue superior al precio medio de venta en todos los años, salvo en 2018. Aunque los precios de venta aumentaron significativamente entre 2020 y el período de investigación de la reconsideración, la industria de la Unión aún no había sido capaz de aumentar el precio de venta hasta un nivel suficiente para cubrir el coste de producción.

## 4.4.3.2. Costes laborales

- (204) Durante el período considerado, los costes laborales medios de los productores de la Unión incluidos en la muestra evolucionaron de la manera siguiente:

Cuadro 8

**Costes laborales medios por empleado**

	2018	2019	2020	Período de investigación de la reconsideración
Costes laborales medios por empleado (EUR)	91 664	97 412	93 113	97 981
<i>Índice</i> (2018 = 100)	100	106	102	107

Fuente: Productores de la Unión incluidos en la muestra.

- (205) Durante el período considerado, los costes laborales medios fluctuaron, pero registraron un incremento global del 7 %. El número de empleados disminuyó y los costes laborales totales también se redujeron, pero en menor medida.

#### 4.4.3.3. Existencias

- (206) Los niveles de existencias de los productores de la Unión incluidos en la muestra evolucionaron de la manera siguiente durante el período considerado:

Cuadro 9

#### Existencias

	2018	2019	2020	Período de investigación de la reconsideración
Existencias al cierre (toneladas)	488 722	429 657	284 572	262 487
Índice (2018 = 100)	100	88	58	54
Existencias al cierre como porcentaje de la producción	4 %	4 %	3 %	2 %
Índice (2018 = 100)	100	88	65	55

Fuente: Productores de la Unión incluidos en la muestra.

- (207) Durante el período considerado, el volumen de existencias de la Unión experimentó una reducción continua. Normalmente, cualquier variación de las existencias de productos planos de acero laminados en frío sigue las mismas tendencias que la producción, que también disminuyó durante el período considerado, como se muestra en el cuadro 4 <sup>(70)</sup>. Durante el período considerado, sin embargo, se llevaron a cabo determinadas actividades de reestructuración en una de las empresas incluidas en la muestra, que implicó una escisión parcial que también afectó a las existencias. Además, una de las empresas incluidas en la muestra tuvo problemas con varios equipos durante un cierto tiempo, lo que requirió unas ventas de existencias mayores de lo previsto. Sin embargo, como también se estableció en la investigación original, las existencias no se consideran un indicador de perjuicio importante para esta industria, ya que la industria de la Unión fabrica la mayoría de los tipos del producto similar a partir de pedidos específicos de los usuarios <sup>(71)</sup>.

#### 4.4.3.4. Rentabilidad, flujo de caja, inversiones, rendimiento de las inversiones y capacidad para reunir capital

- (208) La rentabilidad, el flujo de caja, las inversiones y el rendimiento de las inversiones de los productores de la Unión incluidos en la muestra evolucionaron durante el período considerado de la manera siguiente:

Cuadro 10

#### Rentabilidad, flujo de caja, inversiones y rendimiento de las inversiones

	2018	2019	2020	Período de investigación de la reconsideración
Rentabilidad de las ventas en la Unión a clientes no vinculados (como porcentaje del volumen de negocios de las ventas)	16,1	- 2,8	- 14,7	- 3,1

<sup>(70)</sup> Este extremo se confirmó también en la investigación original; véase el considerando 136 del Reglamento de Ejecución (UE) 2016/181.

<sup>(71)</sup> Reglamento de Ejecución (UE) 2016/181, considerando 136.

Índice (2018 = 100)	100	- 17	- 92	- 20
Flujo de caja (en EUR)	1 197 337 649	1 024 735 660	744 992 480	822 335 704
Índice (2018 = 100)	100	86	62	69
Inversiones (EUR)	65 866 851	75 059 376	61 159 498	72 616 722
Índice (2018 = 100)	100	114	93	110
Rendimiento de las inversiones (%)	5	0	- 3	- 1
Índice (2018 = 100)	100	- 8	- 69	- 12

Fuente: Productores de la Unión incluidos en la muestra.

- (209) La Comisión determinó la rentabilidad de los productores de la Unión incluidos en la muestra expresando el beneficio neto, antes de impuestos, obtenido en las ventas del producto similar a clientes no vinculados en la Unión como porcentaje del volumen de negocios de esas ventas.
- (210) Debido a la imposición de las medidas antidumping, la industria de la Unión había logrado mejorar su rentabilidad desde el período de investigación original e incluso superar el objetivo de beneficio establecido en dicha investigación <sup>(72)</sup>. Sin embargo, tras el máximo alcanzado en 2018, la disminución del consumo de la Unión en el mercado libre, junto con la disminución de los precios de venta en los años siguientes, como se muestra en el cuadro 7 anterior, dieron lugar a un coste unitario de producción superior al precio medio de venta. La reducción del consumo de la Unión de productos planos de acero laminados en frío no permitió a la industria de la Unión fijar precios de venta a un nivel que cubriera, como mínimo, el coste de producción.
- (211) El flujo de caja neto es la capacidad de los productores de la Unión para autofinanciar sus actividades. La tendencia del flujo de caja neto evolucionó en gran medida en consonancia con la rentabilidad; alcanzó su máximo en 2018 para, a continuación, experimentar una disminución sustancial en 2019 y 2020. Durante el período de investigación se recuperó en cierta medida, pero situándose todavía por debajo de los niveles de 2018 y 2019.
- (212) El rendimiento de las inversiones es el beneficio expresado en porcentaje del valor contable neto de las inversiones. Si bien en términos globales las inversiones aumentaron durante el período considerado, a lo largo de 2020 y del período de investigación de la reconsideración se mantuvieron por debajo del nivel de 2019. El rendimiento de la inversión evolucionó de forma negativa y siguió la misma tendencia que la rentabilidad.

#### 4.5. Conclusión sobre el perjuicio

- (213) Todos los indicadores macroeconómicos registraron una tendencia negativa durante el período considerado, como la producción, la utilización de la capacidad, el volumen de ventas en el mercado de la Unión (tanto cautivo como libre), la cuota de mercado, el empleo y la productividad. De igual modo, la mayoría de los indicadores microeconómicos registraron una tendencia negativa durante el período considerado, como los precios de venta en el mercado libre de la Unión, el coste de la producción, la rentabilidad, las existencias al cierre, el flujo de caja y el rendimiento de las inversiones. Las inversiones fueron el único indicador que mostró una tendencia positiva.

<sup>(72)</sup> Reglamento de Ejecución (UE) 2016/1328.

- (214) Aunque la industria de la Unión consiguió aumentar los precios en el período de investigación de la reconsideración, registró un margen de beneficio negativo del -3,1 % en el período de investigación de la reconsideración. El flujo de caja y el rendimiento de las inversiones también se deterioraron, lo que dificulta que la industria de la Unión reúna capital y aumente su crecimiento.
- (215) Sobre la base de lo anterior, la Comisión concluyó que, hasta 2018, la industria de la Unión se había recuperado del importante perjuicio anterior, en el sentido del artículo 3, apartado 5, del Reglamento de base, causado por las importaciones objeto de dumping procedentes de China y de Rusia. Sin embargo, durante el período considerado, la situación de perjuicio se deterioró y la industria de la Unión volvió a encontrarse en una situación económica frágil y perjudicial durante el período de investigación de la reconsideración.
- (216) Tras la comunicación de la información, el Gobierno ruso no estuvo de acuerdo con la conclusión de la Comisión en cuanto a la situación de la industria de la Unión durante el período de investigación de la reconsideración. Según el Gobierno ruso, la situación mejoró durante el período de investigación de la reconsideración con respecto al año anterior, a excepción del coste unitario de producción.
- (217) Sin embargo, si bien es cierto que algunos de los indicadores de perjuicio mejoraron ligeramente entre 2020 y el período de investigación de la reconsideración, como también se señaló en el análisis anterior (por ejemplo, en los considerandos 193 o 211), los indicadores mostraron un deterioro durante el período considerado. No obstante, la mejora observada en el período de investigación de la reconsideración no fue suficiente para sacar a la industria de la Unión de la frágil situación económica a la que se había enfrentado desde 2018. Por tanto, la Comisión rechazó esta alegación.
- (218) Debido a los niveles insignificantes de importaciones procedentes de los países afectados durante el período considerado, la Comisión concluyó que las importaciones procedentes de China y de Rusia no podían haber causado el perjuicio sufrido por la industria de la Unión.
- (219) Por consiguiente, la Comisión examinó, además, la probabilidad de reaparición del perjuicio causado originalmente por las importaciones objeto de dumping procedentes de China y de Rusia si las medidas se derogasen.

## 5. PROBABILIDAD DE REAPARICIÓN DEL PERJUICIO

- (220) La Comisión concluyó en el considerando 215 que la industria de la Unión se encontraba en una situación económicamente frágil durante el período de investigación de la reconsideración. La Comisión también concluyó en el considerando 218 que el perjuicio a la industria de la Unión observado durante el período de investigación de la reconsideración no pudo haber sido causado por importaciones objeto de dumping procedentes de China y de Rusia, debido a que su volumen era muy limitado. Por lo tanto, la Comisión evaluó, de conformidad con el artículo 11, apartado 2, del Reglamento de base, si existía una probabilidad de reaparición del perjuicio causado por las importaciones objeto de dumping procedentes de China y de Rusia en el caso de que las medidas dejaran de tener efecto.
- (221) A este respecto, la Comisión examinó la capacidad de producción y la capacidad excedentaria de los países afectados, la relación entre los precios de exportación a terceros países y el nivel de precios en la Unión, así como el impacto de las posibles importaciones y los niveles de precios de dichas importaciones procedentes de estos países en la situación de la industria de la Unión en caso de que las medidas dejaran de tener efecto.

### 5.1. Capacidad excedentaria de China y de Rusia y atractivo del mercado de la Unión

- (222) Como ya se ha descrito en las secciones 3.1.11.2 y 3.2.3.2, los productores exportadores de China y de Rusia tienen importantes capacidades excedentarias, que en conjunto superan sustancialmente los volúmenes de producción actuales y la demanda interna en esos países. Estas capacidades excedentarias podrían utilizarse para fabricar el producto objeto de reconsideración para exportarlo a la Unión en caso de que las medidas dejaran de tener efecto. Las cantidades que podrían exportar los productores exportadores chinos y rusos son significativas en comparación con el tamaño del mercado de la Unión. De hecho, las capacidades excedentarias representaron más del doble del consumo total en el mercado libre de la Unión durante el período de investigación de la reconsideración.



- (223) Como se describe en las secciones 3.1.11.1 y 3.2.3.1, los productores exportadores chinos y rusos exportaron a sus terceros mercados principales a precios significativamente inferiores al valor normal establecido, que, además, eran inferiores a los precios medios (indicativos) de venta de los productores de la Unión en el mercado de la Unión durante el período de investigación de la reconsideración. Por lo tanto, teniendo en cuenta el nivel de precios de las exportaciones procedentes de China y de Rusia a otros terceros mercados, exportar a la Unión es potencialmente mucho más atractivo para los exportadores de dichos países. En consecuencia, cabe esperar razonablemente que, si las medidas se derogaran, los productores exportadores chinos y rusos retomarían la exportación de grandes volúmenes del producto objeto de reconsideración a la Unión. La disponibilidad de una capacidad excedentaria sustancial en estos países refuerza esta expectativa. Como se señala en el considerando 167, aunque actualmente existe una prohibición de importación en la Unión de determinados productos siderúrgicos exportados desde Rusia, cuyo ámbito de aplicación incluye los productos planos de acero laminados en frío <sup>(73)</sup>, es probable que se trate de una medida temporal y no hay forma de prever su duración en relación con la duración de la prórroga de las medidas actuales. Por lo tanto, no afecta a las conclusiones sobre el atractivo del mercado de la Unión.
- (224) Los tres productores exportadores rusos alegaron que, en su solicitud, el solicitante sobrestimaba el atractivo del mercado de la Unión para Rusia. Según las empresas rusas, si aumentaran sus exportaciones a terceros países, dichas exportaciones se destinarían más bien a los socios comerciales preferentes de Rusia que a la Unión. Sin embargo, como también ha señalado el solicitante, no hay ninguna razón por la que la capacidad excedentaria rusa deba utilizarse para aumentar las exportaciones a los socios comerciales preferentes de Rusia. De hecho, estas exportaciones ya se benefician actualmente de un derecho del 0 %, por lo que ya se podrían haber exportado libres de derechos. Por el contrario, las exportaciones a la Unión están actualmente sujetas a derechos y una comparación de los precios rusos y chinos a terceros países más el derecho antidumping de la Unión no daría lugar a una subvaloración del precio indicativo, mientras que la supresión del derecho antidumping sí produciría dicho efecto. Por lo tanto, no resulta convincente argumentar que las exportaciones a estos socios comerciales aumentarían, ya que estos no habían identificado ningún cambio que pudiera producirse en un futuro previsible que aumentara las exportaciones de Rusia a dichos países. Por consiguiente, la Comisión rechazó esta alegación.
- (225) Tras la comunicación de la información, los tres productores exportadores rusos y el Gobierno ruso alegaron que no habría ninguna probabilidad de reaparición del dumping perjudicial por parte de Rusia. En opinión de estas partes, «la legislación y la práctica de la UE demuestran que las sanciones de la UE son un instrumento político a largo plazo», mientras que «las medidas antidumping de la UE no tienen una duración preestablecida» <sup>(74)</sup>. Los productores exportadores rusos alegaron que no había indicios de que las sanciones contra Rusia se fueran a relajar o suprimir. Sin embargo, incluso si se levantaran las sanciones, el mercado de la UE no sería atractivo para los exportadores rusos «debido a los elevados riesgos de imposición de rigurosas restricciones comerciales».
- (226) Como también se expone en los considerandos 165 y 166, no se presentaron pruebas que demostraran por qué el mercado de la Unión sería menos atractivo para los exportadores rusos en un escenario sin sanciones. Asimismo, en los considerandos 172, 223 y 248 del presente Reglamento se explica por qué la Comisión concluyó que las sanciones no pueden influir en las conclusiones de este procedimiento. Por consiguiente, se rechazaron estas alegaciones.

## 5.2. Efecto en la situación de la industria de la Unión

- (227) Con el fin de determinar cómo afectarían las importaciones procedentes de China y de Rusia a la industria de la Unión en caso de que las medidas dejaran de tener efecto, la Comisión llevó a cabo un análisis prospectivo y comparativo de los precios en ausencia de medidas antidumping.
- (228) Debido a la falta de cooperación de los productores exportadores de los países en cuestión y dadas las muy bajas cantidades importadas en la Unión procedentes de dichos países, no fue posible establecer precios de importación fiables durante el período de investigación de la reconsideración. Por lo tanto, no fue posible realizar un cálculo significativo de la subcotización de precios sobre esta base. En estas circunstancias, para estimar el precio probable

<sup>(73)</sup> Véase el Reglamento (UE) 2022/428, por el que se modifica el Reglamento (UE) n.º 833/2014 relativo a medidas restrictivas motivadas por acciones de Rusia que desestabilizan la situación en Ucrania.

<sup>(74)</sup> Según los productores exportadores rusos, toda medida antidumping «se dará por concluida cuando dejen de existir las condiciones en que se sustenta su imposición», mientras que la Comisión utiliza las medidas antidumping «como instrumento de protección del comercio a largo plazo».

al que los productores chinos y rusos venderían sus exportaciones al mercado de la Unión, la Comisión realizó una comparación de precios entre el precio medio (franco fábrica) de los productores de la Unión incluidos en la muestra y el precio medio ponderado correspondiente del producto objeto de reconsideración cuando se exporta a terceros países <sup>(75)</sup> desde China y Rusia.

- (229) El resultado de la comparación se expresó como porcentaje del volumen de negocios de los productores de la Unión incluidos en la muestra durante el período de investigación de la reconsideración. Mostró una diferencia de precios de casi un 13 % en el caso de Rusia. Por consiguiente, la Comisión constató que los precios rusos subcotizarían los precios de la Unión a un nivel similar en el mercado de la Unión en el caso de que las medidas dejaran de tener efecto.
- (230) La misma comparación con China reveló que los precios de exportación desde China a terceros países no eran inferiores a los precios de la Unión. Sin embargo, un análisis más detallado mostró que estos precios seguían estando por debajo del precio indicativo de la Unión. Utilizando el mismo objetivo de beneficio que en la investigación original (9,9 %) <sup>(76)</sup>, se constató que las importaciones procedentes de China al nivel de los precios de exportación chinos a terceros países eran un 10 % inferiores al precio indicativo de la Unión. Por lo tanto, sería probable que las importaciones procedentes de China causaran un perjuicio si no se mantuvieran las medidas.

### 5.3. Conclusión

- (231) A partir de todo lo expuesto, la Comisión concluyó que la ausencia de medidas daría lugar, con toda probabilidad, a un aumento considerable de las importaciones objeto de dumping procedentes de China y de Rusia a precios perjudiciales, lo cual conduciría probablemente a la reaparición de un perjuicio importante.

## 6. INTERÉS DE LA UNIÓN

- (232) De conformidad con el artículo 21 del Reglamento de base, la Comisión examinó si el mantenimiento de las medidas antidumping en vigor sería claramente contrario al interés de la Unión en su conjunto. La determinación del interés de la Unión se basó en una estimación de los diversos intereses pertinentes, concretamente los de la industria de la Unión, los de los importadores y los de los usuarios.

### 6.1. Interés de la industria de la Unión

- (233) La industria de la Unión está situada en catorce Estados miembros (Bélgica, Alemania, Grecia, España, Italia, Luxemburgo, Hungría, Países Bajos, Austria, Portugal, Eslovenia, Eslovaquia, Finlandia y Suecia). Emplea a más de 9 000 trabajadores en relación con el producto objeto de reconsideración.
- (234) Aunque las medidas antidumping en vigor impidieron en gran medida que entrasen en el mercado de la Unión importaciones objeto de dumping procedentes de China y de Rusia, la industria de la Unión se encontraba en una situación económicamente frágil durante el período de investigación de la reconsideración, como confirman las tendencias negativas de los indicadores de perjuicio.
- (235) Sobre la base de lo anterior, la Comisión estableció que existe una gran probabilidad de reaparición del perjuicio originalmente causado por las importaciones procedentes de los países afectados en caso de que expiren las medidas. La afluencia de volúmenes sustanciales de importaciones objeto de dumping procedentes de Rusia y China empeoraría la situación económica de la industria de la Unión, ya de por sí muy frágil, y pondría en peligro su viabilidad.
- (236) Por lo tanto, la Comisión concluyó que el mantenimiento de las medidas antidumping contra Rusia y China redundaba en interés de la industria de la Unión.

### 6.2. Interés de los usuarios y los importadores no vinculados

- (237) La Comisión se puso en contacto con todos los usuarios e importadores no vinculados notorios. Ningún usuario ni ningún importador no vinculado se dieron a conocer ni cooperaron en la presente investigación mediante la presentación de las respuestas al cuestionario.

<sup>(75)</sup> Este precio se estableció sobre una base CIF, tal como se indica en la base de datos GTA (<https://www.gtis.com/gta/>), con los ajustes adecuados para tener en cuenta los costes posteriores a la importación.

<sup>(76)</sup> Reglamento de Ejecución (UE) 2016/1328, considerando 156.

- (238) Un importador no vinculado, Duferco SA, y un usuario, ATS SA, presentaron observaciones sobre el inicio de la investigación. Según Duferco SA, los precios del acero han aumentado de manera significativa, generando escasez en la cadena de suministro. El Gobierno ruso también señaló que los usuarios y consumidores de la Unión se ven afectados por un fuerte aumento de los precios de los productos planos de acero laminados en frío. ATS SA y los tres productores exportadores rusos hacen referencia a un incremento de precios en el primer semestre de 2021, que, según afirmaron, había perjudicado a los usuarios y consumidores de productos planos de acero laminados en frío. Además, las partes alegaron que las medidas de salvaguardia existentes sobre las importaciones de productos siderúrgicos constituyen un instrumento independiente de protección del comercio que contribuye al crecimiento de los precios y a un desequilibrio entre la oferta y la demanda <sup>(7)</sup>.
- (239) A este respecto, las medidas de salvaguardia tienen una lógica y un objetivo distintos de los de las medidas antidumping. Como se explica en el considerando 132 anterior, las medidas de salvaguardia no son suficientes para proteger el mercado de la Unión contra importaciones en cantidades significativas a precios objeto de dumping. Además, los datos facilitados por Duferco SA en apoyo de su declaración se remontan a abril y julio de 2021, y abarcan las tendencias observadas durante el período de investigación de la reconsideración. Como muestra el análisis expuesto en la sección 4.4.2, la utilización de la capacidad de la industria de la Unión solo fue del 68 % durante el mismo período, mientras que sus precios de venta se situaron en un nivel relativamente bajo. Esto indicaba que existía un amplio margen para aumentar la producción a precios competitivos.
- (240) Ni ATS SA ni los productores exportadores rusos aportaron pruebas que justificaran las afirmaciones realizadas en sus observaciones. Como se muestra en el análisis de la sección 4.4.3, los datos correspondientes al período de investigación de la reconsideración, que incluye el primer semestre del año 2021, no corroboraron las afirmaciones de ATS SA. De hecho, los precios de la industria de la Unión no eran anormalmente altos. Se situaban por debajo del coste unitario e incluso por debajo de los precios de exportación de algunos terceros países, incluido China, así como del precio indicativo de la industria de la Unión.
- (241) Dado que ninguna de las partes interesadas mencionadas en el considerando 238, ni ningún otro usuario o importador no vinculado facilitó una respuesta al cuestionario ni ninguna otra información aparte de las observaciones anteriormente mencionadas, la Comisión no disponía de suficiente información para concluir que la continuación de las medidas sería perjudicial para los intereses de los usuarios o de los importadores.

### 6.3. Conclusión sobre el interés de la Unión

- (242) Sobre la base de lo anterior, la Comisión concluyó que, desde el punto de vista del interés de la Unión, no había razones convincentes contra el mantenimiento de las medidas vigentes sobre las importaciones del producto objeto de reconsideración originario de Rusia y China.

## 7. SOLICITUDES DE SUSPENSIÓN O TERMINACIÓN DE MEDIDAS

- (243) Tres productores exportadores rusos y un usuario (ATS SA) alegaron que debían suspenderse las medidas actuales. Además, incluso antes del inicio de la investigación de reconsideración por expiración, un importador no vinculado establecido en el Reino Unido (Stemcor London Limited) también había presentado una alegación similar.
- (244) Los argumentos presentados por las distintas partes hacían referencia a un supuesto incremento elevado de los precios en la Unión desde finales de 2020, a la disminución de las importaciones de productos planos de acero laminados en frío procedentes de los países afectados y a un supuesto desequilibrio entre la oferta y la demanda. Las pruebas y los datos facilitados en apoyo de estos argumentos, aunque limitados, se referían casi exclusivamente a un período de tiempo cubierto por el período de investigación de la reconsideración. Ninguna de las partes había facilitado datos relativos al período posterior al período de investigación de la reconsideración ni datos de previsiones futuras para respaldar sus argumentos, excepto para los precios de venta de la Unión en el tercer trimestre de 2021 y la mención de una moderada tendencia a la baja a finales de 2021. Los tres productores exportadores rusos alegaron que «una previsión analítica de la evolución futura del mercado en el período 2022-2023 sería incierta y contemplaría un gran número de escenarios alternativos, incluso contradictorios. Incluso los indicadores económicos más complejos no pueden arrojar luz sobre la evolución futura». Por lo tanto, en esta fase es difícil extraer conclusiones a partir de lo anterior en lo que se refiere a la existencia de un cambio temporal en las condiciones del mercado.

<sup>(7)</sup> Reglamento de Ejecución (UE) 2022/978 de la Comisión, de 23 de junio de 2022, por el que se modifica el Reglamento de Ejecución (UE) 2019/159, que impone medidas de salvaguardia definitivas contra las importaciones de determinados productos siderúrgicos (DO L 167 de 24.6.2022, p. 58).

- (245) La Comisión recordó, en este sentido, que el artículo 14, apartado 4, del Reglamento de base prevé la posibilidad de que se suspendan las medidas antidumping por razones que redunden en interés de la Unión, debido a que las condiciones del mercado hayan experimentado un cambio temporal en grado tal que haya escasas posibilidades de que el perjuicio vuelva a producirse como consecuencia de la suspensión.
- (246) Por lo que se refiere al segundo elemento, y tal como se expone en las secciones sobre el perjuicio, la reaparición del perjuicio y el interés de la Unión (considerando 174 y siguientes), la Comisión señaló que la industria de la Unión seguía encontrándose en una situación frágil durante el período de investigación de la reconsideración y que, en cualquier caso, era muy probable que reapareciera un perjuicio importante originalmente causado por las importaciones objeto de dumping procedentes de China y de Rusia a precios perjudiciales si expiraran las medidas. Además, la Comisión no encontró razones imperiosas de interés para la Unión para no mantener las medidas. Por lo tanto, sobre la base de la información disponible en la presente investigación, la Comisión no pudo concluir en esta fase que fuera poco probable que el perjuicio se reanudara como consecuencia de una suspensión y que redundaría en interés de la Unión suspender las medidas con arreglo al artículo 14, apartado 4, del Reglamento de base. Por consiguiente, la Comisión rechazó la alegación. La Comisión se reservó el derecho de seguir examinando la necesidad de suspender las medidas de conformidad con el artículo 14, apartado 4, del Reglamento de base a su debido tiempo.
- (247) Además, el Grupo NLMK, el Grupo Severstal y el Grupo MMK alegaron que, dado que el suministro ruso de productos planos de acero laminados en frío a la Unión se había interrumpido totalmente mediante sanciones, no existía ninguna base jurídica para mantener las medidas como resultado de la reconsideración por expiración en curso o durante el período reglamentario de aplicación de las medidas. Los productores exportadores alegaron que la reorientación fundamental de los flujos comerciales provocada por esas sanciones era de carácter duradero. Según este argumento, las medidas no servirían para proteger a la industria y el mercado de la Unión de las prácticas comerciales desleales de los exportadores extranjeros y, por lo tanto, no serían necesarias con arreglo al artículo 11, apartado 1, del Reglamento de base.
- (248) La Comisión señaló que, tras el inicio de la investigación, debido a la agresión militar de la Federación de Rusia contra Ucrania, la Unión impuso sucesivos paquetes de sanciones contra Rusia que también afectaban a productos siderúrgicos o a las empresas siderúrgicas que producían y exportaban el producto objeto de reconsideración tras el período de investigación de la reconsideración. Sin embargo, contrariamente a lo que afirman los productores exportadores, la situación actual no puede considerarse de carácter duradero. En efecto, tal como se establece en los considerandos 167 y 172, la Comisión concluyó que esas sanciones no pueden influir en sus conclusiones en el marco de esta investigación. En particular, la Comisión constató que, a pesar de las sanciones actuales, seguían siendo necesarias medidas a tenor del artículo 11, apartados 1 y 2, del Reglamento de base.

## 8. MEDIDAS ANTIDUMPING

- (249) Sobre la base de las conclusiones alcanzadas por la Comisión acerca de la reaparición del dumping, la reaparición del perjuicio y el interés de la Unión, deben mantenerse las medidas antidumping sobre los productos planos de acero laminados en frío originarios de Rusia y China.
- (250) Se necesitan medidas especiales para garantizar la aplicación de los derechos antidumping individuales. Las empresas a las que se apliquen derechos antidumping individuales deben presentar una factura comercial válida a las autoridades aduaneras de los Estados miembros. Dicha factura debe ajustarse a los requisitos establecidos en el artículo 1, apartado 3, del presente Reglamento. Las importaciones que no vayan acompañadas de esa factura deben someterse al derecho antidumping aplicable a «todas las demás empresas».
- (251) Si bien es necesario presentar esta factura para que las autoridades aduaneras de los Estados miembros apliquen los tipos del derecho antidumping individuales a las importaciones, no es el único elemento que deben tener en cuenta dichas autoridades. De hecho, aunque se presente una factura que cumpla todos los requisitos establecidos en el artículo 1, apartado 3, del presente Reglamento, las autoridades aduaneras de los Estados miembros deben llevar a cabo las comprobaciones habituales y pueden, como en cualquier otro caso, exigir documentos adicionales (de transporte, etc.), con objeto de verificar la exactitud de los datos incluidos en la declaración y garantizar que la consiguiente aplicación del tipo menor del derecho esté justificada, de conformidad con el Derecho aduanero.

- (252) Si el volumen de exportación de una de las empresas que se benefician de los tipos de derecho individuales más bajos aumentara significativamente tras imponerse las medidas en cuestión, podría considerarse que ese aumento del volumen constituye en sí mismo un cambio en las características del comercio como consecuencia de la imposición de las medidas en el sentido del artículo 13, apartado 1, del Reglamento de base. En tales circunstancias, y si se dieran las condiciones, podría iniciarse una investigación antielusión. En esta investigación podría examinarse, entre otras cosas, la necesidad de retirar los tipos de derecho individuales con la consiguiente imposición de un derecho de ámbito nacional.
- (253) Los tipos del derecho antidumping individuales aplicables a cada empresa que se establecen en el presente Reglamento son aplicables exclusivamente a las importaciones del producto objeto de reconsideración procedentes de los países afectados y fabricado por las personas jurídicas mencionadas. Las importaciones del producto objeto de reconsideración producido por cualquier otra empresa no mencionada expresamente en la parte dispositiva del presente Reglamento, incluidas las entidades vinculadas a las mencionadas específicamente, deben estar sujetas al tipo del derecho aplicable a «todas las demás empresas». Dichas importaciones no deben estar sujetas a ninguno de los tipos del derecho antidumping individuales.
- (254) Una empresa puede solicitar la aplicación de estos tipos individuales del derecho antidumping si posteriormente cambia el nombre de su entidad. La solicitud debe remitirse a la Comisión <sup>(78)</sup>, y debe incluir toda la información pertinente necesaria para demostrar que el cambio no afecta al derecho de la empresa a beneficiarse del tipo del derecho que se le aplica. Si el cambio de nombre de la empresa no afecta a su derecho a beneficiarse del tipo de derecho que se le aplica, se publicará un reglamento sobre el cambio de nombre en el *Diario Oficial de la Unión Europea*.
- (255) Con arreglo al artículo 109 del Reglamento (UE, Euratom) 2018/1046 del Parlamento Europeo y del Consejo <sup>(79)</sup>, cuando deba reembolsarse un importe a raíz de una sentencia del Tribunal de Justicia de la Unión Europea, el tipo de interés será el aplicado por el Banco Central Europeo a sus operaciones principales de refinanciación, publicado el primer día natural de cada mes en la serie C del *Diario Oficial de la Unión Europea*.
- (256) Mediante su Reglamento de Ejecución (UE) 2019/159 <sup>(80)</sup>, la Comisión impuso una medida de salvaguardia con respecto a determinados productos siderúrgicos durante un período de tres años. La medida se prorrogó hasta el 30 de junio de 2024 mediante el Reglamento de Ejecución (UE) 2021/1029. El producto objeto de reconsideración es una de las categorías de productos incluidas en la medida de salvaguardia. En consecuencia, una vez que se superen los contingentes arancelarios establecidos en virtud de la medida de salvaguardia, tanto el arancel por encima del contingente como el derecho antidumping serían pagaderos sobre las mismas importaciones. Puesto que esta acumulación de medidas antidumping con las medidas de salvaguardia puede tener un efecto sobre el comercio mayor de lo deseado, la Comisión decidió evitar la aplicación simultánea del derecho antidumping con el arancel por encima del contingente en el caso del producto objeto de reconsideración mientras dure la imposición de la medida de salvaguardia.
- (257) Esto significa que, en caso de que el arancel por encima del contingente mencionado en el artículo 1, apartado 6, del Reglamento (UE) 2019/159 pase a ser aplicable al producto objeto de reconsideración y supere el nivel de los derechos antidumping con arreglo al presente Reglamento, solo se percibirá el arancel por encima del contingente mencionado en el artículo 1, apartado 6, del Reglamento (UE) 2019/159. Durante el período de aplicación simultánea de la salvaguardia y de derechos antidumping, la percepción de los derechos impuestos con arreglo al presente Reglamento quedará suspendida. Cuando el arancel por encima del contingente contemplado en el artículo 1, apartado 6, del Reglamento (UE) 2019/159 pase a ser aplicable al producto objeto de reconsideración y se haya fijado en un nivel inferior al nivel de los derechos antidumping con arreglo al presente Reglamento, el arancel por encima del contingente mencionado en el artículo 1, apartado 6, del Reglamento (UE) 2019/159 se percibirá además de la diferencia entre dicho derecho y los derechos antidumping más altos impuestos en virtud del presente Reglamento. Se suspenderá la parte del importe de los derechos antidumping no percibida.

<sup>(78)</sup> Comisión Europea, Dirección General de Comercio, Dirección G, Rue de la Loi 170, 1040 Bruselas (Bélgica).

<sup>(79)</sup> Reglamento (UE, Euratom) 2018/1046 del Parlamento Europeo y del Consejo, de 18 de julio de 2018, sobre las normas financieras aplicables al presupuesto general de la Unión, por el que se modifican los Reglamentos (UE) n.º 1296/2013, (UE) n.º 1301/2013, (UE) n.º 1303/2013, (UE) n.º 1304/2013, (UE) n.º 1309/2013, (UE) n.º 1316/2013, (UE) n.º 223/2014 y (UE) n.º 283/2014 y la Decisión n.º 541/2014/UE y por el que se deroga el Reglamento (UE, Euratom) n.º 966/2012 (DO L 193 de 30.7.2018, p. 1).

<sup>(80)</sup> Reglamento de Ejecución (UE) 2019/159 de la Comisión, de 31 de enero de 2019, que impone medidas de salvaguardia definitivas contra las importaciones de determinados productos siderúrgicos (DO L 31 de 1.2.2019, p. 27).

(258) Las medidas previstas en el presente Reglamento se ajustan al dictamen del Comité creado en virtud del artículo 15, apartado 1, del Reglamento (UE) 2016/1036.

HA ADOPTADO EL PRESENTE REGLAMENTO:

#### Artículo 1

1. Se establece un derecho antidumping definitivo sobre las importaciones de productos laminados planos de hierro o acero sin alear, o de otro tipo de acero aleado, excepto de acero inoxidable, de cualquier anchura, sin chapar ni revestir, simplemente laminados en frío (reducidos en frío), clasificados actualmente en los códigos NC ex 7209 15 00 (código TARIC 7209 15 00 90), 7209 16 90, 7209 17 90, 7209 18 91, ex 7209 18 99 (código TARIC 7209 18 99 90), ex 7209 25 00 (código TARIC 7209 25 00 90), 7209 26 90, 7209 27 90, 7209 28 90, 7211 23 30, ex 7211 23 80 (códigos TARIC 7211 23 80 19, 7211 23 80 95 y 7211 23 80 99), ex 7211 29 00 (códigos TARIC 7211 29 00 19 y 7211 29 00 99), 7225 50 80 y 7226 92 00, y originarios de la República Popular China y de la Federación de Rusia.

Están excluidos de la definición del producto afectado los siguientes tipos de productos:

- los productos eléctricos planos de hierro o de acero sin alear, de cualquier anchura, sin chapar ni revestir, simplemente laminados en frío (reducidos en frío), enrollados o sin enrollar, de cualquier espesor,
- los productos recocidos (denominados «chapa negra») planos de hierro o de acero sin alear, de cualquier anchura, laminados en frío (reducidos en frío), sin chapar ni revestir, enrollados, de un espesor inferior a 0,35 mm,
- los productos laminados planos de los demás aceros aleados, de cualquier anchura, de acero magnético al silicio, y
- los productos laminados planos de acero aleado, simplemente laminados en frío (reducidos en frío), de acero rápido.

2. Los tipos del derecho antidumping definitivo aplicables al precio neto franco en la frontera de la Unión, antes del pago de derechos, del producto descrito en el apartado 1 y producido por las empresas indicadas a continuación serán los siguientes:

País	Empresa	Derecho antidumping (%)	Código adicional TARIC
República Popular China	Angang Steel Company Limited, Anshan	19,7	C097
	Tianjin Angang Tiantie Cold Rolled Sheets Co. Ltd, Tianjin	19,7	C098
	Otras empresas que cooperaron enumeradas en el anexo	20,5	
	Todas las demás empresas	22,1	C999
Rusia	Magnitogorsk Iron & Steel Works OJSC, Magnitogorsk	18,7	C099
	PAO Severstal, Cherepovets	34	C100
	Todas las demás empresas	36,1	C999

3. La aplicación de los tipos del derecho individuales especificados para las empresas mencionadas en el apartado 2 estará condicionada a la presentación a las autoridades aduaneras de los Estados miembros de una factura comercial válida en la que figure una declaración fechada y firmada por un responsable de la entidad que expida dicha factura, identificado por su nombre y cargo, con el texto siguiente: «El abajo firmante certifica que (volumen) de (producto objeto de



reconsideración) vendido para su exportación a la Unión Europea consignado en esta factura han sido fabricados por (nombre y dirección de la empresa) (código adicional TARIC) en (país afectado). Declara, asimismo, que la información que figura en la presente factura es completa y correcta». En caso de que no se presente esta factura, será aplicable el derecho calculado para todas las demás empresas.

4. El artículo 1, apartado 2, podrá ser modificado para añadir nuevos productores exportadores de la República Popular China, quedando estos, así, sujetos al tipo de derecho antidumping medio ponderado apropiado aplicable a las empresas cooperantes no incluidas en la muestra. Cualquier productor exportador nuevo deberá demostrar que:

- a) no exportó las mercancías descritas en el artículo 1, apartado 1, originarias de la República Popular China durante el período comprendido entre el 1 de abril de 2014 y el 31 de marzo de 2015 (el período de investigación original);
- b) no está vinculado a ningún exportador o productor sujeto a las medidas establecidas en el presente Reglamento, y
- c) realmente ha exportado el producto objeto de reconsideración o ha contraído una obligación contractual irrevocable de exportar una cantidad significativa a la Unión una vez concluido el período de investigación original.

5. Salvo que se disponga lo contrario, se aplicarán las disposiciones vigentes en materia de derechos de aduana.

#### Artículo 2

1. En caso de que el arancel por encima del contingente mencionado en el artículo 1, apartado 6, del Reglamento de Ejecución (UE) 2019/159 pase a ser aplicable a los productos laminados planos de hierro o acero sin alear, o de otro tipo de acero aleado, excepto de acero inoxidable, de cualquier anchura, sin chapar ni revestir, simplemente laminados en frío (reducidos en frío), y supere el nivel del derecho antidumping establecido en el artículo 1, apartado 2, solo se percibirá el arancel por encima del contingente mencionado en el artículo 1, apartado 6, del Reglamento de Ejecución (UE) 2019/159.

2. Durante el período de aplicación del apartado 1, la percepción de los derechos impuestos con arreglo al presente Reglamento quedará suspendida.

3. En caso de que el arancel por encima del contingente mencionado en el artículo 1, apartado 6, del Reglamento de Ejecución(UE) 2019/159 pase a ser aplicable a los productos laminados planos de hierro o acero sin alear, o de otro tipo de acero aleado, excepto de acero inoxidable, de cualquier anchura, sin chapar ni revestir, simplemente laminados en frío (reducidos en frío), y se fije a un nivel inferior al derecho antidumping establecido en el artículo 1, apartado 2, se percibirá el derecho por encima del contingente mencionado en el artículo 1, apartado 6, del Reglamento de Ejecución(UE) 2019/159, además de la diferencia entre dicho derecho y el derecho antidumping más elevado establecido en el artículo 1, apartado 2.

4. Se suspenderá la parte del importe del derecho antidumping no percibida de conformidad con el apartado 3.

5. Las suspensiones a las que se hace referencia en los apartados 2 y 4 estarán limitadas temporalmente al período de aplicación del arancel por encima del contingente mencionado en el artículo 1, apartado 6, del Reglamento (UE) 2019/159.

#### Artículo 3

El presente Reglamento entrará en vigor el día siguiente al de su publicación en el *Diario Oficial de la Unión Europea*.

El presente Reglamento será obligatorio en todos sus elementos y directamente aplicable en cada Estado miembro.

Hecho en Bruselas, el 26 de octubre de 2022.

*Por la Comisión*  
*La Presidenta*  
Ursula VON DER LEYEN

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## ANEXO

Productores exportadores chinos que cooperaron no incluidos en la muestra:

País	Nombre	Código adicional TARIC
República Popular China	Hesteel Co., Ltd Tangshan Branch, Tangshan	C103
República Popular China	Handan Iron & Steel Group Han-Bao Co., Ltd, Handan	C104
República Popular China	Baoshan Iron & Steel Co., Ltd, Shanghai	C105
República Popular China	Shanghai Meishan Iron & Steel Co., Ltd, Nanjing	C106
República Popular China	BX Steel POSCO Cold Rolled Sheet Co., Ltd, Benxi	C107
República Popular China	Bengang Steel Plates Co., Ltd, Benxi	C108
República Popular China	WISCO International Economic & Trading Co. Ltd, Wuhan	C109
República Popular China	Maanshan Iron & Steel Co., Ltd, Maanshan	C110
República Popular China	Tianjin Rolling-one Steel Co., Ltd, Tianjin	C111
República Popular China	Zhangjiagang Yangtze River Cold Rolled Sheet Co., Ltd, Zhangjiagang	C112
República Popular China	Inner Mongolia Baotou Steel Union Co., Ltd, Baotou City	C113

## LEYES, REGLAMENTOS, DECRETOS Y RESOLUCIONES DE ORDEN GENERAL

Núm. 43.721

Sábado 9 de Diciembre de 2023

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## Normas Generales

CVE 2418529

## COMISIÓN DE DISTORSIONES

COMISIÓN NACIONAL ENCARGADA DE INVESTIGAR LA EXISTENCIA DE  
DISTORSIONES EN EL PRECIO DE LAS MERCADERÍAS IMPORTADAS

La Comisión, en su Sesión N° 436, celebrada el 28 de noviembre de 2023, en virtud de lo previsto en el artículo 9 de la Ley N° 18.525 y el artículo 5 del Acuerdo relativo a la aplicación del Artículo VI del Acuerdo General sobre Aranceles Aduaneros y Comercio de 1994 (Decreto N° 16/95 del Ministerio de Relaciones Exteriores, publicado en el Diario Oficial del 17.05.95), resolvió iniciar de oficio una investigación por eventual dumping en los precios de importación de barras de acero para la fabricación de bolas para molienda convencional de diámetro inferior a 4 pulgadas. A su vez, en virtud de lo previsto en el artículo 9 de la Ley N° 18.525 y el artículo 5 del Acuerdo relativo a la aplicación del Artículo VI del Acuerdo General sobre Aranceles Aduaneros y Comercio de 1994 (Decreto N° 16/95 del Ministerio de Relaciones Exteriores, publicado en el Diario Oficial del 17.05.95), resolvió iniciar una investigación por eventual dumping en los precios de importación de bolas para molienda convencional de diámetro inferior a 4 pulgadas en virtud de la solicitud presentada por Moly Cop.

**Extracto de los Antecedentes relativos a la investigación por eventual dumping en los precios de importación de barras de acero para la fabricación de bolas para molienda convencional de diámetro inferior a 4 pulgadas**

- Fecha de inicio de la investigación: Fecha de publicación del presente aviso.
- Producto investigado: Barras de acero para fabricación de bolas para molienda convencional de diámetro inferior a 4 pulgadas, clasificadas en el código arancelario 7228.3000 del Sistema Armonizado Chileno.
- País de origen: República Popular China.
- Base de la alegación del dumping denunciado: Dado que el alambro y las barras de acero comparten una similar estructura de costos, se considera como indicio de dumping que los precios de exportación del alambro de acero de origen chino sean menores a los precios de exportación de alambro de acero de origen en Turquía y Latinoamérica. Índice de precios CRUspi Longs mayor al índice de precios CRUspi Asia (influenciado mayormente por el acero de origen chino).
- Factores en que se basan el daño y la amenaza de daño a la rama de la producción nacional: Caída en los precios de venta nacional, caída en la producción nacional, caída en el margen operacional, caída en las ventas del producto nacional en el mercado doméstico.

**Extracto de los Antecedentes relativos a la investigación por eventual dumping en los precios de importación de bolas para molienda convencional de diámetro inferior a 4 pulgadas**

- Fecha de inicio de la investigación: Fecha de publicación del presente aviso.
- Producto denunciado: Bolas para molienda convencional de diámetro inferior a 4 pulgadas, clasificadas en el código arancelario 7326.1111 del Sistema Armonizado Chileno.
- País de origen: República Popular China.
- Base de la alegación del dumping denunciado: Precio de exportación EXW reconstruido en base a precios CIF registrados por el Servicio Nacional de Aduanas, descontados los costos de puesta en el puerto, fobbing, transporte marítimo y seguro, sería menor que el valor normal EXW reconstruido en base a datos aportados en la denuncia.
- Factores en que se basan el daño y la amenaza de daño a la rama de la producción nacional: caída en producción; caída en los precios, disminución de las ventas; caída de la

producción, caída de la capacidad instalada, cierre de dos productores nacionales, caída en la utilización de la capacidad instalada, disminución de las ventas nacionales como porcentaje del consumo aparente.

Los antecedentes que las partes interesadas quisieran presentar por escrito, las solicitudes y, en general, cualquier información acerca de la marcha de las investigaciones, serán recibidos en la Secretaría Técnica, Agustinas N° 1180, Banco Central de Chile, Teléfono 2670 2564, correo electrónico [sectec@bcentral.cl](mailto:sectec@bcentral.cl). Si dentro de la información proporcionada existen antecedentes de carácter confidencial, deberán darse las razones que justifiquen la reserva de los mismos y, además, suministrarse simultáneamente un resumen público de ellos, lo más detallado posible. El fundamento de este requerimiento es garantizar la transparencia y el debido acceso de todas las partes a la información relativa a estas investigaciones. Si los resúmenes no son entregados oportunamente y no existe una causa justificada, la Comisión podrá prescindir de la información calificada como confidencial.- La Comisión.

