The WTO Violations in China's New Automobile Policy As it Seeks to Protect its Domestic Conglomerates Through Non-Market Means

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I. Introduction

On June 1, 2004, China's National Development and Reform Commission (NDRC), after ratification by the State Council, announced the "Development Policy of the Automobile Industry" ("NAP")[2] that would direct the future of China's automobile sector.[3] The NAP replaces the "Industrial Policy for the Automotive Sector" ("1994 Policy") in effect since 1994.[4] Following the NAP, other agencies promulgated laws to implement the NAP, including the: Automobile Trade Policy, Measures for Supervising the Sale of Brand Name Automobiles (still in draft version), and the Marketing Management Measures on Automobile Brand Names (scheduled to begin implementation on Jan. 1, 2005, but has not been enacted yet). In China's WTO Protocol of Accession ("Protocol") containing its general commitments, China committed to amending the 1994 Policy, to ensure compliance with WTO rules and principles.[5]

In this paper I will show that NAP does not conform to China's WTO commitments. Instead of promoting free market competition, the NAP aims to reorganize domestic dealerships into a few conglomerates in order to develop China's own brand of cars. The NAP and its implementing regulations achieve this goal by protecting the big three "state-related" Chinese automobile conglomerates at the expense of foreign automobile manufacturers and the mid to

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[3] People's Republic of China, *hereinafter* PRC, QICHE CHANYE FAZHAN ZHENGCE [POLICY ON THE DEVELOPMENT OF THE AUTOMOBILE INDUSTRY] adopted by the State Council on June 1, 2004, *available at* http://www.sdpc.gov.cn/, *hereinafter* NAP.

[4] PRC QICHE GONGYE CHANYE ZHENGCE [POLICY ON THE AUTOMOBILE INDUSTRY], adopted by the State Council in 1994, *available at* http://business.sohu.com/2004/06/02/31/article220353167.shtml, *hereinafter* 1994 Policy.

[5] GATT, *Working Party on the Accession of China*, WT/MIN(01)/3, at 41 (Nov. 10, 2001), *hereinafter* Report.

small-size domestic dealer. I call these three conglomerates "state-related" rather than state-owned because the state has ownership in these companies but the extent of the state's control is unclear. The NAP discriminates against foreign automobile manufacturers and small to mid-sized domestic private dealers by treating the big three state-related domestic car producers better.

Someone pointed out that foreign investors have obtained a "super-national treatment" in China above domestic private dealers.[6] But the government gives "extra-super national treatment" to protect its three state-related conglomerates against the big foreign manufacturers. China has opened up to the deep-pocketed foreigners just enough to benefit its conglomerates but has closed the door to smaller dealers, both foreign and domestic. China treats its own people discriminatorily because the government perceives domestic private investment as "irresponsible investment."[7] Large amounts of private capital flowed into the auto industry starting in 2003 because of the NAP.[8] Private investors knew that the new policy would close the door on new investors so wanted to get in before this happened.[9]

This paper addresses subsidy programs, intellectual property rights protection, investment, importation, and distribution of entire new passenger cars.[10] With each issue, I will discuss

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[6] Jia Xinguang, *Qiche Ye: Minqi "Weicheng"* [*Automobile Industry: Private Enterprises "Besiege City"*] ZHONGGUO GONGSHANG [CHINA BUSINESS], vol 221, May 2004, at 68.

[7] *Id*. at 69.

[8] *Id*. at 65.

[9] *Id*. at 66.

[10] I narrowed this paper so that it is not about: auto parts, financing, used cars, consumer protection, commercial vehicles.

China's WTO commitments, the new Chinese laws passed that relate to the issue, and whether those laws comply with China's WTO commitments. I will draw mainly on Chinese-language sources as well as English-language sources, which will allow me to mediate the culture gap between China and the world.

II. China's Automobile Industry

A. Background

China's automobile industry has grown in three phases. From 1956 to 1980, China manufactured its first car and there appeared a couple of automobile manufacturing plants. From 1981 to 1991, the automobile industry opened its doors to foreigners inviting in technology and capital to produce more and better cars. The state-related manufacturers Jiefang, Yaojing, and Huanghe upgraded its cars. In 1994, the "Automobile Manufacturing Industry Policy" was passed which: established the three major car manufacturers: First Automotive Works Corp. (FAW), Dongfeng Motor Corp. (Dongfeng), Shanghai Automotive Industry Corp. (SAIC).[11]

The automobile industry in China has grown rapidly since China entered the World Trade Organization (WTO). China currently has more than 120 entire automobile manufacturers.[12] At the moment, China's auto industry is dominated by fewer than a dozen domestic and foreign firms.[13] The Big Three Chinese, state-related auto conglomerates--First Auto Works (FAW),

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[11] 1994 Policy, *supra* note 4.

[12] Guo Kaisen, *Chanye Guancha: Kanbujian De Shou Yu Kandejian De Zhengce* [*Industry Observation: The Invisible Hand and the Visible Policy*], IT JING LI SHIJIE [WORLD OF IT ECONOMIC THEORY], June 22, 2004, available at: http://www.hailang.org/enews/changye/auto/200406/6932.html (last visited Jan. 13, 2005).

[13] Andrew Yeh & Toshio Aritake, *China Issues New Rules for Auto Makers, Aims at Cosolidations, Assists Foreign Firms* 21 INT'L TRADE REP. (BNA) 980 (June 10, 2004).

Shanghai Auto Industry Corporation (SAIC) and Dongfeng Motors--has captured 47 percent of the total market in 2001.[14] "Germany's Volkswagen AG and General Motors Co. together command about half of the domestic market. "[15] As of April 2004, imported cars constitute 3.6% of the Chinese automobile market.[16] These cars are primarily imported from Germany (35.53%), Japan (28.31%), and Korea (25.75%).[17] Analysts predict that in the next three years, multinational automobile companies will invest more than $10,000,000,000US in China.[18]

A draft version of the NAP had been circulating since Dec. 2002. The NDRC received comments from: other relevant agencies, automobile industry representatives from tens of companies (including Sino-joint ventures), local development and reform commissions, other affected industries (i.e. oil), and experts. In the end, the Chinese government had to make choices between competing interests: Chinese and foreigners, central and local governments, state-owned and private enterprises, within and outside the industry. The Chinese government's

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[14] DOING BUSINESS WITH CHINA, *supra* note 3.

[15] Yeh, *supra* note 13.

[16] Yu Wang, *Qiche Maoyi Zhengce He Qiche Pinpgai Guanli Banfa Zheng Zai Zhiding* [*The Automobile Trade Policy and Automobile Brand Management Measures is Currently Being Formed*] ZHONGGUO QICHE BAO [CHINA AUTOMOBILE NEWSPAPER] 14 (June 15, 2004), *available at* http://www.anews.cn/anews/list.asp?id=18007 (last visited Nov. 10, 2004).

[17] *2004 Nian Shang Ban Nian Jiaoche Jingkou Yungxing Taishi Fenxi* [*Analysis of the Trend of Passenger Cars Imported in the First Half of 2004*] ZHONGGUO QICHE BAO [CHINA AUTOMOBILE NEWSPAPER] 36 (Aug. 31, 2004), *available at* http://www.anews.cn/anews/list.asp?id=20858 (last visited Nov. 10, 2004).

[18] *Qiche Xin Zheng Chutai Anzhan Gei Waizi Yi Guomin Teyu* [*Behind-the-Scene Battle Over the Appearance of the NAP Gives Foreign Investors National Treatment*] CAIJING SHIBAO [FORTUNE AND ECONOMIC TIMES], June, 22, 2004, *available at*: http://info.auto.hc360.com/html/001/003/001/162291.htm (last visited Jan. 17, 2005).

choices reflect in the final version of the policy and in a plethora of implementing regulations promulgated by various agencies.

B. "State-Related" Conglomerates

The current layout of the domestic automobile manufacturing industry is "3+6": the three conglomerates— FAW, Dongfeng, and SAIC—and the six major enterprises—Guangzhou Honda, Chongqing Changan Automotive, Anhui Chery, Brilliance Automotive, Nanjing City's Fiat, and Zhejiang Province's Geely.[19] In addition, there a few second-tier companies: Shenzhen BYD [Bi Ya Di], Zhong Da Group, Xiang Torch, Shanghai's Bao Feng, Guangzhou City's Bao Long, Guizhou City's New Century Automobile Investment Company, and Hua Xiang Group.[20]

C. Domestic Private Manufacturers

The Chinese government has always monopolized the auto industry and has always been against private capital entering the industry. For example, when the founder of Geely attempted to obtain a permit to manufacture its own brand of cars, he was told by an official: "Automobiles are a capital-intensive, technology-intensive industry. Private companies can't do it."[21]

Unlike most of the second-tier companies, which are privately-owned, most of the

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[19] He Qigang, *Woguo Qiche Chanye Nei Bingkou Chongzu Qushi Ji Qi Falu Zhidu Zhangai Fenxi* [*Analysis of The Trend and Legal Obstacles to Merging and Restructuring Within China's Automobile Industry*] (2003)，*available at*: http://article.chinalawinfo.com/article/user/article_display.asp?ArticleID=23978 .

[20] Jia, *supra* note 6 at 67.

[21] Lu Feng, et. al., *Jingcai Huigu: Zao Zhongguo Ziji De Qiche* [*Special Reflection: Building China's Own Cars*] SHANGWU ZHOUKAN [BUSINESS AFFAIRS WEEKLY], Nov. 16, 2004, *available at*: http://business.sohu.com/20041116/n223021343.shtml

first-tier companies are state-related.[22] For example, "Chery is owned by the Anhui provincial government and has access to plenty of investment cash, including, it says, from Beijing."[23] Brilliance Automotive is owned by the Liaoning provincial government.[24] The CEO of Brilliance Automotive is Baoshan Yang, the former assistant to the Governor of Liaoning province and the current Liaoning representative to the [liaoningsheng zhengxie changwei].[25] Qinchuan Flyer is ultimately an offshoot of NORINCO, the commercial arm of the People's Liberation Army."[26] Only Geely is a first-tier company that is privately-owned.[27] The brothers Li, who own Geely, had made fortunes from the construction and motorcycle industries.[28]

D. Foreign Manufacturers

In contrast to the "3+6" layout of the domestic automobile market, the current layout of the foreign automobile manufacturing industry is "6+3": six foreign conglomaterates—General Motors, Daike, Ford, Toyota, Volkswagon, Leinuo [transcribed]—and the three big automobile

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[22] Unclear if owned by the state but at least has government relations.

[23] 1/31/05 Economist Intelligence Unit - Bus. China 1
2005 WL 63069594, "Let's go global".

[24] He Yuxin, *Automaker Brilliance in Showdown with Executives Over Stock Options*, CAIJING, available at: http://www.caijing.com.cn/english/2004/040920/040920huachen.htm (last visited Jan. 10, 2005).

[25] Ge Wen, *Xin Huachen De Hou Yangrong Shidai* [New Huacheng's Post-Yangrong Era] FALU YU SHENGHUO [LAW & LIFE], vol. 259, April 1, 2004, 50.

[26] *Id*.

[27] Lu Feng, et. al., *Jingcai Huigu: Zao Zhongguo Ziji De Qiche* [*Special Reflection: Building China's Own Cars*] SHANGWU ZHOUKAN [BUSINESS AFFAIRS WEEKLY], Nov. 16, 2004, *available at*: http://business.sohu.com/20041116/n223021343.shtml

[28] *Id*.

enterprises—Honda, BMW, and Xuetielong [transcribed]. [29] China hopes to mirror these foreigners' success by mimicking their structure.

[29] Jia, *supra* note 6, at 67.

III. NAP Violates China's WTO Agreement

The NAP can be broken down into the following categories: investment, export subsidies, importing, distribution, local requirements, and intellectual property (IP) protection. I will describe what the NAP provisions are regarding each topic and discuss how those provisions contradict China's commitments to the WTO.

A. Investment

Although the government has eliminated the foreign currency balance and local production-related requirements on investment,[30] the government has replaced these WTO-prohibited requirements with others designed to force production and development to occur domestically.

1. Conditions on Investing

China's Protocol containing its general commitments provides that: "China shall ensure that…the right of…investment…is not conditioned on:…performance requirements of any kind, such as local content, offsets, the transfer of technology, export performance or the conduct of research and development (R&D) in China."[31] During WTO negotiations, the Chinese representative added that: "Amendments would be made to ensure that all measures applicable to motor vehicle producers restricting the categories, types or models of vehicle permitted for production, would gradually be lifted. Such measures would be completely removed two years after accession, thus ensuring that motor vehicle producers would be free to choose the categories,

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[30] Guo, *supra* note 12.

[31] WTO, PROTOCOL ON THE ACCESSION OF THE PEOPLE'S REPUBLIC OF CHINA, Nov. 23, 2001, at 5, *hereinafter* Protocol.

types and models they produced."[32]

However, China has placed conditions on investing including: performance requirements, research and development in China requirement, and restriction on the type of cars produced. Article 47, No. 5 of the NAP requires: "New manufacturers of automobiles must…establish research and development facilities…"[33] Article 47 No. 6 of the NAP imposes the following performance requirement: "New car plants must have a minimum annual output of 50,000 units for four-cylinder cars and 30,000 units for six-cylinder cars."[34] Article 47 No. 4 of the NAP restricts the type of cars produced by requiring: "Automobile manufacturers that want to enter new product lines must have a record of batch-sized automobile production, have accumulated more than 1 billion RMB (1,000,000,000) of after tax profit in the last 3 years (have tax documentation), have assets and liabilities ratio of within 50%, and AAA level of bank credit."[35]

China's conditioning of the right of investment on the number of cars produced, the establishment of research facilities in China, and the type of car produced, explicitly contravenes their commitment not to do so. The requirement on a minimum amount of output from new car factories is a performance requirement on investment. The requirement that new car factories establish R&D facilities also acts as a performance requirement on investment. The conditions for entering into new product lines prevent the manufacturer from investing in new product lines.

China protects its domestic manufacturers against foreign manufacturers with the

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[32] Report, *supra* note 5, paragraph 205.

[33] NAP, *supra* note 3.

[34] *Id*.

[35] *Id*.

performance requirement because it forces foreign manufacturers to produce at least 50,000 four-cylinder cars and 30,000 six-cylinder cars in China. Most foreign manufactures would rather produce all their car parts elsewhere, and then ship them to China for assembly.[36] Instead of importing their inventory into China, foreign manufacturers will now need to produce at least a portion of the cars they sell in China. Foreign manufacturers will now need to use their factories in China to produce cars rather than just for assembly.

China protects its domestic manufacturers against foreign manufacturers with the R&D requirement because it forces the transfer of technology to China. Similar to producing cars outside of China, foreign producers conduct R&D abroad to protect their trade secrets. The requirement to setup R&D facilities in China forces foreign manufacturers to transfer their knowledge to China, which better enables China to nationalize their cars. Many manufacturers may just establish one superficially because of the lack of utility of such a facility.[37]

Although the conditions for entering into new product lines do not necessarily protect Chinese manufacturers against foreign manufacturers, it still directly contradicts China's promises to the WTO member countries.

2. Non-national Treatment in Ownership Limitation

Unlike manufacturers of motor vehicle engines, which China committed, "to remove the 50 percent foreign equity limit for joint-ventures upon accession,"[38] there was no mention of

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[36] U.S.-China Economic and Security Review Commission, Hearing on China's Impact on the U.S. Manufacturing Base, 108th Congress, 26-27 (Jan. 30, 2004).

[37] *Minqi Jinru Qiche Lingyu Tujing Bei "Xin Zheng" Yi Yi Dusi* [*Private Enterprises' Methods of Entry Into the Automobile Sector Are Being Closed Off By the "New Policy"*] SHIDAI SHANGBAO [TIMES BUSINESS PAPER], June 4, 2004, *available at*: http://news.chinacars.com/newsfiles/200406/87091.htm (last visited Jan. 23, 2005).

removing the ownership limitation on joint ventures for the production of entire automobiles. However, one of the two basic tenets of the General Agreement on Tariffs and Trade (GATT) is the national treatment clause. The national treatment clause mandates WTO members treat foreign individuals and foreign-funded enterprises no less favorably than Chinese individuals and enterprises.[39] Thus under GATT, China must treat foreign manufacturers no less favorably than domestic manufacturers.

Nevertheless, Article 48 of the NAP prohibits “the Chinese partner’s stock percentage to fall below 50% in a Sino-joint venture for the production of entire cars, specific-purpose cars, agriculturally-used transport cars, and motorcycles. [40] Article 48 of the NAP provides that: “One foreigner may establish no more than two joint ventures for the production of the same type of automobiles.[41] This restriction does not apply to acquisitions by the Sino-joint venture.[42]

The NAP clearly discriminates against foreign manufacturers because they impose restrictions on them that are not imposed on domestic producers. The Chinese partner may own more than half of the Sino-joint venture but the foreigner may not. Chinese producers may establish more than two joint ventures to produce the same type of automobile but foreign producers may not.

China clearly protects its domestic manufacturers against foreign manufacturers by

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[38] Report, *supra* note 5, at 41.

[39] GATT, *supra* note 5, article III.

[40] NAP, *supra* note 3.

[41] *Id*.

[42] *Id*.

prohibiting the foreign partner of a Sino-joint venture from achieving majority ownership. Most foreign investment in China's automobile industry has taken the form of joint ventures.[43] This limitation shows that China fears the takeover of its car plants by foreigners. Nevertheless foreign manufacturers may still escape this limitation by forming Sino-sino-joint ventures in which two separate Chinese companies each own 25% of the company, but the foreign company owns 50%, and thus the majority share.

China protects its domestic manufacturers against foreign manufacturers by permitting domestic producers to form as many joint ventures as they want, which enables them to better compete against foreign manufacturers that may only sell one or two types of cars.[44] Multinational corporations would prefer to choose two or more partners because they want to obtain more political resources, attack more markets, and reduce the risks of just relying on one or two partners.[45] But because most of the multinational corporations have already entered China and have signed partnership contracts with the three major state-related enterprises, the new limitation of foreigners to two joint ventures precludes them from entering into any additional joint ventures or buying any domestic producers. Also, this limitation prevents a foreign manufacturer from partnering with all three of the Chinese conglomerates and eventually controlling them. For example, Volkswagon has already partnered with FAW and SAIC, and thus

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43 Wen Zhao, *supra* note 41.

44 Xu Ke, *Kuaguo Qi Chang: Yi Tao Banzi Guanyong Hai Shi Liang Tao Banzi Heshuan* [*Multinational Automobile Manufacturers: One Organization Useful or Two Organizations Worthwhile*], SOHU ONLINE, Jan. 27, 2005, *available at*: http://auto.sohu.com/20050127/n224120562.shtml (last visited Jan. 30, 2005).

45 *Id*.

will not be able to partner up with Dongfeng.

China's major automobile companies have already formed multiple joint ventures with foreign automobile manufactures and will be able to continue to form more. Below is a table of current joint ventures:[46]

	FAW Group	Guangqi	Dongfeng	Shanghai	Beiqi	Changan	Brilliance Automotive
GM				X			
Toyota	X	X					
Honda		X	X				
Benz					X		
Nissan			X				
Leinuo			X				
VW	X			X			
Ford						X	
Mazda	X						
Xuetielong			X				
BMW							X
Xiandai Qiya			X		X		

[46] *Id.*

3. Shift in Investment Approval Procedure

For the expediency and efficiency of foreigners to obtain investment approvals, China agreed to "raise the limit within which investments in motor vehicle manufacturing could be approved at the provincial government level only, from the current level of US$30 million, to US$60 million one year after accession, US$90 million two years after accession, and US$150 million four years after accession."[47]

However, instead of complying with its WTO commitment, China has changed its investment approval procedure completely by shifting from approval based on the amount invested to approval based on the type of cars produced. The new approval procedure for investments provides two methods for approval: (1) filing and (2) examining and approving.[48] The method applied depends upon the number of investors and the type of car produced. Current automobile manufacturers that self-fund enlargements of production capacity for *similar* products and current automobile manufacturers that want to establish a new *non-sole* legal persons manufacturing enterprise in another location will only need to file with the provincial-level government's investment supervision department to begin investment.[49] However, newly-established automobile manufacturers and current automobile manufacturers that want to establish a new *sole* legal person manufacturing enterprise in another location, and current automobile manufacturers that want to produce *another* type of car, to allow provincial-level government's investment supervision department to investigate and approve the investment project and then file with the

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[47] Report, *supra* note 5, at 41.

[48] NAP, *supra* note 3, article 40.

[49] *Id*. at article 41 and 42.

National Development and Reform Commission before beginning the project.[50]

The NAP's more stringent procedure for approving investments in new product lines and sole legal person manufacturing enterprises makes it more difficult for foreign manufacturers to produce different types of cars, as well as forcing them to partner with other investors if they do not have the money to fund the new manufacturing enterprise themselves. Foreign manufacturers wanted to raise the provincial government approval limit because it would have "reduce[d] the number of bureaucratic hoops that companies must jump through to establish manufacturing operations."[51] Rather than living up to its promise, China revamped the entire procedure to maintain the same bureaucratic obstacles to foreign manufacturers with the new criteria of product type and investor number. Moreover, a procedure that differentiates between the types of cars produced will make it easier to discriminate between products. Although the provision applies to domestic manufacturers as well, China still acts protectionist by not following through with a key promise it made to foreign investors.

The NRDC's rationale for revamping the approval system is to make it more centralized and efficient. However, requiring sole investors in new manufacturing enterprises to be examined and approved by provincial and central authorities whereas not requiring the same for non-sole investors does not contribute to streamlining the procedure for these investors.

B. Export Subsidies

China's Protocol provides that: "China shall eliminate all subsidy programmes falling

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[50] *Id*. at article 43 and 44.

[51] Hearing before the U.S.-China Economic and Security Review Commission, "China and the WTO: Compliance and Monitoring", 108th Congress, Feb. 5, 2004, 93.

within the scope of Article 3 of the Agreement on Subsidies and Countervailing Measures ["SCM Agreement"] upon accession."[52] Article 3.1(a) of the SCM Agreement prohibits "specific" export subsidies, meaning a subsidy available only to an enterprise or industry or group of enterprises or industries within the jurisdiction of the authority granting the subsidy that is contingent in law or in fact, upon export performance.[53] Previously, China's State Planning Commission (SPC) gave automotive production enterprises priority in obtaining loans and foreign currencies to encourage the export of whole vehicles.[54] The SPC also gave automotive enterprises preferential tariff rates based on the rate of incorporation of imported technology into the production of automobiles.[55] China committed in its Protocol to eliminate these subsidies by the year 2000.[56]

Instead of eliminating export subsidies, however, China has renewed them in the new policy. Article 40 and 41 of the Automobile Trade Policy: encourages the export of automobiles and provides that the State "supports using the State Foreign Trade Development Fund [中央外贸发展基金] to develop the export of automobile products." Article 49 of the NAP provides that the restriction on stock ownership and the number of joint ventures does not apply to manufacturers in the export development zones that export all their products.[57]

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[52] Protocol, *supra* note 31, at 7.

[53] WTO, Agreement on Subsidies and Countervailing Measures, Article 3.1(a).

[54] Protocol, *supra* note 31, at 70-71.

[55] Protocol, *supra* note 31, at 72.

[56] *Id*.

[57] NAP, *supra* note 3.

Although China has eliminated the foreign currency and local content subsidies, China has created new export subsidies that violate the SCM Agreement. The Chinese government gives the benefits of money and exemptions from the law to manufacturers that export automobiles. These benefits are export subsidies because they provide money and exemption from the stock ownership and joint venture limitations contingent upon exportation of automobiles. Thus these benefits are subsidies prohibited by Article 3.1(a) of the SCM Agreement.

C. Importation

1. Limitation on Trading Throughout the Customs Territory

China's Protocol provides that: "Without prejudice to China's right to regulate trade in a manner consistent with the WTO Agreement, China shall progressively liberalize the availability and scope of the right to trade, so that, within three years after accession, all enterprises in China shall have the right to trade in all goods throughout the customs territory of China, except for those goods listed in Annex 2A which continue to be subject to state trading in accordance with this Protocol."[58] Automobiles are not listed in Annex 2A of the Protocol.[59]

Article 58 of the NAP, on the other hand, provides that: "The state designates the following ports for the import of entire cars: Dalian, Tianjin, Shanghai, Huangpu, Manchuria[满洲里], Shenzhen, and Xinjiang (for the import of entire cars to be used in Xinjiang, and cars from the Commonwealth of Independent States)."

The NAP violates China's commitment to open up trade *throughout* its customs territory because now cars may only pass through seven of China's ports. Previously, automobiles may

[58] Protocol, *supra* note 31, at 4.

[59] *Id*. at 53.

pass through any port in China. This article of the NAP is protectionist because now, foreign manufacturers will have a more difficult time importing cars to China because imported cars may only enter through a few ports.

2. End of Duty-Free Zones

China's Protocol provides that: "During the periods specified in Annex 3, the protection afforded by the measures listed in that Annex shall not be increased or expanded in size, scope or duration, nor shall any new measures be applied, unless in conformity with the provisions of the WTO Agreement."[60] This promise applies to automobiles because automobiles fall under Annex 3.[61]

Starting in the year 2005, all duty-free zones may no longer store cars destined to enter the domestic market."[62] Because imported cars will no longer be able to be stored in the duty-free zones, all duties must be paid upon arrival at the border.

Banning automobile products from the duty-free zones contradicts China's commitment not to expand protectionist measures because currently imported cars are permitted to be placed in the duty-free zones. This article hurts foreign small retailers the most because they are the ones that use the duty-free zones as opposed to Chinese dealers.[63] The word in the duty-free zones from Dalian City (foreign car manufacturer's central retailer for the northeast region) to Tianjin City is

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[60] Protocol, *supra* note 31, at 5.

[61] *Id*. at 53.

[62] NAP, *supra* note 3.

[63] *Id*.

that many small to mid-size auto import retailers are preparing to leave the import market.[64]

3. Classification of Kits as Entire Cars

Foreign manufacturers import cars in the form of assemblies so that they may be taxed at the lower tariff rate for parts rather than entire cars. Paragraph 93 of the Report states: "Certain members of the Working Party expressed particular concerns about tariff treatment in the auto sector. In response to questions about the tariff treatment for kits for motor vehicles, the representative of China confirmed that China had no tariff lines for completely knocked-down kits (CKD) for motor vehicles or semi-knocked down kits (SKD) for motor vehicles. If China created such tariff lines, the tariff rates would be no more than 10 per cent."[65]

The NAP classifies CKD and SKD as entire cars, and thus taxed at much more than 10 percent. Article 53 of the NAP requires that: "For the effective supervision by the relevant departments, automobile manufacturers importing SKDs or CKDs must declare to the Ministry of Commerce, the General Customs Administration (Customs), and the NDRC the model of car that is to be assembled and pay duty at the local customs administration office."[66]

Article 55 to 56 of the NAP delineates how Customs will classify entire cars vs. parts: "The following will be identified as constituting entire cars: car body (including the operator's compartment) assemblies, engine assemblies, gearbox assembly, driving axle assembly, non-driving axle assembly, frame assembly, steering system, brake system, etc…The following

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[64] Yu Wang, *Mingnian Jinkou "Shuihuo Che" Jiang "Duan Dun"* [*Smuggled Cars Will be Cut from Its Roots Next Year*] ZHONGGUO QICHE BAO [CHINA AUTOMOBILE NEWSPAPER] 32 (Oct. 25, 2004), *available at* http://www.anews.cn/anews/list.asp?id=22451 (last visited Nov. 10, 2004).

[65] Report, *supra* note 5.

[66] NAP, *supra* note 3.

will be identified as constituting car assembly (kits): completely knocked-down kits (CKD) for motor vehicles or the import of assemblies or systems that one by one constitute a key component. Whenever the import of parts reaches or exceeds the regulated amount, it will be classified as constituting assemblies."[67] Also, "those that have been identified as constituting entire cars and reach the below conditions will be classified as entire cars: (1) import of car body (including operator's compartment) and engine, these two major assemblies for car assembly [装车的]; (2) import of car body (including operator's compartment) or engine, one of these two major assemblies with 3 or more assemblies remaining for car assembly; or (3) import of car body (including operator's compartment) and engine, these two major assemblies with 5 or more assemblies remaining for car assembly."[68] Article 54 of the NAP provides that: "The relevant authorities will investigate when administering quotas, import tariff, and other segments in approving product entry to strictly collect duty based on the tariff rate of entire cars versus parts to avoid tariff evasion."[69] Those entities that purposely conceal the importation of parts that make up entire vehicles, or import disassembled parts to assemble into entire vehicles, and do not report this to the authorities, and avoid the tariff and import-linked value-added tax [进口环节增值税], will be treated as smuggling and ordered by Customs to make up for the tariff and import-linked value-added tax , or penalized criminally if more serious.[70]

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[67] *Id*.

[68] *Id*., article 57.

[69] NAP, *supra* note 3.

[70] The National Development and Reform Commission, Ministry of Commerce, and General Customs Administration have formulated the "Method for Supervising the Import of Automobile Parts that Constitute Whole Cars" that was to be announced in Oct. 2004, *available at*: http://www.szfzb.com/channel/read.asp?id=89459 (last visited Jan. 17, 2005).

China has contradicted its commitment by classifying kits as entire vehicles and taxing them at the rate of entire vehicles, which is and will always be more than 10%.[71] In the WTO case, *Indonesia—Certain Measures Affecting the Automobile Industry*, Indonesia had a 200 percent duty on imports of passenger cars.[72] To avoid this high tariff rate, EC and US car producers shipped CKD kits to Indonesia and assembled them there. The Panel found that the CKD kits and completed cars were like products because the CKD kits are effectively "cars in a box," "they can properly be considered to have characteristics closely resembling those of a completed car."[73] However, unlike Indonesia, China committed not to tax kits as entire cars. Thus, even if CKDs are like assembled cars, they should not be taxed the same duty in China because China specifically promised not to do so.

China argues that the NAP ties up loopholes of the previous law that had allowed evasion of taxes and government supervision. According to an official from the NDRC, one of the goals of the new law is to: "Close loopholes in the current law to prevent tax avoidance by importing cars in parts to benefit from the lower tariff rate and manufacturers' avoidance of manufacturing car parts domestically by importing parts and assembling them domestically." [74] But the government is cracking down and closing this loophole in a way that favors domestic

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[71] According to the Harmonized Commodity Description and Coding System, the code for passenger cars is: 87032130.

[72] WTO Case *Indonesia—Certain Measures Affecting the Automobile Industry*, Panel Report adopted by the DSB on July 23, 1998 (WT/DS54, 59 & 64/R).

[73] WTO Case *Indonesia—Certain Measures Affecting the Automobile Industry*, Panel Report adopted by the DSB on July 23, 1998 (WT/DS54, 59 & 64/R).

[74] *Guojia Fagaiwei Youguan Tan Xin "Qiche Chanye Fazhan Zhengche* [*National Development and Reform Commission Talks About the New "Automobile Industry Development Policy"*], *supra* note 14.

manufacturers by sealing off a method in which foreigners accessed the Chinese market.

Currently, most joint ventures import the parts of entire cars and assemble them domestically in China. Importing “cars in a box” cuts down on production time so the cars can appear in the market faster and avoid the duty imposed on entire vehicles, because the duty imposed on car parts is less. However, importing kits does not help transfer technology to China because the technology of how to produce the parts remains abroad. The NAP will require foreign manufacturers to produce their cars in China or pay to produce them elsewhere. This restricts the foreign manufacturers' freedom and cost-saving methods for production by forcing foreigner manufacturers to produce their cars in China rather than just assemble there, as well as violating China's promise not to impose restrictions on production. The ultimate goal of the NAP is to further the transfer of technology to China, which assembly kits defeat.

4. Condition on Import License

Motor vehicles have always been subjected to import licensing and import quota. The import quota has been eliminated as of Jan. 1, 2005.[75] China’s Protocol provides that: “China shall ensure that the distribution of import licences, quotas, tariff-rate quotas, or any other means of approval for importation, the right of importation…by national and sub-national authorities, is not conditioned on: whether competing domestic suppliers of such products exist; or performance requirements of any kind, such as local content, offsets, the transfer of technology, export performance or the conduct of research and development in China.”[76] China’s Protocol provides

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[75] Protocol, *supra* note 31, at 53-54.

[76] *Id*. at 5.

that: "Foreign individuals and enterprises and foreign-funded enterprises shall be accorded treatment no less favourable than that accorded to other individuals and enterprises in respect of the distribution of import and export licences and quotas."[77]

The NAP adds a new condition on obtaining an import license: only those companies obtaining manufacturer's authorization may import cars. Article 5 of the "Detailed Rules for Issuing Automatic Import Licenses for Automobile Products" lays out the new import licensing procedure: Those importing cars for retail must show proof of the manufacturer's authorization in addition to following the standard procedure for importing goods as required by Customs.[78]

Although foreign manufacturers wanted this provision to stop car smuggling,[79] the requirement for authorization may discriminate against foreign manufacturers by requiring all import retailers to obtain the relevant agency's approval of the make, model, and number of cars they will be allowed to import. Now, the permit can only be used for the specific listed model and type of vehicle, whereas before, the permit was good for any type of vehicle as long as the emission level was the same.[80] The decision of what cars to import will not be determined by the

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[77] *Id*. at 6.

[78] Detailed Rules for Issuing Automatic Import Licenses for Automobile Products (2004), No. 92, promulgated by Ministry of Commerce, available at: http://search.mofcom.gov.cn/site/siteSearch.jsp?ac=d&no=28&p_keyword=%C6%FB%B3%B5

[79] Wang Yu, *Mingnian Jinkou "Shuihuo Che" Jiang "Duandun"* [*Importers of Smuggled Cars Will Starve Next Year*], ZHONGGUO QICHE BAO [CHINA AUTOMOTIVE PAPER], Oct. 25, 2004. Available at: www.anews.cn/anews/list.asp?id=22451

[80] *Che Shi Yi Shi Chunguang Zha Xian Jinkou Che Shang Chou Dui Che Jia Shangzhang* [*Car Market Suspects Sight of Spring Has Caused Car Importers To Worry About the Rise in Automobile Prices*] ZHONGGUO JINGYING BAO [CHINA MANAGEMENT PAPER], Jan. 24, 2005, *available at*: http://auto.sina.com.cn/news/2005-01-24/085296631.shtml (last visited Jan. 28, 2005).

importer but the government based on macroeconomic considerations rather than the retailer's qualifications."[81] This new provision better enables the government to calculate the number and type of cars imported than the quota system did, and possibly discriminate based on the origin of the product.

D. Distribution

China committed upon entry to the WTO to "treat foreign individuals and enterprises and foreign-funded enterprises no less favorably than other individuals and enterprises regarding the conditions under which their goods are marketed or sold, in the domestic market and for export."[82]

1. Separate Distribution Channels

A dual retail system for the sale of domestic and imported cars has been a method to protect Chinese businesses and the Chinese automobile industry.[83] Previously under the planned economy, domestically-produced and imported cars were sold through the same network because imported cars were sold by a single Chinese automobile trade company.[84] But after 1998, under the government's automobile sales agent system, domestic automobile manufacturers requested the government to require retailers to register anew and sell only one brand of cars exclusively.[85]

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[81] Wang, *supra* note 85.

[82] Protocol, *supra* note 31.

[83] Wen Zhao, *supra* note 41.

[84] Wang Yu, *Qiche Maoyi Zhengce He Qiche Pingpai Guanli Banfa Zheng Zai Zhiding* [*The Automobile Trade Policy and Automobile Brand Management Measures is Currently Being Formed*] ZHONGGUO QICHE BAO [CHINA AUTOMOBILE NEWSPAPER] 14 (June 15, 2004), *available at* http://www.anews.cn/anews/list.asp?id=18007 (last visited Nov. 10, 2004).

[85] *Id*.

Thereafter, even domestically-produced GMs were sold separately from imported GMs. Thus in a Sino-joint venture, while the foreign partner controlled the technology, the Chinese partner controlled the distribution network. The Chinese government has protected the Chinese partner of a Sino-joint venture by preserving the Chinese partner's independence and control over the distribution channel.[86]

The separation or merger of networks for distributing imported and domestically-produced cars has been a hot issue in the automobile industry. "Simultaneously, the governments of the Western developed countries like the U.S., E.U., Japan, as well as various organizations (i.e. automobile associations and law firms) and automobile multinational corporations are using various methods at various events to lobby and pressure the Chinese government not to enact a separate distribution system or else it will report China to the WTO.[87] Foreign automobile manufacturers value the distribution channel in China because profits ultimately derive from the sale of cars. WTO requires countries treat imported cars the same as domestically-produced cars by allowing them to use the same distribution channels.[88]

Although the NAP and one of its implementing legislation--the Measures for Supervising the Sale of Brand Name Automobiles (draft version)--are silent about whether imported cars must be

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86 Wen Zhao, *supra* note 41.

87 Wang Yu, *Caiqu Heying Zhidu, Waifang Jiang Hui Zhangkong Woguo the Qiche Xiaoshou Pindao* [*Foreign Parties Will Control China's Automobile Sales Networks if We Enact a Merged Distribution System*] ZHONGGUO QICHE BAO [CHINA AUTOMOBILE NEWSPAPER] 31 (Aug. 3, 2004), *available at* http://www.anews.cn/anews/list.asp?id=19994 (last visited Nov. 10, 2004).

88 Chen Rongxiang, et. al., *2005 Nian Che Shi Si Zhong Qiche Xiaoshou Moushi Shei Neng Zouchu Digu?* [*Which of the Four Types of Automobile Sales Structures in the 2005 Automobile Market Can Leave This Low Ebb?*] ZHONGGUO JINGJI SHIBAO [CHINA ECONOMIC TIMES], Feb. 2, 2005, *available at*: http://auto.sina.com.cn/news/2005-02-02/091798231.shtml (last visited Feb. 2, 2005).

sold in a separate channel from domestically-produced cars, it is not supportive of treating the two alike. The only mention in the new law of separate or same networks is in section 34, article 9 of the draft version of the "Measures for Implementing the Management of the Sale of Automobile Brands": "Foreign or domestic automobile manufacturers selling their cars in China must quickly establish their own sales and service system for their brand of cars. The foreign or domestic manufacturer can invest in the system itself or through a franchised retailer. After a foreign or domestic investor has obtained the authorization of an automobile manufacturer through the proper procedure, he can then sell and service domestic and imported cars." [89]

Separate is not equal and against the basic WTO rule of national treatment. In the WTO case, *Korea—Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, Korea had a dual retail system for beef, requiring imported and domestic beef be sold in different stores.[90] The Appellate Body held that the dual retail system violated the national treatment clause because the law reduced imported beef's access to normal retail channels and competitive opportunity.[91] Similarly, China's dual retail system for imported and domestically-produced cars violates the national treatment clause. According to a scholar of automobile distribution, because distribution is a commercial activity, and "WTO principles restrict the government's interference in commercial activity, the government cannot state a hard rule in policy regarding the separation or

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[89] QICHE PINGPAI XIAOSHOU GUANLI SHITUO BANFA (ZHENGXIU YIJIAN GAO) [MEASURES FOR IMPLEMENTING THE MANAGEMENT OF THE SALE OF AUTOMOBILE BRANDS (DRAFT VERSION)], *supra* note 43.

[90] WTO case, *Korea—Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, Appellate Body Report adopted by the DSB on Jan. 10, 2001 (WT/DS161 & 169/AB/R).

[91] *Id*.

merging of distribution networks."[92] China knows this but instead of reforming the law to merge the retail of domestic and imported cars, the NAP allows foreigners and domestic retailers to sell domestic and imported cars, but does not say whether they can sell them together in one store. Since 2001, the Chinese government has researched 24 domestic automobile manufacturers and surveyed and debated with many multinational corporations regarding whether to merge or separate the distribution networks of domestically-produced and imported cars.[93] In 2003, the relevant government bureau requested public comment on a draft version of an "Automobile Brand Management Measures" that called for separate networks, but was never implemented.[94]

Thus, the NAP leaves the decision of whether to sell imported cars in the same distribution networks as domestic cars falls on the business for now because according to someone inside the industry, the 'independence" of businesses have become customary.[95] Previously, foreign manufacturers like BMW skirted the separation of distribution channels by registering two companies—one for the sale of imported BMWs and one for the sale of domestically-produced

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[92] Meng Li, *Shifou Tongxu Jinkou Che Bingwang Xiaoshou Guonei Qiye Mianling Kaoyian Zhuangkuang Jiang You Suo Gaibian* [*Whether Permitting Imported Cars to Merge Sales Channels Will Change the Experimental Situation that Domestic Enterprises Face*], CHINA AUTOMOBILE PAPER [ZHONGGUO QICHE BAO], June 2, 2004, available at http://news.xinhuanet.com/auto/2004-06/02/content_1503246.htm (last visited Jan. 28, 2005).

[93] Yu Wang, *supra* note 48.

[94] Yu Wang, *Jinkou Che Guochan Che "Bing Wang" Xiaoshou Jian Cheng Shishi You Guan Bumen Yiran Meiyou "Taidu"* [*The Sale of Imported and Domestically-Produced Cars in the "Same Networks" Has Slowly Become a Reality Although the Relevant Bureaus Have No "Attitude"*] ZHONGGUO QICHE BAO [CHINA AUTOMOBILE NEWSPAPER] 32 (Aug. 10, 2004), *available at* http://www.anews.cn/anews/list.asp?id=20378 (last visited Nov. 2, 2004).

[95] Wen Zhao, *supra* note 41.

BMWs.[96] However, Article 48 of the NAP would seal this loophole by treating foreign enterprises that own multiple enterprises as one foreign enterprise."[97] Absent any specific regulations regarding distribution networks, foreign manufacturers are testing the Chinese government to see if they can merge the distribution channels themselves. For example, Germany's Audi Automobile Corporation has quietly begun to sell imported Audis and domestically-produced Audis in the same network in 40 of its 70 dealerships in China.[98]

2. Conditions on the Sale of Imported Cars

Furthermore, the NAP and its implementing legislation place conditions on the sale of cars by foreign manufacturers. Article 7 of the Measures for Supervising the Sale of Brand Name Automobiles (draft version) require foreign car companies to have only one central agent [总代理] in charge of car sales.[99] Article 21 of the Measures for Supervising the Sale of Brand Name Automobiles (draft version) limits foreign investors with 30 or more automobile retail stores in China from investing more than 49% before Dec. 11, 2006.[100]

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[96] Lidong Zhang and Baohua Shi, *Xinban <<Qiche Chanye Fazhan Zhengce>> Dengchang Shiyi Si Da Redian* [*New Version of the "Policy on the Development of the Automobile Industry" Has Arrived: Four Main Hot Points Explained*], JINHUA SHIBAO [BEIJING CHINA TIMES], available at http://news.xinhuanet.com/auto/2004-06/02/content_1503962.htm (last visited Jan. 28, 2005).

[97] NAP, *supra* note 3.

[98] Yu Wang, *supra* note 52.

[99] QICHE PINGPAI XIAOSHOU GUANLI SHITUO BANFA (ZHENGXIU YIJIAN GAO) [MEASURES FOR SUPERVISING THE SALE OF BRAND NAME AUTOMOBILES (DRAFT VERSION)] sec. 3 (Zhonghua Renmin Gonghe Guo Shangwu Bu [P.R.C. Ministry of commerce] Sept. 28, 2004) (P.R.C.), *available at* http://www.anews.cn/anews/list.asp?id=21612 (last visited Nov. 2, 2004), *hereinafter* Measures.

[100] *Id*.

These two provisions treat foreign manufacturers less favorably than domestic manufacturers in the sale of cars because it places conditions on retail by foreign manufacturers. Domestic automobile manufacturers can directly be responsible for designating and implementing the marketing plan, or authorize another domestic enterprise to act as its central retailer responsible for designating and implementing the marketing plan. But foreign automobile manufacturers selling cars domestically must authorize a domestic enterprise or form a domestic enterprise, according to the relevant laws, to act as its central retailer, responsible for designating and implementing the marketing plan." [101] The 49 percent limitations prevents foreign automobile manufacturers from expanding its retail chain exclusively, which does not apply to domestic retailers.

E. Local Requirements

Local government bureaucracy and competition has been a great barrier to the domestic industry by preventing central government's enforcement of regulations and inhibiting domestic production.[102]

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[101] *Id*.

[102] According to *China Hubei Official Urges Talks with Shanghai on Removing Protectionist Auto Laws* CHINAONLINE (Dec. 23, 1999), available on LEXIS, News Library, News Group File, competition between local governments worsened to the point that the local governments of Shanghai and Hubei had to enter into talks to negotiate removing protectionist auto laws. Shanghai had adopted "protectionist measures concerning the purchase of cars by government offices, taxi companies, privately owned enterprises and individuals. For example, when Shanghai government offices replace their cars, they [would] not be charged an RMB10,000 (US$1,209) office-expenditure-control fee if they buy a Santana sedan (which is produced in Shanghai) but will have to pay this fee if they buy other cars. Also, license plates for a privately owned Santana cost only RMB20,000 (US$2,418), while those for privately owned cars made in other provinces cost at least RMB80,000 (US$9,674). In response to Shanghai's measures, the Hubei Provincial Automobile Industry Administrative Office announced in October that when owners of Santana sedans applied in Hubei for license plates, they would have to pay an additional RMB70,000 (US$8,464), which goes to the Relief Fund for

China's Protocol on Accession provides that: "Import and export prohibitions and restrictions, and licensing requirements affecting imports and exports shall only be imposed and enforced by the national authorities or by sub-national authorities with authorization from the national authorities. Such measures which are not imposed by the national authorities or by sub-national authorities with authorization from the national authorities, shall not be implemented or enforced."[103]

Article 62 of the NAP: Prohibits local governments from discriminating against cars produced in other parts of China.[104] Local governments established vehicle and traffic regulations, approval of licenses, environmental standards, government acquisition, taxi replacement, and other tactics to increase the sales of locally-produced cars.[105] Local protectionism resulted from local governments assisting the development of manufacturers with factories in their area because it helps develop the locality, but caused barriers to cars produced in other areas of China.[106]

The lack of uniformity is a major impediment for foreign manufacturers doing business in China and violates China's commitment to only have national and sub-national authorities impose licensing requirements. Rihai Liu, business consultant for General Motors in Shanghai, while recounting the establishment of GM in Shanghai about three years ago commented: "China is a

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Enterprises in Extreme Difficulty."

[103] Protocol, *supra* note 31, at 5.

[104] NAP, *supra* note 3.

[105] He, *supra* note 37.

[106] He, *supra* note 19.

new market. Even the market condition in Shanghai and Beijing are very different…Many things in China is out of your control."[107] Every automobile manufacturing company's government affairs personnel has had the experience of running around between agencies.[108] For example, a long-time employee of an automobile manufacturer in Beijing describes that for a while the procedure for approval became very complex: To obtain a product certificate, he had to run to the Transportation Bureau and the Public Security Bureau, and then to the Machinery Bureau, Inspections Bureau, and Environmental Protection Bureau.[109] He commented: "If we miss one stamp, we cannot produce or distribute our product."[110]

Also, multiple local laws are bad for China because it prevents the growth of the car industry. If local protectionism persists, the industry will not develop because it had severed the uniformity of the market. An influential article in CHINA YOUTH DAILY states: "Because under the current system in China, automobile companies do not have a mechanism for dealers to leave the industry, and local governments interfere with the market. Intense competition has made it hard to achieve the goal of 'survival of the fittest.' In fact the exact opposite might happen. The first to fall are likely to be the good companies that comply with the law but cannot

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[107] Feng Yu, *Rihai Liu: Guonei Qiche Yingxiao Deyi Ren* [*Rihai Liu: The First Person to Sell Cars in China*] 21 SHIJI JINGJI BAODAO [21ST CENTURY ECONOMIC NEWS], *available at* http://www.people.com.cn/GB/qiche/14556/2957275.html (last visited Nov. 10, 2004).

[108] Feng Shujuan, *Qiche Zhunru: "Duotou Guanli" Zhuangkuang Jiang You Suo Gaibian* [*Automobile Entry: "Multi-headed Management" Situation Will Be Changed*], ZHONGGUO QICHE BAO [CHINA AUTOMOBILE PAPER], June 2, 2004, *available at*: http://news.xinhuanet.com/auto/2004-06/02/content_1503183.htm (last visited Jan. 27, 2005).

[109] *Id*.

[110] *Id*.

obtain protection from the local government. Instead, those small companies without technological capability but obtain local government protection may be prolonging its existence. The businesses that cannot survive on their own obtain beneficial pricing from the local government or free land, thus allowing them to outlive upright enterprises. This result would be the exact opposite of the goal of industry development. At a time when multinational companies are massively entering China, it is likely to prevent automobiles from becoming an industry that helps China continue to develop."[111] Yet the NDRC's policies may be overridden by local governments because the State Council has only given it general regulatory powers rather than specific approval powers, which are the more effective administrative tool to limiting the overheating of investment.[112]

F. IP Protection

Currently, Chinese manufacturers have the authorization to use the intellectual property right of foreign manufacturers, but hang the brand name of a foreign company.[113] According to Ying

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[111] *Guoji Che Jia Zhang Zhongguo Che Jia Die Jiaoche Jiangjia Hai Youmeiyou Pu* [*International Car Prices Rise While China's Car Prices Fall, Is There Still a Guide to Decreasing Passenger Car Prices*] ZHONGGUO QINGNIAN BAO [CHINA YOUTH DAILY], Jan. 20, 2005, *available at*: http://auto.sina.com.cn/news/2005-01-20/081296250.shtml (last visited Jan. 28, 2005).

[112] Wei Yao & Huili Gen, *Shituo Xin Qiche Chanye Zhengce Jiang Zaoyu "San Da Zhangai?"* [*Will the Implementation of the New Automobile Industry Policy Befall "3 Big Obstacles?"*] ZHONGGUO QICHE BAO [CHINA AUTOMOBILE NEWSPAPER] (July 13, 2004) *available at* http://www.anews.cn/anews/list.asp?id=19169 (last visited Nov. 12, 2004).

[113] Feng Shujuan, et. al., *Zizhu Zhishichanquan: Zhongguo Qiche Rao Buguoqu De Kaner* [*Self-Owned Intellectual Property Right: The Bank That China's Automobiles Cannot Bypass*] ZHONGGUO QICHE BAO [CHINA AUTOMOBILE PAPER], June 2, 2004, *available at*: http://news.xinhuanet.com/auto/2004-06/02/content_1503191.htm (last visited Jan. 27, 2005).

Zhao, a researcher at the China Academy of Social Sciences' Industry and Economics Research Institute, China's main state-owned think tank, "because China does not have its own independent development, the majority of Chinese car producers lack their own intellectual property."[114]

A foremost concern of foreign investors is protection of intellectual property. Members of the Working Party raised those concerns upon China's WTO entry to which the representative of China stated that it would further its compliance with the Trade-Related Intellectual Property Rights (TRIPS) Agreement by "crack[ing] down on all serious infringements" and "improv[ing] the system for providing damages for trademark infringement."[115]

Instead of strengthening IP and trademark protection, the Chinese government has called for the development of China's own intellectual property rights. Article 6 of the NAP focuses on the creation of brand cars.[116] Article 24 of the NAP states: "Automobile manufacturing enterprises should strengthen their knowledge of their business and product, actively develop products with independent intellectual property, emphasize protection of intellectual property, raise recognition of their company's models and types in investing and distribution activities, and guard the reputation of their company's models and types."[117] The Appendix of the NAP defines "self-owned intellectual property right" as an "enterprise where the industrial property right, right to improve, right to authorize, and right to transfer the technology of products were developed by oneself , together with another, or developed by employing another."[118] According to Article 27

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114 *Id*.

115 Report, *supra* note 5, 56.

116 NAP, *supra* note 3.

117 *Id*.

of the NAP: “Manufacturers may use various methods to develop oneself such as on one’s own, with a partner, or employing others. Enterprises that develop its own products through research will receive tax benefits.”[119] Article 25 suggests that: “All car, motorcycle, engine, and parts’ manufacturers should register their company’s trademark according to the Trademark Law.”

Instead of protecting foreigner’s IP rights through the many ways that China lays out in the Protocol, the NAP focuses on developing Chinese IP rights. Foreign manufacturers would not benefit from the development of intellectual property because they have already developed their own brand name. The government is encouraging self-development of IP rights to protect its domestic companies. Liang Qiao, the foremost scholar on China’s automobile industry, advocates for China to develop its own brand of automobile to avoid the domestic market from becoming marginalized by foreign brands.[120]

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118 *Id*.

119 *Id*.

120 Ge Subiao and Qiao Liang, *Zhongguo Qiche Pinpai Bixu Fangzhi “Bianyuan Hua”* [*China’s Automobile Brands Must Prevent “Marginalization”*] XINHUA ONLINE, July, 19, 2004, *available at*: http://news.xinhuanet.com/auto/2004-07/19/content_1612948.htm (last visited Jan. 18, 2005).

IV. Goal of China's NAP

A. Communist Concept of Corporations

After the Communist Party of China (CPC) came to power in 1949, Mao Zedong, the Chairman of the CPC began a series of reforms. In the industrial sector, the CPC setup state-owned enterprises (SOE), which were the foundation of China's economy and continues to be its mainstay. A SOE is a business owned and operated by the state for industrial output. Also, the SOE provided social welfare services to its workers and their families including: housing, schooling, medical care, and pensions. Workers' professional and personal lives revolved around the SOE. The SOEs became very inefficient because of their lack of autonomy from the State and their social welfare role.

When Deng Xiaoping came to power in 1978, he reformed China's command economy to a socialist market economy. Unlike the U.S. market economy, the socialist market economy still limits private ownership and preserves the state sector as a dominant portion of the economy.[121] The private sector is viewed as a complement to the state sector, with most of the economy remaining state-owned and controlled.[122] Prior to economic reform, 83% of China's industrial output.[123] By 1994, SOEs produced 38% of industrial output.[124] In 2000, SOEs accounted for

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[121] Chow, Daniel, THE LEGAL SYSTEM OF THE PEOPLE'S REPUBLIC OF CHINA (West Group) (2003).

[122] *Id*.

[123] *Id*.

[124] *Id*.

48.3% of China's industrial output.[125]

Contrary to the WTO's major goal of creating and fostering free market economies, the Chinese government reverts to its non-market roots by adopting legislation aimed at reorganizing its automobile industry into fewer and larger companies--which happen to be the former state-owned enterprises that monopolized the automobile industry pre-WTO entry. The Chinese government encourages the three conglomerates by disadvantaging current and future smaller competitors, many foreign but also domestic producers. China seems to be growing its Chinese car companies into bigger manufacturers so that they may better compete internally and externally with foreign manufacturers. As the Chinese government has noted, its "eventual goal is to have innovative homegrown vehicle makers that can export a sizable number of cars and parts."[126] Beijing wants to "develop state-controlled firms into globally competitive firms, and the auto sector is a key strategic industry."[127]

Wei Xie, an analyst at the Beijing Automotive Industry Development and Research Institute, argues that: "The method for elimination is very market-oriented."[128] However, I will argue that enacting the NAP to force small manufacturers to leave the industry is non-market because it protects and grows three state-related companies. The provisions in the NAP that I have already

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[125] *Id*.

[126] Yeh, *supra* note 10.

[127] Yeh, *supra* note 10.

[128] *Minqi Jinru Qiche Lingyu Tujing Bei "Xin Zheng" Yi Yi Dusi* [*Private Enterprises' Methods of Entry Into the Automobile Sector Are Being Closed Off By the "New Policy"*] SHIDAI SHANGBAO [TIMES BUSINESS PAPER], June 4, 2004, *available at*: http://news.chinacars.com/newsfiles/200406/87091.htm (last visited Jan. 23, 2005).

mentioned illustrate this motive.

B. Investment

1. Conglomeration

The NAP states explicitly in Article 13 that: “The state encourages conglomeration to develop the automotive industry.” Article 6 of the NAP provides that: “Enterprises with more than 15 percent share of the market can constitute an automotive conglomerate and individually report its development strategy to the NDRC, and may implement it after approval.”[129] According to 2003 statistics, FAW Group makes up 20.54% of the market, SAIC has 18.21%, and Dongfeng has 10.68% of the market.[130] So far, only FAW Group and SAIC satisfy the new law’s definition of a “large-scale automobile conglomerate.”[131] Not even the third major automobile manufacturer in China, Dongfeng, fulfills the requirement.[132]

The same philosophy for SOEs as the way to carry the economy and care for society is used to justify the creation of fewer and larger state-related conglomerates. Yushi Tian, CEO of FAW Group—Ford—Audi said at the annual meeting of China’s Automobile Parts Companies that state-related automobile enterprises need to group together; otherwise the biggest in China may

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129 NAP, *supra* note 3.

130 *Qiche Xin Zheng Chutai Anzhan Gei Waizi Yi Guomin Teyu* [*Behind-the-Scene Battle Over the Appearance of the NAP Gives Foreign Investors National Treatment*] CAIJING SHIBAO [FORTUNE AND ECONOMIC TIMES], June, 22, 2004, available at: http://info.auto.hc360.com/html/001/003/001/162291.htm (last visited Jan. 17, 2005).

131 Chen Zixuan, et al，*15% Xuanji* [*Profound Theory*] CHINA AUTOMOBILE PAPER [ZHONGGUO QICHE BAO], June 2, 2004, available at http://news.xinhuanet.com/auto/2004-06/02/content_1503068.htm (last visited Jan. 28, 2005).

132 *Id*.

not be able to compete against the large multinational corporations.[133] Hongwei Fang, CEO of Shanqi, agrees with the support of large conglomerates because "it is the best way to optimize society's resources and cure chaos in the industry."[134]

2. Higher Capital Requirement

Article 47 of the NAP establishes higher capital requirements for new manufacturers: "Producers of engines for newly-built cars must not invest less than RMB1.5 billion (1,500,000,000), of which free-flowing cash must not fall below RMB500,000,000..."[135] Article 47, No. 5 of the NAP requires: "New manufacturers of automobiles must invest more than RMB2 billion (2,000,000,000). At least RMB800 million (800,000,000) of which must derive from the investor himself..."[136] Thus, 40% of the required capital must come from the investor himself rather than another source.

The higher capital limits prevent small domestic enterprises from entering the automobile industry because they have less capital and are prohibited from using foreign capital. Previously, domestic enterprises would enter the automobile industry by partnering with a multinational corporation. Because the "Temporary Regulation on Foreign Investors Acquiring Domestic Enterprises" considers foreign investors who purchase domestic enterprises legal stockholders

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133 Guo, *supra* note 12.

134 Liu Xiaoyong, *Watching Product Development: The New Policy Warms People's Hearts* [*Guanzhu Chanpin Kaifa: Xin Zhengce Nuan Ren Xin*], CHINA AUTOMOBILE PAPER [ZHONGGUO QICHE BAO], June 2, 2004, available at http://news.xinhuanet.com/auto/2004-06/02/content_1503199.htm (last visited Jan. 27, 2005).

135 NAP, *supra* note 3.

136 *Id*.

only after they hold onto the stock for more than a year, domestic capital can first be used to establish a company to attract foreign investment, and then accumulate the capital to purchase or become an automobile manufacturer.[137] However, the NAP seals off this method of entry by prohibiting domestic investors from attainting the capital requirement through foreign sources.

3. Joint Venture Limitation

The NAP's limitation on foreigners to two joint ventures favors the three major Chinese automobile conglomerates that are competing against the smaller manufacturers for joint ventures with foreign manufacturers. Because foreign manufacturers may only choose two partners, they will be more inclined to partner with one of the three major Chinese conglomerate, rather than any of the second-tier domestic car companies, whom they would probably have greater leverage over.

Thus, whichever one of the three major conglomerates the foreign manufacturer partners with will have more leverage over the foreign manufacturer. For example, instead of partnering up with FAW Group directly, Ford had Mazda (1/3 owned by Ford) partner with FAW Group because Ford already had one partner, Changan Automotive, who opposed Ford partnering with FAW Group, and Ford wanted to keep its second and last joint venture allotment available.[138] Because Mazda is weaker than Ford, FAW Group would have the controlling voice in their partnership.

4. Easier Approval for Conglomerates

The Chinese government also displays favoritism to conglomerates in its dual approval procedure. Article 45 of the NAP provides that conglomerates, defined as companies with more

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[137] He, *supra* note 19.

[138] Ma Jun, *Lianyin Yi Qi, Ma Zi Da Zhongguo Zhanlu Shuiluo Shichu* [*Mazda's Strategy in China is Revealed By Its Marriage With FAW*], NANFANG ZHOUMOU, Jan. 27, 2005, available at: http://www.nanfangdaily.com.cn/zm/20050127/jj/qc/200501270041.asp (last visited Jan. 30, 2005).

than 15 percent market share, just need to file their development plan with the NDRC to begin new investment projects.[139] The NAP's more stringent procedure for approving investments only applies to investments by new sole legal persons, which makes it more difficult for independent investors to setup new manufacturing enterprises. The Chinese government usually "suspends or altogether stops approval of foreign investments in areas of the economy that have already received sufficiently large amounts of capital and that are already developed."[140]

5. Performance Requirement

The NAP's requirement that new car plants produce a certain number of cars annually forces the smaller, privately-owned domestic producers to shut down. Presently, each of the provinces in China has at least one automobile manufacturing plant.[141] Most of these are small, producing 10,000 to 35,000 cars per year.[142] Because many enterprises entered the industry blindly, this caused the production of cars to be chaotic and weak.[143] There are more than 20 of these "zero enterprises" that produce close to nothing.[144] For example, Tangshan Automobile Manufacturing

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139 NAP, *supra* note 3.

140 Chow, *supra* note 127, at 37.

141 Hei Beishi, *Chanye Jiegou Tiaozheng Chang Xian San Da Liangdian* [*Adjustments in the Industry's Organization Tastes Three Main Highlights*], CHINA AUTOMOBILE PAPER [ZHONGGUO QICHE BAO], June 2, 2004, available at http://news.xinhuanet.com/auto/2004-06/02/content_1503161.htm (last visited Jan. 27, 2005).

142 *Id*.

143 Zhu Junwei, Policy on the Development of the Automobile Industry Enacted: Automobile "Shell" Has Been Stuffed [Qiche Chanye Fazhan Zhengce, Chutai Qiche "Ke" Bei Kazhu Le], PEOPLE'S LIBERATION ARMY DAILY [JIEFANG RIBAO], June 2, 2004, available at http://news.xinhuanet.com/auto/2004-06/02/content_1503902.htm (last visited Jan. 28, 2005).

144 Hei Beishi, *Chanye Jiegou Tiaozheng Chang Xian San Da Liangdian* [*Adjustments in the Industry's Organization Tastes Three Main Highlights*], CHINA AUTOMOBILE PAPER [ZHONGGUO QICHE

Limited Company has three employees receiving wages, but has produced only one car in the past four years.[145]

6. End of Permit Sales

Buying permits has been the way that most private investors entered the industry because of the government's strict standards on automobile products.[146] Private domestic investors would buy an automobile company's right to operate, and not change names at first but just use the licensed company's items, then strategize about how to develop.[147]

Article 17 of the NAP: "Prohibits automobile manufacturers from selling their production licenses to anyone outside of the automobile manufacturing business."[148] This provision stops another method of entry into the automobile industry, which is another way to protect the major conglomerates.

The prohibition on selling automobile manufacturing permits to those outside of the industry forces conglomeration because those that want to leave the industry may only sell to another automobile manufacturer or merge with another.[149] According to Huang Taiyan, a professor at People's University's Economics School in Beijing: "This [prohibition] contradicts the ideal of

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BAO], June 2, 2004, available at http://news.xinhuanet.com/auto/2004-06/02/content_1503161.htm (last visited Jan. 27, 2005).

145 *Id*
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146 Jia, *supra* note 6.

147 *Id*.

148 NAP, *supra* note 3.

149 Zhu, *supra* note 149.

complete competition. The new automobile industry policy protects the existing 123 automobile manufacturer…The result of this protection is that a few large-scale state-owned enterprises will become abnormal [畸形] monopolies."[150]

C. Importation

1. Classification

Another bar on entry into the industry to protect China's existing conglomerates is the NAP's classification of CKD and SKD kits as entire cars. Such a classification system "forecloses all new foreign investments and effectively precludes foreign competition from global rivals for those companies that invested early in China."[151] An industry insider asked rhetorically: "Is there any joint venture that when they first invested, did not first use imported cars or CKD, SKD? Now this policy prohibits using these methods to supplement certification. This will definitely have detrimental effect on the previous period's popularity of assembling cars."[152]

2. End of Duty-Free Zones

The NAP's elimination of duty-free zones hurts small retailers because they will have to decide on their own and take more risk in: what cars they import, at what price to import those

150 *Minqi Jinru Qiche Lingyu Tujing Bei "Xin Zheng" Yi Yi Dusi* [*Private Enterprises' Methods of Entry Into the Automobile Sector Are Being Closed Off By the "New Policy"*] SHIDAI SHANGBAO [TIMES BUSINESS PAPER], June 4, 2004, *available at*: http://news.chinacars.com/newsfiles/200406/87091.htm (last visited Jan. 23, 2005).

151 CHOW, *supra* note 25.

152 Feng, *supra* note 119.

cars, and whether they will quickly sell after entry.[153] Retailers must have three times more cash on hand than they needed previously when they could store their cars in the duty-free zone and wait until they found a buyer to pay duties.[154]

D. Distribution

The requirement that all retailers have manufacturer's authorization eliminates most dealers. This policy benefits big and hurts small-sized retailers because the big ones are the ones that already have authorizations from the manufacturer or from their joint ventures. According to statistics from the Beijing City Automobile Circulation Society, there are more than 2,000 automobile dealers in Beijing now, 80% of which will no longer be able to operate under the new policy unless they obtain a manufacturer's authorization.[155] Almost 80% of the dealers in Shanghai have not obtained the authorization of the original manufacturers.[156] Currently, mid to small-sized retailers are leaving the automobile industry, while the big ones are obtaining more

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[153] Tingfang Li, *Jiage Yingxiang Yue Lai Yue Da, Tianjin Baoshui Qu Jinkou Cheshang Chibian* [*Automobile Retailers in Tianjin's Duty-Free Zone Keep Changing as Prices Effects Increase*] ZHONGGUO QICHE BAO [CHINA AUTOMOBILE NEWSPAPER] 32 (Oct. 18, 2004), *available at* http://www.anews.cn/anews/list.asp?id=22258 (last visited Nov. 10, 2004).

[154] Feng Deng & Ke Ku, *Jinkou Che Liangxiang Zhidu Bingyong, Shichang Jiage Zoushi Nan Panduan* [*The Simultaneous Application of Two Systems on Imported Cars Makes the Direction of Market Prices Hard to Predict*] SHICHANG BAO [MARKET PAPER] (Sept. 28, 2004), *available at* http://www.anews.cn/anews/list.asp?id=21603 (last visited Nov. 10, 2004).

[155] Dai Zhiyun, *2005 Nian Guanshui Ruqi Jiangdi Yiweizhe Shenme?* [*What Will the Scheduled Decrease in the Tariff in 2005 Mean?*] FAZHI RIBAO [Legal Daily], Dec. 29, 2004, available at http://auto.eastday.com/eastday/node29270/node36070/node41853/index4.html (last visited Jan. 28, 2005).

[156] Linsheng Ye, *Zhongguo "4S" Dian Ying Yu Guoji Jiegue* [*China's "4S" Stores Should Conform With the World*] GUOJI JINGRONG BAO [INT'L FINANCE NEWSPAPER] 8 (Aug. 5, 2004), *available at* http://www.anews.cn/anews/list.asp?id=20177 (last visited Nov. 5, 2004).

franchises.[157]

E. IP Protection

A manager of Hafei Automobile Company thinks that the new policy's support of independent development is to develop Chinese automobiles with independent products with independent labels and independent intellectual property rights so that they may break into the global market.[158] The Chinese government's call for domestic manufacturers to develop their own intellectual property marks a shift in strategy from the last ten years of obtaining technology through transfers from foreigners. China is shifting strategies because the previous strategy of joint ventures is not succeeding in transferring technology. This strategy is not working for a few reasons.

At the time of forming a joint venture, there were not detailed research demands or specific times for the transfer of technology, nor high-level industry policy regulating the rules of the game.[159] Thus, the foreign partner brought in out-dated technology causing China to continue to rely on them.[160] Also, these large Chinese companies are more interested in attracting foreign

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157 Yang Pan, *Jinkou Shi Da Pan Zhendang Mianling Xipai Pinpai Xiaoshou Jiang Cheng Zhudao* [*Oscillation in the Layout of the Import Car Market Faces Reshuffling, Brand Sales Will Become the Main Guide*] SHENZHEN SHANGBAO [SHENZHEN BUSINESS PAPER], Oct. 26, 2004, available at http://news.xinhuanet.com/auto/2004-10/26/content_2138791.htm, (last visited Jan. 10, 2005).

158 Xiaoyong Liu, *Watching Product Development: The New Policy Warms People's Hearts* [*Guanzhu Chanpin Kaifa: Xin Zhengce Nuan Ren Xin*] , CHINA AUTOMOBILE PAPER [ZHONGGUO QICHE BAO], June 2, 2004, available at http://news.xinhuanet.com/auto/2004-06/02/content_1503199.htm (last visited Jan. 27, 2005).

159 Guo, *supra* note 12.

160 He, *supra* note 19.

capital and ramping up production than researching new technologies.[161]

Also, any success in technology transfer is now at risk of suit for IP rights violation. Since 2003, IP disputes have erupted due to the conflict of interest between China--which wants to barter technology for cheap Chinese labor, and multinational companies--which neither want to share their technology nor give anything in return for the cheap labor. Disputes began to occur in 2003 between Nissan and Great Wall Automobile (a domestic Chinese company), Toyota and Geely, and GM and Gery.[162] The situation became so bad that the Vice Minister of Commerce had to call a meeting between GM and Gery to avoid any legal action.[163] China's first IP case involves Toyota suing Geely in Beijing Highest People's Court, alleging that Geely's model Meiri copies Toyota's "Toyota" insignia, thus violating Toyota's trademark.[164] But Toyota lost this case for lack of proof.[165] The disputes continued in 2004 when Honda sued Hebei Province's Shuanghuan Automobile Company and its retailer, the Beijing Xu Yang Heng Xing Economic and Trade Limited Company [旭阳恒兴经贸有限公司], in Beijing's Highest People's Court for

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161 *Id*.

162 Wang Jinying, *Waiguan Xiang Xiang Mafan Shangshen Ping San Qi Qiche Qinquan An* [*Commentary on the Three Automobile Tort Cases That Look Like Trouble On the Outside*], DONGFANG WANG [EASTERN PORTAL], Dec. 9, 2003, also available at: http://www.shlottery.gov.cn/epublish/gb/paper282/1/class028200001/hwz1356285.htm.

163 *Id*.

164 PRC Second Intermediate Court's Judgment Order in the Japanese Toyota Automobile Association's [丰田自动车株式会社] Lawsuit Against Zhejiang's Geely for Violating its Trademark and Anti-Competitive Practices, Civil Case Judgment No. 06286 (Nov. 24, 2003), *available at*: http://bjgy.chinacourt.org/public/detail.php?id=6534&k_title=%B7%E1%CC%EF&k_content=%B7%E1%CC%EF&k_author=

165 *Id*.

pirating the Honda CRV.[166] Moreover, in December 2004, Dongfeng joined Honda in its suit against Shuanghuan, marking the first time a Chinese partner in a Sino-joint venture sued a domestic private company.[167]

V. Conclusion

China has implemented new measures that do not conform with the WTO Agreement. Although China does not have to completely eliminate its restrictions on the automobile industry because it is subject to phased elimination, China must not increase those restrictions, which it has through the NAP. The NAP will protect its three state-related automobile manufacturers from foreign manufacturers by limiting foreign investment, providing export subsidies, burdening importing, separating distribution, adding local requirements, and creating Chinese IP rights.

Contrary to the WTO's encouragement of creating free market conditions, China reverts to the command economy of the Mao-era rather than letting in more competition to let the market forces guide the industry because it feels that that is the quickest way to eventually exporting Chinese-brand of cars. This year, China exported US$4,700,000,000 worth of entire cars.[168]

China hopes to: "become the major automobile manufacturing country in the world before the year 2010. To have automobile products satisfy the majority of domestic demand and enter

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[166] An Tong, *Bentian Gao Wo Shuanghuan Qiche Qinquan, Zhongguo Che Yao Yanfa Zi Qiang* [*Honda Sues China's Shuanghuan Automotive for Tort, China's Cars Must Research and Develop Itself to Become Strong*], April, 8, 2004, *available at*: http://news.xinhuanet.com/herald/2004-04/08/content_1408598.htm.

[167] *Dengfeng Bentian Zai She Shuanghuan Qinquan Di Yi An Lakai Di Er Mu* [The First Tort Case by Dongfeng and Honda's Against Shuanghuan Enters Its Second Phase], XIAMEN RIBAO [XIAMEN DAILY] Dec. 5, 2004, available at: http://yibbszr.xicp.net/Article/Tmanli/Tmjf/200412/3515.html

[168] Yu Wang, *supra* note 11.

the global market in batch-sizes."[169] China may achieve this goal even with all of the NAP's WTO violations because by the time the implementing legislation detail the protections and other member countries collect the statistics on the discriminatory effects, it may be the year 2010.

If the rest of the world waits to see the effects of the NAP, it may be too late. According to the director of the Office of Automobile Affairs at the U.S. Department of Commerce, the U.S. will begin to import large numbers of cars produced in China in the year 2010.[170] But by that time, China may have already developed its three state-related automobile manufacturers into the world's major exporters.

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[169] NAP, *supra* note 3, article 2.

[170] *Mei Jiang Zai 2010 Nian Jingkou Zhongguo Qiche* [*U.S. Will Import Chinese Cars in 2010*] ZHONGGUO QICHE BAO [CHINA AUTOMOBILE NEWSPAPER] 3 (June 29, 2004), *available at* http://www.anews.cn/anews/list.asp?id=18466 (last visited Nov. 10, 2004).