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China's Indigenous Innovation Policies and the World Trade Organization

*By Daniel C.K. Chow**

Abstract: China's Indigenous Innovation Policies are a web of policies, regulations, and strategies that are designed to develop an indigenous capacity to create innovation and advanced technology as part of China's larger strategy to ascend to the top ranks of the world's industrialized nations. As part of these policies, China has implemented rules related to government procurement, i.e. the purchase by Chinese government entities of products from private vendors. China's policies provide strong incentives for the purchase of products containing technology or intellectual property owned by Chinese business enterprises. U.S. companies claim that these policies are discriminatory and could preclude them from selling their products to the Chinese government, which has an annual government procurement budget estimated by some to be as high as \$1 trillion. U.S. companies also claim that these policies are designed to force them to transfer their technology to China as a condition of selling products to the Chinese government. Critics of these policies in the U.S. Congress and in U.S. industry groups argue that they are unfair, illegal, and in violation of China's obligations under the World Trade Organization. This article assesses these arguments and concludes that China is within its legal rights in promulgating its government procurement policies favoring products containing indigenous technology.

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I. INTRODUCTION

China’s Indigenous Innovation Policies are a web of policies, regulations, and strategies that create incentives for Chinese enterprises to create advanced technologies in order to propel the People’s Republic of China (China) into the leading ranks of the most competitive nations in the world.¹ One key goal of these strategies is to develop “national champions”²: Chinese companies that aspire to compete effectively with the largest and most powerful multinational companies (MNCs) in the world today.³ Since innovation and advanced technology are crucial requirements of competitiveness in the modern global economy, a key component of these strategies is to spur Chinese entities to develop the capacity to create

¹ For a detailed discussion of China’s Indigenous Innovation Policies, see U.S. INT’L TRADE COMM’N, INVESTIGATION NO. 332-514, CHINA: INTELLECTUAL PROPERTY INFRINGEMENT, INDIGENOUS INNOVATION POLICIES, AND FRAMEWORKS FOR MEASURING THE EFFECTS ON THE U.S. ECONOMY (USITC Pub. 4199, 2010) [hereinafter ITC Report].

² See *id.* at 5-6. “National champions” is a term used by the Chinese government to describe state-owned or state-invested enterprises. These enterprises, all controlled by the state, will be the leading business entities in China.

³ See *id.*

innovative and advanced technologies.⁴ By “technology,” this Article refers to knowledge, know-how, and information, usually protected by intellectual property (IP) rights such as patents, trademarks, trade secrets, and other forms of IP.⁵ In China’s view, it can never ascend to the leading ranks of industrialized nations if it continues to be a recipient or importer of advanced technologies or IP created by innovator countries, such as the United States.⁶ Innovator countries are often reluctant to provide access to their “core” technologies but often only provide access to their secondary technologies in order to preserve a competitive advantage.⁷ China wants to become a leading innovator country in its own right and does not want to depend on access to technology from the United States, Japan, and western European nations, which now dominate the area of technology innovation.⁸

To encourage innovation, China’s Indigenous Innovation Policies create incentives in the form of government procurement policies that favor the purchase of products that embody technology created or owned by Chinese business entities.⁹ Government procurement refers to the purchase of goods and services by government entities from private vendors.¹⁰ Today in most countries, government procurement accounts for 15%–20% of gross domestic product (GDP).¹¹ In some countries, such as India, government procurement accounts for 30% of GDP. In 2011, the United States government spent about \$537 billion,¹² or about 14% of the federal

⁴ See *id.* at 5-1 (“From China’s perspective, its indigenous innovation policies are part of a legitimate and necessary effort to raise the level of domestic innovation to respond to pressing economic and development challenges.”).

⁵ See DANIEL C.K. CHOW & THOMAS J. SCHOENBAUM, *INTERNATIONAL BUSINESS TRANSACTIONS: PROBLEMS, CASES, AND MATERIALS* 324 (2d ed. 2010) [hereinafter CHOW & SCHOENBAUM, *INTERNATIONAL BUSINESS TRANSACTIONS*].

⁶ The leading industrialized nations of the world—the United States, some of the countries of the European Union, and Japan—are all innovator countries. See DANIEL C.K. CHOW & EDWARD LEE, *INTERNATIONAL INTELLECTUAL PROPERTY: PROBLEMS, CASES, AND MATERIALS* 12 (2d ed. 2012) [hereinafter CHOW & LEE, *INTERNATIONAL INTELLECTUAL PROPERTY*].

⁷ See CHOW & SCHOENBAUM, *INTERNATIONAL BUSINESS TRANSACTIONS*, *supra* note 5, at 325.

⁸ *Id.* at 328.

⁹ China’s Indigenous Innovation Policies are a web of policies that deal with many different aspects of China’s economy. This Article focuses on the use of government procurement policies as an incentive to spur local innovation, but there are many other aspects of China’s Indigenous Innovation Policies that involve technical standards, competition policy under China’s Anti-Monopoly Law, taxation policy, and intellectual property rights and enforcement. See ITC Report, *supra* note 1, at 5-1.

¹⁰ See DANIEL C.K. CHOW & THOMAS J. SCHOENBAUM, *INTERNATIONAL TRADE LAW: PROBLEMS, CASES, AND MATERIALS* 173 (Aspen 2d ed. 2012) [hereinafter CHOW & SCHOENBAUM, *INTERNATIONAL TRADE LAW*].

¹¹ *Id.*

¹² See U.S. GOV’T ACCOUNTABILITY OFFICE, *GAO-12-919, IMPROVED AND EXPANDED USE COULD SAVE BILLIONS IN ANNUAL PROCUREMENT COSTS* (2012). The size of government procurement in China depends on what types of entities (central, sub-central, and state owned enterprises) are included. State owned enterprises, or companies that are administrative units of the state, continue to dominate China’s economy. If spending by state-owned enterprises is included, spending figures increase significantly.

budget,¹³ on the purchase of goods and services from private sector vendors. The United States estimates that China now spends between \$88–\$200 billion per year on government procurement,¹⁴ while the European Union estimates that China spends up to \$1 trillion in annual government procurement.¹⁵ The growth in government procurement provides private vendors with eager government buyers with enormous resources and the ability to pay in cash for a fleet of jet passenger airplanes or immense infrastructure projects, such as the building of airports and bridges. Since China states that its procurement budget grew ten-fold between 2002 and 2012, China's government procurement is likely to become even more important going forward as a source of revenue for private businesses.¹⁶ Not surprisingly, many U.S. companies are eager to sell products and services to the Chinese government.¹⁷ If Chinese government entities are required to purchase products that embody technology created or owned by Chinese entities, however, U.S. companies may find few opportunities to sell products to Chinese government entities.

China's Indigenous Innovation Policies have triggered a storm of controversy and protest in the United States.¹⁸ Many U.S. companies argue that these policies have now surpassed counterfeiting and commercial piracy as the most important IP issue between the United States and China.¹⁹ U.S. companies claim that these policies blatantly discriminate against U.S. goods in China's government procurement and do not fairly reciprocate the trading relationship between the United States and China.²⁰ Currently U.S. state and local governments purchase billions of dollars in

¹³ See Jeanne Sahadi, *Cutting Washington Could Hit Main Street*, CNN MONEY (July 23, 2012), <http://money.cnn.com/2012/07/23/news/economy/federal-spending/index.htm>.

¹⁴ See ITC Report, *supra* note 1, at 5-9 (reporting \$88 billion figure); WAYNE M. MORRISON, CONG. RESEARCH SERV., RL33536, CHINA–U.S. TRADE ISSUES 43 (July 17, 2013) (testimony of Karen Laney, acting director of operations of the International Trade Commission, reporting the \$200 billion figure).

¹⁵ *China Unlikely to Join WTO Agreement*, XINHUA NEWS AGENCY (Mar. 21, 2012), http://news.xinhuanet.com/english/china/2012-03/21/c_131489311.htm.

¹⁶ When China's entry into the WTO was being negotiated, China's government procurement budget was only a fraction of what it is today. In 2002, China's government procurement budget was only \$16 billion, but it grew ten-fold over the last decade. See Lan Lan, *Government Procurement Expanded 10-Fold*, CHINA DAILY (Oct. 12, 2012, 8:24 PM), http://www.chinadaily.com.cn/china/2012-07/03/content_15546264.htm (Deputy Finance Minister Wang Boan stating that China's government procurement budget expanded from \$16 billion in 2002 to \$178 billion in 2012).

¹⁷ Jose W. Fernandez, *Fostering a Rules-Based System in the U.S.-China Economic Relationship*, U.S. DEP'T OF STATE (Aug. 3, 2012), <http://www.state.gov/e/eb/rls/rm/2012/197015.htm>.

¹⁸ See Levin Warns of Potential Hill Action on China, CONGRESSDAILY, July 16, 2010, at 10-10.

¹⁹ U.S. INT'L TRADE COMM'N, INVESTIGATION NO. 332-519, CHINA: EFFECTS OF INTELLECTUAL PROPERTY INFRINGEMENT AND INDIGENOUS INNOVATION POLICIES ON THE U.S. ECONOMY (USITC Pub. 4199, 2011).

²⁰ *China's Indigenous Innovation Trade and Investment Politic: How Great a Threat?: Hearing Before the Subcomm. on Terrorism, Nonproliferation, and Trade of the H. Comm. on Foreign Affairs*, 112th Cong. (2011).

goods and services from Chinese companies, but China's government procurement policies effectively close off the Chinese government procurement market to U.S. private businesses.²¹ According to U.S. companies, most U.S. products will not qualify for purchase by the Chinese government under the criteria set forth by these policies. In addition, U.S. companies claim that these policies are designed to force them to transfer their advanced technologies to Chinese entities as a condition of being able to sell goods and services to the Chinese government.²² If they do not transfer their technologies to Chinese entities, these U.S. companies will be shut out from the highly lucrative Chinese government procurement market.²³ Furthermore, if U.S. companies do transfer their technologies to Chinese entities, then the technologies will be stolen or pirated. Consequently, U.S. companies argue that China intends for these policies to help it steal U.S. intellectual property rights.²⁴ A later part of this Article explains, in detail, why U.S. companies believe that they are being coerced into transferring their technologies to Chinese entities where the technology will be stolen.²⁵

Spurred on by the concerns of U.S. businesses, the United States government has put pressure on Chinese authorities to change these policies.²⁶ Some critics argue that China's policies violate its WTO obligations with the United States.²⁷ The United States is a member of the WTO Government Procurement Agreement (GPA),²⁸ which prohibits the United States from discriminating against goods and services from other GPA members in favor of U.S. goods and services in government

²¹ See David Barboza, *Bridge Comes to San Francisco with a Made in China Label*, N.Y. TIMES, June 26, 2011, at A1 (describing \$7.2 billion spent by California in government procurement of Chinese services to build a bridge in San Francisco, and purchases by New York of a wide array of Chinese services and goods related to infrastructure projects).

²² See MORRISON, *supra* note 14, at 30 (quoting a U.S. WTO representative as stating that China's policies were aimed at "coercing technology transfer" and that "Chinese regulations . . . frequently called for technology transfer, and in certain cases, conditioned, or proposed to condition, the eligibility for government benefits or preferences on intellectual property being owned or developed in China, or being licensed, in some cases exclusively, to a Chinese party").

²³ See *id.* at 29–30 (noting concerns of U.S. Chamber of Commerce that China's Indigenous Innovation Policies would "make it virtually impossible for any non-Chinese companies to participate in China's government procurement" without transferring their technology to China).

²⁴ See *Geithner Slams China's Intellectual Property Policies*, REUTERS (Feb. 23, 2011), <http://www.reuters.com/article/2011/09/23/us-china-geithner-idUSTRE78M15G20110923> (quoting a statement by Treasury Secretary Timothy Geithner that China's Indigenous Innovation Policies are a continuation of its "decades old strategy to steal American intellectual property rights").

²⁵ See *infra* Part II.A.

²⁶ See *U.S. to Raise IPR Issues with China*, CHINA DAILY (May 22, 2010), http://www.china.org.cn/business/2010-05/22/content_20096107.htm.

²⁷ See *infra* Part III.B.

²⁸ *WTO Government Procurement Agreement*, OFFICE OF THE U.S. TRADE REPRESENTATIVE, <http://www.ustr.gov/trade-topics/government-procurement/wto-government-procurement-agreement> (last visited Sept. 10, 2013).

procurement.²⁹ Under the GPA and federal laws, the United States is prohibited from using federal funds to purchase goods and services from non-GPA members. Unlike the federal government, however, state governments can and do purchase goods and services from China.³⁰ China is currently not a member of the GPA, however, so it can effectively require Chinese government entities to purchase goods and services from Chinese vendors instead of U.S. vendors. Since the GPA is a “plurilateral” agreement under the WTO,³¹ WTO members decide whether to join the GPA on a voluntary basis. By contrast, other WTO agreements, such as the General Agreement on Tariffs and Trade (GATT), the General Agreement on Trade in Services (GATS), and the Agreement on Trade Related Intellectual Property Rights (TRIPS) are mandatory treaties that are automatically binding on all nations that accede to the WTO. Since China is within its rights in not acceding to the GPA, China is under no obligation to provide reciprocal non-discriminatory treatment to foreign goods in government procurement and is free to discriminate in favor of Chinese goods. As a result, China is permitted under the WTO to discriminate in favor of Chinese goods and against foreign firms in awarding government procurement contracts.³² Some critics, however, reject China’s position and argue that China’s Indigenous Innovation Policies violate China’s obligations under the WTO.³³ A later part of this Article surveys these arguments and concludes that they are either invalid or ineffective.

This Article examines the controversy between the United States and China in detail. Part II reviews China’s Indigenous Innovation Policies and the concerns of U.S. companies. This part explains the crux of U.S. companies’ complaints that these policies are unfair because they “force” them to transfer technology to China and help Chinese companies steal their intellectual property. Part III then analyzes whether China’s Indigenous Innovation Policies are in violation of the WTO agreements. This part examines whether China is allowed to discriminate in government procurement under the WTO agreements,³⁴ as well as under China’s Protocol of Accession to the WTO,³⁵ i.e., the legal instrument setting forth

²⁹ See *Overview of the Government Procurement Agreement*, WORLD TRADE ORG., http://www.wto.org/english/tratop_e/gproc_e/gpa_overview_e.htm (last visited Nov. 20, 2013).

³⁰ See Barboza, *supra* note 21.

³¹ See CHOW & SCHOENBAUM, INTERNATIONAL TRADE LAW, *supra* note 10, at 173.

³² See ITC Report, *supra* note 1, at 5-8–5-9; INFO. TECH. INDUS. COUNCIL, WRITTEN COMMENTS TO THE U.S. GOVERNMENT INTERAGENCY TRADE POLICY STAFF COMMITTEE IN RESPONSE TO FEDERAL REGISTER NOTICE REGARDING CHINA’S COMPLIANCE WITH ITS ACCESSION COMMITMENTS TO THE WORLD TRADE ORGANIZATION (WTO) 5 (Sept. 27, 2010), available at <http://www.tiaonline.org/sites/default/files/pages/PUSITOCChinaWTOComplianceFiling.pdf>.

³³ See *infra* Part III.B.

³⁴ Official versions of all WTO agreements are available on the WTO website. See *Documents and Resources*, WORLD TRADE ORG., www.wto.org/english/res_e/res_e.htm (last visited Sept. 11, 2013).

³⁵ See World Trade Org., *Protocol on the Accession of the People’s Republic of China*, Ministerial

the conditions of China's admission to the WTO. This part also examines other arguments by critics that China has violated other WTO obligations. Part III reaches several tentative conclusions. First, China is within its legal rights to discriminate in favor of Chinese goods and services because China's Indigenous Innovation Policies do not violate any significant WTO obligations. Second, although some aspects of China's Indigenous Innovation Policies may violate certain peripheral WTO obligations, the remedy for these violations under the WTO is to bring the offending measures into compliance with the WTO Agreements.³⁶ Bringing violations into WTO compliance, however, does not address the key underlying problem confronting the United States government and U.S. companies. The ultimate goal of the United States is to induce China to join the GPA, which after all is a voluntary decision on the part of China, given that no WTO member is required to join the GPA.³⁷ No litigation in the WTO or pressure from the United States will induce China to join the GPA on terms acceptable to the United States.³⁸ Rather, threatening China with litigation in the WTO over its Indigenous Innovation Policies could have the opposite effect of hardening China's stance and delaying China's accession to the GPA. What may be necessary in the long term are trade concessions from the United States that will serve as an inducement for China to join the GPA.³⁹

Decision of 10 November 2001, WT/L/432 (2002) [hereinafter China's Protocol of Accession], available at <http://unpan1.un.org/intradoc/groups/public/documents/APCITY/UNPAN002123.pdf>.

³⁶ See CHOW & SCHOENBAUM, *INTERNATIONAL TRADE LAW*, *supra* note 10, at 67. The ultimate goal of the WTO is to induce an offending member to bring a non-complying measure into conformity with the WTO agreements. Although the aggrieved member may be authorized in some cases to impose retaliatory trade measures on the offending member, these measures are always viewed as temporary. The long-term goal is to induce compliance with WTO obligations, which will reduce or eliminate trade distortions caused by the offending measure and produce the greatest benefit to the WTO system. *See id.*

³⁷ *See id.* at 173.

³⁸ Joining the GPA is completely up to each WTO member. There is no legal basis within the WTO to legally coerce a member to join the GPA, so any litigation by the United States in the WTO would be part of a campaign to pressure China to join the GPA against its will. China has recently demonstrated that it has no tolerance for being bullied by the United States or any other country. *See China Defends Expanded Military After Memories of Bullying*, BLOOMBERG NEWS (Mar. 4, 2013), <http://mobile.bloomberg.com/news/2013-03-04/china-defends-expanded-military-after-memories-of-bullying-1-.html> (discussing lessons learned after being bullied). Both the United States and the European Union have objected to China's past offers to join the GPA because China is making commitments that obligate only a few government entities to purchase foreign goods and services and involve only a small volume of trade. *See Europe Says China's Latest Bid to Join Procurement Agreement "Highly Disappointing,"* REUTERS (Dec. 6, 2012, 5:25 AM), <http://www.reuters.com/article/2012/12/06/us-china-eu-trade-idUSBRE8B50G720121206>. If the United States, the EU, and other GPA members were to accept China's offer, China would get the full benefit of the more expansive commitments of the United States and the EU in exchange for a narrow commitment on the part of China. This type of tactic leads many critics to argue that China tries to exploit the WTO system.

³⁹ A trade concession is a trade benefit given to China by the United States as part of a deal that

II. A CLOSER LOOK AT CHINA'S INDIGENOUS INNOVATION POLICIES

Under China's Indigenous Innovation Policies, PRC government entities are encouraged to buy products that have been officially accredited by PRC authorities.⁴⁰ Only enterprises having Chinese legal person status⁴¹ can apply for accreditation for a product.⁴² To be accredited, a product must have been manufactured by an entity that has full ownership of intellectual property rights in China, either by creating the rights or by acquiring them.⁴³ For example, in the case of a product protected by patents, the Chinese entity must be the registered patent owner in China.⁴⁴

If the product also has a trademark, a Chinese entity must be the registered trademark owner in China before the product can be accredited for procurement by Chinese government entities.⁴⁵ An additional set of measures creates incentives and priorities for the purchase of accredited products by PRC government authorities.⁴⁶ The combination of these

China will join the GPA. For example, the United States federal government might offer to purchase a large quantity of Chinese made goods and services, conditioned upon China's accession to the GPA. In addition to providing financial benefits, a trade concession would be politically more acceptable to China's leaders because it would be perceived as a carrot and not as a stick. Bowing to pressure—a stick—might revive painful memories of China's long period of domination by foreign powers. See DANIEL C.K. CHOW, *THE LEGAL SYSTEM OF THE PEOPLE'S REPUBLIC OF CHINA IN A NUTSHELL* 8–9 (West, 2d ed. 2009).

⁴⁰ See Guojia Zizhu Chuangxin Changpin Rending Guanli Banfa (Shixing) (国家自主创新产品认定管理办法(试行)) [Trial Measures for the Administration of the Accreditation of National Indigenous Innovation Products] (promulgated by the Ministry of Sci. & Tech., the Nat'l Dev. & Reform Comm'n & the Ministry of Fin., Dec. 28, 2006, effective Dec. 28, 2006), ¶ 2 [hereinafter Trial Measures].

⁴¹ A Chinese legal person is an enterprise or business entity formed under Chinese law. See Ming Fa Tongze (民法通则) [General Principles of the Civil Law] (promulgated by the Standing Comm. Nat'l People's Cong., Apr. 12, 1986, effective Jan. 1, 1987), available at <http://en.chinacourt.org/public/detail.php?id=2696>. Foreign entities can establish a Chinese business entity known as a Foreign-Invested Enterprise under PRC law. See DANIEL C.K. CHOW & ANNA HAN, *DOING BUSINESS IN CHINA: PROBLEMS, CASES, AND MATERIALS* 85 (West 2012) [hereinafter CHOW & HAN, *DOING BUSINESS IN CHINA*].

⁴² See Trial Measures, *supra* note 40, ¶ 3.

⁴³ *Id.* ¶ 4.

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ For example, government entities are required to give priorities in their budgets for the purchase of accredited products. See Zizhu Chuangxin Changpin Zhengfu Caigou Yusan Guanli Banfa (自主创新产品政府采购预算管理办法) [Administrative Measures on Government Procurement Budget for Indigenous Innovation Products] (promulgated by the Ministry of Fin., effective Apr. 3, 2007) (China). Accredited products enjoy financial incentives such as price reductions and extra weight in product evaluations. Zizhu Chuangxin Changpin Zhengfu Caigou Pingshen Banfa (自主创新产品政府采购评审办法) [Evaluation Measures on Indigenous Innovation Products for Government Procurement] (promulgated by the Ministry of Fin., effective Apr. 3, 2007) (China). The Ministry of Finance officially revoked these measures in June 2011, but the American Chamber of Commerce believes that

measures means that few opportunities may exist for non-accredited products in PRC government procurement.

As noted earlier, the goal of these policies is to encourage domestic innovation, and to build and support “national champions.”⁴⁷ By providing financial incentives that favor domestic innovation, the Chinese government hopes to nurture research and develop indigenous capabilities to create advanced technologies rather than relying upon access to technologies from foreign suppliers, which has been the case for China during the past three decades since the beginning of its economic reforms.⁴⁸ China believes that relying on technologies created by foreign countries places China at a significant competitive disadvantage.⁴⁹ In a typical technology transfer transaction that occurs between parties from the United States and China, the United States IP owner will register patents, trademarks, or copyrights with the appropriate PRC authorities.⁵⁰ The U.S. party is the legal owner of the IP rights in China and then licenses the use of the rights to a Chinese entity in a technology transfer agreement.⁵¹ The Chinese licensee is permitted to use the technology but remains a licensee, not an owner.⁵² The disadvantages of this approach are two-fold. First, the U.S. licensor will typically charge licensing fees or royalties, which may be onerous. Second, the U.S. licensor may be unwilling to license its most advanced, cutting-edge technologies, but will only license secondary or outdated technologies to the Chinese licensee.⁵³ U.S. IP owners have held longstanding concerns that any technology that is transferred may be misappropriated or stolen.⁵⁴ An additional concern is that when contract disputes arise between the parties, the technology licensing agreements may be difficult to enforce in Chinese courts.⁵⁵ Another concern is that

challenges persist as local provinces have not stopped applying the national regulations or their own local legislation. See AMCHAM CHINA, AMERICAN BUSINESS IN CHINA: 2013 WHITE PAPER 42 (2013) [hereinafter 2013 WHITE PAPER], available at <http://www.amchamchina.org/article/11206>. For instance, on November 11, 2011, Guangdong Province issued a local regulation providing preferences to indigenous innovation. *Id.* In addition, the central level Ministry of Industry and Information issued its 2012 Catalogue for Indigenous Innovation of Major Technical Equipment on January 12, 2012 to replace the 2009 version, which gave clear preferences to indigenous innovation. The 2012 catalogue does not provide clear guidelines on whether indigenous innovation will still be given preferences leaving U.S. businesses with uncertainty on whether other Chinese central level authorities will respect the 2011 revocation by the Ministry of Finance of the measures creating preferences for indigenous innovation. *Id.* at 44.

⁴⁷ ITC Report, *supra* note 1, at 5-6.

⁴⁸ See *id.* at 5-2-5-3.

⁴⁹ See Siyuan An & Brian Peck, *China's Indigenous Innovation Policy in the Context of its WTO Obligations and Commitments*, 42 GEO. J. INT'L L. 375, 385 (2011).

⁵⁰ See CHOW & HAN, DOING BUSINESS IN CHINA, *supra* note 41, at 321.

⁵¹ *Id.*

⁵² *Id.*

⁵³ See CHOW & SCHOENBAUM, INTERNATIONAL BUSINESS TRANSACTIONS, *supra* note 5, at 328.

⁵⁴ *Id.* at 328.

⁵⁵ Effective enforcement of court judgments in China remains a serious issue. Many barriers, such

when the licensing agreement is terminated, the licensee may continue to use the technology, now in its possession, without permission.⁵⁶ For all of these reasons, U.S. IP owners are concerned about the risks involved in technology transfer contracts. One method of mitigating these risks is to demand high royalty payments. A second method is to license only non-essential and secondary technologies while keeping advanced core technologies in-house.

China has recognized that its dependence on foreign innovation places it at a competitive disadvantage and to some extent at the mercy of foreign IP owners.⁵⁷ China is also keenly aware that it cannot assume a role as a leading economic power unless it becomes an innovator nation. Nations that are innovators not only create competitive products but also set industry standards that other competitors will need to follow.⁵⁸ In the modern global economy, nations can be divided into two categories: (1) innovators and exporters of technology and (2) recipients and importers of technology.⁵⁹ No country that falls in the latter category can be considered to be a leading economic power.⁶⁰ It is no coincidence that the United States, Japan, and certain members of the EU lead the list of innovator countries;⁶¹ China's long-term goal is to be among them. To achieve that goal, China needs to wean itself off its dependence on acquiring technology from foreign nations, with all of its shortcomings, and to develop its own capacity to innovate and create advanced technology. China's Indigenous Innovation Policies are a key component of its strategy to reach this goal.⁶²

as a lack of resources and local protectionism, prevent the enforcement of the majority of court judgments. See CHOW & HAN, *DOING BUSINESS IN CHINA*, *supra* note 40, at 531–32.

⁵⁶ See CHOW & SCHOENBAUM, *INTERNATIONAL BUSINESS TRANSACTIONS*, *supra* note 5, at 325.

⁵⁷ See An & Peck, *supra* note 49, at 385.

⁵⁸ Setting global standards is another part of China's Indigenous Innovation Policies. See ITC Report, *supra* note 1, at 5-12–5-20. China is determined to use its own national standards and to promulgate them on a global level. The promulgation of Chinese standards will give technology that is of Chinese origin a competitive advantage in the world marketplace as other countries will need to adopt China's standards and, in the process, use China's technology. This implicates a second issue under the WTO: China's use of its own national technical standards when international standards are already available and should be used instead. The WTO Agreement on Technical Barriers to Trade (TBT Agreement) requires the use of international standards over national standards whenever international standards are available, so China's policies may be in tension with the TBT. See CHOW & SCHOENBAUM, *INTERNATIONAL TRADE LAW*, *supra* note 10, at 276.

⁵⁹ See CHOW & LEE, *INTERNATIONAL INTELLECTUAL PROPERTY*, *supra* note 6, at 12.

⁶⁰ See *id.*

⁶¹ See *id.*

⁶² See ITC Report, *supra* note 1, at 5-2–5-3 (“[I]ndigenous innovation policies encompass several of the Chinese government’s long-term policy goals, including promoting domestic companies’ contributions to the Chinese economy rather than relying on foreign know-how and technology, building domestic R&D capabilities to upgrade Chinese firms’ innovative capacity, and generally increasing the share of added value that Chinese companies contribute to China’s economy.”).

A. Concerns of U.S. Multinational Companies

China's Indigenous Innovation Policies have caused great consternation and concern among U.S. companies that wish to sell products and services to the Chinese government.⁶³ U.S. companies argue that these policies are discriminatory and are designed to force them to transfer their technology to China.⁶⁴ What exactly are these arguments?

Let us suppose that Company A, a U.S.-based company, wishes to sell products to the PRC government. Company A has patents for the products registered in the United States, as well as patents for the products registered in China.⁶⁵ In order to sell products to the Chinese government, these products must be accredited for government procurement by the appropriate Chinese authorities. Company A is concerned with a measure that only Chinese legal enterprises can apply for accreditation of their products, and the Chinese enterprise must be the full owner of any intellectual property rights embedded in the products or the service.⁶⁶ In this case, although Company A owns the Chinese patent, Company A is not a Chinese legal enterprise, but is a U.S. company. Company A is not entitled to apply for accreditation for its products and, as a result, the Chinese government will not purchase Company A's products. If Company B, a Chinese enterprise, sells competing products that are accredited, then the Chinese government will purchase the products from B, even if the products contain a lower level of technology or are inferior in some other respect to A's products. U.S. companies argue that these

⁶³ See Vicki Needham, *Chinese Policies Hurting U.S. Businesses*, THE HILL (Apr. 26, 2011), <http://thehill.com/blogs/on-the-money/801-economy/157811-chinese-business-policies-hurting-us-businesses> (expressing concern of American Chamber of Commerce (representing U.S. businesses) that China's policies related to indigenous innovation and government procurement favor local companies over foreign competition).

⁶⁴ See Michele Nash-Hoff, *Chinese Innovation Mercantilism is Hurting American Manufacturers*, CAN AM. MFG. BE SAVED? (Dec. 12, 2012), <http://savingsmanufacturing.com/blog/outourcing/chinese-innovation-mercantilism-is-hurting-american-manufacturers/> (claiming that Chinese policies are designed to force technology transfer to China). For a particularly aggressive criticism of how China's Indigenous Innovation Policies are hurting U.S. companies, see ROBERT D. ATKINSON, ITIF, ENOUGH IS ENOUGH: CONFRONTING CHINESE INNOVATION MERCANTILISM (Feb. 2012), <http://www2.itif.org/2012-enough-enough-chinese-mercantilism.pdf>. The U.S. Secretary of the Treasury has publicly stated that China has been "very, very aggressive" in stealing U.S. intellectual property and that China's Indigenous Innovation Policies are a continuation of this strategy. See Timothy Geithner, *China Very, Very Aggressive in Stealing U.S. Technology*, HUFFINGTON POST, http://www.huffingtonpost.com/2011/09/23/timothy-geithner-china-very-aggressive-stealing-technology_n_977509.html (last updated Nov. 23, 2011).

⁶⁵ Under the principle of territoriality, each patent is independent and is a creature of the legal system in which the rights are created and provides protection only within the borders of the nation granting the patent in the absence of an international agreement providing for cross border recognition. Thus, in the example above, Company A has two patents: a U.S. patent and a Chinese patent for the same invention. See CHOW & LEE, INTERNATIONAL INTELLECTUAL PROPERTY, *supra* note 6, at 16–17.

⁶⁶ See Trial Measures, *supra* note 40, ¶¶ 3–4.

policies discriminate against U.S. products and services in Chinese government procurement.⁶⁷

Given China's current policies, how would it be possible for a U.S. company to sell products with U.S. created technology to the Chinese government? One obvious approach would be for a U.S. company to assign or sell ownership of its intellectual property rights to an unaffiliated Chinese legal enterprise.⁶⁸ An assignment is a transfer of complete ownership of the intellectual property, so the Chinese purchaser now becomes the owner of the technology and can obtain accreditation for the products made using the technology. Company A has been able to earn a profit by selling its technology to a Chinese purchaser, so in this sense Company A has been able to benefit indirectly from China's government procurement. However, since the advanced technology itself is the most valuable business asset in this transaction,⁶⁹ not the products that embody the technology,⁷⁰ most MNCs would find such an approach to be completely unacceptable.

An alternative, less-drastic method that will allow the U.S. IP owner to retain some control over the technology involves a series of complicated steps beginning with establishing a business entity in China, which the U.S. company will own in whole or in part. The Chinese business entity will then serve as the recipient of the technology. This process necessarily involves the transfer of technology to the Chinese business entity. This required step is what U.S. companies are referring to when they claim that China's policies are "forcing" them to transfer their IP to China.⁷¹ A

⁶⁷ This scenario has played out in a number of industries, affecting U.S. wind energy companies, telecommunications manufacturers, software companies, and the automotive industry. For example, "[f]oreign firms have limited access to the government procurement market, which accounts for all of the largest wind farm projects in China. This situation sharply limits the prospects for U.S.-based wind energy companies in China. Chinese joint-venture companies that are majority foreign-owned reportedly are not considered to be domestic companies in the concession process, largely excluding foreign firms that have invested in local production in China." U.S. INT'L TRADE COMM'N, CHINA: EFFECTS OF INTELLECTUAL PROPERTY INFRINGEMENT AND INDIGENOUS INNOVATION POLICIES ON THE U.S. ECONOMY 5-19 (2011), available at <http://www.usitc.gov/publications/332/pub4226.pdf>.

⁶⁸ The proper procedure is for A to assign its Chinese patent to a Chinese legal enterprise, which becomes the new owner. See CHOW & SCHOENBAUM, INTERNATIONAL BUSINESS TRANSACTIONS, *supra* note 5, at 328-29.

⁶⁹ For a discussion of the importance of technology in modern international business, see *id.* at 324-25.

⁷⁰ For example, assume that a high quality detergent contains an enzyme formula that is protected by a patent in China. For the purposes of this Article, the technology involved is the enzyme formula, not the detergent. The enzyme formula is the core business asset, not the boxes of detergent that are sold to the Chinese buyer. Assigning the patent to a Chinese business entity would grant the assignee the know-how to make the formula to use it in all detergent in the future.

⁷¹ The argument that China is "forcing" U.S. companies to transfer their technology is often made in the popular press. See, e.g., Robert Oak, *China's Indigenous Innovation Policy Bigger Threat to U.S. Economy Than Offshore Outsourcing*, ECONOMIC POPULIST (June 18, 2012), <http://www.economicpopulist.org/content/chinas-indigenous-innovation-policy-bigger-threat-us->

detailed discussion of these steps follows below.

The MNC will first have to set up a Foreign-Invested Enterprise (FIE) in China. By law, an FIE is a Chinese legal entity that is a special vehicle designed for foreign direct investment, i.e., a recipient of foreign capital and technology.⁷² The FIE is set up and owned by a foreign entity, i.e., an entity that is a national of a country other than China.⁷³ All FIEs must be specifically approved by the Chinese government and operate under a legal regime specifically designed for FIEs.⁷⁴ An FIE could be a joint venture, i.e., a business entity that is jointly owned by the U.S. company and a local Chinese partner, or it can be a wholly foreign-owned enterprise (WFOE), which is essentially a wholly-owned subsidiary of the MNC.⁷⁵ Although an FIE is partly or wholly owned by the U.S. multinational company, the FIE is a business entity formed under Chinese law, so it is a Chinese legal person. The next step is for the U.S. MNC to have the Chinese legal enterprise register the U.S. company's intellectual property rights in the name of the Chinese business entity. For example, if Company A has a U.S. patent for an invention, then Company A will authorize its FIE to register the same patent in China using the FIE's own name. The registration of the patent in China under the name of the FIE means that the FIE now becomes the official and legal owner of the patent in China.⁷⁶ Finally, the FIE manufactures the product using the patent or other intellectual property registered in the FIE's own name. At this point, the FIE, a Chinese legal person that owns the IP rights, can now apply for accreditation for its property because the FIE has fulfilled all of the requirements for accreditation under China's Indigenous Innovation Policies. This process is what U.S. companies describe as "forcing" them to transfer their technologies to China in order to bid on PRC government

economy-offshore-outsourcing ("China's indigenous innovation policy means corporations are forced to technology transfer to China their intellectual know-how, advanced technologies in order to even do business in China and certain to obtain Chinese government contracts."). These arguments do not set out in detail the discussion in the text on the use of Chinese business entities by which this technology transfer is accomplished. The discussion below sets forth a step-by-step procedure for technology transfer that will allow a U.S. corporation to qualify for accreditation in order to sell to the Chinese government.

⁷² See CHOW & HAN, *DOING BUSINESS IN CHINA*, *supra* note 41, at 85.

⁷³ *See id.*

⁷⁴ *See id.*

⁷⁵ See CHOW & HAN, *DOING BUSINESS IN CHINA*, *supra* note 41, Chapter 2.

⁷⁶ *Zhonghua Renmin Gonghe Guo Zhuanli Fa* (中华人民共和国专利法) [Patent Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 27, 2008, effective Oct. 1, 2009), art. 8, available at http://www.wipo.int/wipolex/en/text.jsp?file_id=178664 ("After the application is granted, the applying unit(s) or individual(s) shall be deemed the patentee(s)."). The PRC Patent Law distinguishes only between foreigners, foreign enterprise, and foreign organizations without a regular residence or business site in China on one hand and Chinese companies and individuals on the other. *Id.* arts. 18–19. FIEs are Chinese companies so they can apply for patent rights. See GRAHAM BROWN, *CHINA COMPANY LAW GUIDE* 29–110 (2005).

procurement contracts.⁷⁷

B. Risks to U.S. Companies in Complying with China's
Accreditation Policies

From the perspective of U.S. MNCs, going through all of the steps set forth above in order to meet the conditions to obtain accreditation and to have its products qualify for government procurement in China is both burdensome and full of risk.⁷⁸ Setting up an FIE in China is a time consuming process. For example, setting up a joint venture can easily take 18 months from the start of negotiations to the final approval of the joint venture by the appropriate authorities.⁷⁹ Unlike the simple procedure for establishing a corporation in most states in the United States, the approval of an FIE involves numerous meetings with PRC authorities, who will make specific and detailed demands. A major concern of the PRC approval authorities is that the FIE must have sufficient capital in order to operate as a going concern. For this reason, PRC authorities will often insist on injections of capital in the millions or tens of millions of dollars as a condition of approval.⁸⁰

A second, and perhaps even greater concern, is risk created by the transfer of technology to the FIE. Once the IP is registered in its name, the FIE is the legal owner of the technology in China, not the MNC.⁸¹ In cases where the FIE is a joint venture, the local Chinese partner becomes a partial owner of the IP in proportion to the equity ownership of the local partner in the joint venture.⁸² Even where the MNC is the sole owner of the FIE as in the case of a WFOE, the FIE is a separate legal person. The FIE is a

⁷⁷ This is the author's own elaboration and explanation of arguments by U.S. companies.

⁷⁸ Setting up an FIE consumes a great deal of senior management time and involves many layers of government approval. See CHOW & SCHOENBAUM, INTERNATIONAL BUSINESS TRANSACTIONS, *supra* note 5, at 489–94.

⁷⁹ See *id.* at 493.

⁸⁰ This observation is based on the author's own working experience as in-house counsel for a multinational company in China. The author attended a number of meetings with PRC approval authorities in which PRC officials made specific requests concerning capital requirements in connection with several joint ventures that the multinational company was in the process of establishing. PRC officials want to ensure that the new business entity will be successful and so will insist on an injection of sufficient capital to allow the entity to meet all of its operational needs. If anything, PRC officials err on the side of requiring more capital, rather than less. From the author's own experience there are numerous joint ventures in China with capital requirements of tens of millions of dollars.

⁸¹ See CHOW & HAN, DOING BUSINESS IN CHINA, *supra* note 41, at 321.

⁸² See *id.* If the local joint venture partner owns 40% of the equity of the joint venture, the joint venture partner owns 40% of the joint venture's assets, including the intellectual property rights. See Zhonghua Renmin Gonghe Guo Zhongwai Hezi Jingying Qiye Fa (中华人民共和国中外合资经营企业法) [Sino-Foreign Equity Joint Venture Enterprise Law of the People's Republic of China] (promulgated by the Nat'l People's Cong., Mar. 15, 2001, effective Mar. 15, 2001), art 4, available at <http://www.china.org.cn/english/DAT/214773.htm>.

Chinese legal entity with its own management. While the management of a wholly-owned entity will usually follow instructions from the parent company, there can be cases where disagreement and conflict arise between parent and subsidiary.⁸³ The FIE, even where it is a WFOE, can legally transfer the IP rights without the consent of the parent since the FIE is the legal owner of the IP rights in China and the parent has no ability to stop such a transfer because it has relinquished ownership rights to the FIE.⁸⁴ The FIE might lose the IP rights for other reasons, such as insolvency, debt, or a hostile merger and acquisition.⁸⁵ The risk is that as soon as the IP is in the name of the FIE, not in the name of the U.S. company, the IP can be transferred, assigned, or lost without any control by the U.S. company.⁸⁶ This type of risk is why all MNCs that do business in China (or in any other country) will insist on registering the IP in their own names in the foreign country so that they remain the legal owners and can then license the IP to their own subsidiaries or joint ventures.⁸⁷

A third and related risk is misappropriation or theft. If the U.S. company must transfer its IP rights to a Chinese legal entity, then the IP rights might become exposed to misappropriation, theft, or counterfeiting.⁸⁸ Theft of IP rights is always a risk in China but under PRC law, generally only the registered owner of the IP right can bring an enforcement action.⁸⁹ Since the FIE is technically the legal owner, not the U.S. company, only the FIE can bring an enforcement action, such as a lawsuit or an administrative action.⁹⁰ Again, even where the FIE is a wholly-owned entity of the MNC,

⁸³ See CHOW & HAN, *DOING BUSINESS IN CHINA*, *supra* note 41, at 321.

⁸⁴ See *id.* As the registered owner of the patent, the FIE has authority to assign the patent to a new owner. If the U.S. parent company has an agreement with the FIE that the FIE will not assign the patent, the agreement creates a contract right, not an intellectual property right. If the FIE assigns the patent in disregard of the agreement, the U.S. parent may have a breach of contract claim against the FIE, but the assignment is still legally valid, and the U.S. parent still lacks the direct right to enforce the patent.

⁸⁵ See CHOW & HAN, *DOING BUSINESS IN CHINA*, *supra* note 41, at 321.

⁸⁶ *Id.*

⁸⁷ *Id.* If the U.S. company is the licensor of the IP rights and the foreign subsidiary is the licensee, the subsidiary has no authority to transfer any intellectual property rights. The license can provide that in the event of such intervening events, such as insolvency, the license will terminate, leaving the parent company as the owner of the IP rights. *Id.* at 320–22.

⁸⁸ Counterfeiting and commercial piracy are considered to be serious business problems in China. *Id.* at 375.

⁸⁹ For example, only the registered trademark owner can bring a trademark enforcement action. Zhonghua Renmin Gongheguo Shangbiao Fa (中华人民共和国商标法) [Patent Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 27, 2008, effective Oct. 1, 2009), art. 53, available at http://www.wipo.int/wipolex/en/text.jsp?file_id=131395.

⁹⁰ Patent Law of the People's Republic of China, *supra* note 76, art. 60 ("If a dispute arises as a result of exploitation of a patent without permission of the patentee, that is, the patent right of the patentee is infringed, the dispute shall be settled through consultation between the parties. If the parties are not willing to consult or if consultation fails, the patentee or interested party may take legal action before a people's court, and may also request the administration department for patent-related work to

the MNC is unable to take any action on its own to protect the IP rights, and it must rely on the FIE.⁹¹ Thus, once the IP rights are registered in the name of the FIE, the U.S. company has lost the ability to exercise direct control over how the rights are to be protected.⁹² The exposure of IP rights to misappropriation and theft once the rights are transferred to the FIE is what U.S. companies mean when they claim that China's Indigenous Innovation Policies are designed to allow China to "steal" their IP rights.⁹³

An additional risk is that once Chinese entities obtain technology transferred from U.S. IP owners, these entities will use the technology to compete with the U.S. IP owners in China and in other countries.⁹⁴ China will use the advanced technology to improve its own international competitiveness and may eventually leapfrog the innovator of the technology.⁹⁵ In other words, U.S. companies fear that they are giving China the very tools to overtake them in the global economy, a concern that many observers believe has already been realized in practice.⁹⁶

MNCs view the many risks attendant in meeting the requirements set forth under China's Indigenous Innovation Policies to qualify for accreditation as serious barriers.⁹⁷ Few U.S. companies are likely willing to undertake the time, to expend the resources, and to incur the risks involved in undergoing the process described above to qualify for

handle the dispute.").

⁹¹ The U.S. company might enter into an agreement under which the FIE will enforce all IP rights on behalf of the parent, but if the FIE refuses to enforce the rights for any reason, the U.S. company will have only a breach of contract action against the FIE. Since the IP rights are in the name of the FIE as the owner, the U.S. company has no legal interest in the rights and would still be unable to directly enforce the IP rights. *See id.* This is the basic shortcoming of relying on an FIE to enforce the IP rights of a U.S. parent company.

⁹² The U.S. company is faced with a dilemma here. If the U.S. company wants to be able to directly enforce its IP rights, it must register the IP right in its own name. However, registering the IP right in its own name will disqualify the U.S. company from receiving accreditation for government procurement. In order to receive accreditation, the U.S. company must allow the FIE, a Chinese legal entity, to register the IP right. This forces the U.S. company to lose direct control over how the IP rights are enforced.

⁹³ *See Geithner, supra* note 64 (quoting U.S. Treasury Secretary Geithner as saying: "We're seeing China continue to be very, very aggressive in a strategy they started several decades ago, which goes like this: you want to sell to our country, we want you to come produce here . . . if you want to come produce here, you need to transfer your technology to us.").

⁹⁴ *See ITC Report, supra* note 1, at 5-1 ("[F]oreign businesses have reportedly been pressured to transfer know-how and technology to Chinese firms in order to gain access to the Chinese market. Businesses are concerned that this IP ultimately will be used by Chinese companies competing against them in China and in third-country markets.").

⁹⁵ This concern is a valid one but it may be too late to prevent the consequences discussed above. In fact, China has used technology obtained from foreign technology transfers to transform itself from an agrarian-based economy into an industrial power in the span of just a few decades. *See CHOW & LEE, INTERNATIONAL INTELLECTUAL PROPERTY, supra* note 6, at 15.

⁹⁶ *See id.*

⁹⁷ *See supra* Part II.B.

accreditation.⁹⁸ As a result, U.S. companies risk being shut out of the lucrative government procurement in China while Chinese companies have the option of selling to U.S. states in local government procurement.⁹⁹ Many U.S. companies believe that this situation is unfair and some argue that it is illegal under the WTO.¹⁰⁰

III. ANALYSIS OF CHINA'S OBLIGATIONS UNDER THE WTO

Rather than undertaking the risks of qualifying their products for government procurement as discussed above, U.S. companies have chosen to pressure China to change its Indigenous Innovation Policies.¹⁰¹ Several of these critics contend that China has failed to fulfill its WTO obligations contained in the WTO Agreements and in China's Protocol of Accession.¹⁰² Critics argue that the United States government should file a case against China in the WTO dispute settlement system unless China withdraws or modifies its government procurement policies to allow equal access by U.S. companies.¹⁰³ This part of the Article examines the merits of these arguments and this strategy in detail, and shows that the Chinese government is not required under WTO undertakings to change its procurement policies.

⁹⁸ “[A]s of September 2010, a number of provincial indigenous innovation catalogues are in effect There are almost no products made by foreign companies in these catalogues, a pattern that seemingly excludes foreign companies from provincial government procurement markets unless there is no Chinese-made alternative to a foreign product For example, only two of the 523 products in Shanghai’s catalogue were made by FIEs, both of which have majority Chinese ownership; Jiangxi’s 475-product catalogue includes only one from an FIE; and Beijing’s government procurement catalogues include only one foreign product out of 56 listed.” ITC Report, *supra* note 1, at 5-12.

⁹⁹ See Barboza, *supra* note 21, at A-1, A-4 (describing the California and New York state purchase of massive infrastructure projects from China).

¹⁰⁰ See *infra* Part III.

¹⁰¹ See Paul Eckert, *Lawmakers Urge Firm Line on China in Bilateral Talks*, REUTERS, July 9, 2013, available at <http://www.reuters.com/article/2013/07/09/us-usa-china-congress-idUSBRE9681AM20130709> (“Among the Chinese practices the lawmakers said required more U.S. pressure to change were ‘indigenous innovation’ policies that require foreigners to transfer technology to China in order to sell into the market . . .”).

¹⁰² China’s Protocol of Accession is the legal document that effects China’s entry into the WTO and that also creates binding WTO obligations on par with any of the WTO Agreements. See *infra* Part III.B.

¹⁰³ See, e.g., Chris Isidore, *U.S. vs. China: The Trade Battles*, CNN MONEY (Mar. 13, 2012, 4:03 PM), <http://money.cnn.com/2012/03/13/news/international/china-trade/index.htm> (“And while U.S. businesses in a wide variety of industry sectors, from autos to technology to financial services, are unusually vocal in complaining about this set of Chinese rules, they haven’t been challenged at the WTO. ‘To me, that’s actually the biggest issue, more even than currency valuation,’ said David Joy, chief market strategist for Ameriprise Financial. ‘Being forced to give up technology for access to the market is essentially blackmail.’”). See also ATKINSON, *supra* note 64, at 76 (asserting the necessity of a WTO resolution).

A. The National Treatment Principle

The WTO sets forth the legal framework for trade and economic relations among its member states in number 157, which, as of this writing, includes all of the world's major trading powers.¹⁰⁴ The WTO contains three major treaties which are mandatory and binding upon all members upon accession to the WTO: (1) the General Agreement on Tariffs and Trade (GATT), governing the trade in goods; (2) the General Agreement on Trade in Services (GATS), governing the trade in services; and (3) the Agreement on Trade-Related Intellectual Property Rights (TRIPS), governing the trade in technology or intellectual property.¹⁰⁵ Together, these three agreements, each administered by a WTO body dedicated to each agreement, govern three of the four major channels of international trade.¹⁰⁶ For historical and political reasons, only foreign direct investment, the fourth major channel of trade, is not covered by a WTO agreement.¹⁰⁷ A fourth major agreement, the Dispute Settlement Understanding (DSU), is also a mandatory agreement which governs the resolution of disputes and creates an effective enforcement mechanism of WTO obligations.¹⁰⁸

One of the foundational principles of the WTO is the National Treatment Principle, first enshrined in the GATT in 1947¹⁰⁹ but now also found in the GATS¹¹⁰ and TRIPS.¹¹¹ GATT Article III provides in relevant part:

Article III National Treatment on Internal Taxation and Treatment

1. The contracting parties recognize that internal taxes and other

¹⁰⁴ *WTO Members and Observers*, WORLD TRADE ORG., http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm (last visited Sept. 23, 2013).

¹⁰⁵ See CHOW & SCHOENBAUM, *INTERNATIONAL TRADE LAW*, *supra* note 10, at 28.

¹⁰⁶ *See id.*

¹⁰⁷ *See id.* at 567, 570. An attempt was made to draft a general agreement, the Multilateral Agreement on Investment (MAI), but the MAI, drafted by the Organization of Economic Cooperation and Development, based in Paris and comprised of advanced industrialized countries, failed to win support due to unprecedented opposition by developing countries, which believed that their interests were not represented. After the failure of the MAI, the priorities of the WTO shifted to other areas of concern, such as agriculture and food security, environmental protection, and access to medicines. There appears to be little political will to resuscitate any attempts to create a general agreement on foreign investment. For a fuller discussion, see *id.* at 570.

¹⁰⁸ *See id.* at 28.

¹⁰⁹ *See* General Agreement on Tariffs and Trade art. III, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194 [hereinafter GATT].

¹¹⁰ *See* General Agreement on Trade in Services arts. II, XVII, Apr. 15, 1994, 1869 U.N.T.S. 183 [hereinafter GATS].

¹¹¹ *See* Agreement on Trade Related Intellectual Property Rights, arts. 3–4, April 15, 1994, 1869 U.N.T.S. 299 [hereinafter TRIPS].

internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.

4. The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.¹¹²

GATT Articles III:1 and III:4 set forth a principle of non-discrimination against foreign imports, i.e., WTO members cannot impose laws or regulations that discriminate in the purchase or sale of foreign goods in favor of local goods, but must provide equal treatment to both types of goods. The National Treatment Principle is a principle of non-discrimination designed to prohibit countries from discriminating against imports in favor of domestic products.¹¹³ The National Treatment Principle does not depend on actual effects¹¹⁴: no discrimination in practice must be proven; National Treatment requires equality in competitive conditions for imports and local products.¹¹⁵

GATT Article III:1 and III:4, however, are limited by an explicit exception contained in GATT Article III:8, which provides as follows:

8(a). The provisions of this Article shall not apply to laws, regulations, or requirements governing the procurement by governmental agencies of products purchased for governmental purposes and not with a view to commercial resale or with a view to use in the production of goods for commercial sale.¹¹⁶

The combination of the provisions of GATT Article III set forth above shows that the National Treatment Principle is a broad principle of non-discrimination. The principle prohibits WTO members from discriminating

¹¹² GATT, *supra* note 109, art. III.

¹¹³ See CHOW & SCHOENBAUM, INTERNATIONAL TRADE LAW, *supra* note 10, at 142.

¹¹⁴ See *id.* at 143.

¹¹⁵ See GATT, *supra* note 109, art. III:8(a).

¹¹⁶ *Id.*

against foreign goods in favor of domestic products, but it does not apply to government procurement.¹¹⁷ In the area of government procurement, Article III:8(a) creates an exception to National Treatment; Article III:8(a) makes clear that nothing in the GATT prevents WTO members from discriminating against imports in favor of domestic goods in government procurement.¹¹⁸ When the GATT was originally drafted in 1947, the drafters believed that it was important to exempt government procurement from the National Treatment Principle in recognition of the importance to many countries of buying goods from domestic suppliers in order to support their own economies.¹¹⁹ Due to the same policies and concerns, a similar provision in GATS also exempts government procurement of services from the National Treatment principle.¹²⁰ Thus, under the GATT, which applies to trade in goods, and the GATS, which applies to trade in services, WTO members are free to discriminate against foreign goods and services in favor of domestic goods and services in government procurement.¹²¹

After the original GATT came into effect in 1947, government procurement became an increasingly important part of international trade and an effort was made to adopt some standards to prevent discrimination in government procurement of foreign goods.¹²² An agreement on government procurement, requiring National Treatment as applied to goods

¹¹⁷ *Id.*

¹¹⁸ *See* CHOW & SCHOENBAUM, INTERNATIONAL TRADE LAW, *supra* note 10, at 173.

¹¹⁹ *See id.*

¹²⁰ GATS art. XVII provides in relevant part:

National Treatment

1. In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers.

See GATS art. XVII. GATS Article XIII(1) states in relevant part:

1. Article . . . XVII shall not apply to laws, regulations or requirements governing the procurement by governmental agencies of services purchased for governmental purposes and not with a view to commercial resale or with a view to use in the supply of services for commercial sale.

2. There shall be multilateral negotiations on government procurement in services under this Agreement within two years from the date of entry into force of the WTO Agreement.

See also GATS art. XIII(1).

¹²¹ *See* GATT, *supra* note 109, art. III; GATS, *supra* note 110, arts. II, XVII.

¹²² *See id.*

only, was negotiated during the Tokyo Round and entered into force on January 1, 1981.¹²³ The Tokyo Agreement, like all subsequent agreements on government procurement, was binding only on countries that chose to join the agreement.¹²⁴ The Tokyo Agreement was narrow in scope and coverage¹²⁵ and negotiations were conducted during the Uruguay Round, begun in 1986, to greatly expand it.¹²⁶ At the end of the Uruguay Round of negotiations, which led to the establishment of the WTO, the Government Procurement Agreement was adopted in 1994 and recently a new GPA was adopted in 2011 (2011 GPA).¹²⁷ Article IV of the 2011 GPA provides:

Article IV: Non-Discrimination

1. With respect to any measure regarding covered procurement, each Party, including the procuring entities, shall accord immediately and unconditionally to the goods and services of any other Party and to the suppliers of any other Party offering the goods or services of any Party, treatment no less favourable than the treatment the Party, including its procuring entities, accords to:

(a) domestic goods, services and suppliers; and

(b) goods services and suppliers of any other Party.¹²⁸

¹²³ *Plurilaterals: Of Minority Interest*, WORLD TRADE ORG., http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm10_e.htm#govt (last visited Sept. 20, 2013).

¹²⁴ *See id.*

¹²⁵ The Tokyo Agreement applied only to national entities and to tendering procedures for the purchase of goods. The present agreement achieves a tenfold expansion in coverage, which now includes sub-national government entities and trade in services. *See id.*

¹²⁶ *See id.*

¹²⁷ *See* CHOW & SCHOENBAUM, *INTERNATIONAL TRADE LAW*, *supra* note 10, at 174. The 2011 GPA expands the number of central and sub-central government entities as well as government owned enterprises that are covered by GPA commitments and adds over fifty new categories of services. The 2011 GPA was also designed to expedite accession of new members, such as China. *See id.* at 173–74.

¹²⁸ *See* Comm. on Gov't Procurement, *Decision on the Outcomes of the Negotiations Under Article XXIV:7 of the Agreement on Government Procurement, Annex to the Protocol Amending the Agreement on Government Procurement*, art. IV, WTO Doc. No. GPA/113 (Apr. 2, 2012). The full text of the 2011 GPA is contained in the Annex to the Protocol amending the Agreement on Government Procurement, which is attached to the March 2012 Decision. Under paragraph 2 of the March 2012 Decision, the Protocol Amending the 1994 Government Procurement Agreement—that is, the 2011 GPA—will enter into force on the 30th day following deposits of acceptance of the Protocol by two thirds of the Parties to the 1994 GPA. So far the EU, the United States, Hong Kong/China, the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu, Canada, Norway, and Liechtenstein have deposited instruments of acceptance of the Protocol. As there are 15 parties to the GPA, the 2011 GPA will come into effect when 3 more parties deposit their instruments of acceptance. The deposits are considered a formality since all members of the GPA have already agreed to adopt the 2011 GPA, and the March 12 Decision “means that all elements of the re-negotiations have now been agreed and that

The result of Article IV:(1)(a) of the 2011 GPA is that it removes the exception for government procurement contained in GATT Article III:8(a) for members of the GPA because all GPA members must extend non-discriminatory treatment in government procurement of goods and services from foreign vendors from other GPA countries. In purchasing goods and services, governments of GPA members must provide to foreign goods and services from other GPA countries “treatment no less favourable than the treatment the Party . . . accords to . . . domestic goods, services, and suppliers.”¹²⁹ This treatment has been interpreted to mean equality in the conditions of competition such as equality in the bidding conditions by domestic and foreign suppliers for government contracts and in the award of government contracts.¹³⁰ No GPA member can discriminate in favor of its own domestic vendors of goods or services and against goods or services from other members of the GPA.¹³¹

Note that members of the GPA are required to apply this obligation of non-discrimination only to goods and services from other GPA members.¹³² Article IV:1(b) of the 2011 GPA requires that the GPA signatories (including the United States) “shall accord immediately and unconditionally to the goods and services of any *other* Party . . . treatment no less favorable than the treatment the Party . . . accords to . . . goods, services and suppliers of any *other* Party.”¹³³ “[O]ther Party” refers to other parties of the GPA, so all GPA members are entitled to receive treatment equivalent to that afforded to any “other party” of the GPA.¹³⁴ In other words, the United States is required to extend non-discriminatory treatment in government procurement to other GPA members, but it is not required to provide non-discriminatory treatment in government procurement to China or any other member of the WTO that is not a member of the GPA.¹³⁵ However, this prohibition applies only to the federal government or entities using federal funds. States are free to use state funds to purchase goods and services from China.¹³⁶ Some states,

the revised Agreement can enter into force subject to the submission of instruments of acceptance by GPA Parties.” *Id.*

¹²⁹ *Id.* art. IV:1(a)–(b).

¹³⁰ *Id.* art. IV (Non-Discrimination), art. VIII (Conditions for Participation), art. IX (Qualification of Suppliers); art. XIII (Limited Tendering); art. XV (Treatment of Tenders and Awarding of Contracts).

¹³¹ *Id.* art. IV:1(a)–(b).

¹³² *Id.* art. IV:1(b).

¹³³ *Id.* (emphasis added).

¹³⁴ *See supra* note 128.

¹³⁵ *See* Trade Agreements Act of 1979, 19 U.S.C. §§ 2501–2518 (2006), §§ 301, 302, 308.

¹³⁶ *See, e.g.,* Richard Gonzales, *California Turns to China for New Bay Bridge*, NPR (Sept. 16,

such as New York and California, have purchased billions of dollars of public works from China.¹³⁷ This scheme suggests that China is able to benefit from government procurement from the United States at the state level, but that China discriminates at all levels, both central and local, against all U.S. vendors in its government procurement. Some view this relationship as non-reciprocal and unfair to the United States.¹³⁸

While China's discriminatory government procurement policies would violate the GPA if China were a member of the GPA, China is not a member and has no obligation to join the GPA. Unlike the GATT, GATS, TRIPS, and the DSU, which are automatically binding on all WTO members upon accession to the WTO, the GPA is a "plurilateral" agreement, which means that it is voluntary.¹³⁹ As of this writing, there are fifteen members of the GPA composed of forty-two WTO members (the EU has joined on behalf of its twenty-seven member states) and virtually all are developed countries.¹⁴⁰ Since the WTO has 157 member states, the bulk of the WTO are not members of the GPA, and most of these states are developing countries. It is important to note that even those states that are members of the GPA are allowed to exclude certain government entities from GPA obligations, and excluded government entities are free to discriminate in favor of domestic goods.¹⁴¹ As we shall see, the ability of GPA members to exclude government entities from the GPA is an important element in the current controversy between the United States and China.¹⁴²

While China is not currently a member of the GPA, China has been negotiating with GPA members, led by the United States and the European

2011), <http://www.npr.org/2011/09/16/140515737/california-turns-to-china-for-new-bay-bridge>. State actions like these do not mean, however, that the federal government has not attempted to emphasize its desire to curtail U.S. spending in China by states. See China Fair Trade Act of 2012, S. 3449, 112th Congress (2d Sess. 2012).

¹³⁷ See Barboza, *supra* note 21, at A1.

¹³⁸ Pointing out the non-reciprocal relationship in government procurement between the United States and China, recent presidential candidate Mitt Romney vowed to discontinue all government procurement from China until China joined the GPA. See *Mitt Romney Wants Reciprocity with China When It Comes to Government Procurement*, ALLIANCE FOR AM. MFG. BLOG (Apr. 19, 2012), <http://americanmanufacturing.org/blog/mitt-romney-wants-reciprocity-china-when-it-comes-government-procurement>.

¹³⁹ See CHOW & SCHOENBAUM, INTERNATIONAL TRADE LAW, *supra* note 10, at 173. No nation is required to join the GPA. Nations that join do so when they believe that it is in their own economic interests. For official WTO site and explanation, see *Overview of the Government Procurement Agreement*, *supra* note 29.

¹⁴⁰ See CHOW & SCHOENBAUM, INTERNATIONAL TRADE LAW, *supra* note 10, at 173.

¹⁴¹ See *id.* The new 2011 GPA is a major advancement because GPA members have committed to include many new government entities within the scope of GPA obligations.

¹⁴² See *infra* note 212 and accompanying text. The ability to exclude government entities from GPA commitments is consistent with the voluntary nature of the GPA. WTO members can choose to join the GPA on terms and conditions as they determine.

Union, for accession to the GPA for several years.¹⁴³ Yet, the prospects for China's accession in the immediate future appear to be dim.¹⁴⁴ Recently, the United States opposed China's offer of accession to the GPA on the grounds that China's offer excluded too many government entities from GPA obligations.¹⁴⁵

B. Arguments That China's Indigenous Innovation Policies Violate WTO Obligations

Although China is not a member of the GPA and is not bound to extend National Treatment to foreign goods in government procurement, a number of critics have argued that China's Indigenous Innovation Policies violate other WTO obligations.¹⁴⁶ These obligations can be divided into two groups: procedural and substantive obligations.

1. Violations of Procedural Obligations

The WTO contains a number of provisions requiring transparency, a basic principle of the WTO contained in GATT X. Article X:1 requires the prompt publication of laws, regulations, and administrative rulings that affect the sale and distribution of goods in a manner that will enable governments to become familiar with them.¹⁴⁷ GATT Article X:2 further

¹⁴³ Since China's entry into the WTO in 2001, China has made four offers to join the GPA, but GPA members have rejected all of these offers. An "offer" includes a schedule of which Chinese government entities will be bound by the GPA and the volume of trade that will be subject to the GPA. China has a history of making offers that are limited in scope and coverage. If China's offer is accepted by other GPA members, then China is entitled to the full benefits of the much more expansive schedules of the United States and the European Union. The European Union was very critical of China's latest offer. See Terrill Yue Jones, *Europe Says China's Latest Bid to Join Procurement Agreement "Highly Disappointing,"* REUTERS (Dec. 6, 2012, 5:28 AM), <http://www.reuters.com/article/2012/12/06/us-china-eu-trade-idUSBRE8B50G720121206>.

¹⁴⁴ See *China Announces Next Step in Joining Government Procurement Agreement*, WORLD TRADE ORG. (July 18, 2012), http://www.wto.org/english/news_e/news12_e/gpro_18jul12_e.htm.

¹⁴⁵ See Paul Eckert, *China Agreements to Currency, Procurement Reforms in Talks with U.S.*, REUTERS, July 12, 2013, available at <http://www.reuters.com/article/2013/07/12/us-usa-china-economy-idUSBRE96B0MI20130712> (noting that China's recent bid in 2012 did not pass muster with the United States).

¹⁴⁶ See, e.g., An & Peck, *supra* note 49.

¹⁴⁷ GATT Article X:1 provides in relevant part:

1. Laws, regulations, judicial decisions and administrative rulings of general application made effective by any contracting party, pertaining to the classification or the valuation of products for customs purposes, or to rates of duty, taxes or other charges, or to requirements, restrictions or prohibitions on imports or exports or on the transfer of payments therefor, of affecting their sale, distribution . . . shall be published promptly in such a manner as to enable governments and traders to become acquainted with them.

requires that countries should have a reasonable opportunity to acquire information about such measures in order to protect and adjust their interests or to seek modification of such measures.¹⁴⁸

An additional set of transparency obligations are contained in China's Protocol of Accession.¹⁴⁹ The Working Party Report, leading up to China's Protocol of Accession, states that China's laws, regulations, and administrative rulings must be made available to the public.¹⁵⁰ The Protocol of Accession states that with respect to laws, regulations, and other measures affecting the trade in goods, WTO members are to be allowed a "reasonable period for comment to the appropriate authorities before such measures are implemented."¹⁵¹ The Working Party Report requires that China "make available to WTO Members translations into one or more of the official languages of the WTO all laws, regulations and other measures . . . affecting the trade in goods . . . in no case later than 90 days after they were implemented or enforced."¹⁵²

A related transparency argument is that China may also be in possible violation of GATT Article X:3(a) requiring the uniform, impartial, and reasonable administration of laws and regulations pertaining to the trade in goods.¹⁵³ Part I.2(A) of China's Protocol of Accession also contains a requirement that "China shall apply and administer in a uniform, impartial and reasonable manner" laws and regulations pertaining to the trade in goods.¹⁵⁴ A related transparency argument is that China may also be in possible violation of GATT Article X:3(a) requiring the uniform, impartial, and reasonable administration of laws and regulations pertaining to the trade in goods.¹⁵⁵ Part I.2(A) of China's Protocol of Accession also

See GATT, *supra* note 109, art. X:1.

¹⁴⁸ GATT Article X:2 provides in relevant part:

2. No measure of general application taken by any contracting party effecting an advance in a rate of duty or other charge on imports under an established uniform practice, or imposing a new or more burdensome requirement, restriction or prohibition on imports, or on the transfer of payments therefor, shall be enforced before such measure has been officially published.

See id. art. X:2.

¹⁴⁹ *See* China's Protocol of Accession, *supra* note 35, Part I.4(C).

¹⁵⁰ *See* Working Party on the Accession of China, *Working Party Report on the Accession of China*, WT/ACC/CHN/49 (Oct. 1, 2001), ¶ 339, available at <http://unpan1.un.org/intradoc/groups/public/documents/apcity/unpan002144.pdf> [hereinafter Working Party Report].

¹⁵¹ China's Protocol of Accession, *supra* note 35, Part 1, ¶ 2(C)(1)–(2).

¹⁵² *See* Working Party Report, *supra* note 150, ¶ 334.

¹⁵³ GATT Article X:3(a) provides in relevant part: "Each contracting party shall administer in a uniform, impartial and reasonable manner of its laws, regulations, decisions and rulings of the kind described in paragraph 1 of this Article." *See* GATT, *supra* note 109, art. X:3(a).

¹⁵⁴ *See* China's Protocol of Accession, *supra* note 35, Part 1, ¶ 2(A)(2).

¹⁵⁵ GATT Article X:3(a) provides in relevant part: "Each contracting party shall administer in a uniform, impartial and reasonable manner of its laws, regulations, decisions and rulings of the kind

contains a requirement that “China shall apply and administer in a uniform, impartial and reasonable manner” laws and regulations pertaining to the trade in goods.¹⁵⁶ These two provisions require the administration of laws in a transparent manner and many argue that China applies its accreditation policies through internal processes that are not made publically available.¹⁵⁷

Critics contend that the publication of China’s policies related to the accreditation measures under the Indigenous Innovation Policies failed to satisfy these transparency obligations in a number of ways, including the failure to offer a period for comment and the failure by China to provide translations from Chinese into English or another one of the official languages of the WTO.¹⁵⁸ Several foreign industries claim that China does not administer measures implementing China’s Indigenous Innovation Policies and its Protocol of Accession in an impartial or uniform manner but does so in a haphazard, unpredictable, and non-transparent fashion.¹⁵⁹

These merits of the arguments that China has violated its WTO transparency obligations depend on a number of technical distinctions and arguments that are too detailed to discuss in depth here, including whether China’s policies are the types of measures that are subject to transparency and uniform administration requirements.¹⁶⁰ But these arguments are not to the point. Assuming that China’s measures implementing its policies are subject to and constitute violations of the WTO provisions related to transparency and uniform administration, what are the consequences for China?

In any dispute between WTO members, the ultimate goal of dispute settlement, whether through informal mediation or through the formal litigation process of the WTO Dispute Settlement Body, is for an offending member to bring its non-complying measures into compliance with its WTO obligations.¹⁶¹ Alternatively, the parties may reach a mutually satisfactory solution.¹⁶² This basic approach is set forth in the DSU and is

described in paragraph 1 of this Article.” See GATT *supra* note 109, art. X:3(a).

¹⁵⁶ See China’s Protocol of Accession, *supra* note 35, Part 1, ¶ 2(A)(2).

¹⁵⁷ See Kathrin Hill, *European Companies Attack Chinese Procurement Policy*, FINANCIAL TIMES (Eng.), Apr. 20, 2011, <http://www.ft.com/intl/cms/s/0/94e9b5c4-6af6-11e0-9744-00144feab49a.html#axzz2GRfv55VN> (criticizing local governments and state owned enterprises for setting procurement policies in a non-transparent way).

¹⁵⁸ See An & Peck, *supra* note 49, at 413.

¹⁵⁹ See, e.g., Coalition of Services Industries, *Industry Comments on the Draft Notice Launching the National Indigenous Innovation Product Accreditation Work for 2010*, TIA (May 10, 2010), <http://www.tiaonline.org/sites/default/files/pages/FINALMultiAssocNIIPComments05-07-2010English.pdf>.

¹⁶⁰ For example, whether China has met the transparency requirements of GATT Article X:1 depends on whether China’s measures fall within the scope of GATT Article X:1 relating to sale and distribution and whether the measures have met the timing requirement of GATT Article X:1 that the measures be published in a timely manner so as to allow governments and traders to become acquainted with them. These are very technical issues. See An & Peck, *supra* note 49, at 406–14.

¹⁶¹ See CHOW & SCHOENBAUM, INTERNATIONAL TRADE LAW, *supra* note 10, at 67.

¹⁶² See *id.*

an accepted norm and expectation within the WTO system.¹⁶³ As compliance or mutual agreement is the ultimate goal of the dispute settlement system, if China is in violation of these provisions, China would need to cure its deficiencies by meeting transparency requirements (such as by publishing translations) and by administering its Indigenous Innovation Policies in a uniform, impartial, and transparent manner. In other words, the remedy for non-transparency is creating transparency.

China's transparent administration of its Indigenous Innovation Policies, of course, would create important benefits. U.S. vendors would benefit from greater transparency in understanding the accreditation process and the workings of the central and sub-central entities involved in government procurement; the United States would also benefit from greater transparency in negotiating with China for future changes.¹⁶⁴ While these benefits may accrue, China is not required, even assuming that these claims are proven in a WTO dispute settlement case, to change the substantial content of its policies. Furthermore, China is most certainly not required to join the GPA. In other words, the argument that China has violated its procedural obligations relating to transparency may result in China's correction of those procedural irregularities, but it will not affect the substantial content of any of China's current existing government procurement policies. At this time, one has to wonder why such a challenge would be brought in a case, or even raised with China informally, as the result will not achieve what U.S. industries really desire: the withdrawal of the policies and China's entry into the GPA. To the contrary, if the United States were to bring a formal challenge against China for procedural violations, such a case could antagonize China and might only harden China's stance.¹⁶⁵

2. Violations of Substantive Obligations

¹⁶³ For example, Article 22.8 of the WTO DSU provides in relevant part:

8. The suspension of concessions or other obligations shall be temporary and shall be applied until such time as the measure found to be inconsistent with a covered agreement has been removed, or the Member that must implement recommendations or rulings provides a solution to the nullification or impairment of benefits, or a mutually satisfactory solution is reached.

See Understanding on Rules and Procedures Governing the Settlement of Disputes art. 22, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, 1869 U.N.T.S. 401 [hereinafter DSU].

¹⁶⁴ The author is indebted to Professor Timothy Webster for pointing out the benefits of transparency.

¹⁶⁵ No country, including the United States, likes being sued in the WTO and having to defend itself against an accusation that it is not living up to its WTO obligations. Most countries are likely to view being sued as an unfriendly act.

Apart from possibilities of procedural violations, critics have made a number of arguments that China's government procurement policies violate China's substantive obligations under the WTO.¹⁶⁶ Although a number of arguments have been raised,¹⁶⁷ the discussion below focuses on arguments that China's Indigenous Innovation Policies violate commitments in TRIPS and in its Protocol of Accession.

a. TRIPS

So far we have examined the National Treatment Principle contained in GATT Article III and the exceptions for government procurement. As noted earlier, the National Treatment Principle is also contained in TRIPS, which governs trade in technology. Do China's Indigenous Innovation Policies, which relate to technology trade, violate the TRIPS National Treatment Principle? Article 3 of TRIPS provides in relevant part:

Each member shall accord to the nationals of other Members treatment no less favourable than it accords to its own nationals with regard to the protection of intellectual property, subject to exceptions [in existing IP treaties not relevant here].¹⁶⁸

The language of TRIPS Article 3 refers to "treatment . . . with regard to the *protection*" of intellectual property.¹⁶⁹ TRIPS further explains that "'protection' shall include matters affecting the availability, acquisition, scope, maintenance and enforcement of intellectual property rights as well as those matters affecting the use of intellectual property rights specifically addressed in this Agreement."¹⁷⁰

As an example of a violation of TRIPS Article 3, the United States required Cuban nationals who owned certain registered U.S. trademarks to undertake an additional procedural step to protect their U.S. trademarks in U.S. courts, a step that U.S. nationals are not required to take to protect their trademarks.¹⁷¹ Cuban nationals, including state owned companies,

¹⁶⁶ See, e.g., An & Peck, *supra* note 49, at 423–42.

¹⁶⁷ See *id.*

¹⁶⁸ TRIPS, *supra* note 111, art. 3.

¹⁶⁹ *Id.* (emphasis added).

¹⁷⁰ See *id.* n.3.

¹⁷¹ See Appellate Body Report, *United States – Section 211 Omnibus Appropriations*, ¶¶ 277–281, WT/DS176/AB/R (Jan. 2, 2002) (adopted Feb. 1, 2002) [hereinafter *Section 211 Omnibus Appropriations*]. This case arose in the context of a French-Cuban joint venture that sought to enforce the trademark rights to "Havana Rum," a trademark that had been confiscated from the Arechabala family in Cuba by the Cuban government. The Cuban government then assigned the confiscated trademark to a Cuban state-owned company, which then registered the "Havana Rum" trademark in the United States and later formed a joint venture with a French company. Bacardi, a U.S. company, had purchased any rights to the trademark from the Arechabalas, who had moved to Spain. Bacardi and

who sought to enforce U.S. registrations of trademarks based upon the same or a similar Cuban trademark were required to demonstrate that they had the permission of the original trademark owner whose trademark had been confiscated by the Cuban government.¹⁷² Nationals of the United States and all other WTO countries were not required to prove consent of the owner of the original Cuban trademark.¹⁷³ The purpose of this law was to prevent the Castro government from expropriating private businesses and their trademarks and then using the trademarks in U.S. commerce.¹⁷⁴ Under these facts, the WTO Appellate Body held that the applicable U.S. law violates the National Treatment Principle contained in TRIPS, since the law imposed more onerous conditions on Cuban nationals than on U.S. nationals.¹⁷⁵ Or suppose that Country A imposed more restrictive administrative requirements and higher fees for the filing of patent applications by foreign nationals than for applications filed by its own nationals. This type of requirement would also violate the National Principle contained in TRIPS.¹⁷⁶ China's Indigenous Innovation Policies, however, do not relate to the *protection* of IP rights.¹⁷⁷ The policies contain a requirement that Chinese government entities purchase products with technology owned by Chinese legal enterprises.¹⁷⁸ This is a policy that relates to the purchase of goods, which is within the scope of the GATT relating to goods,¹⁷⁹ but falls outside of the scope of Article 3 of TRIPS, which relates to the *protection* of intellectual property.¹⁸⁰

b. The WTO Agreement on Subsidies and Countervailing

Cuban interests in the United States lobbied the U.S. Congress to pass legislation that would block the French-Cuban venture from enforcing trademark rights to "Havana Rum." As a result, Congress passed Section 211, which required Cuban nationals asserting trademark rights in a trademark that had been confiscated from the original owners by the Cuban government to demonstrate that they had the approval of the original owner of the trademark. U.S. nationals asserting trademark rights that had been confiscated from the original owners by the Cuban government did not have to demonstrate that they had acquired consent from the original trademark owners. This discriminatory treatment—which imposed an additional procedural hurdle on Cuban nationals, but not on U.S. nationals—violated the National Treatment Principle.

¹⁷² See *id.* ¶¶ 276–277.

¹⁷³ See *id.*

¹⁷⁴ See CHOW & SCHOENBAUM, INTERNATIONAL TRADE LAW, *supra* note 10, at XX.

¹⁷⁵ See Section 211 Omnibus Appropriations, *supra* note 171, ¶ 280.

¹⁷⁶ See CHOW & LEE, INTERNATIONAL INTELLECTUAL PROPERTY, *supra* note 6, at 257.

¹⁷⁷ See Section 211 Omnibus Appropriations, *supra* note 171, ¶ 243 (finding that the Article 3 National Treatment Principle of TRIPS requires "WTO Members to accord no less favorable treatment to non-nationals than to nationals in the '*protection*' of trade-related intellectual property rights") (emphasis added).

¹⁷⁸ See *supra* notes 42–48.

¹⁷⁹ The procurement of goods by governmental agencies is explicitly excepted from the National Treatment Principle under GATT Article III:8(a). See GATT, *supra* note 109, art. III.

¹⁸⁰ For a definition of "protection," see CHOW & SCHOENBAUM, INTERNATIONAL TRADE LAW, *supra* note 10.

Measures

Some have argued that China's Indigenous Innovation Policies result in the granting of illegal subsidies and must be withdrawn.¹⁸¹ A subsidy is a financial contribution by a government¹⁸² that is specific to an enterprise, industry, or group of enterprises or industries.¹⁸³ A subsidy distorts trade because the financial contribution provides a cost advantage that can be passed on by the recipient industry in the form of lower prices to consumers in the home country.¹⁸⁴ If the enterprise or industry exports the goods, then the subsidy allows the exporter to charge a lower price in the export market, harming industries in the export market.¹⁸⁵ If an illegal subsidy exists, an aggrieved WTO member state can directly challenge the subsidy with the WTO.¹⁸⁶ If the WTO dispute settlement body finds that an illegal subsidy exists, the WTO will recommend that the nation providing the subsidy withdraw the measure without delay.¹⁸⁷

Certain types of subsidies are deemed prohibited or illegal per se.¹⁸⁸ In the case of prohibited subsidies, as opposed to all other types of subsidies, the aggrieved state does not need to prove any harm caused;¹⁸⁹ the existence of the prohibited subsidy alone is sufficient to require its withdrawal.¹⁹⁰ Among the category of prohibited subsidies are "subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods."¹⁹¹ The argument is that China's Indigenous Innovation Policies provide a prohibited subsidy to Chinese enterprises by requiring Chinese governmental entities to purchase domestic goods over imported goods.¹⁹²

¹⁸¹ I am indebted to Professors Juscelino Colares and Timothy Webster for pointing out this argument.

¹⁸² See Agreement on Subsidies and Countervailing Measures art. 1.1(a)(1), Apr. 15, 1994, 1869 U.N.T.S. 14 [hereinafter SCM Agreement].

¹⁸³ See *id.* art. 2.1.

¹⁸⁴ See CHOW & SCHOENBAUM, INTERNATIONAL TRADE LAW, *supra* note 10, at 494–95.

¹⁸⁵ See *id.*

¹⁸⁶ In a case where a domestic industry exports subsidized goods to the United States, the United States is also allowed to impose a "countervailing duty," i.e., an additional tariff, equal to the amount of the subsidy to offset its effects. This is a unilateral remedy. If the recipient of the subsidy does not export any products, then the only remedy available is to bring an action with the WTO seeking the withdrawal of the measure. See *id.* at 493.

¹⁸⁷ See SCM Agreement, *supra* note 182, art. 4.7.

¹⁸⁸ See *id.* art. 3.

¹⁸⁹ All other subsidies are actionable subsidies. See *id.* Part III. To be illegal, an actionable subsidy must result in "adverse effects to the interests of other Members." See *id.* art. 5.

¹⁹⁰ See *id.* arts. 3–4.

¹⁹¹ *Id.* art. 3.1(b).

¹⁹² The purchase of goods by the Chinese government is a payment to a Chinese enterprise and is "contingent" upon the purchase of the Chinese goods in place of a foreign made good. This falls within the definition under SCM Article 3.1(b) of a subsidy that is contingent upon the purchase of a domestic good over imported goods.

Subsidies are a complex issue under the WTO and a full analysis of whether China's Indigenous Innovation Policies constitute subsidies would require an extended study, which is beyond the scope of this Article. It is also notoriously difficult to predict the outcome of complex litigation with the WTO. For the sake of argument, assume that the United States is able to successfully litigate this issue and obtain a decision from the WTO requiring China to withdraw its Indigenous Innovation Policies as prohibited subsidies. Note that nothing would prevent China from implementing a different set of policies, outside the scope of any WTO decision on its Indigenous Innovation Policies, which would achieve the same result.¹⁹³ For example, China could provide direct grants to Chinese enterprises to spur research and development instead of buying products from Chinese enterprises in place of imports.¹⁹⁴ China could also reformulate its policies so that they are outside the bounds of any WTO decision rejecting its Indigenous Innovation Policies.¹⁹⁵ The United States would have to file a new case challenging China's new policies and spend three to five years preparing and litigating the case to a successful outcome in the WTO.¹⁹⁶ Meanwhile, China will reap the benefits of these new policies and can continue the cycle of litigation and issuance of new policies indefinitely. Further, obtaining a withdrawal of China's Indigenous Innovation Policies will not achieve the result most desired by the United States: China's entry into the GPA. It is difficult to see how requiring China to withdraw its policies will induce China to join the GPA,

¹⁹³ The fundamental purpose of dispute settlement in the WTO is to bring non-conforming measures enacted by a WTO member into compliance with the WTO. This means that if the panel or the Appellate Body finds that a measure violates the WTO agreements, the panel or the Appellate Body will recommend that the offending nation withdraw the measure. This is the extent of the role performed by WTO panels and the Appellate Body. See CHOW & SCHOENBAUM, INTERNATIONAL TRADE LAW, *supra* note 10, at 64–67. The WTO does not instruct its members on how to conduct their own internal affairs. This would allow China or any other WTO member to adopt a different set of measures that violate the same WTO obligations, but in a different manner. Chinese central authorities could also issue oral demands, which is a common practice in China. Of course, such maneuvers would be viewed rather dimly by other WTO members, but are not illegal.

¹⁹⁴ Domestic subsidies, i.e., payments made by a government only to domestic industries but not to foreign industries, are permitted under the GATT. GATT Article III:8(b) explicitly recognizes that the National Treatment obligation set forth in Article III “shall not prevent the payment of subsidies exclusively to domestic producers.” This GATT exception allows a country to make a direct payment to a domestic industry without making a similar payment to a foreign industry. See Italian Discrimination Against Imported Agricultural Machinery, Report of the GATT Panel, L/833-&S/60, adopted on Oct. 23, 1958, ¶ 14.

¹⁹⁵ See *supra* note 193.

¹⁹⁶ See CHOW & SCHOENBAUM, INTERNATIONAL TRADE LAW, *supra* note 10, at 69–70 (setting forth a step-by-step schedule in *U.S.-Standards for Reformulated and Conventional Gasoline* in which the timeline is three to five years, depending on whether the case is measured by date of adoption of contest legislation (five years) or date of commencement of the WTO dispute settlement process (two years, seven months)); Appellate Body Report, *U.S.-Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R (Apr. 29, 1996).

as GPA membership is purely voluntary. Such an action might have the opposite effect of hardening China's stance (because no nation likes to lose in WTO litigation) and creating additional delays.

c. China's Protocol of Accession

The issue of China's joining the GPA arose during the negotiations of China's Protocol of Accession. The relevant paragraph in the Working Party Report, which was incorporated into the Protocol of Accession, reads in relevant part:

339. The representative of China stated that China intended to become a Party to the GPA and that until such time, all government entities at the central and sub-national level . . . would conduct their procurement in a transparent manner, and provide all foreign suppliers with equal opportunity to participate in that procurement pursuant to the principle of MFN treatment.

341. The representative of China responded that China would become an observer to the GPA upon accession to the WTO Agreement and initiate negotiations for membership in the GPA . . . as soon as possible.¹⁹⁷

Critics have argued that this language stating that China intended to join the GPA creates a legitimate expectation on the part of other WTO members that China would not introduce additional discriminatory measures that further disadvantaged foreign suppliers in government procurement.¹⁹⁸ In other words, China's promise to join the GPA as soon as possible was an implicit promise by China that, until its entry into the GPA, it would maintain the status quo in government procurement rather than creating further disadvantages for foreign suppliers.¹⁹⁹ A line of WTO decisions beginning with *EEC - Oilseeds I*²⁰⁰ and continuing with *Japan-Photographic Film*²⁰¹ has considered cases in which a member is denied a

¹⁹⁷ Working Party Report, *supra* note 150, ¶¶ 339–341.

¹⁹⁸ See An & Peck, *supra* note 49, at 423–33.

¹⁹⁹ *Id.* at 427–28 (noting that “[o]ther members may derive a legitimate expectation from the accession Protocol and the Working Party Report that China would not introduce additional discriminatory measures affecting China’s government procurement market prior to its accession to the GPA”).

²⁰⁰ Report of the Panel, *European Economic Community—Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*, L/6627 (Jan. 25, 1990), GATT B.I.S.D. (37th Supp.) at 86 (1991) [hereinafter *EEC - Oilseeds I*].

²⁰¹ Panel Report, *Japan—Measures Affecting Consumer Photographic Film and Paper*, ¶ 10.61, WT/DS44/R (Apr. 22, 1998) (Report of the Panel adopted on April 22, 1998) [hereinafter *Japan—Photographic Film*].

legitimate benefit derived from a justified expectation based upon an understanding or agreement with another WTO member.²⁰² If an understanding or agreement was reached during negotiations involving a trade concession between WTO members, the later withdrawal of the understanding by the party making the promise might create harm to the aggrieved party that is actionable under the WTO.

The legal standard under the WTO for bringing a cause of action is where a legitimate benefit is “nullified or impaired”²⁰³ by a measure of the offending nation. Such an action can give rise to a claim under GATT Article XXIII:1(b), the original dispute settlement provision in the GATT, although GATT Article XXIII has been supplemented by the DSU.²⁰⁴ The argument is that China’s stated intentions of joining the GPA created a legitimate expectation on the part of other WTO members that until its entry into the GPA, China would not act in a way that is inconsistent with the GPA or at least would not introduce additional discriminatory measures

²⁰² *EEC - Oilseeds I*, *supra* note 200, ¶ 147.

²⁰³ GATT Article XXIII reproduced in full in the following note.

²⁰⁴ GATT Article XXIII Nullification and Impairment provides:

1. If any contracting party should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired or that the attainment of any objective of the Agreement is being impeded as the result of

(a) the failure of another contracting party to carry out its obligations under this Agreement, or

(b) the application by another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement, or

(c) the existence of any other situation, the contracting party may, with a view to the satisfactory adjustment of the matter, make written representations or proposals to the other contracting party or parties which it considers to be concerned. Any contracting party thus approached shall give sympathetic consideration to the recommendations or proposals made to it.

GATT, *supra* note 109, art. XXIII. Article XXIII was the original provision providing for dispute settlement. It has since been supplemented by the DSU, which set up a more elaborate dispute settlement system. GATT Article XXIII has been incorporated into the DSU by DSU Article 3 so the “nullification and impairment” standard is still the current legal standard under the DSU. The claim that China’s Indigenous Innovation Policies cause a nullification and impairment of a trade benefit created by China’s Protocol of Accession is an example of a so-called “non-violation” case under Article XXIII:1(b). A “violation” case under Article XXIII:1(a) involves the breach of a provision in a WTO agreement. By contrast, a “non-violation” case does not violate the language of any provision of a WTO agreement but otherwise undermines a benefit. In the case of China’s Indigenous Innovation Policies, it is not possible to point to the language of a covered WTO agreement and show that China is acting in violation of the provision. Rather, China has created certain legitimate expectations by the language in its Protocol of Accession and is now defeating those expectations by the unexpected issuance and implementation of the Indigenous Innovation Policies. No case has ever arisen under Article XXIII:1(c) referring to the “existence of any other situation.”

in government procurement prior to China's entry into the GPA.²⁰⁵ This agreement by China formed part of the conditions under which WTO members agreed to allow China to accede to the WTO. China's failure to fulfil the legitimate expectations of other WTO members by enacting its Indigenous Innovation Policies is a violation of a WTO obligation for which a remedy is appropriate.

The complaining party bears the burden of proof to establish a legitimate expectation of a benefit that has been nullified or impaired.²⁰⁶ The language of the Working Party Report itself states that until it joins the GPA, China will provide foreign suppliers with "equal opportunity . . . pursuant to the principle of *MFN treatment*." MFN stands for "Most Favored Nation" treatment, one of the two fundamental principles of the GATT, along with National Treatment Principle, which were enshrined in the original GATT 1947.²⁰⁷ MFN is a principle of equality, i.e., China will treat all foreign suppliers equally and will not favor any single foreign supplier or disadvantage any single foreign supplier;²⁰⁸ all foreign suppliers from all countries will be given identical treatment. MFN should be distinguished from National Treatment, which is also a principle of equality that states that all foreign and domestic suppliers shall receive equal treatment.²⁰⁹ It is perfectly possible to comply with MFN treatment and still violate National Treatment. For example, suppose that China has a rule that only domestic suppliers can receive accreditation for government procurement purposes and that no foreign suppliers can receive accreditation. This rule would violate National Treatment (assuming that China was required to apply this principle) because the rule discriminates in favor of domestic suppliers and against foreign suppliers. However, this rule does not violate MFN so long as all foreign suppliers receive equal treatment, i.e., all are denied accreditation. If China accredited some foreign suppliers but refused to accredit others under the same conditions then a possible MFN violation might have occurred.

It is also possible to violate National Treatment Principle without violating MFN. Suppose that China prohibits discrimination in favor of domestic goods and against foreign goods; but as among foreign goods, certain goods receive preferences while others do not. This policy would satisfy National Treatment Principle as domestic and foreign goods are treated equally but would violate MFN because certain foreign goods

²⁰⁵ See An & Peck, *supra* note 49, at 427–28.

²⁰⁶ See *Japan—Photographic Film*, *supra* note 201, ¶ 10.32.

²⁰⁷ See *supra* note 109.

²⁰⁸ See CHOW & SCHOENBAUM, *INTERNATIONAL TRADE LAW*, *supra* note 10, at 130.

²⁰⁹ The Most Favored National Principle requires that all foreign vendors from other WTO members be given equal treatment. The National Treatment Principle requires that all foreign imports be given treatment no less favorable than that given to domestic products. Thus, the Most Favored Nation Treatment Principle is a principle of external non-discrimination whereas the National Treatment Principle is a principle of internal non-discrimination. See *id.* at 129.

receive better treatment than other foreign goods. In other words, while both MFN and National Treatment Principle are principles of discrimination, they have different targets. MFN is a principle of external non-discrimination while National Treatment Principle is a principle of international non-discrimination.²¹⁰ It is possible to violate one without violating the other. China's statement that it intended to treat all foreign suppliers equally under the MFN cannot be read to imply that China also agreed to extend National Treatment to foreign suppliers. In fact, the explicit reference to MFN accompanied with the omission of any reference to National Treatment seems to support the opposite inference that China was making no promises to accord National Treatment to foreign suppliers.

Another hurdle in establishing legitimate expectations by other WTO members that China's stated intention to join the WTO was an indication that China would not institute additional discriminatory measures in government procurement is created by the GPA itself.²¹¹ As noted earlier, the GPA allows its members to declare exceptions, i.e., to exclude designated government entities from the National Treatment of the GPA.²¹² These excluded entities are then free to discriminate in favor of local products. If China is free to condition its accession to the GPA on exceptions, it becomes more difficult to argue that China's Protocol of Accession created a promise that no additional conditions of discrimination would be added prior to China's accession to the GPA. Exclusions are actually permitted by the GPA itself for developing countries.²¹³

If the United States were to bring a case within the WTO alleging China's violation of its substantive obligations, the burden would be on the United States to demonstrate that language in the Working Party Report referring to MFN treatment in government procurement creates a legitimate expectation of National Treatment or no additional discriminatory measures inconsistent with National Treatment in government procurement.²¹⁴ The discussion above indicates that this might be a difficult burden to meet. Even assuming that the United States can meet this burden and show nullification and impairment, what relief would be available to the United States? DSU Article 26.1 states that "where a

²¹⁰ *See id.*

²¹¹ Each GPA member submits a schedule of covered government entities and goods and services subject to the GPA. Any government entity or goods or services not on the schedule are not subject to the obligations of the GPA. *See Overview of the Government Procurement Agreement, supra* note 29.

²¹² *See* CHOW & SCHOENBAUM, INTERNATIONAL TRADE LAW, *supra* note 10, at 173. The United States objected to China's offer to join the GPA in 2010 because China's offer excluded too many government entities. *See* Loretta Chao, *China Reapplies to WTO Procurement Group*, WALL ST. J., July 21, 2010, <http://online.wsj.com/news/articles/SB10001424052748704723604575378833136966648> (noting that China's proposal falls far short of their requirements on several accounts since state owned enterprises and provincial or local governments are excluded from the GPA by the proposal).

²¹³ *See Overview of the Government Procurement Agreement, supra* note 29.

²¹⁴ *See Japan—Photographic Film, supra* note 201, ¶ 10.32.

measure has been found to nullify or impair benefits . . . there is no obligation to withdraw the measure. The panel or Appellate Body shall recommend the Member concerned make a *mutually satisfactory* adjustment.”²¹⁵ The most important part of this provision is that even if China’s measures related to its Indigenous Innovation Policies were found to violate its obligations under the Protocol of Accession, China is not required to repeal or withdraw them. China is to make a “mutually satisfactory adjustment.”²¹⁶ An adjustment that is mutually satisfactory must be satisfactory to China; it is unclear how long this process is to take, but achieving a result that is mutually satisfactory could result in long delays or an indefinite stalemate.²¹⁷ Moreover, it is difficult to see how such a result would persuade China to withdraw its policies or expedite China’s accession into the GPA.

C. China’s Incentive to Join the GPA

Before we examine how the controversy might be resolved going forward, this part discusses why China might have little incentive to join the GPA. Under current U.S. law, the U.S. federal government is prohibited from procuring goods and services from non-GPA members, including China.²¹⁸ The states, however, can and do purchase goods and services from China.²¹⁹ If China joins the GPA, the U.S. federal government will be required to open up its government procurement to China and provide Chinese vendors with non-discriminatory treatment.

China may perceive, however, that it does not really stand to benefit in its trading relationship with the United States even if China joins the GPA.

²¹⁵ DSU, *supra* note 163, art. 26.1 (emphasis added).

²¹⁶ *Id.*

²¹⁷ China’s pattern of behavior indicates that China is not enthusiastic about joining the GPA. China has made four offers, each rejected by the United States and the European Union. See Terril Yue Jones, *Europe Says China’s Latest Bid to Join Procurement Agreement “Highly Disappointing,”* REUTERS, Dec. 6, 2012, <http://www.reuters.com/article/2012/12/06/us-china-eu-trade-idUSBRE8B50G720121206>. The reasons for China’s lack of enthusiasm are discussed in Part III.C *infra*.

²¹⁸ See Trade Agreements Act of 1979, 19 U.S.C. §§ 2501–18 (2006), §§ 301, 302, 308.

²¹⁹ See *supra* note 21; see also Richard Gonzales, *California Turns to China for New Bay Bridge*, NPR (Sept. 16, 2011), <http://www.npr.org/2011/09/16/140515737/california-turns-to-china-for-new-bay-bridge>; John W. Miller & Chuin-Wei Yap, *U.S. Icons Now Made of Chinese Steel*, WALL ST. J. (June 20, 2013), <http://online.wsj.com/news/articles/SB10001424127887324049504578545431938331880> (“The Verrazano-Narrows Bridge was a feat of American engineering when it was built across New York’s harbor in the 1960s. Now, it’s being repaired with steel made in China.”); Keith Schneider, *Infusing from China for Toledo, Ohio*, N.Y. TIMES (May 24, 2011), http://www.nytimes.com/2011/05/25/realestate/commercial/riverfront-in-toledo-ohio-gets-infusion-from-china.html?_r=1& (“There were a few letters and a few blogs that took issue with our selling riverfront property to the Chinese or any foreign investor,” said Thomas S. Crothers, the deputy mayor for external relations. “Our job, though, is to bring investment from domestic or foreign sources to revitalize our community.”).

China may believe that the U.S. government does not really intend to purchase from China, and China already has access to government procurement from the states.²²⁰ The U.S. government would be under political pressure to forgo the purchase of goods and services from China for several reasons. In 2011, the United States had a \$301.5 billion trade deficit with China.²²¹ A trading nation (the United States) has a trade deficit with a trading partner (China) when the trading nation buys more in goods than it sells to its trading partner.²²² A nation with a trade deficit buys more than it earns from the trade in goods and is living beyond its means, so its wealth will begin to shrink unless it can create economic growth by other means such as by innovation in technology, by attracting inward foreign direct investment, or by borrowing money.²²³ With its revenues earned through sales to the United States, China is buying up U.S. assets in the form of government securities, such as Treasury bonds, which means that China owns more and more of the U.S. economy.²²⁴ The negative consequences of a long term and expanding trade deficit with China have drawn harsh criticism in Congress.²²⁵

Consequently, the U.S. government would likely come under severe political pressure to forgo buying goods from China instead of adding to the trade deficit. Even if China joins the GPA, the U.S. government might find other means to prevent government procurement from China. For example, under GATT Article XXI, a nation can refuse to follow a WTO obligation if such action is “necessary for the protection of its essential security interests [in an] emergency in international relations.”²²⁶ Recently, the U.S. Congress issued a report declaring that two Chinese telecommunications companies posed a threat to national security and urged U.S. companies to find other vendors.²²⁷ The Chinese government might view this action and the current political climate in the United States as indications that even if China joins the GPA, the U.S. government is not

²²⁰ China may believe that even if it joins the GPA, the U.S. federal government will come under intense political pressure to forgo buying goods and services from it due to the current hostile attitude towards China in the U.S. Congress.

²²¹ See CHOW & SCHOENBAUM, *INTERNATIONAL TRADE LAW*, *supra* note 10, at 44.

²²² See *id.* at 30. The 2011 figure quoted in the text above only refers to the trade in goods.

²²³ See *id.*

²²⁴ See *id.* at 44–48.

²²⁵ See *Bucking Trend: U.S. Trade Gap Grows*, WALL ST. J. (July 10, 2012), <http://online.wsj.com/article/SB10001424052702303292204577516673966206002.html> (quoting an official from Congress’ U.S.-China Economic and Security Review Commission stating that China engages in “predatory, protectionist, and unfair trade practices”).

²²⁶ See GATT, *supra* note 109, art. XXI (Security Exceptions).

²²⁷ See U.S. House of Representatives Permanent Select Comm. on Intelligence, 112th Cong., Investigative Report on the U.S. National Security Interests Posed by Chinese Telecommunications Companies Huawei and ZTE (Oct. 8, 2012), available at http://www.fas.org/irp/congress/2012_rpt/huawei.pdf.

likely to award large contracts to Chinese vendors.²²⁸ This means that China might perceive that it has little to gain from joining the GPA; the U.S. government will find reasons to limit its purchase of goods and services from China, and the states already buy from China. While China has little to gain from joining the GPA, once China becomes a member, China will be required to dismantle its Indigenous Innovation Policies, which are crucial to attain China's long term goals. In other words, China may believe that the costs of joining the GPA far outweigh the benefits, if any, of becoming a GPA member.

D. Resolving the Controversy Going Forward

The discussion and analysis of China's Indigenous Innovation Policies that relate to government procurement makes clear several points that should guide U.S. companies and the U.S. government going forward. First, it is clear that few, if any, U.S. companies will be willing to meet the conditions necessary to qualify their products for accreditation by Chinese authorities for government procurement. Few, if any, U.S. companies are likely to assign or sell their technology to an unaffiliated Chinese legal enterprise. It is also unlikely that a U.S. company will undertake the time-consuming and expensive process of setting up a Foreign-Invested Enterprise to serve as the recipient of its technology. In light of these realities, the claim by some U.S. companies that they are being "forced" to transfer their technology to China where it will be "stolen"²²⁹ seems flatly disingenuous. No one is forcing U.S. companies to look for opportunities in China's government procurement market. Instead, many U.S. companies do not see the options involving technology transfer described above to qualify for accreditation as practicable or desirable. As a result, U.S. companies will either attempt to qualify for accreditation despite the risks or seek business opportunities elsewhere. This is a business decision that U.S. companies will make after an assessment of the risks and rewards, a process that U.S. companies undergo every day. If U.S. companies decide to apply for accreditation, then they have decided to accept China's requirement that they transfer their technology to China. This is ultimately a voluntary decision to accept business risks in pursuit of profits. Since U.S. companies do not want to accept the risks associated with transferring their technologies to China and also do not want to lose the opportunity to sell to the Chinese government, U.S. companies, with the assistance of the

²²⁸ This observation is based upon the author's own discussions with academics and lawyers in China. Of course, the Chinese government would never express such sentiments in print.

²²⁹ See *Hearing: China's Five-Year Plan, Indigenous Innovation and Technology Transfers and Outsourcing Before U.S.-China Economic and Security Review Commission* (2011) (testimony of Adam Segal, Ira A. Lipman Senior Fellow, Council on Foreign Relations), available at <http://origin.www.uscc.gov/sites/default/files/6.15.11Segal.pdf>.

U.S. government, are actively engaged in lobbying and pressuring China to withdraw these policies and join the GPA.²³⁰

The legal arguments that China's Indigenous Innovation Policies violate other procedural or substantive obligations under the WTO have serious shortcomings, both on a doctrinal level and as a matter of political strategy. Even if the United States were able to successfully litigate these points in the WTO and force China to withdraw its current government procurement policies, it still would not solve the crux of the problem facing U.S. companies. What U.S. companies want is an equal opportunity to compete for government purchases of goods and services under conditions that do not favor Chinese goods and services. Even if China withdrew its current policies, nothing prevents China from issuing other discriminatory rules against foreign goods and services in government procurement.²³¹ The only effective way to achieve the goal of equal access is to induce China to join the GPA under meaningful conditions that make this possible, i.e., without the use of broad exclusions of government entities that will significantly weaken the impact of the GPA.²³²

In light of the complaints by the United States, China has made some changes to its policies. In 2011, China announced that central level authorities would no longer engage in accreditation of products for government procurement.²³³ However, since 95% of all government procurement in China occurs at the sub-central level, i.e., at the provincial levels or lower,²³⁴ this change in policy is likely to have minimal effect on China's government procurement.²³⁵ Moreover, while central-level authorities will no longer accredit products, it remains unclear whether the central-level authorities will ultimately purchase goods and services from U.S. vendors. China often makes changes in response to external pressure

²³⁰ See *Hearing on President Obama's Trade Policy Agenda with U.S. Trade Representative Ron Kirk, Second Panel on the Future of U.S. Trade Negotiations: Hearing before the Committee on Ways and Means*, 112th Cong. 112-22 (2012) (statement of Congressman Earl Blumenauer), available at <http://waysandmeans.house.gov/news/documentsingle.aspx?DocumentID=318517>.

²³¹ While most WTO members would have dim views of such a sharp maneuver, it is legal under the WTO. For example, in *Japan—Taxes on Alcoholic Beverages*, WT/DS8.AB/R, WT/DS10.AB/R, WT/DS11.AB/R (Oct. 4, 1996), the Appellate Body made clear that panel reports “are not binding, except with respect to resolving the particular dispute between parties to that dispute.” See *Japan—Taxes on Alcoholic Beverages*, *supra*, at 14. In the view of the author, this would allow China to enact a different set of laws that discriminate against goods and services from the United States because these measures would trigger a new and different dispute.

²³² Joining the GPA creates a positive obligation on the part of China to give non-discriminatory treatment to U.S. goods and services in government procurement. See *WTO Government Procurement Agreement*, *supra* note 28, art. III.

²³³ See 2013 WHITE PAPER, *supra* note 46, at 42.

²³⁴ Government Procurement Administrative Measures (P.R.C.) (2011), available at <http://www.ccg.gov.cn>.

²³⁵ The central government does not actually purchase large amounts of goods and services. The provinces and municipalities account for 95% of government procurement. See *id.*

that may appear to offer real concessions, but they are, in the end, cosmetic changes that have little impact on the underlying problem.²³⁶ These modest changes are not likely to have a significant effect on the implementation of China's Indigenous Innovation Policies and have not stemmed the flow of criticism from U.S. politicians and U.S. companies about China's policies.²³⁷

In hindsight, it is now clear that an opportunity existed but was missed during the negotiations for China's Protocol of Accession to the WTO.²³⁸ The United States, which assumed a leading role in the negotiations, made a strategic error in obtaining a promise by China that it intended to join the GPA instead of obtaining a binding commitment by China to join the GPA by a certain deadline and under certain conditions.²³⁹ The United States could also have negotiated China's entry into the GPA simultaneously with China's accession to the WTO under the Protocol of Accession. Under this scenario, China would have been bound by the mandatory disciplines of the GATT, GATS, and TRIPS upon accession to the WTO and the GPA. Of course, in retrospect, it is easy to point out this oversight. When China was negotiating its entry into the WTO, China's annual government procurement budget was a fraction of what it is today. In the 1990s, it would have been hard to foresee that China's government procurement budget would, by China's own admission, grow ten-fold between 2002 to 2012 from \$16 billion to \$178 billion.²⁴⁰ Moreover, according to the United States and the EU, China's own estimates of its current government procurement budget significantly understate the full amount of resources that are currently available.²⁴¹

The United States and other WTO countries had leverage during the negotiations of the conditions of China's accession to the WTO because China wanted to accede to the WTO as expeditiously as possible,²⁴² but this

²³⁶ If sub-central entities engage in 95% of all government procurement, a change in policy affecting the central government, which engages in only 5% of government procurement is, in actuality, a very minor concession.

²³⁷ The China Fair Trade Act, which was not enacted in 2011, has been reintroduced in Congress in 2012. The China Fair Trade Act prevents the use of federal funds to purchase Chinese goods and services until China joins the Government Procurement Agreement. See China Fair Trade Act of 2012, *supra* note 136.

²³⁸ The United States likely did not anticipate that China's government procurement would grow ten-fold in the span of one decade. See *supra* note 16.

²³⁹ In the negotiations leading up to China's accession to the WTO, China stated that it "intended" to join the GPA and that it would become an observer to the GPA and initiate negotiations to join the GPA as soon as possible. See Working Party Report, *supra* note 150, ¶¶ 339, 341. This is a "soft" commitment and is not a legally binding.

²⁴⁰ See *supra* note 16.

²⁴¹ See *supra* note 14.

²⁴² China had a strong interest in joining the WTO because without WTO membership, China endured a humiliating annual lecture and review of its human rights record by the U.S. Congress in order to obtain the much lower Most Favored Nation tariffs from the United States. See Daniel C.K.

leverage no longer exists. Indeed, the opposite may be true because the negotiating leverage has now shifted in China's favor. China may see little benefit in joining the GPA, at least in its trading relationship with the United States.²⁴³ This means that China has little incentive to join the GPA or to join the GPA without significant exclusions of its government entities from the GPA's obligations. What may be necessary are trade concessions in other areas, such as intellectual property, tariffs, and the use of antidumping and countervailing duties,²⁴⁴ from the United States to induce China to join the GPA on meaningful terms. In other words, instead of using a "stick," which seems to antagonize China, the United States and other GPA members might consider using a "carrot." One example of a trade concession would be to enter in to a free trade agreement with China under which some goods from members of the free trade agreement could be traded with very low tariffs or duty free—with tariffs of zero.²⁴⁵ Other examples of "carrots" might include commitments by the United States to forgo the extremely aggressive use of trade remedies currently in place and targeted at China,²⁴⁶ and to scale back on the aggressive use of U.S. trade

Chow, *Why China Opposes Human Rights in the World Trade Organization*, 34 U. PA. J. INT'L LAW (forthcoming 2013).

²⁴³ See *supra* Part III.C.

²⁴⁴ For a discussion of the controversy between the United States and China over dumping and countervailing duties, see Daniel C.K. Chow, *China's Coming Trade Wars with the United States*, 81 UMKC L. REV. 257 (2012).

²⁴⁵ A free trade agreement (FTA) imposes zero tariffs on all goods (or a selected list of goods) traded between the members of the FTA. FTAs are expressly allowed by the WTO. See GATT, *supra* note 109, art. XXIV. Perhaps the most famous example of a free trade area is the European Union. The United States has been particularly active in pursuing FTAs, both for trade and political purposes, i.e., the United States rewards friendly countries with FTAs. In recent years, the United States has concluded bilateral FTAs with Australia, Jordan, Morocco, Bahrain, Chile, Israel, Oman, Panama, the South African Customs Union, Singapore, and South Korea. Several FTAs are now being negotiated, including a Japan–U.S. FTA as well as an EU–U.S. FTA. See CHOW & SCHOENBAUM, INTERNATIONAL TRADE LAW, *supra* note 10, at 56. China has also begun to pursue FTAs with countries around the world. As of 2011, China has entered into FTAs with Chile, New Zealand, Pakistan, Singapore, and the Association of South East Asian Nations. See Jun Zhao & Timothy Webster, *Taking Stock: China's First Decade of Free Trade*, 33 U. PA. J. INT'L L. 65, 68 (2011). China's pursuit of FTAs indicates a new stage in China's use of international law and international institutions to cultivate economic relationships. See *id.*

²⁴⁶ The United States maintains that it is possible, despite a ruling from the WTO, to impose antidumping duties and countervailing duties on the same imports from China. An antidumping duty is an extra tariff imposed on a product that is "dumped" in the United States. See Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994, art.9, Apr. 15, 1994, 1868 U.N.T.S. 201 [hereinafter Anti-Dumping Agreement]. Dumping occurs if the product is sold at a lower price in the U.S. market than in China. See *id.* art. 2. Suppose, for example, that a good is sold for \$100 in China and for \$75 in the United States. In this case, dumping may exist. To offset the margin of dumping, the United States can impose an additional tariff, called an antidumping duty, of \$25. See *id.* art. 9.1; see also CHOW & SCHOENBAUM, INTERNATIONAL TRADE LAW, *supra* note 10, at 443. A countervailing duty is an extra tariff imposed when a foreign government provides a payment to a manufacturer contingent on export. See SCM Agreement, *supra* note 182, arts. 1, 3. Suppose, for

laws to influence the internal political affairs of other countries.²⁴⁷

IV. CONCLUSIONS

China has a long-term goal of becoming an innovator of technology, not a recipient of technology created by the United States and other developed nations. China believes that it can never enter the top ranks of the most competitive nations in the world unless it can develop its own capacity to create world-class technology and intellectual property. A key component of this strategy is a government procurement policy that favors the government purchase of products and services containing technology developed in China or owned by Chinese legal enterprises. This policy is designed to spur innovation in China and to develop a capacity for future innovation by Chinese industries, private inventors, and government institutes. These policies have also caused a storm of controversy in the United States, which claims that these measures are unfair and illegal under the WTO.

An analysis of this controversy, however, has demonstrated that China is likely within its legal rights in discriminating against foreign products and services in government procurement under an exception to National Treatment for government procurement. While some critics have argued

example, that the Chinese government pays a manufacturer of solar panels \$100 per panel exported to the United States. In this case, the United States can impose a countervailing duty of \$25 to offset the subsidy. *See id.* arts. 19.1–19.2. Recently, the United States began imposing anti-dumping duties and countervailing duties on the same imports from China. *See* CHOW & SCHOENBAUM, INTERNATIONAL TRADE LAW, *supra* note 10, at 496. Subsequently, China challenged this practice in the WTO. In Appellate Body Report, *United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, WT/DS379/AB/R (Mar. 11, 2011), the Appellate Body ruled that assessing both anti-dumping and countervailing duties on the same imports from China without assessing whether such duties would constitute double remedies violated Article 19.3 of the WTO Subsidies and Countervailing Duties Agreement. In response, on March 13 2012, President Obama signed into law “An Act to Apply the Countervailing Duty Provisions of the Tariff Act of 1930 to Non-Market Economies, and for Other Purposes,” Pub. L. No. 112-99, 126 Stat. 265. The 2012 Act states that when the United States applies anti-dumping duties and countervailing duties to the same imports from China, if the United States can detect any double counting, the United States should reduce the duties to the extent of the double counting. *See* Request for Consultation by China, *United States – Countervailing and Anti-Dumping Measures on Certain Products from China*, WT/DS449/1 (Sept. 20, 2012), available at [http://www.worldtradelaw.net/cr/ds-448-1\(cr\).pdf](http://www.worldtradelaw.net/cr/ds-448-1(cr).pdf). In other words, the United States still intends to impose both anti-dumping and countervailing duties on imports from China and will reduce the duties to the extent of double counting if it can “detect” any double counting. This example is meant to illustrate the extremely aggressive and hostile stance that the United States currently adopts towards trade with China, which creates tension between the two countries. Some indication from the United States that it intends to relax its aggressive stance might be viewed as a friendly gesture by China and lead to a more positive attitude in joining the GPA.

²⁴⁷ *See* Daniel C.K. Chow, *How China Uses International Trade to Promote its View of Human Rights*, 45 GEO. WASH. INT’L L. REV. (forthcoming 2013) (describing how China feels threatened by the United States’ aggressive use of trade to influence political reform in countries around the world and China’s own efforts to create a competing approach).

that China's policies are in violation of other WTO obligations, the problem with this approach is that even if China is in violation of other WTO obligations, pressing those violations against China in the WTO would not reach the result that is most desired by U.S. businesses and the U.S. government. This preferred end result is China's entry into the GPA on meaningful terms, without broad exclusions that would significantly weaken the scope of application of the GPA to China's government procurement. Joining the GPA is a voluntary decision and there is no way to legally compel China to join the GPA. At this point, however, the balance of power in negotiating leverage has shifted from the United States and other WTO powers to China, which may have little incentive to join the GPA. Since joining the GPA is an entirely voluntary decision, the United States and other WTO countries might need to offer trade concessions to induce China to the GPA.

For the long term, several larger lessons may be gleaned from this controversy. Some have criticized China in the recent past for its failure to respect intellectual property rights.²⁴⁸ Some have argued that China's shortcomings reflect a lack of understanding of the importance of intellectual property in modern economic development.²⁴⁹ China's Indigenous Innovation Policies should dispel this misconception once and for all. China completely understands the importance of advanced technology and intellectual property as well as the importance of being an innovator country. In the author's view, the issue has never been China's lack of understanding of the importance of intellectual property; rather, the issue for China has always been how to get access to cutting-edge advanced technology without having to pay exorbitant fees or to be subject to onerous restrictions. One lesson from this controversy is that China now wants to create powerful economic incentives to develop its own capacity to innovate. This Article focuses on China's Indigenous Innovation policies as they relate to government procurement, but China is attempting to create capacity through many different initiatives, including attracting top-flight scientists and foreign faculty to Chinese universities.²⁵⁰ Achieving indigenous capacity to innovate is such a top national priority that it appears unlikely any amount of pressure from U.S. companies will deter China in reaching this goal.

A second lesson is that China has made significant progress in

²⁴⁸ See KERRY DUMBAUGH, CONG. RESEARCH SERV., R40457, CHINA-U.S. RELATIONS: CURRENT ISSUES AND IMPLICATIONS FOR U.S. POLICY (2009), available at <http://www.fas.org/sgp/crs/row/R40457.pdf>.

²⁴⁹ See Peter K. Yu, *Intellectual Property, Economic Development, and the China Puzzle*, in INTELLECTUAL PROPERTY, TRADE AND DEVELOPMENT: STRATEGIES TO OPTIMIZE ECONOMIC DEVELOPMENT IN A TRIPS PLUS ERA 173-220 (Daniel J. Gervais ed., 2007), available at <http://www.law.drake.edu/academics/ip/docs/ipResearch-op1.pdf>.

²⁵⁰ See Liz Gooch, *Chinese Universities Send Big Signals to Foreigners*, N.Y. TIMES (Mar. 11, 2012), http://www.nytimes.com/2012/03/12/world/asia/12iht-educlde12.html?pagewanted=all&_r=0.

learning how to use the rules of the multilateral trading system effectively and has come a long way since it negotiated its Protocol of Accession. The Protocol of Accession contains a number of provisions that place China at a disadvantage, including a number of “WTO plus” obligations²⁵¹ that require China to exceed requirements of the WTO. The controversy over China’s Indigenous Innovation Policies indicates, however, that China now has the advantage in this set of negotiations. As China’s economic power continues to grow, the United States and other members of the multilateral trading system can also expect China’s expertise and sophistication in matters of WTO law and its use of aggressive but effective negotiating strategies in international trade to grow accordingly.

Finally, China’s own current pattern of action indicates that China intends to pursue highly aggressive policies in international trade, within the WTO, and on a bilateral basis with the United States. China’s conduct indicates that the United States and other WTO members should not expect China to be willing to compromise its own economic interests, even slightly, in order to support broader systemic interests or changes that might benefit the multilateral trading system as a whole, but not China directly. To the contrary, China believes that it is within its rights to use the rules of the multilateral trading system to its full advantage and to the outer limits of the law, with the overriding goal of aggressively promoting its own economic interests in order to increase its global power, influence, and stature in the modern world.

²⁵¹ See Julia Qin, “WTO-Plus” Obligations and Their Implications for the WTO Legal System: An Appraisal of the China Accession Protocol, 37 J. WORLD TRADE 483 (2003).