CHINA

TRADE SUMMARY

The United State’s trade deficit with China was $83.0 billion in 2001, a decrease of $787 million from $83.8 billion in 2000. U.S. goods exports in 2001 were $19.2 billion, up 18.8 percent from the previous year. Corresponding U.S. imports from China were $102.3 billion, up 2.3 percent. China is currently the 9th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to China were $4.6 billion in 2000 (latest data available), and U.S. imports were $2.8 billion. Sales of services in China by majority U.S.-owned affiliates were $1.7 billion in 1999 (latest data available), while sales of services in the United States by majority China-owned firms were $61 million.

The stock of U.S. foreign direct investment (FDI) in China in 2000 was $9.6 billion, up from $8.1 billion in 1999. U.S. FDI in China is concentrated largely in electronics manufacturing, petroleum and financial sectors.

OVERVIEW

With a population of 1.3 billion, China offers a vast potential market for foreign goods and services. Over the past 20 years, China has made important progress in opening its market to foreign products and investment. Economic and financial reforms have introduced market forces into China, and privileges accorded state-owned firms are gradually being removed.

China acceded to the World Trade Organization (WTO) on December 11, 2001. China's accession will further open its market to U.S. goods and services. In the long run, adherence to WTO rules and international norms should encourage structural reform and promote the rule of law throughout China.

The Chinese Government has recognized for several years that economic reform and market opening are essential components of sustainable and balanced economic growth. China's shift away from a planned economy model to a market economy has been difficult but is being rewarded by sustained economic growth and improving living standards. Reforms have been particularly difficult in sectors that traditionally relied upon substantial state subsidies. The aging state-owned industrial sector is now under significant pressure from domestic and foreign competition. As a result of WTO accession, these pressures may intensify. On the other hand, many Chinese economists point out that China’s private sector will benefit from WTO accession, as the government will be limited by international rules from favoring state-owned enterprises.

While China has a more open and competitive economy than 20 years ago, substantial barriers have yet to be dismantled. Import barriers, opaque and inconsistently applied legal provisions, and limitations on market access combined to make it difficult for foreign firms to operate in China in 2001. The central government continues to protect noncompetitive or emerging sectors of the economy. Provincial and local governments have strongly resisted reforms that would eliminate protection of local enterprises or reduce government receipts. This inhibits the central government's ability to implement trade reforms.

In anticipation of China’s WTO accession, China’s central government in 2001 commenced a massive effort to revise its laws and regulations to bring them into conformity with WTO requirements. Understanding of WTO rules remains limited, however, particularly outside of Beijing and Shanghai. Membership in the WTO will bring substantial changes – both economically and socially – but it will not remove all commercial problems and the implementation process will take time.

The Chinese Economy in 2001

China officially estimated real GDP growth at 7.3 percent in 2001, a decrease of 0.7 percent from that recorded for the previous year, and China's second-worst economic performance in a decade. Relatively weak private investment growth and cautious consumer spending led to a slower increase in GDP, despite the government's efforts to stimulate the economy through rapid growth in fixed-asset investment by state-owned entities. After posting 28 percent annual export growth in 2000, export growth slowed dramatically to 6.8 percent in 2001 (falling short of the unofficial growth target of 8 percent). Annual growth in imports similarly slowed from 36 percent in 2000 to 8.2 percent in 2001. Slower growth in exports combined with relatively greater increases in levels of imports meant that net exports made a negative contribution to GDP growth for the third year in a row, although China still maintained an overall trade surplus.

Government steps to encourage private consumption by increasing civil service wages helped sustain retail sales growth at about 10 percent year-on-year, but exacerbated the widening gap between urban and rural incomes. Growth in bank credit decelerated in comparison to 2000 as the government continued to pressure the state-dominated banking sector to reduce its balance of non-performing loans. This policy, however, exacerbated the lack of capital for private investment and contributed to slower GDP growth.

China continued reforms of its foreign trade sector in 2001 in preparation for entry into the WTO. The "Outline of the Tenth Five-year Plan for Social and Economic Development" approved by China's National People's Congress in March, reiterated the government's long-standing commitment to meet the requirements of entry into the WTO. The Outline also called for strengthening China's anti-dumping, anti-subsidy and safeguard measures and for establishing more effective means to regulate foreign trade’s effect on public health, hygiene, security and the environment.

The months before and after China’s accession saw a flurry of activity aimed at reviewing all of China’s national-level laws and regulations in light of WTO obligations. China has revised a large number of laws and regulations with potentially major implications for U.S. producers and investors. For example, China’s revision of its patent, trademark and copyright laws to better accord with WTO rules could have positive consequences for foreign and Chinese businesses alike. Likewise, in order to implement commitments made in its accession agreement, China opened venture funds to foreign investors, revised rules regulating foreign investment in telecommunications, insurance, banking and other sectors, combined the domestic and quarantine testing agencies with a goal of eliminating double testing of imports, and lowered tariff rates on a wide range of products. China has also issued new measures in the areas of international courier services, legal services, audio-visual services, maritime services, import and export administration, import and export licensing, customs valuation and standards, among others.

IMPORT POLICIES

China has traditionally restricted imports through high tariffs and taxes, non-tariff measures, restrictions on trading rights, and other barriers. Chinese officials are increasingly aware, however, that such protective measures contribute to economic inefficiencies and encourage smuggling. To address these problems, China cut tariff rates on some products in January 2001. In addition, as part of its WTO commitments, China has substantially reduced the number of goods subject to import quotas and will phase-out other quotas. China also clarified its licensing procedures.

Tariffs

Tariff Reductions. Under the terms of its WTO accession, China was to reduce tariff rates upon accession. Because China acceded so late in the year (December 11, 2001), it delayed making its scheduled WTO tariff cuts until January 1, 2002, when it implemented two rounds of reductions. The overall average tariff rate fell from over 15 percent to 12 percent, with the average for industrial goods falling to 11.6 percent. Tariff treatment of certain products – including chicken parts and 15 products subject to the Information Technology Agreement (ITA), however, does not appear to fully match China's WTO commitments. The United States and other WTO members have raised these issues with China and will ensure that China fully implements its tariff commitments.

Over the next three years, China must further reduce the duties charged on imports. China's elimination of tariffs on the products covered by the ITA (semiconductors and semiconductor manufacturing equipment, computers and computer parts, software, telecommunications equipment and computer-based analytical instruments), which began upon accession, is to be completed by January 1, 2005. Tariffs for U.S. priority agricultural products will fall from an average of 31 percent to 14 percent by January 1, 2004. China's post-WTO tariff rates are also now "bound," meaning that China cannot raise them above the bound rates without "compensating" WTO trading partners (i.e., re-balancing tariff concessions or, in accordance with WTO rules, being subject to withdrawal of substantially equivalent concessions by other WTO members). "Bound" rates will give importers a more predictable environment.

WTO accession will have a dramatic effect on tariffs for many products of interest to the United States. Tariffs for some passenger cars, for example, were over 100 percent prior to accession, and will be reduced to 25 percent by 2005. China will also reduce its tariffs on frozen beef cuts to 12 percent, frozen potato products and grapes to 13 percent, on beef and pork offal, cheese, and citrus to 12 percent, and frozen poultry parts, apples, pears, almonds, and pistachios to 10 percent by January 1, 2004.

China may also apply tariff rates significantly lower than the published MFN rate in the case of goods that the government has identified as necessary to the development of a key industry. For example, China's Customs Administration has occasionally announced preferential tariff rates for items that benefit key economic sectors, in particular automobiles, steel and chemical products.

China plans to maintain high duties on some products that compete with those of domestic industries. For example, the tariff on large motorcycles will only fall from 60 percent to 45 percent. Likewise, most video, digital video, and audio recorders and players still face duties of around 30 percent.

Tariff classification. Tariff classification remained a problem in 2001. Customs officers have wide discretion in classifying a particular import. Processed food importers report that they had to "negotiate" tariff classification with customs officers at each port. While foreign businesses might at times have benefitted from their ability to negotiate tariff classification into tariff categories with lower import duty rates, lack of uniformity made it difficult to anticipate in advance what the applied duty would be. U.S. exporters of dehydrated potatoes and veneer reported tariff misclassifications resulting in higher duty rates. At the end of 2001, China revised its laws on the import of goods and its regulations for determining origin in order to comply with WTO rules. These new rules attempt to address longstanding problems related to tariff classification.

Import valuation. Valuation of imports has sometimes been an issue for importers. For example, the U.S. wine industry has expressed its concern about certain customs taxes and the application of a minimum invoice value of $2.70 per 750 ml on all imported wine (although other importers claim that this is also often taken as a maximum value for much more expensive bottles). In late 2001, China released new valuation regulations in order to bring its valuation practices into conformity with the WTO Customs Valuation Agreement. Under the regulations, the Customs Administration has been tasked with assessing a fair valuation to all imports. The United States will be monitoring China's implementation of the Customs Valuation Agreement to ensure that Customs officials do not use minimum or reference prices for valuation purposes.

Border trade. Firms along China's borders can receive an exemption from, or reduction of, tariff and licensing requirements based on a regulation issued in 1996. (The regulation expired in 2000, but in the absence of a new policy governing border trade, customs officials are still applying the 1996 regulation.) This exemption was intended to allow small-scale traders to operate in border communities. However, larger operators appear to be taking advantage of this system to import larger shipments across China's land borders into its interior at preferential rates. China has been reluctant to stop such shipments in its economically depressed northern and western areas, although after accession China must apply tariffs and other import measures on an NTR/MFN basis. Among affected U.S. businesses are soda ash exporters, who report paying higher duties and taxes than their Russian competitors.

Taxation

China continued to reform its tax system during 2001. In April, the National People's Congress Standing Committee passed long-awaited changes to the tax collection law, designed to standardize and increase the transparency of China's tax procedures. As part of a broader campaign to "rectify market order" and eliminate inter-provincial barriers to domestic commerce, the Chinese central government also implemented measures to prevent local governments from applying discriminatory tax treatment that favored locally owned firms.

Application of China's single most important revenue source – the value-added tax (VAT) – is uneven. Imports are sometimes subject to discriminatory application of the VAT, which ranges between 13 percent and 17 percent, depending on the product. In addition, while the VAT is collected regularly on imports at the border, importers in a variety of sectors have complained that their domestic competitors often fail to pay the VAT. Some importers have also reported that they have been charged the VAT twice, once on the cost, insurance and freight (C.I.F.) value of the imported product and then on the total of the C.I.F. value plus the amount of the applicable import duty.

As discussed below in the section on import substitution policies, China has announced the selective exemption of certain fertilizer products from the VAT, which could disadvantage U.S. imports.

Non-Tariff Barriers

China's accession to the WTO should address many of the non-tariff barriers China has used to restrict trade. China is now obligated, for example, to phase out its import quota system, apply international norms to its testing and standards administration, remove local content requirements, and make its licensing and registration regimes transparent.

At the national level, China made some progress in 2001 reforming its testing and licensing systems, improving overall regulatory transparency, and revising the rules governing local content requirements for foreign investors. However, quarantine and testing standards and procedures have continued to delay entry of some imports following China's accession to the WTO.

As for other non-tariff barriers, China has said repeatedly that it will abide by WTO rules, but it is too soon after accession to meaningfully assess implementation. Several national-level officials have stated openly in the state-run media that China should manipulate standards, technical regulations and sanitary and phytosanitary measures to limit imports. At the sub-national level, importers have expressed concerns that local officials do not understand China's WTO commitments and are not prepared to relinquish control over the local economy.

Non-tariff barriers have been administered primarily by the State Economic and Trade Commission (SETC), the State Development and Planning Commission (SDPC), the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), the Ministry of Information Industry (MII), and the State Administration for Quality Supervision and Inspection and Quarantine (AQSIQ).

Import Quotas

Quotas on most products have been eliminated or are scheduled to be phased out as part of China's WTO accession. At present, quotas still limit imports in eight categories of goods, including watches, automobiles, motorcycles, oil and rubber. China did not have a system to allocate quotas in place upon accession as required. China's delay in implementing a quota allocation system is causing concern, and the United States and other WTO members have urged China to allocate quotas immediately.

In the past, China often did not announce quota amounts or the process for allocating quotas. The government set quotas through negotiations between central and local government officials at the end of each year. Under the terms of its WTO accession agreement, China must make quota available at agreed levels that increase 15 percent each year. China is required to allocate quotas to importers based on detailed rules outlined in China's accession agreement.

In the past, monopoly importers have been able to establish *de facto* quotas that maximize their monopoly rents. For example, the sole official government theatrical film importer informally limits the number of foreign theatrical releases it allows each year. The number of foreign films distributed on a revenue-sharing basis will rise from eight in 2001 to 20 in 2002 under the terms of China's accession.

Tariff-Rate Quotas

In 1996, China claimed to have introduced a tariff-rate quota (TRQs) system for imports of wheat, corn, rice, soy oil, cotton, barley, and vegetable oils. The quota amounts were not publicly announced and application and allocation procedures were not transparent. China later introduced a quota on fertilizer imports. Under this TRQ system, China places quantity restrictions on the amount of these commodities that can enter at a low "in-quota" tariff rate; any imports over that quantity are charged a prohibitively high duty.

As part of its WTO accession commitments, China established large and increasing TRQs for these and other commodities, with in-quota duties ranging from 1 percent to 10 percent. Each year, a portion of each TRQ will be reserved for importation through non-state trading entities. China's accession agreement sets forth specific rules for administration of the TRQs, including increased transparency and reallocation of unused quota to end-users that have an interest in importing.

Based in part on comments from the United States, other WTO trading members and industry, China revised the regulations governing TRQs and promulgated them in January and February 2002. Although China did take into account some of the comments made by its trading partners, the final regulations still contain problems and appear likely to impair market access envisioned by China's TRQ commitments. As of March, however, China has not yet allocated its TRQs as required. The United States is working with other WTO members in an effort to obtain immediate allocation of the TRQs and to resolve problems with the regulations.

Import Licenses

Since the early 1990s, China has eliminated many import licensing requirements. However, almost all products that are subject to quotas or TRQs – including grains, vegetable oil, livestock products, soy oil, cotton, iron and steel products, commercial aircraft, passenger vehicles, hauling trucks, and rubber products -- still require licenses. Although issuance of most licenses may be labeled "automatic" by China, license applicants maintain that they have had to prove that there is "demand" for the import and must provide sensitive business details. In its accession agreement, China committed to limit the information that a trader must provide in order to receive a license under an automatic licensing system. China also committed to increase transparency and predictability in the licensing process.

In February 2002, China announced that it was reducing the number of products requiring import licenses from 26 to 12. At the same time, China is considering adding to the list of products requiring import licenses in an effort to combat smuggling. For example, Customs officials have suggested that China will require "automatic" licenses for meat imports in order to track legitimate imports.

Export Licenses

China has progressively reduced the number of products requiring export licenses; by 2001 less than 10 percent of Chinese exports required licenses. Garment and textile exports--which require quota visas to enter foreign markets such as the United States--make up the bulk of these exports. Other products still requiring licenses include some raw materials and metals, lethal chemicals, and food products. In addition, China still occasionally imposes new licensing requirements on strategically sensitive commodities.

China also requires export licenses on products that are the subject of antidumping duties in a foreign market. However, the central government has delegated responsibility for issuing these licenses to new industry associations formed to take the place of the ministries that governed production during the central planning era. Foreign investors report that the industry associations are using the power to issue export licenses to force companies to participate in association-supported activities. For example, the steel producers industry association will not issue an export license to any company that does not contribute to its antidumping defense funds.

Antidumping, Countervailing Duty and Unfair Trade Measures

As trade barriers come down, China's beleaguered state-owned enterprises increasingly are resorting to anti-dumping measures to address allegedly unfair imports. Since China first promulgated Antidumping and Anti-subsidy Regulations in 1997, China has initiated nine antidumping investigations regarding imports of newsprint, steel, and chemical products. Without exception, the Chinese complainants in these cases have been large state-run firms, employing large numbers of workers, suddenly facing pressure from domestic reform and competition from imports. China's WTO accession--and the accompanying competitive pressure on some outmoded Chinese producers–appears to amplify China's new interest in anti-dumping measures. Chinese officials and the state-run media have often commented that Chinese industries may resort to antidumping or safeguard measures to protect their markets after WTO-mandated tariff cuts.

The nine pre-accession antidumping investigations conducted by China lacked transparency, basic procedural fairness and methodological consistency. The agencies responsible for investigating dumping allegations--MOFTEC and SETC--did attempt to address some of these problems as accession neared, but many problems remained.

In late 2001, China issued new antidumping and countervailing duty regulations in an attempt to comply with the applicable WTO rules. It also promulgated a regulation on safeguard measures for the first time. These new regulations lack detail and contain many provisions that are vaguely worded. Most decisions regarding procedures and methods are left to the discretion of the implementing agencies.

Transparency

Under the 1992 U.S.-China Memorandum of Understanding (MOU) on Market Access, China agreed to publish all laws and regulations relating to international trade in the MOFTEC Gazette. The Gazette is updated as new regulations are announced and is available on a subscription basis. Chinese trade officials have stated that China plans to expand the Gazette. Economic newspapers now routinely carry the texts of government regulations, implementing rules, circulars and announcements. Most government ministries also publish digests or gazettes containing the texts of these measures, both in written form and on their websites. The State Council and MOFTEC websites, www.cei.gov.cn and www.moftec.gov.cn, respectively, are examples of this trend. In addition, there has been a proliferation of online news and information services, such as www.chinaonline.com, www.sinolaw.com, and www.sohu.com that routinely offer up-to-date news about and texts of new laws and regulations.

WTO rules on transparency, if implemented fully in China, should increase dramatically access to information about economic and trade measures. In its accession agreement, China committed to publish all laws, regulations and other measures that relate to WTO matters, including those that affect imports, and to allow its WTO trading partners an opportunity to comment on them before implementation. China also agreed to provide a copy of new laws, regulations and other measures to the WTO Secretariat in Geneva, translated into one or more of the WTO's official languages (English, French and Spanish) no later than 90 days after implementation. China also agreed to create various contact points for its WTO trading partners and foreign businesses to inquire about these measures.

The Trade Ministry (MOFTEC) in late 2001 established an "Enquiry Center" to provide information on new trade and investment laws, regulations and other measures. In addition, Chinese government officials are currently researching the United States' "Federal Register" and are planning to begin a journal to publish all national, provincial and local laws, regulations and other measures related to trade and investment.

The Chinese government also began to consider a system to solicit input from interested parties before issuing trade and investment laws or regulations. However, government officials have not provided details on the mechanism for soliciting input. In the past, ministries have sometimes circulated unofficial copies of draft measures to concerned industry representatives and scholars for comment. Face-to-face consultations between government agencies and industry representatives on the text of new measures are also becoming more common.

During the first months after China's accession, three Chinese agencies--SETC, SDPC and the China Securities Regulatory Commission--issued regulations and other measures in draft form for public comment. However, most agencies have issued new measures in final form without providing a formal opportunity for comment before implementation. Despite the lack of formal requests for comments, the United States is reviewing and commenting on these measures as they are issued.

Importers have also expressed concerns regarding whether China will actually publish all "measures" related to trade, as required by the WTO. China's ministries in the past routinely implemented policies based on internal "guidance" or "opinions" that were not available to foreign firms. Experimental or informal policies and draft regulations were regarded as internal matters and public access was tightly controlled.

China's implementation efforts have been focused principally on central government level measures. China's provinces and municipalities have begun a review of their local trade regimes for WTO-consistency and a few have repealed some WTO-inconsistent regulations and other measures. For the most part, however, provinces and municipalities have not yet fully implemented WTO obligations.

TRADING RIGHTS AND OTHER RESTRICTIONS

Trading Rights

China restricts the types and numbers of entities with the right to trade. Only those firms with trading rights may import goods into or export goods out of China. Restrictions on the type and number of firms with trading rights contribute to systemic inefficiencies in the trading system and create substantial incentives to engage in smuggling and other corrupt practices. The restrictions also inhibit Chinese firms' ability to export their products into foreign markets.

Liberalization of the trading rights system had been proceeding gradually since 1995. The pace picked up in 1999 when MOFTEC announced new guidelines allowing a wide variety of Chinese firms to register to conduct foreign trade. The guidelines allow, for the first time, firms with annual export volumes valued in excess of $10 million to register for trading privileges for most products. Firms with trading rights must undergo an annual qualifications test and certification process.

As part of its effort to bring its regulations into compliance with anticipated WTO commitments, China in August 2001 extended this regulation to include foreign-invested enterprises. Research and development centers in China may also now import small quantities for test marketing. Firms without a presence in China still must use a local agent.

At the same time China extended trading rights to foreign-invested firms, it also revised its trading rights administration system. According to trade officials, the new regulations were an attempt to shift MOFTEC away from managing trade and towards simple supervision. The regulations give trading rights to private trading companies, which can now compete with China's state-run trading conglomerates. The regulations set time limits for the approval process, meaning that authorities can no longer delay approvals indefinitely.

Some goods, such as grains, cotton, vegetable oils, petroleum, fertilizers, news publications, and related products are imported principally through state trading enterprises. In its accession agreement, China committed to reserving a portion of the trade in grains, cotton, vegetable oils, and fertilizers quota available to non-state traders each year. China also committed to phase in trading rights within three years of its accession for all enterprises.

Local Agents Requirements

China's WTO accession should improve the ability of foreign-invested firms to distribute their products effectively. In general, foreign-invested firms had only been allowed to distribute products that they manufactured in China. Foreign firms were forced to engage local agents to distribute imported goods. China has agreed to phase out such distribution restrictions for most products within three years of accession.

Import Substitution Policies

Throughout the 1990s, China gradually reduced formal import substitution policies. In anticipation of its accession to the WTO, China enacted legal changes in 2000 and 2001 to eliminate local content requirements for many types of foreign investors. Under these rules, investors are still "encouraged" to follow the formerly mandated practices.

Instances in which the Chinese Government has reportedly encouraged import substitution include:

Fertilizer. In 2001, China offered VAT exemptions and rebates for the types of fertilizers that are produced domestically, but not for like or directly competitive imported fertilizers of interest to American producers. Industry representatives believe China is trying to encourage consumption of domestically-produced fertilizer.

Telecommunications Equipment. There have been continuing examples of China's Ministry of Information Industries (MII) and China Telecom adopting policies to discourage the use of imported components or equipment. For example, MII has still not rescinded an internal circular issued in 1998 instructing telecommunications companies to buy components and equipment from domestic sources.

Power Generation Equipment. The Chinese Government announced in 1998 that power generation facilities of 600 megawatts or smaller could not use imported equipment. Such limitations are often justified as government procurement and are not subject to some WTO rules.

In its accession agreement, China committed that it would not condition import or investment approvals on whether there are competing domestic suppliers or impose other performance requirements.

STANDARDS, TESTING, LABELING AND CERTIFICATION

In preparation for China's WTO entry, China has devoted significant energy towards reforming its standards, testing, labeling, and certification regimes. In September 2001, the State Council approved the merger of China's domestic standards and conformity assessment agency and China's entry-exit inspection and quarantine agency into one new organization--the Administration of Quality Supervision, Inspection, and Quarantine (AQSIQ). AQSIQ intends to consolidate administration of China's various technical regulations, including both testing and enforcement. China also established two new quasi-governmental testing organizations--modeled on the American Underwriter's Laboratory--to certify products, establish technical standards, and unify testing procedures and fees. The new testing regimes were designed to eliminate double testing and multiple fees for imports.

While the formation of AQSIQ and semi-independent testing bodies is a step forward, the system is not yet fully in place. At a local level, quarantine and domestic testing agencies remain separate. Importers still complain about transparency problems and that it is often difficult to ascertain what inspection requirements apply to a particular import, as China's import standards are not fully developed and often differ substantially from requirements imposed on domestic goods. Although China has a transition period to bring some aspects of this regime into conformity with WTO requirements, China agreed to apply the same standards and fees to imported and domestic products, upon its accession to the WTO.

Inspection Standards

China maintains so-called "statutory inspection" requirements on about 800 imported goods and an even greater number of exported products. Chinese buyers or their purchase agents must register for inspection of imported goods at the port of entry. The scope of inspection includes quality, technical specifications, quantity, weight, packaging, and safety requirements. As part of its accession to the WTO, China agreed to bring these requirements into conformity with the WTO Agreement on Technical Barriers to Trade upon accession. China also agreed that any inspection to determine conformity with contractual provisions must be authorized by the parties and that these inspections must not affect customs clearance or the grant of an import license.

Quality Licenses

For manufactured goods, China requires that a quality license, which can require an inspection of the manufacturing facility, be issued before they can be imported into China. Obtaining quality licenses is a time-consuming process, sometimes taking over a year. The delays are sometimes a function of excessively detailed inspection and registration requirements. Often, the agency in charge of the licensing process has devoted insufficient resources to obtaining qualified inspection and licensing personnel or office equipment, leading to backlogs and delays. While requirements vary according to the product, U.S. exporters have complained that these requirements often contravene the principle of national treatment.

Safety Licenses

China began requiring an import commodity safety license on certain products in 2001. Major problems with China's system included the lack of transparency and the difficulty of determining relevant standards. In December 2001, AQSIQ issued Regulations on Compulsory Product Certification. Upon taking effect on May 1, 2002, they will merge the old CCIB and CCEE marks into one single CCC mark for both domestic and foreign goods. After May 1, 2003, only CCC-marked products can be sold and imported into China.

Examples of problem areas include:

Electronic Products. China in 1999 imposed mandatory safety inspections for imports of electronic products, including personal computers, monitors, printers, switches, television sets, and stereo equipment. An additional safety test for electromagnetic compatibility (EMC) was added for these same products in 2000.

Processed food. National health and quarantine regulations require a product safety sticker on imported (but not domestic) food items. Importers are charged between five and seven cents for each of these stickers.

Phytosanitary and Veterinary Import Quarantine Standards

China's phytosanitary and veterinary import standards are sometimes based on dubious scientific principles and are not always consistently applied. China denies access for U.S. exporters of softwood lumber for packaging reasons, and it denies access for U.S. exporters of fresh potatoes, avocados, peaches, pears and certain varieties of apples for phytosanitary reasons.

Nonetheless, China has made some progress over the past decade. China signed several bilateral protocols with the United States governing the import of agricultural items including live horses, apples, ostriches, bovine embryos, swine, cattle, cherries, bovine and swine semen, and grapes. However, the U.S. industry remains concerned that China's medfly trapping requirements for grapes from California are more burdensome than, and not as scientifically sound as, existing U.S. Government trapping programs. In an effort to advance its bid to join the WTO, China lifted its longstanding barriers on imports of U.S. grain, citrus, and meat and poultry with the signing of the U.S.-China Agricultural Cooperation Agreement (ACA) in April 1999. The major provisions of the agreement are as follows:

Meat. China agreed to recognize the U.S. certification system for meat. China promised to accept U.S. beef, pork, and poultry meat from all USDA-certified plants.

Citrus. China lifted its ban on imports of citrus from the United States allowing imports of citrus from most counties in Arizona, California, Florida, and Texas.

Wheat. China lifted its ban on imports of wheat and other grains from the U.S. Pacific Northwest and promised to allow the import of U.S. wheat that meets specified tolerances for TCK fungus.

During 2001, China’s implementation of the ACA produced mixed results. Citrus imports proceeded from the approved counties, but China has thus far delayed approving five other counties, as required in the ACA. Quarantine officials approved Pacific Northwest wheat imports, but importers reported that quarantine officials applied unnecessary requirements to shipments. Barley shipments into China faced problems due to alleged presence of TCK. Traders report that China has made quarantine procedures more cumbersome for all meat imports, restricting the quantity allowed under a single quarantine import permit, lengthening processing times, and introducing a number of new import requirements for poultry.

In December 2001, Chinese quarantine officials blocked two shipments of U.S. poultry parts claiming they had found E. coli contamination.

Chinese officials destroyed the shipment before any re-testing could be performed to confirm the initial finding. As far as U.S. officials know, this particular strain of E. coli has never previously been found under these circumstances. Rather, E. coli is a pathogen commonly associated with beef.

Labeling

The U.S. processed food industry has registered its concerns on a number of standards and labeling requirements on its exports to China. In particular, the U.S. industry has cited China's implementation of a label approval law. Similarly, the distilled spirits industry is concerned that China would require its products to comply with all existing food labeling regulations. The industry believes that some of these requirements are inappropriate since the industry does not consider distilled spirits to be a food.

Agricultural importers are also concerned about new measures requiring labels for products containing transgenic material, such as soybeans and corn. In June 2001, China published a new biotechnology regulation requiring labeling, among other things, but did not at that time make clear when the rules would take effect or how importers could apply for approvals. Although trade returned to normal by the end of the year, in January 2002 China published implementation rules that created tremendous uncertainty.

GOVERNMENT PROCUREMENT

China became an observer to the WTO Agreement on Government Procurement (GPA) in February 2002. China has agreed to conduct its government procurement in a transparent manner and to provide all foreign suppliers with equal opportunity to participate in procurements opened to foreign suppliers. China has also agreed to table an offer and to initiate negotiations for membership in the GPA as soon as possible.

Many Chinese officials are beginning to recognize the high cost of not allowing an open and competitive bidding process for government contracts. The "Provisional Procedures for the Administration of Government Purchases" issued by the State Council in 1999 --China's first national law regulating government procurement practices --contained language aimed at relaxing restrictions on foreign participation. These interim regulations are intended to establish a regulatory framework while work on an omnibus law continues in the Financial Committee of the National People's Congress. The interim regulations appoint the Ministry of Finance (MOF) and the provincial and municipal finance bureaus as the governing agencies in the administration and supervision of government procurement. The interim regulations call on all government procurement offices to "follow the principles of openness, fairness, equality, effectiveness, and safeguarding of the public interest." The interim regulations establish rudimentary criteria for the qualification of domestic and foreign suppliers and various categories of procurement, including open tenders, tenders by invitation, competitive negotiation, and sole sourcing. They also set broad standards for publicity, notification, bid scheduling, sealed bidding and bid evaluation. Existing contracts are grandfathered under the interim regulations.
On January 9, 2001, the Ministry of Finance (MOF) issued a document titled "Procedures Concerning Public Bidding for Procurement Companies in Foreign Government Loan Projects." According to the document, the MOF promises to investigate any company suspected of monopolizing the bidding process for a foreign government loan project. The procedures stipulate that government agency financial departments must release all pertinent information regarding qualified foreign

government loan projects to procurement companies. Companies responsible for implementing a project must tender bid invitations to more than three procurement companies within 10 working days. If fewer than three companies apply for bids, the project must begin again and tender new bids. The entity responsible for offering bids must keep all information that appears in the application forms submitted by procurement companies confidential until after the results of the bidding have been announced.

The procedures stress that noncompetitive or protectionist ploys are strictly prohibited while selecting a procurement company for a loan project. Within any given calendar year, any mid-level company that wins more than 50 percent of that year's loan-project bids may be considered to have "monopolistic inclinations." Similarly, any local company that wins more than 60 percent of a year's bids in a province, autonomous region, municipality directly under the central government, or in a city with independent planning where the bidding company happens to be located, will be regarded by authorities as having "monopolistic inclinations." The MOF will regularly examine bids put out for loan projects and promises to restrict procurement companies with "monopolistic inclinations."

However, as written, the procedures offer insufficient protection to foreign participants in government procurement projects. Among other requirements, foreign suppliers must still obtain permission from the MOF before bidding on a project. There is no similar requirement for domestic suppliers. Adding to the problem, the State Economic Trade Commission (SETC) in 1999 issued regulations requiring state-owned enterprises (SOEs) to purchase all capital equipment from either domestic manufacturers or foreign-invested enterprises in China except where the equipment is not available domestically.

In its accession agreement, China agreed that purchases or sales by state-owned and state-invested enterprises of goods and services for commercial sale, production of goods or supply of services for commercial sale, or for non-governmental purposes would be subject to national treatment, market access and MFN requirements. It further agreed to ensure that state-owned and state-invested enterprises would make purchases and sales based solely on commercial considerations and, in addition, that foreign enterprises would be allowed to compete for sales to and purchases from SOEs without discrimination. It also agreed that the government would not influence the commercial decisions of these enterprises.

EXPORT SUBSIDIES

China officially abolished direct budgetary outlays for exports of industrial goods on January 1, 1991, and Ministry of Finance officials have claimed that the government can no longer afford large-scale export subsidies. Nonetheless, several industries claim that many of China's exports benefitted from export subsidies through 2001.

China’s export subsidies on industrial goods are difficult to identify and quantify because they are most often the result of internal administrative measures and not publicized or they may be provided through mechanisms such as credit allocations or low-interest loans. Other forms of export subsidies involve guaranteed provision of energy, raw materials or labor supplies.

U.S. industry has expressed its concern, in particular, that China is subsidizing goods such as soda ash, wood products, fiberglass, auto glass, steel and flat glass through export (and other) subsidies.
Exports of some agricultural products, such as

corn and cotton, have benefitted from export subsidies in recent years. Industry experts claim that China continued substantial corn export subsidies in 2000 and 2001. Traders also report that the government authorized subsidized corn exports through March 2002.

China agreed to stop all export subsidies on industrial and agricultural goods upon its accession to the WTO in December 2001.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

China has made substantial progress in some aspects of intellectual property rights (IPR) protection since it signed agreements with the United States on IPR in 1992, 1995 and 1996. In 2001, China improved its legal framework considerably, amending its patent, trademark and copyright laws to comply with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). In addition, China launched a major crackdown on counterfeiting. There is also a heightened focus on IPR protection as an important factor in domestic growth. Over the past several months, books, television talk shows, media articles, and government and academic reports have highlighted the importance of IPR protection to China's economic development. Recent speeches by China's leaders and papers on economic strategy stressed the importance of intellectual property.

However, significant problems remain, particularly in the area of enforcement. Although China has revised its laws to provide criminal penalties for certain IPR violations, poor enforcement, combined with weak punishments, mean that IPR violations are still rampant. Piracy and counterfeiting are sophisticated and widespread. Pirates find ways to get digital copies of blockbuster films and computer programs into the Chinese market almost immediately after they are released in the United States. Knock-off consumer products are readily available almost everywhere in China, and consumers are often unaware that they are purchasing IPR-infringing goods. Some U.S. companies claim losses from counterfeiting equal to 15 to 20 percent of total sales in China. One U.S. consumer products company estimates that it loses $200 million annually due to counterfeiting. Industry notes that the destructive effect of widespread IPR violations has discouraged additional direct foreign investment and threatened the long-term viability of some U.S. business operations in China. The inferior quality of fake and unauthorized products can also pose serious health and safety risks to Chinese consumers and damage the image of the product.

Patents

China's new patent law came into effect on July 1, 2001. The new law strengthens patent protection, simplifies patent examination and issuance procedures, and adjusts the law to make it conform more closely to TRIPS provisions. Patent administrators may now confiscate income from infringing products and fine violators. State-owned and non-state-owned enterprises have the same patent rights. TRIPS-related modifications include a prohibition on advertising or marketing of infringing products, judicial review of patent revocations, and a provision allowing a patent holder to request immediate suspension of potentially infringing acts before requesting a formal legal determination.

Administrative Protection for U.S.-Patented Pharmaceuticals

U.S. pharmaceutical companies in China continue to experience difficulties in obtaining administrative protection for products patented in the United States before China’s original patent law went into effect in 1993. It can take months to approve an application for administrative protection of a foreign pharmaceutical. Under regulations enacted in 1994, domestic imitation or similar pharmaceuticals can legally be registered while a foreign manufacturer's application for administrative protection is pending. In some cases, administrative protection is never forthcoming.

Trademarks

China's new trademark law went into effect December 1, 2001. While the changes were intended primarily to bring the law into compliance with the minimum requirements of the TRIPS Agreement of the WTO, their most significant impact is in the area of enforcement. The new law provides access to preliminary injunctions and allows for statutory damages of up to $60,000 in cases where the plaintiff's damage or the infringer's profits cannot be determined. Administrative enforcement authorities and civil courts are authorized to confiscate and destroy counterfeit products and the equipment used to manufacture them. They also are required to transfer cases to the police for criminal investigation based on the suspicion that a crime has been committed. The previous law called for proof, not just suspicion of a crime, in order to transfer the case. The new law also contains provisions for determining the "well-known" status of trademarks.

In 2001, China also issued judicial interpretations and prosecution guidelines in the trademark area aimed at clarifying the standards for criminal enforcement. In addition, China issued regulations to promote the timely transfer of counterfeiting cases from administrative enforcement authorities to the police.

Although it is still too early to assess the full effect of China's new trademark law and regulations, counterfeiting, especially of brand name products, remains prevalent and in some cases may have worsened. Brand owners, however, are generally encouraged by the central government's increased commitment to anti-counterfeiting efforts. While regional and interagency cooperation on IPR protection has similarly improved, it is still inadequate and inconsistent. Insufficient administrative sanctions and infrequent use of criminal sanctions remain major enforcement problems. Further complicating this situation, a shortage of trademark agents authorized to file trademark applications for foreign companies makes it difficult for foreigners to register trademarks.

The United States and other WTO members have raised concerns about whether foreign trademark owners are receiving national treatment with respect to trademark agent requirements and protection of well-known marks. China has committed to review its measures to provide national treatment for all aspects of IPR protection.

In a further action against counterfeiters, China launched the National Campaign for the Rectification of Market Disorder on April 15, 2001, in many respects an extension of an earlier anti-counterfeiting campaign begun in November 2000. The taskforce established to oversee the Market Disorder Rectification Campaign has focused its efforts on cracking down on counterfeit, fake, and shoddy products, as well as on local protectionism, with particular attention to products that affect human health, including food, drugs, medical supplies, and agricultural products. As of July 2001, some 115,000 cases were reported to have been identified. Various enforcement agencies involved with the campaign claimed to have shut down a total of 13,500 factories that produce fake goods and to have taken 567 suspects to court. Initial U.S. business reaction was positive, with the proviso that the campaign should continue and that China should continue legal reforms and make more use of criminal sanctions.

Copyrights

China's new copyright law went into effect October 27, 2001. As part of overall efforts to bring the language of the law into compliance with minimum TRIPS requirements, enforcement measures have been strengthened. Courts can order confiscation of illegal gains, pirated copies and property used to conduct infringement activities. The new law places the burden of proof on the accused infringer to prove it has a legitimate license, and includes a reference to China's contract law as a basis for fulfillment of the parties' obligations. Incentives for arbitration are encouraged as an alternative to litigation. The new law for the first time addresses copyrights issues related to the Internet.

A new regulation on the copyright protection of computer software products went into effect on January 1, 2002. It specifies the interests involving computer software development, circulation and application. According to the regulation, an individual software developer may keep his or her copyright for life, and it will continue in the individual's name for 50 years after death.

China is gradually recognizing that copyright infringement threatens economic development. The software industry is but one example. One international business association estimates that 94 percent of software used in China at the end of 2000 was pirated. According to industry, this represents the second highest piracy rate in the world after Vietnam. Authorities published a notice in August 2001 requiring Beijing government departments to buy authorized software and to include a special budget for such purchases. Despite such official efforts to promote growth of the software sector, however, more than one-fourth of domestic Chinese software companies polled in a recent survey considered piracy to be the main obstacle to their future development.

China continues to take action against music and video piracy. Chinese authorities estimate that they seized more than 114 million illegal audio-visual products in 2001, including 48 million copies smuggled from overseas. Guangdong Province, neighboring Hong Kong and Macau, is the main channel for smuggling VCDs, DVDs and CDs. Local customs and police departments have intensified their crackdown on these types of pirated products. Central and Guangdong authorities held an anti-piracy exercise in Zhuhai in late August 2001 in which 16.4 million pirated CDs, DVDs and CDs were destroyed.

China's growing interest in copyright enforcement aside, there are still profound problems. The software industry lacks clear procedures for addressing corporate end-user software piracy; retail software revenue lost to piracy was estimated to total $1.1 billion at the end of 2000. Pirated music and films are readily available in a variety of retail outlets and from street vendors. There is no noticeable improvement in the market for books and journals in China, with piracy hampering development of the legitimate market. Industry remains concerned that despite the small but growing number of publicized actions and fines, piracy of U.S. works continues unabated. Producers and sellers of pirated journals have been linked with some of China's largest and best-known publishers. Over half of all copies of academic journals found in university libraries in China are unauthorized copies. Losses to U.S. publishers stemming from academic journals piracy are estimated at $100 million annually.

Protection of Lay-out Designs of Integrated

Circuits

China adopted the Regulations on the Protection of the Design of Integrated Circuits, which went into effect on October 1, 2001. These provisions are intended to implement China's TRIPS obligations relating to protection of lay-out designs.

ELECTRONIC COMMERCE

China has experienced noticeable growth in Internet usage and electronic commerce. The number of people in China with access to the Internet exceeded 26.5 million by June 2001 compared with 620,000 in October 1997. Worldwide, Chinese is now the second most used language on the Internet after English. A fall in personal computer prices and the arrival of information appliances tailored for the Chinese market will further expand Internet access.

China has more than 1,100 consumer-related electronic commerce websites. The majority are shopping websites. Others include auction websites; distance education websites; and distance medical and health-related websites. Among the shopping sites, approximately two-thirds are pure online shops; the remainder are part of traditional retail businesses.

The Chinese government recognizes the potential of electronic commerce to promote exports and increase competitiveness and has made some progress toward establishing a viable commercial environment. However, some of the Chinese ministries with responsibility for electronic commerce have excessively regulated the Internet, thereby stifling the free flow of information and consumer privacy needed for electronic commerce to flourish. Content is still controlled and encryption regulated.

A number of technical problems also inhibit the growth of the industry. Rates charged by government-approved Internet service providers make Internet access unaffordable for most Chinese. Slow connection speeds are another barrier, although this is changing as cable connections become more readily available. The lack of a safe and secure payment system requires that Internet transactions in China be conducted on a cash-on-delivery basis or delayed by a ten- to fifteen-day verification period.

SERVICES BARRIERS

China's services sector has been one of the most heavily regulated and protected parts of the national economy. Until China's entry into the WTO, foreign service providers were largely restricted to operations under the terms of selective "experimental" licenses. Both as a matter of policy and as a result of its WTO commitments, China has decided to open significantly foreign investment in the services sector. The market, though currently underdeveloped due to historical attitudes and policies, has significant growth potential in both the short and long terms.

Because of the historical limits on the services sector, it is difficult to estimate how much these market access barriers represented in lost U.S. services exports. Nevertheless, many experts estimate the potential of the services sector for foreign suppliers as being well into the billions of dollars. Some markets will benefit more than others from China's WTO commitments. Experts expect that the insurance and distribution sectors will likely grow more rapidly than the banking and securities fields. China's WTO commitments should, however, provide meaningful access for U.S. service providers across a wide range of industries. Specific changes to current barriers are identified below. In many cases, China will phase out restrictions over a number of years.

Financial Services (Banking and Securities)

Although the situation should improve as China takes steps to meet its WTO commitments, foreign banks and securities firms continue to face a restrictive, opaque regulatory environment. In particular, China continues to have strict limitations on foreign banks' participation in local currency operations.

On December 30, 2001, the Chinese government announced revisions to the regulations on foreign financial institutions. The revised regulations permit the establishment of foreign bank branches anywhere in China so long as the applicant meets the listed criteria. These include gross assets of $20 billion for those foreign banks looking to establish branches in China. Although foreign currency business with any customer, foreign or domestic, is also freely permitted under the new regulations, the Bank of China, one of China's four major state-owned commercial banks, continues to enjoy a monopoly on forward foreign exchange contracts. Foreign bank branches must also place 30 percent of their operating capital in interest bearing assets designated by the People's Bank of China (PBOC). Foreign branch current assets (cash, local bank demand deposits, and PBOC deposits) must continue to be greater than 25 percent of customer deposits. In addition, foreign banks' ratio of customer deposits in foreign currency to domestic foreign currency loans may not exceed 70 percent, an increase from the 40 percent level mandated previously. China calculates prudential ratios and limits based on the local capital of foreign bank branches rather than on the capital base of the entire bank.

The China Securities Regulatory Commission circulated draft regulations on the establishment of joint-venture fund management companies and securities underwriting by Chinese-foreign joint ventures for comment. No regulations, however, had been issued as of the end of 2001. Pursuant to the terms of China's accession agreement, foreign securities firms received the right to form joint ventures for fund management upon China's accession to the WTO; joint ventures for securities underwriting must be permitted within three years after accession.

As part of its WTO accession agreement, China agreed to allow foreign banks to conduct local currency business with Chinese companies two years after WTO entry, and with Chinese individuals three years later. The revised regulations released in December 2001, place the authority for determining the geographic and operational scope for foreign financial institutions to participate in local currency business with the PBOC. A December 9, 2001, PBOC public notice stated that foreign-funded financial institutions established in the cities of Shanghai and Shenzhen had been allowed to engage in local currency business as of December 1. Those foreign financial institutions located in the cities of Dalian and Tianjin would be permitted to apply for permission to engage in local currency operations on the same day. The Chinese government has committed to opening four new cities every year to foreign banks to engage in local currency operations. All non-prudential restrictions on foreign banks are to be lifted within five years of China's accession to the WTO.

Distribution

Historically, distribution in China was reserved for wholly Chinese-owned firms. Foreign firms had an extremely limited ability to market, transport, service, or support their products. Under China's WTO commitments, many of these restrictions will be lifted over a phase-in period of three years. Currently, it is not clear how China intends to implement its commitments within the distribution sector.

The ability to distribute goods freely throughout China will significantly improve the ability of U.S. firms to sell goods to the Chinese public. However, even after accession to the WTO, China will have to resolve many contradictions within existing rules before the promise of full access is realized. For historical reasons, distribution even by Chinese firms had been organized on a provincial or municipal basis. There was little organization between cities or provinces. True nationwide distribution networks do not currently exist. Firms wishing to establish such networks will find it difficult to obtain clear and accurate guidance on management and taxation requirements for their operations.

Retailing

In 1999, the Chinese government broadened the scope for foreign investment in the retail sector. New regulations at that time encouraged the entry of large international retailers (such as Wal-Mart or Carrefour) into China.

China's WTO commitments further expand the ability of foreign retailers to enter the market through a much wider range of modalities. Smaller retail operations, some large retail operations, gas stations and even car dealerships will be allowed to be wholly foreign-owned within three to five years of accession. In addition, franchising, sales away from a fixed location (both wholesale and retail) and related subordinate activities will be permitted without restrictions within three years of accession. Certain types of large retail operations, however, may still face ownership limitations.

Direct selling remains problematic within China. In 1998 China banned all direct selling activities because some foreign and domestic firms used direct selling techniques to operate pyramid schemes and other less-than-legitimate operations. However, China has indicated it will allow full resumption of direct selling activities within three years of accession to the WTO. This commitment notwithstanding, firms using a direct selling model have found local regulators to be extremely vigilant in enforcing direct selling regulations.

Telecommunications

China has made progress in increasing competition in telecommunications services over the past few years. China has formally separated post and telecommunications services, separated policy and regulatory functions from operator functions, developed a telecommunications law, and lowered connection costs. The government confirmed in November, 2001 that it will break up China's largest telecommunications company, China Telecom, into northern and southern parts. Two of China's seven national basic telecommunications companies, China Netcom and Jitong, will merge with China Telecom's subsidiaries in 10 northern provinces to form China Network Communications; subsidiaries in the other 21 provinces and municipalities in southern and northwestern China will retain the China Telecom name. Other national companies--China Unicom, China Mobile, China Satellite, and Railcom--will continue to operate separately.

China's new Regulations on Foreign-Invested Telecommunications Enterprises went into effect January 1, 2002. They define registered-capital requirements, equity caps, requirements for Chinese and foreign partners, and licensing procedures. The regulations stipulate that foreign-invested telecommunications enterprises can undertake either basic or value-added telecommunications services. Foreign ownership may not exceed 49 percent in the case of basic telecommunications services (excluding wireless paging) and 50 percent in the case of value-added services (including wireless paging, which is otherwise categorized as a basic service). The entire process of forming a Sino-foreign joint venture for basic services pursuant to the new regulations is expected to be lengthy, lasting on average 9 to 12 months.

Draft revisions of China's other telecommunications regulations are still under consideration, and when approved, will represent China's first comprehensive set of regulations in this sector. China's current telecommunications regulations, issued by the State Council in September 2000, allow for interconnection, cost-based pricing, universal service, and stipulate licensing authority and procedures. However, these regulations are generally vague and lacking in specific and necessary details. For instance, they do not stipulate any transparent methodology for determining cost-based interconnection rates.

Progress in opening the market for value-added services--such as Internet service and content providers--has been less clear. The Ministry of Information Industries (MII) announced moves towards convergence in voice, video and data services in 2000, but China considers communications and information content sensitive, so foreign companies face significant barriers in the Internet services sector. The definition of websites as a "value-added telecom service" hinders foreign companies from owning China-based websites, even if only for the sole purpose of promotion of their own businesses. The requirement that Internet Service Providers (ISPs) must provide user log-in information and transaction records to authorities upon request, without clear guidelines as to the circumstances and situations that warrant such actions, raises concerns about consumer privacy and prevention of data misuse.

Foreign equity investment limitations for ISPs and Internet Content Providers (ICPs) mirror the timetable for value-added services in the WTO agreement (30 percent upon accession, 49 percent within one year after accession and 50 percent within two years after accession). However, ICPs must still win the approval of the MII before they can receive foreign capital, cooperate with foreign businesses, or attempt domestic or overseas stock listings.

Insurance Services

China's insurance market is growing steadily, but not as quickly as its potential. Some experts believe potential revenues for U.S. insurers could rise as high as $15 billion per year after a full opening of the market. Since 1992, China has allowed foreign investors limited access to its insurance market. Prior to 2001, 16 foreign insurers reportedly received licenses to operate either in Shanghai or in Guangdong province. The pace of opening increased rapidly in 2001 when the China Insurance Regulatory Commission committed to accepting an additional 16 license applications from foreign firms.

In its WTO accession agreement, China committed to a gradual opening of both its life and non-life insurance sectors. Foreign life insurers are limited to a 50 percent equity stake in a joint venture, while non-life firms are limited to a 51 percent stake. After two years, non-life firms can be wholly-owned. Geographic restrictions will also be eased over the next three years after which the entire country will be open to foreign-invested firms.

In late 2001, China issued new regulations regarding the activities of foreign insurance firms in China. While China agreed that it would open its insurance market to all eligible firms on a prudential basis with no economic needs test, the specifics of how this commitment will be implemented are still far from clear.

Transportation and Logistics

Much like the distribution sector, the transportation and logistics sector has in the past faced severe regulatory restrictions, high costs, dominance by government-invested agents, and limitations on permitted activities. The multiple government bodies responsible for this industry include: the State Domestic Trade Bureau, Ministry of Communications, Ministry of Railways, Ministry of Foreign Trade and Economic Cooperation, State Economic and Trade Commission, State Development Planning Commission, and the Civil Aviation Administration of China. Overlapping jurisdictions, multiple sets of approval requirements, and opaque regulations hinder market access. Current service providers have used government connections and investments to monopolize the industry. Shipping firms have found it impossible to open subsidiaries in inland ports. The Chinese Postal Bureau is in the process of assessing its own role in the delivery of small packages and urgent letters. New measures have been issued which could jeopardize market access that express mail companies enjoyed prior to China's accession.

These restrictions notwithstanding, China's WTO commitments and its own reform policies support a broad opening of the transportation sector to foreign service providers. After periods of time ranging from three to six years after WTO accession, foreign firms will be able to invest freely in warehousing, road freight transport, rail freight transport, and freight forwarding companies. However, the exact form of new rules and how they will be implemented remains unclear.

Audiovisual Services

China's new Regulations on the Administration of Audio-Visual Products and Regulations on the Management of Film went into effect on February 1, 2002. They are designed to bring more order and transparency to the film and audio-visual industries, with an eye to moving toward greater commercial efficiency in accordance with domestic reform efforts and WTO commitments. Despite these positive moves, desires to keep the monopoly rents earned by the state-owned importers and distributors, and China's concerns about politically sensitive materials, have led to restrictions in audiovisual services.

Distribution of sound recordings, videos, movies, books and magazines remains highly restricted. In addition, the websites of foreign news organizations are often blocked for extended periods of time, and news services remain wary that the government will impose new restrictions on their activities. Inconsistent and subjective application of censorship regulations further impede market growth for foreign and domestic providers alike.

China began importing foreign films on a revenue-sharing basis in 1994. Under its WTO commitments, China will allow at least 20 foreign films annually into China on a revenue-sharing basis. China also will open theaters and distribution to foreign investment. Imported films must be 35mm and include Chinese subtitles, and imported films must be reviewed and approved.

Education and Training

China faces a shortage of qualified teachers and clearly needs educators in inland regions. However, the Ministry of Education (MOE) continues to restrict participation by foreign educators and trainers. China permits only non-profit educational activities and only activities that do not compete with the MOE-supervised nine years of compulsory education, thereby inhibiting much-needed foreign investment in the education sector. In April 2000, the MOE banned foreign companies and organizations from offering educational services via satellite networks. Universities may set up non-profit operations, but foreign universities must have a Chinese university host and partner to ensure that programs bar subversive content and localize imported information. China's training market is unregulated, which discourages potential investors from entering the market.

Legal Services

As of December 2001, foreign law firms were permitted to practice in one city only. Chinese law firms, on the other hand, have been able to open offices freely throughout China since 1996. Unlike their counterparts in other professional services such as accounting, architecture and insurance, foreign law firms are not permitted to form joint ventures with Chinese law firms. Foreign attorneys may not take China's bar examination, and they may not hire registered members of the Chinese bar as attorneys. Foreign law firms are not allowed to perform any legal services involving Chinese law. They may only engage in legal services related to the laws of their home country and to international law. Nevertheless, as more foreign firms enter Chinese markets, the demand for U.S. legal firms will likely grow as well.

As part of its WTO accession, China agreed to lift quantitative and geographical restrictions on the establishment of representative offices by foreign law firms within one year after accession. China has also promised to clarify the type and duration of the contractual relationships between foreign and Chinese law firms. In addition, foreign law firms may provide information to clients on the impact of China's legal environment.

Despite these changes, other restrictions currently faced by foreign law firms will not be eliminated as a result of WTO accession. The Ministry of Justice (MOJ) has recently issued regulations governing foreign law firms. These regulations are being reviewed, and we will work with China's officials so that these regulations are drafted and applied in a manner consistent with China's WTO obligations.

Tourism and Travel Services

At present, foreign travel and tourism service providers are prohibited from operating full-service travel agencies in China. Permitted activities are subject to geographic restrictions. There are also a number of restrictions in place regarding the hiring of guides and travel agents.

China's system of channeling individual tourism through government-controlled travel agencies has hampered outbound tourism to the United States. The Chinese National Tourism Administration has a policy of signing bilateral tourism agreements with foreign governments who in turn designate domestic travel agencies to handle Chinese group tours. The U.S. Government has been willing to negotiate an arrangement, but has stipulated that it cannot select domestic companies to serve as official travel agencies.

Holders of Chinese official passports, over 80,000 of whom applied for U.S. visas in FY2001, are required to use China's state-owned airlines or their code-share partners. Most of these individuals would not be considered government employees in most countries. This represents a significant loss of business for U.S. airlines.

China's accession to the WTO will have a limited impact on the tourism industry in the near term. Foreign travel companies continue to be restricted from marketing to Chinese outbound tourists. Foreign travel companies may, however, create a joint venture with a Chinese company to promote foreign inbound tourism.

Wholly foreign-owned ventures catering to foreign inbound tourists will be permitted six years from accession.

Accounting and Management Consultancy Services

The Chinese Institute of Certified Public Accountants (CICPA), a government body under the Ministry of Finance (MOF), has made significant progress in modernizing accounting in China. Last year, the MOF released four newly revised auditing statements covering inter-bank confirmation, capital verification, accounting estimates and the audit of commercial bank financial statements. Furthermore, MOF has been active in standardizing accounting procedures across a wide range of topics including investments, inventories, cash flow statements, and fixed assets. The Chinese Securities Regulatory Commission required listed companies to appoint a certified international CPA firm to conduct audits on prospectuses and annual reports in accordance with international standards. While specific numbers are not available, most observers agree that the demand for internationally qualified accountants will grow rapidly in coming years.

Despite these positive changes, pervasive problems remain. Differing accounting regulations limit the comparability of data. The accounting practices followed by many domestic firms do not meet international conventions. Prior to China's accession to the WTO, foreign accounting firms could not choose their own Chinese joint venture partners without outside interference or enter into contractual agreements that could fully integrate these joint ventures.

In its WTO accession agreement, China committed to remove the restriction on representative offices engaging in profit-making activities. For new entities providing taxation, management consulting, computer-related and software implementation services, operations must be conducted through joint ventures, although majority foreign ownership is permitted. Wholly foreign owned operations in the taxation and management consulting sectors are to be permitted six years after accession.

Advertising

The State Administration of Industry and Commerce (SAIC) enforces China's 1995 Advertising Law. Among other things, the law bans messages "hindering the public or violating . . . social customs." The law is subject to interpretation by the SAIC, which must approve all advertising campaigns. One additional difficulty for foreign advertising firms, as well as foreign manufacturers, is that China has strict regulations prohibiting comparative advertising as well as any advertising with claims about the relative superiority of one brand over another. Marketing strategies that are successful in other countries are therefore illegal in China.

Foreign firms have been restricted to representative offices or minority ownership of joint-venture operations. As part of its WTO accession commitments, however, China agreed to allow majority foreign ownership of joint venture advertising companies within two years and wholly foreign-owned subsidiaries after four years.

As in many other areas, experts believe the potential demand for U.S. advertising services is high, but specific numbers are difficult to obtain or are highly unreliable.

Construction Services

U.S. engineers, architects and contractors have enjoyed a relatively cooperative and open relationship with the Chinese government. These professionals operate in the Chinese market through joint venture arrangements and are less affected by regulatory problems than other service sectors. Nevertheless, they also face restrictions. Lack of clear guidelines makes it difficult for foreign architecture and engineering firms to obtain licenses to perform architecture and engineering services except on a project-by-project basis. There have been instances where U.S. architectural firms have had to pay Chinese domestic taxes on designs prepared in the United States for Chinese projects. China sets extremely low design fees, rather than letting the market set prices. Currently, Chinese architecture and engineering firms must approve and stamp all drawings prior to construction. Foreign firms cannot hire Chinese nationals to practice architecture and engineering services as licensed professionals. Foreign contractors face severe partnering and bidding restrictions. In addition, China does not have adequate lien laws to protect the rights of engineers, architects, contractors, and material suppliers from non-payment.

INVESTMENT BARRIERS

Foreign investors show interest in China despite significant obstacles. Among developing economies, China was the leading recipient of foreign direct investment (FDI), taking in $46.9 billion in 2001. Barriers to investment include opaque and inconsistently enforced laws and regulations and a lack of a rules-based legal infrastructure. China's leadership has reaffirmed its commitment to "further open" China to investment and to continue movement towards a rules-based economy.

The Standing Committee of the Ninth National People's Congress (NPC) approved amendments to three regulations covering joint ventures, wholly foreign-owned firms and foreign direct investment in October 2000. The amendments expanded the list of "encouraged" sectors for foreign investment, eliminated provisions mandating export performance requirements (e.g., rules that required companies to export a certain percentage of products), revised "Buy China" policies that regulated procurement of raw materials and fuels, and removed requirements that companies submit production/operation plans to Chinese authorities. More detailed implementing rules for these regulations were issued in April and July 2001.

Investment Guidelines

Foreign investment inflows continue to be controlled and channeled toward areas that support national development objectives. China has adjusted its investment guidelines a number of times over the last five years. The revisions have confused potential investors and added to the perception that the investment guidelines do not provide a stable basis for business planning. Uncertainty as to which industries are being promoted as investment targets, and how long such designations will be valid, undermines confidence in the investment climate. In 2000, China last published revised lists of sectors in which foreign investment would be encouraged, restricted or prohibited. SDPC and SETC officials have stated that China will announce a new list in 2002 that will further liberalize the scope of permitted foreign investment in China.

The Chinese government emphasizes guiding new foreign investment towards "encouraged" industries and areas that support national development objectives. Regulations relating to the encouraged sectors were designed to direct FDI to areas in which China could benefit from foreign assistance or technology, such as in the construction and operation of infrastructure facilities. The government announced a series of measures in August 1999 that began to decentralize investment approval decision-making authority and to create new incentives for investments in key sectors and geographic regions. These guidelines allowed authorities at the provincial level of government to approve "encouraged" foreign-invested projects and raised the investment value beyond which central government approval is required.

Over the past five years, China has introduced new incentives for investments in high-technology industries, such as a regulation issued in November 1999 which provided foreign-invested firms a tax deduction for contributions to non-affiliated research and development or educational institutions. In December 2001, China announced comprehensive new incentives for investment in the less-developed central and western parts of the country.

Under the terms of its accession to the WTO, China is scheduled to progressively liberalize limitations on foreign investment in value-added telecommunications, banking, insurance and distribution, among other sectors.

Investment Restrictions

The Chinese government prohibits or restricts foreign investment in projects not in line with the state plan. In many sectors, foreign firms must form a joint venture with a Chinese company and restrict their equity ownership to a minority share in order to invest in the Chinese market. There are, in addition, a number of sectors in which foreign investment is technically allowed but not "encouraged."

There are numerous examples of investment restrictions. For example, China bans investment in the news media, broadcast, and television sectors, citing national security interests. The production of arms and the mining and processing of certain minerals remain prohibited sectors. Many investments are restricted under the guise of avoiding excess capacity.

U.S. investors have expressed concerns about sectors which China may add to the prohibited investment category, in particular those related to transgenic and genetically-modified seed research. Ongoing work and planned projects could be terminated.

Investment Requirements

In keeping with its commitment to implement the WTO Agreement on Trade-Related Investment Measures (TRIMS) and obligations in its protocol of accession, China has eliminated export performance and local content requirements on foreign investors. China also agreed not to condition investment or import approvals on performance requirements of any kind, including local content requirements, offsets, transfer of technology, or requirements to conduct research and development in China. Notwithstanding the above, industry is concerned that the government may impose unofficial requirements in exchange for extra-legal, *quid pro quo* decisions by government officials at both the national and sub-national level.

Other Investment Issues

Venture Capital. There are currently no laws or regulations that define the legal and organizational structures for domestic private equity funds, although an April 2001 regulation prohibited securities firms from entering the private equity business. Chinese laws concerning foreign private equity firms set limits on corporate structure, share issuance and transfers, and investment exit possibilities. For example, China has no regulations allowing issuance of preferred stock or options. The difficulty of listing on China's stock exchanges, coupled with the bureaucratic approval required to list overseas, limits interest in establishing China-based venture capital firms. As a result, most foreign private equity investments in China have actually occurred in offshore investment entities. With a new provisional regulation that took effect September 1, 2001, China permitted the establishment of foreign-invested venture capital firms, including wholly foreign-owned firms, but the firms are limited in scope to encouraged and permitted high technology areas.

Holding Companies. There has been some relaxation of the restrictions on the business scope and operations of holding companies. Some restrictions on services provided by holding companies and on their financial operations and their ability to balance foreign exchange internally will remain even after full implementation of China's WTO commitments. Profit and loss consolidation within holding companies also remains prohibited.

Access to Capital Markets. Foreign-invested companies in China remain largely unable to access domestic and international stock markets, to sell corporate bonds, to accept venture capital investment, to sell equity, or to engage in normal merger, acquisition, and divestment activity. Foreign exchange transactions on the capital account can be concluded only with case-by-case official review. These approvals and are subject to very tight regulatory control. Barriers to capital market access will not be removed by China's WTO entry. China has begun to experiment with liberalization, such as the opening of domestic stock markets to listings by foreign-invested firms.

ANTICOMPETITIVE PRACTICES

China continues to struggle with economic inefficiencies and investment disincentives created by local protectionism, predatory pricing, and preservation of industry-wide monopolies. There are several existing competition laws, and China is drafting a new anti-monopoly law. However, existing laws are ineffective due to poor national coordination and inconsistent local and provincial enforcement.

Anticompetitive practices in China take several forms. In some cases, industrial conglomerates operating as monopolies or near monopolies (such as China Telecom) have been authorized to fix prices, allocate contracts, and in other ways restrict competition among domestic and foreign suppliers. Regional protectionism by provincial or local authorities often blocks efficient distribution of goods and services inside of China. Such practices may restrict market access for certain imported products, raise production costs, and restrict market opportunities for foreign-invested enterprises in China.

OTHER BARRIERS

Legal Framework

Laws and Regulations. Laws and regulations in China tend to be more general than in other countries. While this allows them to be applied flexibly, it also results in inconsistency and confusion in application. Companies often have difficulty determining precisely whether their activities contravene a particular regulation, and agencies at several levels of government have rulemaking authority frequently resulting in inconsistent or conflicting regulation.

This lack of a clear and consistent framework of laws and regulations is in effect a barrier to the participation of foreign firms in the Chinese domestic market. A comprehensive legal framework, coupled with adequate prior notice of proposed changes to laws and regulations, and an opportunity to comment on those changes, would greatly enhance business conditions, promote commerce and reduce opportunities for corruption.

In China, regulations are promulgated by a host of different ministries and governments at the provincial and local levels, as well as by the National People's Congress. As a result, regulations are frequently at odds with each other. Even though laws and regulations are now routinely published in China, they often leave room for discretionary application and inconsistencies arise, either through honest misunderstanding or by design.

Government bureaucracies have sometimes been accused of selectively applying regulations. China has many strict rules that are usually ignored in practice until a person or entity falls out of official favor. Governmental authorities can wield their discretionary power to "crack down" on foreign or disfavored investors or make special demands on such investors simply by threatening to wield such power.

In its accession agreement, China committed to establish tribunals for the review of all administrative actions relating to the implementation of laws, regulations, judicial decisions and administrative rulings.

These tribunals must be impartial and independent of the government authorities entrusted with the administrative enforcement in question, and their review procedures must include the right of appeal. China also committed, at all levels of government, to apply, implement and administer all of its laws, regulations and other measures relating to trade in goods and services in a uniform and impartial manner throughout China, including in special economic areas. In connection with this commitment, China further committed to establish an internal review mechanism to investigate and address cases of non-uniform application of laws based on information provided by companies or individuals.

*Commercial Dispute Resolution***.** Skepticism about the independence and professionalism of China's court system and the enforceability of court judgments and awards remains high among foreign companies. There is a widespread perception that judges, particularly outside of China's big cities, are more influenced by local political or business pressures than they are by written regulations or signed contracts. Few judges have any legal training. This has often caused both foreign and domestic companies to avoid enforcement actions through the Chinese courts. The Chinese government is moving to establish consistent and reliable mechanisms for dispute resolution through the adoption of improved codes of ethics for judges and lawyers and increased emphasis on the consistent and predictable application of laws.

The China International Economic and Trade Arbitration Commission (CIETAC) has become, over a short time frame, the preferred forum for the arbitration of trade disputes. CIETAC's policies to approve foreign professionals to act as arbitrators and streamline procedural requirements to allow for timely resolution of disputes have been well received by the foreign business community. The business community continues to press, however, for improvements in CIETAC rules, including increased flexibility in choosing arbitrators and enhanced procedural rules to ensure orderly and fair management of cases.

Even in cases where the judiciary or arbitration panels have issued judgments in favor of foreign-invested enterprises, execution of such judgments has sometimes been difficult. Officials responsible for enforcement are often beholden to local interests and unwilling to enforce court judgments against locally powerful companies or individuals.

In late February 2002, the Supreme People's Court announced that it was going to designate a number of courts at provincial and local levels to handle commercial cases involving foreign parties. The announced goal is "to achieve justice and efficiency in handling cases, enhance the authority of China's rule of law and create a fine legal environment now that China has entered the WTO." Rules relating to the operation of these courts were to take effect on March 1, 2002.

Labor and Benefits

Lack of uniformity and transparency in applying labor laws and regulations and restrictions on labor mobility complicate investors' personnel planning. The Chinese Government is developing nationwide pension, unemployment insurance, and medical insurance systems. However, these new systems are not yet fully or consistently funded. China is considering, but has not yet enacted, legislation that might regulate these systems nationwide. At present, differences in benefit costs and taxation between, and even within, regions and localities, complicate investors' planning. Inconsistent application of labor regulations between foreign-invested enterprises and Chinese enterprises pose further difficulties for foreign investors.

The cost of labor--especially unskilled labor--is low in much of China. The existence of an enormous surplus rural labor force, many of whom find work in urban areas, helps to keep unskilled wages low. However, substantial restrictions on labor mobility can distort labor costs. Many Chinese are bound by a household registration system that makes it difficult for them to work or live outside their home area. China is gradually easing restrictions under this system, recognizing that the creation of a genuine labor market is essential to the continued growth of the economy. Where competition for workers is intense and the supply limited, especially in the case of technical, managerial, and professional staff, labor costs can be high. This is particularly true in China's rapidly growing coastal areas.

Corruption

Chinese officials admit that corruption is one of the most serious problems the country faces. China pursued more than 43,000 anti-graft cases last year, recovering more than $400 million. Lower-level officials bore the brunt of the ongoing anti-corruption campaign, but several high-ranking officials, including a former provincial governor, were expelled from the Communist Party. Chinese law enforcement officials detained several senior Chinese officials, including the head of one of China's four large state-owned commercial banks. China's entry into the WTO, which will greatly reduce tariff barriers to imports, will significantly reduce incentives for smuggling and the attendant corruption. Most other official graft in China involves misappropriation of funds, abuse of power, and embezzlement.

China promulgated its first law on unfair competition in December 1993, and the government continues to call for improved self-discipline and anticorruption initiatives at all levels of government. However, it remains the case that contracts are often not awarded solely on the basis of commercial criteria. U.S. suppliers complain that the widespread existence of such practices in China puts them at a competitive disadvantage. This dilemma is less severe in sectors where the United States holds clear technological preeminence or cost advantages. Corruption nevertheless undermines the long-term competitiveness of both foreign and domestic entities in the Chinese market.

Smuggling

Since Beijing implemented an anti-smuggling campaign in the summer of 1998, more goods have entered China legally, resulting in higher customs revenues. China's tariff revenues hit a record $27 billion for the first 11 months of 2001, up 13 percent from the 2000 figure. China investigated 19,091 smuggling cases in the first 10 months of 2001, up six percent from 2000. The value of goods involved in those cases was $570 million.

Almost all of the smuggling cases involve local officials who either enjoy the profits of the criminal enterprise or are paid by the smugglers to look the other way. Lai Changxing, chairman of the Yuan Hua Group based in the port city of Xiamen, Fujian, is the alleged mastermind of the group responsible for China's largest smuggling scandal in 50 years. Court documents in Fujian stated that Yuan Hua smuggled a total of $6 billion of goods, costing the state $3.6 billion in revenue. In the Xiamen case, local vice mayors, police and customs officials, and Communist Party leaders have been under investigation since the inquiry began in August 1999. Fourteen people have been sentenced to death. A similar scandal existed in the city of Shenyang in 2001, involving the mayor, his wife, the local police chief, and numerous other regional officials.

Land Issues

Constitutional prohibitions against private land ownership, as well as complex regulations on land usage, can complicate efforts by foreign investors to establish operations in China. By law, urban land is owned by the State, while rural and suburban land is owned by collectives, i.e., residents of the local village or township. The State and collectives can either "grant" or "allocate" land usage rights to enterprises in return for payment. In recent years, farmers to whom collectives have allocated land usage rights have also been allowed to rent these rights to enterprises. Enterprises that are granted usage rights are guaranteed compensation if the State or collectives assert eminent domain over the land, while those with "allocated" usage rights are not. Granted usage rights, of course, cost more than allocated rights. Standards for compensation for land use rights withdrawn to make way for public purposes are not well-defined in law nor well-established in practice, leading to considerable uncertainty for foreign investors ordered to vacate. The absence of public hearings over planned public projects, moreover, can give affected parties, including foreign investors, little advance warning of possible notices.

The problem for foreign investors is the array of regulations that govern their ability to acquire land use rights. In addition, local implementation of these regulations may vary from central government standards, and prohibited practices may be tolerated in one region while prohibitions are enforced in another. Most wholly-owned foreign enterprises seek granted use rights to state-owned urban land as the most reliable protection for their operations. Foreign joint venture companies usually attempt to acquire granted use rights through lease or contribution arrangements with local partners. The time limit for use rights acquired by foreign investors for both industrial and commercial enterprises is 50 years.