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TRADE SUMMARY

The U.S. trade deficit with China was $103.1 billion in 2002, an increase of $20.0 billion from $83.1 billion in 2001. U.S. goods exports in 2002 were $22.1 billion, up 15 percent from the previous year. Corresponding U.S. imports from China were $125.2 billion, up 22.4 percent. China is currently the 7th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to China were $5.3 billion in 2001 (latest data available), and U.S. imports were $3.0 billion. Sales of services in China by majority U.S.-owned affiliates were $2.1 billion in 2000 (latest data available), while sales of services in the United States by majority China-owned firms were $80 million.

The stock of U.S. foreign direct investment (FDI) in China in 2001 was $10.5 billion, up from $9.9 billion in 2000. U.S. FDI in China is concentrated largely in manufacturing, petroleum and finance sectors.

OVERVIEW

With a population of 1.3 billion, China offers a vast potential market for foreign goods and services. Over the past 25 years, China has made important progress in opening its market to foreign goods and services as well as foreign investment. Economic and financial reforms have introduced market forces into China, and privileges accorded state-owned firms are gradually being removed. However, the transition from a state-controlled economy to a market-driven one is far from complete.

The Chinese Government has recognized for several years that economic restructuring and market opening are essential components of sustainable and balanced economic growth, particularly on the industrial side. China's shift away from a planned economy model toward a market economy has been difficult but has been rewarded by sustained economic growth and improving living standards. Reforms have been particularly difficult in sectors that traditionally relied upon substantial state subsidies. The state-owned sector faces significant pressure from domestic and foreign competition, particularly in services and light manufacturing.

China acceded to the World Trade Organization (WTO) on December 11, 2001. China's accession has further opened its market to U.S. goods, services and investment. Overall, during the first year of its WTO membership, China made significant progress in implementing its WTO commitments, although much is left to do. Progress was made both in making many of the required systemic changes and in implementing specific commitments. At the same time, serious concerns arose in some areas, where implementation had not yet occurred or was inadequate.

As expected, the principal focus of China's first year of WTO membership was on its framework of laws and regulations governing trade in goods and services, particularly at the central level, as China sought to bring them into compliance with its WTO obligations. China 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 and discriminatory treatment of imports, and lowered tariff rates on a wide range of products. China 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.

Beginning early in 2002, China also devoted considerable resources to the restructuring of the various government ministries and agencies with a role in overseeing trade in goods and services. Some of these changes were mandated by China's accession agreement, while others were undertaken by China to facilitate its compliance with WTO rules.

Another significant focus for China during the past year involved education and training of national and local level officials. In many regions, however, understanding of WTO rules remains limited to a few specially trained officials.

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While the efforts of China's leadership to implement China's WTO commitments should be recognized, there were also a number of causes for serious concern during China's first year of WTO membership. One area of cross-cutting concern involved transparency. Some ministries and agencies took steps to improve opportunities for public comment on draft laws and regulations, and to provide appropriate WTO enquiry points, but China's overall effort was plagued by uncertainty and a lack of uniformity. Apart from this systemic concern, three other areas generated significant problems – agriculture, intellectual property rights and services. The area of agriculture proved to be especially contentious between the United States and China. While concerns over market access for U.S. agriculture products are not unique to China, particularly serious problems were encountered on many fronts, including China's regulation of agricultural goods made with biotechnology, the administration of China's tariff-rate quota system for bulk agricultural commodities, the application of sanitary and phytosanitary measures and inspection requirements. In the area of intellectual property rights (IPR), China has made significant improvements to its framework of laws and regulations, but the lack of effective IPR enforcement remains a major challenge. Meanwhile, concerns arose in many services sectors, largely due to transparency problems and China's use of prudential requirements that exceeded international norms.

With the increased competition being brought on by China's WTO accession, pressures on China to reform large state-owned enterprises have intensified, despite the inevitable short- and medium-term adjustment pains. Many Chinese economists believe that China's private sector, meanwhile, will see more immediate benefits from WTO accession, as government influence is reduced by China's adherence to WTO requirements. In the long run, adherence to WTO rules and international norms should encourage structural reform and promote the rule of law throughout China. Nevertheless, China's membership in the WTO will not remove all commercial problems.

Overall, while China has a more open and competitive economy than 25 years ago, and China's WTO accession has already led to the removal of many trade barriers, there are substantial barriers that have yet to be dismantled. In many sectors, import barriers, opaque and inconsistently applied legal provisions, and limitations on market access often combined to make it difficult for foreign firms to operate in China in 2002. The central government continues to protect noncompetitive or emerging sectors of the economy from foreign competition. Provincial and lower-level governments have strongly resisted reforms that would eliminate sheltered markets for local enterprises or reduce jobs and revenues in their jurisdictions. This phenomenon has inhibited the central government's ability to implement trade reforms.

China's Economy in 2002

China officially estimated real GDP growth at eight percent for 2002. This represents a modest acceleration from the rate of 7.3 percent recorded a year earlier but, consistent with the pattern since 1997, remains well below the double-digit growth rates reported during the boom years of the early and mid-1990s. Fixed-asset investment, growing at the fastest pace since 1994 largely as the result of government policy, fueled the rise in GDP. In addition, net exports made their first positive contribution to GDP growth since 1998. While the contribution of manufacturing and construction to the economy rose in 2002, growth of the service sector component of GDP declined, adding statistical evidence to concerns among China's leaders about slow job creation. Chinese officials acknowledged that urban unemployment was probably in the range of seven percent, a figure close to double the official number of "registered" unemployed.

Other indicators also pointed to ongoing problems within the Chinese economy. Most notably, China continued to experience modest deflation. Maintaining the deflationary trend that began in 1998, retail prices fell about one percent, while the consumer price index, which had shown marginal positive growth in 2000 and 2001 as a result of increases in service prices, also slipped by slightly less than one percentage point. In addition, retail sales growth slowed from the levels seen in recent years, particularly in rural areas. Government-directed increases in civil service wages and welfare benefits spurred average urban income growth per capita of over 15 percent year-on-year. This increase, however, did not extend to the country's rural areas, home to two-thirds of China's 1.3 billion people, where annual income per capita rose by only about five percent. Urban and rural incomes per capita at year end were equivalent to approximately $1,000 and $300, respectively.

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IMPORT POLICIES

China has traditionally restricted imports through high tariffs and taxes, non-tariff measures, restrictions on trading rights, and other barriers. Central government officials are increasingly aware, however, that such protective measures contribute to economic inefficiencies and encourage smuggling. These officials' enthusiasm for reform and trade liberalization helps explain the central government's general commitment to WTO implementation. As part of its first year in the WTO, China slashed tariff rates on many products, substantially reduced the number of goods subject to import quotas, began to phase-out other non-tariff barriers, and clarified its licensing procedures. However, bureaucratic inertia and a desire to protect sensitive industries – such as agriculture – led to the failure at a working level to meet some WTO commitments designed to reduce import barriers.

TARIFFS AND OTHER IMPORT CHARGES

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.

WTO accession will have a dramatic effect on tariffs for many products of interest to the United States. China's elimination of tariffs on the products covered by the Information Technology Agreement (ITA) – semiconductors and semiconductor manufacturing equipment, computers and computer parts, software, telecommunications equipment and computer-based analytical instruments – began upon accession and is to be completed by January 1, 2005. Tariffs for some passenger cars were over 100 percent prior to accession, and will be reduced to 25 percent by 2005. China will also reduce its tariffs on auto parts to 9.5 percent.

Tariffs for U.S. priority agricultural products will fall from an average of 31 percent to 14 percent by January 1, 2004. China will reduce its tariffs on frozen beef cuts to 12 percent, frozen potato products and grapes to 13 percent, beef and pork offal, cheese and citrus to 12 percent, frozen poultry parts, apples, pears, almonds and pistachios to 10 percent, paper to 5.4 percent, and wood to 4.2 percent.

China's post-WTO tariff rates are "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. China may also apply tariff rates significantly lower than the WTO-required 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 sensitive 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. Raisins face duties of 35 percent.

Tariff treatment of certain products in 2002 – including the use of specific rather than *ad valorem* tariff rates for chicken parts and the imposition of a Ministry of Information Industry (MII) end-use certificate requirement for 15 semiconductor and telecommunications equipment products as a precondition for eligibility for reduced duties under the Information Technology Agreement (ITA) – did not appear to fully match China's WTO commitments. The United States and other WTO members raised these issues with China and will work to ensure that China fully implements its tariff commitments. In early 2003, China's Customs Administration issued a bulletin removing the need for MII approval for the ITA products, but apparently still requiring special Customs Administration end-use verifications before applying lower ITA-guaranteed tariff rates.

Tariff Classification

Tariff classification remained a problem in 2002. Customs officers have wide discretion in classifying a particular import. Chemical 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 border charges.

Customs Valuation

Importers have often reported inappropriate valuation methods by customs officials, resulting in higher-than-necessary customs charges. In early 2002, China released new valuation regulations in order to bring its valuation practices into conformity with the WTO Customs Valuation Agreement. However, importers report that many Customs officials continue to use minimum and reference price lists rather than the actual transaction price for valuation purposes. While at times this can result in lower import charges – especially for certain luxury imports – it tends to increase fees for many products, ranging from apples to big-ticket machinery and electronic imports. In addition, many Customs officials are still inappropriately applying royalty and software fees to the dutiable value even if these fees are not a condition of the particular sale in question.

Rules of Origin

China is still using regulations on determining the origin of imports written in the 1980s. Although China Customs has been slow in drafting new regulations, importers have not reported problems stemming from inappropriate application of Rules of Origin.

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. This exemption was intended to allow small-scale traders to operate in border communities. The regulation expired in 2000, but in the absence of a new policy governing border trade, customs officials are still applying the 1996 regulation. Larger operators appear to be taking advantage of this system to import bulk 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. Among affected U.S. businesses are boric acid exporters, who report paying higher duties (and value-added taxes) than their Russian competitors. U.S. timber exporters also face similar discrimination.

Taxation

In April 2001, 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. The State Council issued detailed regulations for the implementation of this law in September 2002. 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.

Foreign investors, including those who have used investment as an entry point to the Chinese domestic market, have benefitted from investment incentives, such as tax holidays and grace periods, which allow them to reduce substantially their tax burden. Domestic enterprises have long resented rebates and other tax benefits enjoyed by foreign-invested firms, and these benefits are being gradually phased out.

Application of China's single most important revenue source – the value-added tax (VAT), which ranges between 13 percent and 17 percent, depending on the product – is uneven. Importers from a wide range of sectors report that, because taxes on imported goods are reliably collected at the border, they are sometimes subject to discriminatory application of a VAT that their domestic competitors often fail to pay. As discussed below in the section on import substitution policies, China has substantially reduced the applied VAT for semiconductors manufactured in China, while the full VAT must be paid on imported semiconductors. China has also announced the selective exemption of certain fertilizer products from the VAT, to the disadvantage of imports from the United States. Other tax exemption programs, designed to eliminate the tax burden on farmers, put U.S. farm imports at a competitive disadvantage. China also retains an active VAT rebate program for exports. Although State Administration of Taxation officials plan eventually to eliminate rebates as a way to increase tax revenues, the authorities have continued this practice to date in order to spur domestic economic growth.

China's 1993 consumption tax system has also raised concerns among exporters. Because China uses a substantially different tax base to compute consumption taxes for domestic and imported products, the tax burden imposed on imported consumer goods ranging from alcoholic beverages to cosmetics to automobiles is higher than for competing domestic products.

Antidumping, Countervailing Duty and Safeguard Measures

Chinese officials and the state-run media have encouraged Chinese industries to petition for antidumping or safeguard measures to protect their markets after WTO-mandated tariff cuts. To facilitate these investigations, the Chinese government following accession created two new departments, in the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) and the State Economic and Trade Commission (SETC), respectively, to pursue unfair trade cases. Indeed, as trade barriers come down, China's beleaguered state-owned enterprises increasingly have turned to antidumping measures to address rising imports. As a result, the volume of trade remedy cases initiated by the Chinese authorities following WTO accession has increased significantly. Nine antidumping investigations were initiated in 2002, a number comparable to the total of similar investigations in the four years leading up to accession, although none of the investigations has yet progressed beyond a preliminary determination. Meanwhile, China’s first safeguards case resulted in significant additional duties on several classes of steel products (with duties affecting mainly imports from Japan, Taiwan and South Korea). On a more positive note, for the first time since the creation of China's fair trade regime in 1997, a U.S. company avoided a final antidumping finding when SETC – recognizing, among other things, the fact that rising costs would hurt Chinese farmers – terminated an investigation into imports of L-Lysine (animal feed additive).

The Chinese government agencies responsible for administering antidumping, countervailing duty and safeguards remedies have issued numerous regulations governing the conduct of investigations, resulting in nineteen new trade remedy-related regulations in 2002. For the most part, these new regulations are good-faith efforts to implement China’s WTO commitments and improve on what may have existed before, but they remain vaguely worded. They therefore permit procedures that are less than transparent and fail to address significant issues, thus leaving many decisions to the broad discretion of the investigating authorities. The Chinese People's Supreme Court also issued documents allowing independent judicial review of determinations, although as yet no cases have reached the courts.

NON-TARIFF BARRIERS

China’s Protocol of Accession to the WTO obligated China to address many of the non-tariff barriers it had historically used to restrict trade. For example, China is obligated 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 progress in 2002 in reforming its testing system, revising regulations requiring local content, and improving overall regulatory transparency, including in the licensing area. Despite this progress, however, as China's trade liberalization efforts moved forward, some non-tariff barriers remained in place and even increased.

One year after China’s WTO accession many industries complain they face increasing non-tariff barriers to trade. These include regulations that set high thresholds for entry into service sectors such as finance and insurance, “quarantine certificates” for agricultural imports, regulations on biotechnology products, and use of technical standards and sanitary and phytosanitary measures to control import volumes. In fact, several national officials have stated openly in the state-run media that China should manipulate technical standards to limit imports. At the sub-national level, importers have expressed concern that local officials do not understand China’s WTO commitments and are not prepared to relinquish control over the local economy.

These problems are compounded by the fact that coordination between the State Administration for Quality Supervision and Inspection and Quarantine (AQSIQ) and its new affiliated bodies, the China National Certification and Accreditation Administration (CNCA) and the Standardization Administration of China (SAC), is lacking, as is coordination between these bodies and China Customs and other local implementers of standards and import regulations.

Import Quotas

Quotas on most products were eliminated or scheduled to be phased out under the terms of China’s WTO accession. China’s accession agreement required China to eliminate existing quotas for the top U.S. priority products upon accession and phase out remaining quotas, generally by two years but no later than five years after accession. In 2002, quotas remained in place for eight categories of goods, including watches, certain vehicles, motorcycles, machine tools, oil and rubber. China did not have a system to allocate quotas in place upon accession as required, and in 2002 bureaucratic delays in allocating quotas disrupted imports of many products, particularly in the auto sector. Because of these problems, in December 2002, MOFTEC announced it would extend the validity of 2002 import quotas for machinery and electronic imports (including automobiles). Holders of a 2002 MOFTEC-issued "Machinery and Electronic Import Quota Certificate," if they applied by December 31, 2002, could receive a 2002 "Import License" valid until March 31, 2003. Continuing the phase-out of its quota system, China announced that beginning January 1, 2003, certain vehicles, vehicle parts, motorcycles, motorcycle parts, cameras, watches, and cranes and chassis would no longer be subject to import quotas.

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 quotas 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 also been able to establish de facto quotas that maximize their monopoly rents. For example, the sole official government theatrical film importer informally limited the number of foreign motion pictures for theatrical release it allowed each year. In 2001, this number was ten. With China's WTO accession, however, China committed to allow 20 foreign films to be distributed in China on a revenue-sharing basis annually. China admitted 18 foreign films in 2002.

Tariff-Rate Quotas

In 1996, China claimed to have introduced a tariff-rate quota (TRQ) system for imports of wheat, corn, rice, soy oil, cotton, barley, and vegetable oils. The quota amounts were not publicly announced, application and allocation procedures were not transparent, and importation occurred through state trading enterprises. China later introduced a TRQ system for fertilizer imports. Under these TRQ systems, 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 imports of wheat, corn, rice, cotton, wool, sugar, vegetable oils, and fertilizer, with most in-quota duties ranging from 1 percent to 9 percent. Each year, a portion of each TRQ is to 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.

However, China's implementation of its TRQ systems has been problematic. Regulations for the administration of the TRQ systems were issued late, did not provide the required transparency and imposed burdensome licensing procedures. TRQ allocations were also plagued by delays. Chinese officials have repeatedly argued that the agencies responsible for TRQ administration were unprepared for such a difficult task, resulting in one-time delays in allocations.

SETC began to allocate fertilizer TRQs in April, nearly four months late. It delayed even longer in naming the non-state trading enterprises that could handle importation. SETC did announce the required re-allocation of 2002 TRQs in a timely manner, although no re-allocation materialized. SETC also issued the announcement of 2003 TRQ levels and procedures on time.

The State Development and Planning Commission (SDPC) did not allocate its agricultural TRQs to non-state trading entities until April, also four months late, and to state traders until early July. SDPC also repeatedly refused to answer requests from government and private entities for specific details on amounts and recipients of TRQ allocations. It became clear, however, that SDPC had issued some TRQ allocations below commercially viable levels. Most worrisome, China confirmed that SDPC had reserved a portion of the TRQs for processing and re-export only. In 2002, the United States repeatedly engaged China, at all levels of government, in an attempt to resolve these issues. The United States also requested formal consultations with China under the provisions of the headnotes contained in the Goods Schedule annexed to China's Protocol of Accession. These issues remain unresolved.

In late 2002, SDPC completed the required re-allocation of 2002 TRQs in a timely manner, and SDPC issued the announcement of 2003 TRQ levels and procedures on time. As in 2002, SDPC will require a significant portion of the TRQs be used only for processing and re-export of imports. This restriction is most important for cotton, where well over one-half of the TRQ is restricted to re-exports. According to SDPC, allocations for TRQs reserved for the processing trade will be made on a first-come first-served basis beginning January 2, 2003. By late January 2003, however, non-state trading companies had received little news of allocations.

Import Licenses

Beginning in the early 1990s, China eliminated most of its import licensing requirements. Upon acceding to the WTO, China further reduced the number of product categories requiring import licenses to 15. However, most products subject to quotas or TRQs – including petroleum, cotton, passenger vehicles, trucks, and rubber − still require licenses in addition to quota or TRQ allocation. China's WTO accession agreement explicitly states that China must automatically provide any necessary import license for goods subject to quotas or TRQs as part of the allocation procedure. Despite this commitment, China requires importers to apply separately for TRQ allocations and import licenses, increasing the burden on importers and potentially causing trade distortions.

China also committed upon accession to limit the information that a trader must provide in order to receive a license, to ensure that licenses are not unnecessarily burdensome, and to increase transparency and predictability in the licensing process. MOFTEC issued new regulations and implementing rules to smooth licensing procedures shortly after China's accession. However, license applicants reported that they have had to provide sensitive business details unnecessary for simple import monitoring. They also reported that MOFTEC was using a "one-license-per-shipment" system rather than providing licenses to firms for multiple shipments, which was acting as an impediment to trade. MOFTEC began to allow more than one shipment per license in late 2002 following U.S. interventions.

China's inspection and quarantine agency, AQSIQ, has imposed inspection-related requirements that had the effect of restricting imports of some U.S. agricultural goods. AQSIQ requires importers to obtain quarantine inspection certificates before agricultural goods can enter China's market, and traders have reported that AQSIQ has imposed quantitative restrictions and time limits in connection with them, as in the case of, for example, imported poultry and pork. Soybean traders have reported sporadic problems, but the most adversely affected U.S. product was chicken meat, whose exports to China were down more than 20 percent by volume in 2002 compared to the previous year, even though for most of the year domestic Chinese prices for popular imported cuts were more than 20 percent above landed costs plus tariff and VAT. Near the end of 2002, after complaints from the United States, traders reported that AQSIQ was more freely awarding permits. However, traders then reported problems with a special MOFTEC "automatic registration" for chicken meat, which, according to MOFTEC, is intended only to monitor trade and to combat smuggling. According to traders, MOFTEC was administering this system in a way that seriously restricted legitimate trade.

Export Licenses and Fees

China has progressively reduced the number of products requiring export licenses. By 2002, 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 quasi-governmental industry associations formed to take the place of the now disbanded ministries that governed production during the earlier 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. In another case, an industry association charges a scaled export fee for chemicals such as fluorspar (which is also subject to export quotas), allowing them to reduce the relative costs for domestic producers of CFCs.

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.

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 with annual export volumes valued in excess of $10 million to register for trading rights. In August 2001, China extended this regulation to include export rights for foreign-invested enterprises. Import rights of foreign-invested enterprises (FIEs) are still restricted to the import of equipment, materials and components directly related to their manufacturing or processing operations. Companies with operations in China can also import small quantities of consumer products for test marketing. Firms without a presence in China still must use a local agent.

Under the terms of China's WTO accession, China must phase in trading rights for all firms within three years. According to its accession documents, on December 11, 2002, China was supposed to grant minority foreign-owned joint ventures trading rights. However, regulations authorizing these liberalizations have not yet been issued. The relevant authorities have maintained drafts of all new regulations in strict confidence, making it difficult to predict how China will actually implement these rights.

Even after WTO accession, the import of some goods − such as grains, cotton, vegetable oils, petroleum, sugar, fertilizers, news publications, and related products − is reserved primarily for state trading enterprises. In its accession agreement, however, China committed to making a portion of the trade (ranging from 10 to 90 percent) in grains, cotton, sugar, vegetable oils, and fertilizers available to non-state traders. In some cases, the percentage available to non-state traders will increase each year.

Local Agent Requirements

China's WTO accession should improve the ability of foreign-invested firms to import and distribute their products effectively. In general, foreign-invested firms had only been allowed to import inputs (see "Trading Rights" section) and distribute products that they manufactured in China (see "Distribution" section). Foreign firms were forced to engage local agents to import end-use products and distribute products not made by their factories on the mainland. China has agreed to phase out such import and 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 foreign investments. Under these rules, investors are still "encouraged" to follow some of the formerly mandated practices. 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.

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 primarily 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.

Semiconductors. China's 10th Five-Year Plan calls for an increase in Chinese semiconductor output from $2 billion in 2000 to $24 billion in

2010. In June 2000, China's State Council announced in Document Number 18 that integrated circuits manufactured within China will receive an 11 percent rebate on the VAT, effectively applying only a 6 percent VAT to these products. Imported circuits still faced the full 17 percent VAT. In October 2002, the Ministry of Finance (MOF) and State Administration of Taxation (SAT) jointly issued Circular No. 70 mandating a 14 percent VAT rebate on integrated circuits designed and built within China, amounting to a 3 percent applied VAT. Circular No. 140, also issued in 2002, extended a 6 percent applied VAT to integrated circuits designed in China but produced overseas if such circuits cannot be manufactured domestically.

Telecommunications Equipment. There have been continuing examples of 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.

Automobile Investment Guidelines. China's automobile industrial policy offered significant advantages for foreign-invested factories using high-levels of local content. In 2001, SETC issued Bulletin No.13, which provided that the preferential policy for automobile localization rates would be cancelled upon China's WTO accession. However, U.S. auto manufacturers report that some local government officials continued in 2002 to cite the old auto policy's localization standards when requiring high local content. SETC and SDPC are working on new auto investment guidelines that officials say will clarify the elimination of local content requirements.

STANDARDS, TESTING, LABELING AND CERTIFICATION

In preparation for its WTO entry, China devoted significant energy to reforming its standards, testing, labeling, and certification regimes. In its accession agreement, China specifically committed that it would ensure that its conformity assessment bodies operate with transparency, apply the same technical regulations, standards and conformity assessment procedures to both imported and domestic goods and use the same fees, processing periods and complaint procedures for both imported and domestic goods. In April 2001, China merged its domestic standards and conformity assessment agency and entry-exit inspection and quarantine agency into one new organization – the Administration of Quality Supervision, Inspection, and Quarantine, or AQSIQ. Chinese officials explained that this merger was designed to eliminate discriminatory treatment of imports and requirements for multiple testing simply because a product was imported rather than domestically produced. In 2001, China also formed two quasi-independent agencies administratively under AQSIQ: CNCA, charged with the task of unifying the country's conformity assessment regime, and SAC, responsible for setting mandatory national standards and unifying China's administration of product standards and aligning its standards and technical regulations with international practices and China's commitments under the WTO Agreement on Technical Barriers to Trade.

While the formation of AQSIQ and a unified system of certification are positive steps, implementation of standardization and certification regulations continues to be a problem. Although China agreed to apply the same standards and fees to imported and domestic products upon its accession to the WTO, some importers report differential treatment and enforcement of standards. For example, foreign companies' products can only be tested at certain laboratories designated to handle foreign products, although this has not appeared to negatively impact foreign companies. U.S. companies do cite problems with a lack of transparency in the certification process, lack of coordination among standards bodies as well as between standards bodies and other agencies, burdensome requirements, and long processing times for licenses. Some companies have also expressed concern that their intellectual property will be released to competitors when they submit samples of high-tech products for mandatory quality testing. In some cases, laboratories responsible for testing imported products are affiliated with domestic competitors, making the possibility of such releases more likely.

A growing concern among many foreign companies and associations is the lack of transparency in the standards development process in China. A vast majority of standards-setting bodies are not fully open to foreign participation, in some cases refusing them membership and in other cases refusing to allow companies with majority foreign ownership to vote. In addition, in a number of sectors, including, for example, autos, telecommunications equipment, electrical products, heating and air conditioning equipment, whiskey and fertilizer, concern has grown over the past year as China has pursued the development of unique requirements, despite the existence of well-established international standards. These standards, which sometimes appear to have little scientific basis, could create significant barriers to entry into China's markets because the cost of complying will be high for foreign companies.

While China made numerous notifications of technical regulations in 2002, as required by the WTO Agreement on Technical Barriers to Trade (TBT), some of them indicated dates of adoption or entry into force that would appear not to provide a meaningful opportunity for comment by interested parties, with insufficient time for Chinese authorities to give due consideration to the comments received before final adoption of the proposals. Additionally, China notified technical regulations promulgated by AQSIQ to the WTO, but not technical regulations promulgated by other ministries.

Quality and Safety Certification

In December 2001, CNCA promulgated a new compulsory product certification system. Under this system, there is one quality and safety mark, called the "China Compulsory Certification" or "CCC" mark, issued to both Chinese and foreign products. Under the old system, domestic products were only required to obtain the "Great Wall" mark, while imported products needed both the "Great Wall" mark and the "CCIB" mark. The CCC mark system became effective May 1, 2002, with a one-year grace period for re-certification of old products before becoming fully effective May 1, 2003. Beginning May 1, 2002, all new products in identified categories were required to have the CCC mark. Products that have previous certifications can continue to use those certifications until May 1, 2003, at which time all products in the required categories will be required to have a CCC mark. When fully implemented, the CCC mark will be required for over 100 product categories.

Despite these changes, U.S. companies in some sectors complained in 2002 that certification remains a difficult, time-consuming and costly process. In many cases, the process involves on-site inspection of manufacturing facilities outside of China, the cost of which is borne by producers. U.S. companies have also expressed concern about continued requirements for redundant testing, particularly for cosmetics, pharmaceuticals, medical equipment, cellular telephones and other telecommunications products and consumer electronic products. For example, telecommunications equipment faces CNCA safety and quality tests, but then MII conducts functionality tests. Industry reports that the tests overlap.

Examples of these problems 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 test for electromagnetic compatibility was added for these same products in 2000.

Spare/Replacement Parts. Companies manufacturing and companies that import and sell heavy equipment report they must obtain CCC marks for spare parts they use or provide to clients. Obtaining these marks can take two weeks to six months, making inventory planning difficult. For some companies, the cost involved in obtaining the CCC marks also makes it difficult to compete in the Chinese market. Although importers of spare parts are eligible for waivers of the CCC mark, these waivers are only available in Beijing, creating difficulties and delays for companies in other parts of the country.

Self-Certification

Under the new CCC mark system, China will not accept self-certification of conformance to Chinese standards from manufacturers. Products must be tested in designated laboratories in China. In some cases, Chinese officials must also inspect and certify manufacturing facilities before products can be certified for import into China. Such inspections are time-consuming and costly for producers.

Sanitary and Phytosanitary Issues

Historically, China's phytosanitary and veterinary import standards have sometimes been based on dubious scientific principles and have not always been consistently applied. In an effort to advance its bid to join the WTO, China addressed certain longstanding barriers to U.S. agricultural imports. China agreed to lift bans 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 ACA 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.

China's implementation of the ACA has produced mixed results, and this situation continued in 2002. Traders reported (as noted above in the Import Licenses section) that China has used the issuance of quarantine inspection permits to place undue quantitative restrictions on meat imports. In addition, China has imposed a "zero tolerance" standard for certain pathogens in imported uncooked meat. This standard has proved problematic for exporters because even the best sanitary practices cannot completely eliminate some pathogens in raw products. It has resulted in the de-listing of four U.S. processing plants, and it has so far proven impossible to get these plants re-listed, as AQSIQ is requiring U.S. health authorities to identify and correct problems in these plants when U.S. authorities believe none exist. Meanwhile, Chinese quarantine officials did approve Pacific Northwest wheat imports. However, traders reported that quarantine officials required special treatment of some wheat imported from the Pacific Northwest, effectively discouraging imports. With regard to citrus, China continues to hold up the approval of imports from four counties in Florida.

Phytosanitary barriers also continued to block imports of several other U.S. products in 2002, including stone fruit, several varieties of apples, pears and fresh potatoes.

Since joining the WTO, China has issued more than 100 new standards for foods, and has set up an "SPS Enquiry Point" at AQSIQ. Although some of these standards have been notified to the WTO as required by the WTO Agreement on Sanitary and Phytosanitary Measures, many of them have not, particularly those issued by the Ministry of Health.

China's Biotechnology Regulations

In January 2002, the Ministry of Agriculture (MOA) issued new rules implementing a June 2001 regulation on agricultural biotechnology safety, testing and labeling. The product most affected was soybeans. However, the implementing rules did not provide adequate time for completion of required safety assessments before their effective date of March 20, 2002. Uncertainty caused by these new measures caused market disruption as traders rushed to ship as many soybeans as possible before March 20, 2002.

Following high-level U.S. interventions, in March 2002, MOA issued "interim measures" to allow imports to continue until December 20, 2002. In spite of this, however, bureaucratic lags in implementing the interim measures prevented new cargoes from arriving in China from March until early June 2002. Increasing uncertainty about the December 20, 2002 expiration of the interim measures again led traders to rush to bring cargoes in before the end of the year. Imports increased steadily since the 2002 U.S. harvest, with bookings for October and November 2002 exceeding 2 million tons. Again following high-level U.S. interventions, in September 2002, MOA published new interim measures that delayed implementation of the January 2002 rules until September 20, 2003.

Substantial U.S. concerns with China's biotechnology regulation and implementing rules remain, particularly with regard to risk assessment (including administration of field trials), labeling and inter-ministerial coordination of biotechnology policy. The United States provided written comments on these issues to MOA in early 2002. MOA agreed to the creation of a special bilateral working group to address these issues, but after an initial meeting MOA has not responded to requests for further talks.

Labeling

The U.S. processed food industry has registered its concerns on a number of standards and labeling requirements on its exports to China. The meat industry in particular is concerned that new meat labeling regulations promulgated in late 2002 have several requirements that go beyond those of any other country. They assert that these requirements are unnecessary and will be costly. In addition, the distilled spirits industry is concerned that China will 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 and importers of processed foods are also concerned about new measures requiring labels for products containing transgenic material, such as soybeans and corn. The June 2001 biotechnology regulation issued by MOA required labeling of bulk commodities, among other things, although without implementation details. In July 2002, the Ministry of Health (MOH) followed with its own measures to require food safety assessment and labeling of processed foods derived from biotechnology ingredients. In November 2002, MOA indicated that MOA, rather than MOH, had received authority from the State Council to regulate food safety in the biotechnology area. Future implementation of these various measures remains uncertain.

GOVERNMENT PROCUREMENT

In accordance with the terms of its WTO accession agreement, China 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 also committed to become an observer to the WTO Agreement on Government Procurement (GPA), which it did in May 2002. In addition, China committed that it would table an offer and initiate negotiations for membership in the GPA "as soon as possible." According to Chinese officials, however, China has no immediate plans to begin discussions.

In July 2002, China promulgated its first Government Procurement Law. In part, this was a response to the need to separate procurement by "state-owned enterprises," which China has promised would be made on a commercial basis, from "government procurement." Although the implementing regulations are not finalized, China's new government procurement system allows bidding to be limited to domestic suppliers. At the same time, many Chinese officials are beginning to recognize the high cost of not allowing an open and competitive bidding process for government contracts. The new law expounds on the principles of fair competition, openness, transparency and recourse. It establishes rudimentary criteria for the qualification of suppliers and various categories of procurement, including open tenders, tenders by invitation, competitive negotiation and sole sourcing. It also sets broad standards for publicity, notification, bid scheduling, sealed bidding and bid evaluation.

On January 9, 2001, MOF issued a measure entitled "Procedures Concerning Public Bidding for Procurement Companies in Foreign Government Loan Projects." Under the procedures set forth in the measure, government agency financial departments must release all pertinent information regarding qualified foreign government loan projects to procurement companies, and the companies responsible for implementing a project must tender bid invitations to more than three procurement companies within 10 working days. The procedures state that non-competitive or protectionist ploys are strictly prohibited while selecting a procurement company for a loan project, and they indicate that MOF will regularly examine bids and restrict procurement companies with "monopolistic inclinations." As written, however, the procedures offer insufficient protection to potential foreign participants. Among other requirements, foreign companies, unlike domestic companies, have had to obtain permission from MOF before bidding on a project. It is not yet clear whether the new Government Procurement Law will lead to the elimination of this requirement.

The status of procurement by state-owned enterprises is as yet unclear. 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 WTO accession agreement, China subsequently 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, although in practice this has not consistently been the case.

EXPORT SUBSIDIES

China officially abolished direct budgetary outlays for exports of industrial goods on January 1, 1991, and MOF officials claim that the government can no longer afford large-scale export subsidies. China agreed to stop all export subsidies on industrial and agricultural goods upon its accession to the WTO in December 2001. Nonetheless, several U.S. industries claim that many of China's exports benefitted from export subsidies through 2002.

China's possible 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 may involve guaranteed provision of energy, raw materials or labor supplies. U.S. industry has expressed its concern that sectors such as high technology electronics, biomedicine, new materials and integrated circuits may benefit from such policies.

U.S. agriculture exporters have expressed concern that China continues to use export subsidies for corn and perhaps cotton. In 2002, China's corn exports reached 11.67 million metric tons, compared to 6 million tons in 2001. It appears that corn is being exported from China, including corn from Chinese government stocks, at prices 20 to 30 percent below domestic Chinese prices. As a result, U.S. corn exporters have lost market share in Asia, while China is exporting record amounts of corn. China claims that it stopped using subsidies in March 2002, and instead supports exports with various WTO-consistent measures, such as transportation subsidies and VAT rebates. Because export procedures are not transparent, it is difficult to determine what effect these measures have on export prices. Particularly given the very low applied VAT on corn in China, the VAT rebate appears to account for only a small proportion of the difference between export prices and domestic prices.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

China has made substantial progress in some aspects of intellectual property rights (IPR) protection since it signed bilateral agreements with the United States on IPR in 1992, 1995 and 1996. Beginning 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 Agreement) and adding implementing regulations. In addition, China has launched several crackdowns on counterfeiting and piracy. 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. The U.S. government is also urging that China take additional steps towards improving its IPR regime in advance of China's hosting the World Intellectual Property Organization (WIPO) Intellectual Property Summit in April 2003.

However, significant problems remain, particularly in the area of enforcement. China has a system of administrative penalties, which is overseen by several administrative agencies. While this system is widely used, the penalties imposed tend to be weak and non-deterrent. Although China has revised its laws to provide criminal penalties for certain IPR violations, actual criminal prosecutions of IPR violations are rare. 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, well before their legal introduction into China. (Most blockbuster foreign films are never legally introduced into China because China permits the screening of only twenty of them per year.) Knock-off consumer products, including textile and apparel products, are readily available almost everywhere in China, and consumers are often unaware that they are purchasing IPR-infringing goods. Chinese customs authorities lack the power to initiate ex officio criminal cases under the criminal IPR laws.

Some U.S. companies claim losses from counterfeiting equal 15 to 20 percent of total sales in China, in addition to losses in export markets. One U.S. consumer products company estimates that it loses $200 million annually due to counterfeiting in China. Industry notes that the destructive effect of widespread IPR violations discourages additional direct foreign investment and threatens 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 legitimate producers and products.

PATENTS

China's new patent law went into effect on July 1, 2001, and implementing regulations became effective shortly thereafter. They generally comply with the TRIPS Agreement.

The amended law and new regulations strengthen patent protection and simplify patent examination and issuance procedures. For example, there is now a prohibition on the advertising or marketing of infringing products. Additionally, judicial review of patent revocations is now available. However, textile designs are excluded from protection under the industrial designs provisions of China's patent law. U.S. companies may be able to protect their designs under China's Provisions on the Implementation of the International Copyright Treaty as works of applied art. There are also several improvements in administrative and civil enforcement. Administrative authorities may now confiscate income from patent-infringing products. On the civil enforcement side, there is a new provision allowing a patent holder in a civil proceeding to request immediate suspension of potentially infringing acts before requesting a final legal determination. In addition, larger damages can be awarded than in the past, when judges had no legal basis for levying stiff awards against violators. Judges in civil proceedings can now issue awards in the amount of the actual damages suffered by the injured party. If damages are difficult to calculate in a particular case, damages can still be awarded in an amount equal to a reasonable multiple of the licensing fee involved.

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 remains pending indefinitely.

TRADEMARKS

China's amended trademark law went into effect on December 1, 2001, and new implementing regulations took effect on September 15, 2002. The changes in the new law and regulations were intended primarily to bring the trademark system into compliance with the minimum requirements of the TRIPS Agreement, which they largely did. Some problems do remain, however.

The United States, with the support of other WTO members, including the European Communities and Japan, raised concerns about whether foreign trademark owners are receiving national treatment in two important areas. The first involves well-known marks, which benefit from enhanced civil and criminal enforcement, such as lower evidentiary thresholds. China currently lists approximately 196 well-known marks, none of which is a foreign mark. The other area involves the registration of trademarks. Chinese enterprises can file for registration on their own, but foreign enterprises must use an agent. Under recent revisions to the trademark implementing regulations, foreign-invested companies in China no longer need to use a Chinese trademark agent. However, it is still unclear how regulators will interpret these provisions.

The new trademark law and regulations made substantial improvements to the legal framework for enforcement. These improvements can be found in each of the three areas of enforcement, i.e., actions by administrative authorities, civil suits brought by rights holders, and criminal prosecutions. In the area of administrative enforcement, authorities are authorized to confiscate and destroy counterfeit products and the equipment used to manufacture them. They can also impose fines up to three times the value of the counterfeit products and, in cases where it is impossible to determine this value, discretionary fines of up to RMB 100,000 (US $12,500). Under the old regulations, fines were limited to 50 percent of the value of the counterfeit products. In the area of civil enforcement, the trademark holder has access to preliminary injunctions and can obtain an award equal to the amount of actual damages. If the plaintiff's damage or the infringer's profits cannot be determined, the plaintiff can obtain statutory damages of up to RMB 500,000 (US $60,420).

The improvements in criminal enforcement began with the State Council's issuance of regulations designed to achieve the timely transfer of counterfeiting cases from administrative enforcement authorities to the police. Under these regulations, the administrative authorities are required to transfer cases to the police for criminal investigation if the suspicion exists that a crime has been committed. The previous law called for proof of a crime, not just suspicion of one, in order to transfer the case. Private parties are also authorized to file complaints with criminal prosecutors, although this procedure has rarely been utilized. In addition, the Supreme People's Court and the Supreme People's Procuratorate have issued judicial interpretations and prosecution guidelines aimed at clarifying standards for criminal liability and enforcement.

COPYRIGHTS

China's new copyright law took effect October 27, 2001, and implementing regulations became effective on September 15, 2002. Together, the new law and regulations are designed to bring China into compliance with minimum TRIPS requirements.

The new law and regulations strengthen enforcement measures. Administrative authorities are authorized to order a person to cease infringing activities and to confiscate and destroy pirate products and the equipment used to produce them. They can also impose fines equal to three times the value of the pirated products and, in cases where it is impossible to determine this value, discretionary fines of up to RMB 100,000 (US $12,500). In civil copyright infringement proceedings, the plaintiff copyright holder now has access to preliminary injunctions and can obtain an award equal to the amount of its actual damages. If damages are difficult to calculate in particular cases, statutory damages can be set as high as RMB 500,000 (US $60,420). Judges can also order confiscation of illegal gains, pirated copies and property used to conduct infringement activities. The new law and regulations also place the burden of proof on the alleged infringer to prove it has a legitimate license, and they allow for reference to China's contract law as a basis for fulfillment of the parties' licensing obligations.

The U.S. home furnishing fabrics segment of the domestic textile industry continues to experience serious problems regarding illegal copying of their designs by Chinese manufacturers. Industry representatives described IPR violations, particularly textile design piracy, as a chronic problem that costs some U.S. textile companies $100 million or more annually in lost sales. Counterfeit trademarked products made in China are reported to affect U.S. sales domestically, as well as in China and third country markets. Lack of enforcement and an inefficient judicial process at the provincial level appear to be the major sources of problems for U.S. companies in China. One major U.S. carpet manufacturer complained of the delays and lack of action by provincial authorities.

The new law for the first time addresses copyright issues related to the Internet. However, no implementing regulations have yet been enacted. The United States would like to see China accede to the WIPO Copyright Treaty and the WIPO Performance and Phonograms Treaty and harmonize its laws and regulations more fully with the requirements of these Internet treaties.

A new regulation on the copyright protection of computer software products delineates the protected interests for computer software development, circulation and application. In addition, the Supreme People's Court has issued a regulation addressing civil liability for end-user piracy of software.

ENFORCEMENT

The new IPR laws and regulations signal a strong interest in enforcement within the central government. However, this commitment has not translated into effective enforcement at the local level, nor has it translated into effective inter-agency coordination on complex IPR matters. IPR infringement remains a serious problem throughout China.

The central government initiated a new anti-counterfeiting and anti-piracy campaign in 2002. As in prior years, this campaign resulted in high numbers of seizures. These centrally mandated enforcement campaigns, however, do not appear to have significantly deterred piracy or counterfeiting. The campaigns' impact in most sectors has been minimal because of the pervasiveness of piracy and counterfeiting, the sporadic nature of the campaigns and the low penalties that result, as well as local officials profiting from continued illicit operations. The campaigns highlight the need to address local government officials' protection of pirates and counterfeiters and to coordinate national policies among the courts, police and various administrative agencies.

Criminal enforcement also remains a problem. U.S. companies complain that, in most regions of China, the police are either not interested in pursuing counterfeiting and piracy or simply lack the resources and training required to investigate these types of cases effectively. At the same time, there are recent reports that central government ministries and agencies and their local branches have begun to refer significantly more IPR violations for criminal prosecution. AQSIQ, for example, has reported approximately 500 of these referrals. In addition, ambiguity in China's criminal code impedes criminal enforcement, as it is not always clear whether a particular activity warrants criminal prosecution as opposed to simply administrative remedies.

Effective enforcement is also impeded by unnecessary limitations on enforcement powers, inadvisable evidentiary standards, and low penalties, particularly in the area of administrative enforcement. Administrative authorities lack the evidence-gathering powers of the police. In addition, when administrative authorities set fines, the amounts are artificially low because they are based on the value of the infringing goods, rather than the far higher value of the genuine articles. Furthermore, evidence that a person was warehousing infringing goods is not sufficient to prove intent to sell. As a result, administrative authorities do not include those goods in the value of the infringing goods when determining fines. These low administrative fines are viewed by organized pirate or counterfeiting enterprises as costs of doing business, not deterrents to further criminal activity.

China is making efforts to upgrade its judicial system, but there is much to be done. China's judicial system is divided into civil, administrative and criminal panels, which may hear different cases involving intellectual property. The civil panels are likely to hear infringement and licensing cases. The administrative panels hear appeals from administrative agencies, including the patent and trademark offices as well as appeals of administrative fines for infringement. The criminal panels hear criminal cases, including those involving illegal business operations or product quality that may involve IPR issues.

U.S. companies complain that there is still a lack of consistent and fair enforcement of China's IPR laws and regulations in the courts. Many judges lack necessary legal or technical training, court rules regarding expert witnesses are vague, use of private investigators is strictly limited, and rules of evidence are ambiguous and not consistently followed. In the patent area, where enforcement through civil litigation is of particular importance, a single case takes four to seven years to litigate, rendering the damages provisions adopted to comply with China's TRIPS Agreement obligations less meaningful.

ELECTRONIC COMMERCE

China has experienced dramatic growth in Internet usage and electronic commerce. According to industry estimates, the number of people in China with access to the Internet was approximately 59 million by the end of 2002, compared with 620,000 in October 1997. China now has the second largest Internet population in the world, behind the United States. A fall in personal computer prices and the arrival of devices 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, as discussed more fully below (in the "Regulation of International Data Flows and Restrictions on Data Processing" section).

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 broadband connections become more readily available. The lack of a safe and secure payment system requires that Internet transactions in China be conducted cash-on-delivery, via post office payments, or be delayed by a ten- to fifteen-day verification period. Still nearly a third of Chinese Internet users surveyed in June 2002 said they had made an online purchase within the past year, and over 30 percent of these said they paid online.

SERVICES BARRIERS

China's services sectors have been among the most heavily regulated and protected sectors 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 its services sectors. The market for services, currently underdeveloped due to historical attitudes and policies, has significant growth potential in both the short and long term.

China's WTO commitments should provide meaningful access for U.S. service providers. In its accession documents, China committed to the substantial opening of a broad range of services sectors through the elimination of many existing limitations on market access, at all levels of government, particularly in sectors of importance to the United States, such as banking, insurance, telecommunications and professional services. These commitments are far-reaching, particularly when compared to the services commitments of many other WTO members.

China also made certain "horizontal" commitments, which apply to all sectors listed in its services schedule. The two most important of these cross-cutting commitments involve acquired rights and the licensing process. Under the acquired rights commitment, China agreed that the conditions of ownership, operation and scope of activities for a foreign company, as set out in the respective contractual or shareholder agreement or in a license establishing or authorizing the operation or supply of services by an existing foreign service supplier, will not be made more restrictive than they were on the date of China's accession to the WTO. In other words, if a foreign company had pre-WTO accession rights that went beyond the commitments made by China in its services schedule, that company could continue to operate with those rights. In the licensing area, prior to China's WTO accession, foreign companies in many sectors did not have an unqualified right to apply for a license to operate in China. They could only apply for a license if they first received an invitation from the relevant Chinese regulatory authorities, and even then the decision-making process lacked transparency and was subject to inordinate delay and discretion. In its accession agreement, China committed to licensing procedures that were streamlined, transparent and more predictable.

However, in many services sectors, while agreeing to lift restrictions over time and de-politicize licensing procedures, China has implemented extremely high capitalization requirements, both for establishment and branching. These high capitalization requirements appear to be higher than necessary from a prudential perspective and act as a barrier to market access. A wide range of foreign firms also emphasized that China's regulations remain vague and do not reflect fully China's WTO commitments. China's ministries have not adequately consulted with foreign firms about new or revised regulations and have not allowed sufficient time for a meaningful comment period.

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 reach $15 billion per year after a full opening of the market. Since 1992, China has allowed foreign firms 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 (CIRC) committed to accept 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 foreign-owned. Geographic restrictions will also be removed over the next three years.

CIRC issued several new insurance regulations shortly after acceding to the WTO, including ones directed at the regulation of foreign insurance companies. These regulations implemented many of China's commitments, but they also created problems in three critical areas, i.e., prudential requirements, transparency and branching.

China's insurance company capital requirements are extremely high and many foreign firms complain they act as a barrier to market access and in some cases to finding a suitable joint venture partner. A national license which includes a main office and three branch offices requires capital infusion of RMB 500 million (US $60 million), while a regional license which includes a main office and two branch offices requires capital infusion of RMB 200 million (US $24 million). Once a firm has a national license an additional RMB 50 million (US $6 million) capitalization will be required for additional branches. With regard to transparency, the regulations continue to permit considerable bureaucratic discretion and offer limited certainty to foreign insurers seeking to operate in China's market. To date, this lack of transparency has manifested itself particularly in the licensing process. Foreign firms complain that the insurance licensing requirements are overly complex and cumbersome. The regulations are also unclear as to whether multiple branch and sub-branch expansion applications may be submitted simultaneously or can only be submitted at intervals. CIRC has also insisted that non-life insurers that are already in the market as a branch and that wish to branch or sub-branch cannot do so unless they first establish as a subsidiary, a costly – and unnecessary – proposition.

In 2002, under the new regulations and prudential requirements, two U.S. insurers received licenses from CIRC. Currently, approximately 50 insurance companies operate in China's market; approximately 30 of them are foreign firms (operating joint ventures with Chinese partners) and 20 of them are Chinese firms. Foreign firms currently garner only 2 percent of insurance premiums in China's market.

Financial Services (Banking and Securities)

With the exception of its failure to produce regulations enabling foreign non-financial institutions to engage in auto financing (see below), China did put in place the necessary legislation and regulations to meet its WTO commitments for financial services during its first year as a WTO member. Nevertheless, foreign banks and securities firms continue to face a restrictive regulatory environment.

China continues to have strict limitations, in particular, on foreign banks' participation in local currency operations. Restrictions on the rights of foreign banks to raise RMB in the interbank market, being planned by the People's Bank of China (PBOC), China's central bank, will inhibit the ability of foreign banks to build RMB loan portfolios necessary for profitable operations in China. In addition, China's capital requirements for foreign bank branches are high, increasing local capital costs for foreign banks.

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 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 global capital base of the bank.

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. 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 notice allowed foreign-funded financial institutions established in the cities of Shanghai and Shenzhen to engage in local currency business as of December 1. Foreign financial institutions located in the cities of Dalian and Tianjin were permitted to apply for permission to engage in local currency operations on the same day. On December 1, 2002, the PBOC increased the geographic scope to include the cities of Guangzhou, Beijing, Qingdao, Wuhan and Zhuhai. 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.

Pursuant to the terms of China's accession agreement, foreign securities firms are to receive the right to form joint ventures for fund management upon China's accession to the WTO, while joint ventures for securities underwriting must be permitted within three years after accession. The China Securities Regulatory Commission issued regulations on the establishment of joint venture fund management companies and securities underwriting by Chinese-foreign joint ventures shortly after China's WTO accession. China's decision to limit foreign partners to a 33 percent stake of these joint ventures, however, has limited their appeal to leading foreign firms.

Motor Vehicle Financing

China's WTO accession agreement requires China to allow non-banks to provide motor vehicle financing upon accession and without any limits on market access. However, the regulations allowing the entry of foreign non-bank auto financial services companies remain in draft form.

PBOC, the institution most responsible in China for regulating auto financing, has shown itself to be receptive to commentary and input from foreign governments including the United States. In addition, PBOC received comments and met with overseas firms and auto groups on PBOC's draft regulations throughout 2002. Foreign governments and firms believed that the first PBOC issued drafts (provided in mid-2002) maintained unreasonably high deposit requirements that were inconsistent with China's requirements for other foreign financial operations. By late 2002, PBOC showed itself to be willing to make selected modifications to China's auto financing regulations to make them more consistent with those in other countries and with China's own financial services regulations.

In mid-December 2002, MOFTEC announced that the motor vehicle financing regulations would be finalized by early 2003. The completion of these regulations will permit overseas foreign financial services firms to compete in the world's fastest-growing auto market.

Express Delivery

Beginning in December 2001, the State Postal Bureau (together with MOFTEC and MII) issued new, restrictive measures that could have jeopardized market access that foreign express delivery firms (which must operate as joint ventures with Chinese partners) enjoyed prior to China's accession. These measures threatened to curtail the scope of operations of foreign express delivery firms licensed prior to China's accession to the WTO, despite China's horizontal commitment on "acquired rights." Specifically, Notice 629, issued in December 2001, required firms wishing to deliver letters to apply for entrustment from China Post. Notice 64 issued in February 2002, extended China Post's monopoly on letters by creating weight and rate restrictions on letter deliveries by private firms. Following high-level U.S. interventions, in September 2002, Notice 472 eliminated the weight and rate restrictions on letter deliveries and streamlined the entrustment application procedure. Two major U.S. express delivery firms subsequently applied for and obtained entrustment certificates from China Post.

Distribution

China's WTO commitments provide for the phase-in of distribution rights for foreign enterprises over the three-year period following China's accession (subject to limited exceptions), starting with minority foreign-owned joint ventures by December 11, 2002, followed by majority foreign-owned joint ventures by December 11, 2003, and wholly foreign-owned enterprises by December 11, 2004. In this context, distribution rights extend to commission agents' services and wholesale trade services.

MOFTEC, SETC and other relevant government agencies are apparently working to revise the existing regulatory framework to satisfy China's WTO commitments. However, despite the fact that liberalization of distribution rights was to take place no later than December 11, 2002, no new or amended laws or regulations have been promulgated in this area.

The relevant authorities have maintained drafts of all new regulations in strict confidence, making it difficult to predict how China will actually implement distribution rights. For example, while it appears that existing minority foreign-owned joint ventures will be granted trading rights, it is not clear whether they will be allowed simply to amend their business licenses to authorize distribution activities, or whether the establishment of new enterprises will be required. Moreover, there has been no indication whether foreign companies will be required to license separate units of their China operations to conduct distribution activities, or whether they will be allowed to integrate these activities under a single entity.

Retailing

In 1999, the Chinese government broadened the scope for foreign investment in the retail sector. New regulations encouraged the entry of large international retailers (such as hypermarkets and warehouse-style stores) into China.

China's WTO commitments will 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 in 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, consistent with the terms of its accession agreement.

Transportation and Logistics

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 sector include: the Ministry of Communications, the Ministry of Railways, MOFTEC, SETC, SDPC, and the Civil Aviation Administration of China. Overlapping jurisdictions, multiple sets of approval requirements, and opaque regulations hinder market access. Domestic firms have used government connections and investments to monopolize the sector. Foreign shipping firms have found it impossible to open subsidiaries in inland ports.

Nevertheless, China's WTO commitments and its own reform policies support a broad opening of the transportation and logistics 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. In November 2002, China issued regulations allowing majority foreign ownership of road transportation firms, as it was required to do within one year of its WTO accession. China was also obligated to issue regulations allowing majority foreign-owned joint ventures to enter the fields of packaging services, storage and warehousing, and freight forwarding one year after its accession; it issued timely regulations allowing 75 percent foreign-owned joint ventures in these fields.

China's international maritime transportation regulations became effective January 1, 2002. Among other things, implementing rules, issued in June 2002, require non-vessel-operating common carriers to make a cash deposit of RMB 800,000 (about US $100,000) in Chinese banks without clear rules on access to and use of this money.

In July 2002, MOFTEC issued a Notice on Establishing Foreign-Invested Logistics Companies in Trial Regions. This notice allows foreign-invested logistics companies (with up to 50 percent foreign ownership and registered capital of US $5 million) to establish in several select cities. U.S. firms have expressed concern about the high capital requirement and the 50 percent cap on foreign ownership, which may conflict with China's WTO commitments for certain types of logistics services.

Regulation of International Data Flows and Restrictions on Data Processing

Chinese authorities routinely filter Internet traffic entering China, focusing primarily on content that Chinese officials deem objectionable on political, social and religious grounds. In 2002, China lifted filters on most major western news sites, including those of the *Washington Post* and *Time*, although access has subsequently been blocked. In addition, China blocks sites related to Taiwan, the Falun Gong spiritual movement, Tibetan and Uyghur support groups, and human rights organizations focusing specifically on China. Few, if any, websites related to strictly economic and business matters are blocked. Changes to Internet filtering can occur without warning or public explanation. For example, the popular Internet search engine Google was blocked completely in China for a few weeks starting in late August 2002. When Google became available again in September, its "cached pages" feature remained blocked; that feature had previously allowed users in China to access "snapshots" of some webpages that were otherwise blocked in China.

Internet content restrictions are governed by a number of measures, not all of which are public. The most important of these measures was issued in September 2000 and cover Internet content providers, electronic commerce sites and application service providers. In March 2002, the Internet Society of China, a nominally private group affiliated with MII, established a "Public Pledge on Self-Discipline for the China Internet Industry." Signatories commit to "refrain from producing, posting or disseminating pernicious information that may jeopardize state security and disrupt social stability, contravene laws and regulations and spread superstition and obscenity." At least one Chinese subsidiary of a U.S. Internet firm has signed the pledge. China generally prohibits foreign-developed encryption and decryption technologies, although this prohibition does not currently apply to software and hardware for which encryption is only an incidental feature.

Telecommunications

In its WTO accession agreement, China made important commitments in the area of telecommunications services. It agreed to permit foreign suppliers to provide a broad range of services through joint ventures with Chinese companies, including domestic and international wired services, mobile voice and data services, value-added services, such as electronic mail, voice mail and on-line information and database retrieval, and paging services. In addition, all geographical restrictions are to be eliminated within two to six years after China's WTO accession, depending on the particular services sector.

Importantly, when it acceded to the WTO, China also accepted key principles from the WTO Agreement on Basic Telecommunications Services. As a result, China is obligated to separate the regulatory and operating functions of MII (which has been both the telecommunications regulatory agency in China and the operator of China Telecom) upon its accession. China also became obligated to adopt pro-competitive regulatory principles, such as cost-based pricing and the right of interconnection, which are necessary for foreign-invested joint ventures to compete with China Telecom.

Since making these commitments, China has separated post and telecommunications services. It has also developed a telecommunications law and lowered connection costs.

In May 2002, the government split China Telecom, the country's largest telecommunications company, into northern and southern parts. Two of China's seven national basic telecommunications companies, China Netcom and Jitong, merged 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 retained 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 existing telecommunications regulations were issued by the State Council in September 2000 and 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.

China has not yet established an independent regulator in the telecommunications sector. The current regulator, MII, is not structurally or financially separate from all telecommunications operators and providers. China has also used regulatory authority to disadvantage foreign firms during 2002. For example, MII arbitrarily raised settlement rates for international calls terminating in China, which had the effect of artificially boosting the revenues of Chinese telecommunications operators at the expense of foreign firms. At times, MII also changed applicable rules without notice and without transparency.

Little progress has been made in opening the market for value-added services, such as Internet service and content providers. MII announced moves toward 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 business. The requirement that Internet Service Providers (ISPs) must provide user login 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 MII before they can receive foreign capital, cooperate with foreign businesses, or attempt domestic or overseas stock listings.

Audiovisual Services (Including Film Imports)

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, the desire to protect the monopoly rents earned by the state-owned movie and print media importers and distributors, and China's concerns about politically sensitive materials, result in continued 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 allows 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. They must be reviewed and approved before release, and are subject to blackout viewing periods during national holidays. Although China has pledged to license another distributor, currently there is only one authorized distributor of foreign films, the state-owned China Film Distribution Company. As discussed above in the Import Quotas section, China admitted 18 foreign films in 2002. U.S. industry sources report that China treats its WTO commitment as a ceiling, rather than a floor, which artificially increases demand for pirated products. Rightholders who comply with Chinese law must forego marketing legitimate products, leaving the demand for movies to be satisfied almost entirely by pirates.

Tourism and Travel Services

Immediately following China's WTO accession, China issued new travel agency administration regulations to allow large foreign travel and tourism service providers to operate full-service joint venture travel agencies to promote foreign inbound tourism in the four major foreign tourist destinations in China - Beijing, Shanghai, Guangzhou and Xian. Wholly foreign-owned firms catering to foreign inbound tourists will be permitted six years after accession. For now, the agencies must have an annual worldwide turnover in access of $40 million, and local registered capital of almost $500,000. At least one major U.S. travel services company received approval to start operations in 2002 aimed at the corporate air travel market.

Foreign firms continue to be restricted from marketing to Chinese outbound tourists. In addition, holders of Chinese official passports, over 85,000 of whom applied for U.S. visas in FY2002, are required to use China’s state-owned airlines or their code-share partners. Most of these individuals - state-owned enterprise employees - would not be considered government employees in most countries. This represents a significant loss of business for U.S. airlines.

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, MOE banned foreign companies and organizations from offering educational services via satellite networks. Foreign universities may set up non-profit operations, but 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.

PROFESSIONAL SERVICES

Legal Services

Prior to its WTO accession, China had maintained various restrictions in the area of legal services. It prohibited representative offices of foreign law firms practicing Chinese law or engaging in profit-making activities with regard to non-Chinese law. It also imposed restrictions on foreign law firms’ formal affiliation with Chinese law firms, limited foreign law firms to one representative office and maintained geographic restrictions. Chinese law firms, on the other hand, have been able to open offices freely throughout China since 1996.

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. In addition, foreign representative offices will be able to advise clients on foreign legal matters and to provide information on the impact of the Chinese legal environment, among other things. They will also be able to maintain long-term “entrustment” relationships with Chinese law firms and be able to instruct lawyers in the Chinese law firm as agreed between the two law firms.

Under new regulations and implementing rules issued by the Ministry of Justice (MOJ) in 2002, it appears that foreign law firms are required to demonstrate there is an actual need for the establishment of a representative office and the development of the firm’s legal services in China. In addition, a foreign law firm may not establish an additional representative office until its most recently established representative office has been in practice for three consecutive years. Foreign attorneys may not take China's bar examination, and they may not hire registered members of the Chinese bar as attorneys.

The new measures also appear to restrict the types of services that foreign law firms may provide in China. 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. Foreign law firms are not permitted to act as an agent in arbitration proceedings or to express opinions or comments on the applications of Chinese law or about facts involving Chinese law. Foreign representative offices are prohibited from completing registration, amendment, application, filing and other procedures with Chinese government agencies. Even after the MOJ measures took effect, some foreign lawyers served as agents in arbitration proceedings and handled other legal procedures when dealing with certain central and local level officials, which indicates that enforcement of the measures is inconsistent.

Nevertheless, as more foreign businesses enter Chinese markets, the demand for U.S. law firms will likely grow as well.

Engineering, Architectural and Contracting 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. Foreign firms also face severe partnering and bidding restrictions. Foreign firms cannot hire Chinese nationals to practice architecture and engineering services as licensed professionals. Currently, Chinese architecture and engineering firms must approve and stamp all drawings prior to construction. 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 also sets extremely low design fees, rather than letting the market set prices. In addition, China does not have adequate lien laws to protect the rights of engineers, architects, contractors and material suppliers from non-payment.

Accounting and Management Consultancy Services

The Chinese Institute of Certified Public Accountants (CICPA), a government body under MOF, has made significant progress in modernizing accounting in China. Last year, 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, and 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 allow foreign accounting firms to partner with any Chinese entity of their choice. China also was required to abandon the restriction on foreign accounting firms' representative offices engaging in profit-making activities. Foreign accounting firms can also engage in taxation and management consulting services, without having to satisfy the more restrictive requirements on form of establishment applicable to new entities seeking to provide those services separately.

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 some 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.

Movement of Professionals

Generally, there are no special entry restrictions placed on professional Americans who wish to work in China, such as doctors or engineers. However, they must receive approval from the Foreign Experts Bureau. Prior to arrival, a prospective American job applicant may be asked to provide notarized copies of his or her professional credentials and a summary of past work experience. The credentials will be used by the employer to file for a "foreign experts residency permit" for the American employee. Once the "foreign expert" permit is authorized, the prospective employee can request a work visa (a "Z" visa) from a Chinese embassy or consulate. If the prospective employee arrives in China on a visitors' visa (an "L" visa) prior to commencing employment, the prospective employee is usually asked to depart China prior to starting work, and to apply for the appropriate work visa from a foreign entry point (usually Hong Kong). Local employers are responsible for all employment or income tax and other withholdings for these "foreign experts" while they are employed in China.

INVESTMENT BARRIERS

Foreign investors show great interest in China despite significant obstacles. China received $52.7 billion in FDI in 2002, apparently becoming the world's top investment destination for the first time. 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 toward a rules-based economy.

The Standing Committee of the Ninth National People's Congress (NPC) approved amendments to three laws covering joint ventures and wholly foreign-owned enterprises in October 2000 and March 2001. The amendments eliminated provisions mandating export performance requirements (e.g., rules that required these enterprises to export a certain percentage of products), revised "Buy China" policies that regulated procurement of raw materials and fuels, and removed requirements that these enterprises submit production/operation plans to Chinese authorities. Several of the previously mandated actions remain "encouraged," however. More detailed implementing 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. A new catalogue took effect April 1, 2002, listing sectors in which foreign investment would be encouraged, restricted or prohibited, replacing the December 1997 list. Unlisted sectors are considered to be permitted.

Among other things, the new catalogue aims to implement sectoral openings that China committed to in its WTO accession agreement, including banking, insurance, petroleum extraction, and distribution. According to an accompanying regulation, projects in "encouraged" sectors benefit from duty-free import of capital equipment and VAT rebates on inputs. The same regulation states that approval authority for "restricted" investments rests with the relevant central government ministry and may not be delegated to the local level. For a number of restricted industries, a Chinese controlling or majority stake is required. Industries in which foreign investment is prohibited include national defense, firearms manufacturing, most media content sectors, and biotechnology seed production.

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 that provided foreign-invested enterprises 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 needs of China's national economic development." 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 numerous examples of investment restrictions. 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 other investments are restricted under the guise of avoiding excess capacity.

U.S. investors have expressed particular concerns about China's prohibition of investment in genetically modified seed development and production. Ongoing work and planned projects are at risk.

Investment Requirements

In addition to taking on the obligations of the WTO Agreement on Trade-Related Investment Measures (TRIMS), China expressly agreed in its protocol of accession to eliminate export performance, local content and foreign exchange balancing requirements from its laws and regulations and not to enforce any contracts imposing those requirements. China also agreed that it would no longer condition investment or import approvals on those requirements or on requirements such as technology transfer and offsets. Despite these commitments, industry remains concerned that the Chinese government may impose unofficial requirements in exchange for extra-legal, quid pro quo decisions by government officials at both the central and sub-national level. In addition, some U.S. companies report that local government officials continue to enforce local-content requirements contained in industrial policy documents.

Other Investment Issues

Venture Capital. There are currently no laws or regulations that define the legal and organizational structures for general purpose domestic private equity funds, although an April 2001 regulation prohibited securities firms from entering the private equity business. Chinese laws and regulations 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. A new regulation took effect March 1, 2003, to allow the establishment of foreign-invested venture capital firms, including wholly foreign-owned firms, to make investments “principally” in unlisted, high-technology firms in China. Under the new regulation, which replaced a 2001 provisional regulation, foreign-invested venture capital funds are, in principal, authorized to invest in foreign-invested firms in China.

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 enterprises 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 are subject to very tight regulatory control. These barriers to capital market access will not be removed by China's WTO protocol of accession. 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. 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 China. Such practices may restrict market access for certain imported products, raise production costs, and restrict market opportunities for foreign-invested enterprises in China.

There are several existing laws and regulations in China addressing competition matters. However, these measures are ineffective due to poor national coordination and inconsistent local and provincial enforcement. China is drafting a new anti-monopoly law that could be adopted as early as 2003. There are also reports that in 2003 MOFTEC will issue long-awaited regulations governing foreign mergers and acquisitions; those regulations would likely include competition policy provisions.

OTHER BARRIERS

Transparency

Laws and regulations directly affecting international trade are increasingly becoming publicly available in China. Since 1992, China has published all trade laws and regulations in the "MOFTEC Gazette," available on a subscription basis. However, many "measures" that did not rise to the level of ministry-issued "regulations" continued to remain unavailable to the public. China's ministries routinely implemented policies based on internal "guidance" or "opinions" that were not available to foreign firms. Experimental or informal policies and draft regulations, in addition, were regarded as internal matters and public access was tightly controlled.

China, in its WTO accession protocol, committed to publishing all laws, regulations and other measures that relate to trade matters, including those that affect imports, and generally to allowing its WTO trading partners an opportunity to comment on them before implementation. China also agreed to provide a copy of new trade-related 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.

In 2002, China did a reasonable job of publishing national laws and regulations. Although several regulations carried effective dates before the dates of publication, the lag was usually only a couple of weeks. Various government-owned specialty newspapers routinely carried the texts of government regulations, implementing rules, circulars and announcements. Many government ministries also published digests or gazettes containing the texts of these measures, both in written form and on their websites. In addition, there has been a proliferation of online news and information services that routinely offer up-to-date news about and texts of new laws and regulations. Some services even provide legal-quality English translations by subscription.

China failed in 2002 to publish all "measures" related to trade, however. Chinese businesses continue to report unofficial "guidance" provided by Chinese regulators, all unavailable to foreign entities. In some cases, Chinese officials provided unpublished documents to interested parties, but this dissemination was ad hoc and based more on personal connections than formal procedures.

MOFTEC, in late 2001, established an "Enquiry Center" to provide information on new trade and investment laws, regulations and other measures.

In addition, MOFTEC officials have over the past year researched 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 began to consider a system to solicit input from interested parties before issuing trade and investment laws or regulations. In December 2001, the State Council issued regulations explicitly allowing comment periods and hearings. However, many of China's ministries and agencies continued to follow the practice prior to China's accession to the WTO. The ministry or agency drafting a new or revised law or regulation will normally consult with and submit drafts to other ministries and agencies, Chinese experts and affected Chinese companies. At times, it will also consult with select foreign companies, although it will not necessarily share drafts with them. As a result, only a small proportion of new or revised laws and regulations have been issued after a period for public comment, and even in these cases the amount of time provided for public comment has generally been too short. Government officials are still researching the wisdom of establishing a formal mechanism for soliciting input prior to finalization of all governmental measures.

In the area of standards, CNCA, the agency in charge of drafting technical requirements, appeared to undergo a change in philosophy in 2002. Where previously CNCA officials were unwilling to share draft standards, in 2002 they established a helpful "TBT Enquiry Point" that not only provided drafts for comment, but also informed interested parties of changes to the drafts during the comment period. The new comment periods proved unworkably short in many cases, although officials showed flexibility by "unofficially" extending deadlines.

Similarly, securities, foreign exchange and banking regulators proved relatively open to the concept of comment periods. In part this may be a reflection of the international educational and work background of these officials. However, they have also apparently recognized the need for international comment to avoid the pitfalls of releasing uninformed regulations in these sensitive industries.

Beyond these narrow areas, most of China's governmental entities had a poor record of providing the required opportunity for comment. Instead, ministries and agencies often circulated unofficial copies of draft measures to a small number of concerned domestic industry representatives and scholars for comment. Face-to-face consultations between government ministries or agencies and foreign industry representatives on the text of new measures were also possible in some cases, but not on a regular basis.

Legal Framework

Laws and Regulations. Laws and regulations in China tend to be more general and ambiguous than in other countries. While this approach allows the Chinese authorities to apply laws and regulations flexibly, it also results in inconsistency and confusion in application. Companies often have difficulty determining whether their activities contravene a particular law or regulation.

In China, regulations are also promulgated by a host of different ministries and governments at the central, provincial and local levels, and it is not unusual for the resulting regulations to be at odds with each other. Even though finalized regulations are now routinely published in China, they often leave room for discretionary application and inconsistencies arise, either through honest misunderstanding or by design. Indeed, 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.

This lack of a clear and consistent framework of laws and regulations can be 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 its WTO accession agreement, China committed to establish tribunals for the review of all administrative actions relating to the implementation of trade-related 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. Both foreign and domestic companies often avoid enforcement actions through the Chinese courts, as skepticism about the independence and professionalism of China's court system and the enforceability of court judgments and awards remains high. There is a widespread perception that judges, particularly outside of China's big cities, are subject to influence by local political or business pressures. Most judges are not trained in the law and/or lack higher education, although this problem decreases at the higher levels of the judiciary.

At the same time, 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 Judges' Law, issued by the Standing Committee of the National People's Congress in 1995, requires judges to have degrees in law or in other subjects where they have acquired specialized legal knowledge, and permits judges appointed before the law's implementation who do not meet such standards to undergo necessary training. In 1999, the Supreme People's Court began requiring judges to be appointed based on merit and educational background and experience, rather than through politics or favoritism. In August 2002, the Supreme People's Court issued rules designating certain higher-level courts to hear cases involving administrative agency decisions relating to international trade in goods or services or intellectual property rights. According to the Supreme People's Court, China's more experienced judges sit on the designated courts, and the geographic area under the jurisdiction of each of these designated courts has been broadened in an attempt to minimize local protectionism. The rules provide that foreign (or Chinese) enterprises and individuals may bring lawsuits in the designated courts raising challenges, under the Administrative Litigation Law, to decisions made by China's administrative agencies relating to international trade matters. The rules also state that when there is more than one reasonable interpretation of a law or regulation, the courts should choose an interpretation that is consistent with the provisions of international agreements to which China has committed, such as the WTO rules. The rules took effect in October 2002.

Despite initial enthusiasm, foreign observers have grown increasingly skeptical of the China International Economic and Trade Arbitration Commission (CIETAC) as a forum for the arbitration of trade disputes. Some foreign firms have obtained satisfactory rulings from CIETAC but other firms and legal professionals have raised concerns about restrictions on the selection of arbitrators and inadequacies in procedural rules necessary to ensure thorough, orderly and fair management of cases.

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

Labor and Benefits

In recent years, China has enacted national labor laws and regulations that cover most, though not all, key labor areas. However, lack of uniformity and transparency in applying these laws and regulations complicates investors' personnel planning. The Chinese government is slowly developing nationwide pension, unemployment insurance and medical insurance systems that will require substantial employer contributions. The system is still rudimentary and characterized by serious funding shortfalls, in part due to widespread non-compliance, particularly among domestic firms.

China is developing, but has not yet enacted, national social security legislation. At present, differences in benefit costs and taxation between, and even within, regions and localities, complicate investor 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 less-educated Chinese are still 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, in part due to rampant non-compliance by Chinese citizens, and in part due to the recognition 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 36,447 anti-graft cases in 2002, recovering almost $500 million. Lower-level officials bore the brunt of the ongoing anti-corruption campaign, but the head of one of China's four large state-owned commercial banks was arrested and expelled from the Communist Party. Chinese law enforcement officials also detained several prominent businesspeople for engaging in corrupt activities. China's entry into the WTO, which has greatly reduced tariffs, should 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 issued its first law on unfair competition in December 1993, and the Chinese government continues to call for improved self-discipline and anti-corruption initiatives at all levels of government. While the government has pledged to begin awarding contracts solely on the basis of commercial criteria, however, it is unclear how quickly and to what extent the government will be able to follow through on this commitment. U.S. suppliers complain that the widespread existence of unfair bidding 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.

Land Issues

China's constitution specifies that all land is owned in common by all the people. In practice, agricultural collectives distribute agricultural land to the peasants, while city governments distribute land for residential and industrial use. The State and collectives can either "grant" or "allocate" land usage rights to enterprises in return for payment of fees. Enterprises granted land use rights are guaranteed compensation if the State asserts eminent domain over the land, while those with allocated rights are not. Granted land usage rights cost more, of course, than allocated rights. However, the law does not define standards for compensation when eminent domain supercedes land use rights. This situation creates considerable uncertainty when foreign investors are 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.

A new 2002 rural land law gives peasants fixed contracts for periods of 30 to 50 years, and permits peasants to exchange or rent out their land usage rights while their usage contract remains in force. There is no present prospect for changing from land usage rights to direct ownership of rural land.

The problem for foreign investors is the array of regulations that govern their ability to acquire land use rights. Local implementation of these regulations may vary from central government standards; prohibited practices may occur in one area while they 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.