CHINA

TRADE SUMMARY

The United States trade deficit with China reached $83.8 billion in 2000, an increase from $68.7 billion in 1999. U.S. exports in 2000 were $16.3 billion, up 23.9 percent from the previous year. Corresponding U.S. imports from China were $100.1 billion, up 22.4 percent. China is currently the 11th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to China were $3.9 billion in 1999, and U.S. imports were $2.7 billion. Sales of services in China by majority U.S.-owned affiliates were $888 million in 1998, while sales of services in the United States by majority Chinese-owned firms were $62 million. The stock of U.S. foreign direct investment (FDI) in China in 1999 was $7.8 billion, up from $6.5 billion in 1998. U.S. FDI in China is concentrated largely in the manufacturing, petroleum and finance sectors.

OVERVIEW

With a population of 1.3 billion people, China offers a potentially lucrative market for foreign goods and services. Over the past twenty years, Beijing has made much progress in opening its market to foreign products and investment. Economic and financial reforms are gradually removing the privileges accorded state-owned firms, and introducing market forces. China's accession to the WTO, based on the U.S.–China Bilateral Market Access Agreement of November 15, 1999, will further open China's market to U.S. goods and services. The commitments China has undertaken in its bilateral negotiations with the United States and other WTO members will encourage structural reform and the rule of law. Accession to the WTO will also support China's own domestic reform process.

China completed its bilateral WTO negotiations with all WTO members formally requesting them, except Mexico. The WTO Working Party on China's accession resumed drafting of a Protocol and Working Party Report with a view towards completing the accession process as soon as possible. WTO membership will build on and strengthen China's implementation of its commitments to the United States in the 15 trade agreements negotiated since 1979.

The Chinese Government has recognized for a number of years that economic reform and market opening are essential components of sustainable and balanced economic growth. China's shift away from the planned economy model to a market economy has been difficult but is being rewarded by sustained strong economic growth and improving living standards. Reforms have been particularly difficult in sectors that traditionally relied upon heavy state subsidies. The aging state-owned industrial sector and the heavily protected agricultural sector are now under significant competitive pressure. In the short term after WTO accession, these pressures may intensify.

While China has a more open and competitive economy than 20 years ago, there are still substantial barriers in place that have yet to be dismantled. The Chinese government has undertaken a massive effort to revise its laws and regulations in a manner consistent with WTO rules. Understanding of these provisions remains limited, however, particularly outside of Beijing and Shanghai. The central government continues to protect noncompetitive or emerging sectors of the economy. Provincial and local governments have strongly resisted reforms that would eliminate protection of local enterprises or reduce government receipts. This inhibits the central government's ability to implement trade reforms. Import barriers, an opaque and inconsistent legal system, and limitations on market access combine to make it difficult for foreign firms to compete in China. Business interests must be realistic about the impact of WTO accession. It will bring enormous changes – both economically and socially – but the process will take time.

The Chinese Economy in 2000

China officially estimated GDP growth at 8.0 percent in 2000, reversing the deceleration in economic growth since the early 1990s. Burgeoning exports, increased government infrastructure investment, and stronger urban consumer demand were the chief factors stimulating growth. The improved economic conditions, however, were largely concentrated in a few coastal and urban areas. Rural income growth and consumption – affecting roughly two-thirds of China's population of 1.3 billion – continued to stagnate. Deflation, based on the consumer price index, eased in 2000, primarily as the result of higher costs for petroleum and services. Retail prices for manufactured goods and agricultural products, however, continued to fall. New bank lending accelerated only marginally over 1999, continuing to reflect the government's efforts to stem the flow of bad loans which has supported the predominantly state-owned sector.

Prospect of WTO Entry Stimulates Further Reform

China continued unilateral reforms of its foreign trade sector in 2000 in preparation for entry to the World Trade Organization. A "proposal" for the 2001-2005 Tenth Five-year Plan approved by the Communist Party Central Committee in October notes that China will seek to improve its foreign trade system in ways consistent both with international norms and "China's national characteristics." The "proposal" also calls for an improved legal and regulatory framework and increased transparency. For example, the Patent Law was revised and a concerted effort is underway to ensure that revisions of the Trademark and Copyright laws are completed in time for approval by the March 2001 session of the National People's Congress. Bringing these laws into consistency with WTO rules, including Trade Related Aspects of Intellectual Property Rights (TRIPS), will have positive implications for foreign and Chinese businesses alike. These revisions were part of the Chinese government's effort to revise its laws and regulations consistent with its WTO obligations.

Problems Continue Despite Progress

While China's trade liberalization efforts represent a step forward, there were also a number of new regulations introduced that erected new or worsened existing trade barriers. Examples of special concern in 2000 included:

Cosmetic Testing and Registration Requirements. China requires quality licenses for manufacturing goods before granting import approval. Testing assesses conformity to standards and specifications often unknown or unavailable to foreigners and not applied equally to domestic products. In 2000, the Ministry of Health further tightened conformity assessment procedures for imported cosmetics products and required expensive testing procedures. Cosmetic companies complain that they have also been required to pay between $1,200 to $9,600 per product for product registration. The conformity assessment and registration process takes as long as a year to complete and represents the de-facto creation of a new import barrier.

Educational Testing Service. U.S. companies providing testing services in China have faced problems with the illegal copying, distributing, and selling of their testing materials. For example, one Chinese tutoring company has continued to infringe copyrighted product despite repeated raids and confiscation of such material. The lack of adequate copyright safeguards threatens the credibility of the results of these tests.

Chain Store Regulations. Regulations on chain stores implemented in March 2000 impose minimum branching and space requirements and will limit the number of entrants to the market to very large firms. In addition, they undermine the intention of the bilateral Market Access Agreement between the United States and China signed on November 15, 1999 by placing limits on the scope of operations and type of business that chain stores and franchises may undertake.

Restrictions on the Import of Chicken Meat. Rules promulgated in December 2000 place strict controls on the import of chicken meat. Chinese government authorities claim the measures were implemented as a means of controlling smuggling and in the interests of food safety, but in effect these regulations caused a serious disruption in the flow of poultry imports into China. In addition, they are inconsistent with commitments in the bilateral Agriculture Cooperation Agreement (ACA) signed in April 1999.

Implementation of Agreements on Tilletia Contraversa Kuhn (TCK) in Wheat and Barley. In early December 2000, State Administration for Entry-Exit and Quarantine (CIQ) officials prevented the offloading of a shipment of U.S. origin barley because they claimed it contained unacceptably high concentrations of TCK mold spores. This action took place despite the fact that the shipment carried documentation certifying it was TCK-free in accordance with conditions outlined in the bilateral Agriculture Cooperation Agreement (ACA) signed in 1999. The incident reflects continuing resistance by CIQ to full implementation of China's commitments under the bilateral ACA.

Registration of Internet Content Providers. On November 7, 2000, the Chinese government issued rules governing Internet-based news providers. The regulations, jointly drafted by the Information Office of the State Council and the Ministry of Information Industries (MII), specify that the Information Office will supervise the management of all websites engaged in news dissemination in China. Internet sites run by media organizations at the central government and provincial government levels may publish news, but only after obtaining approval from the Information Office. Other media organizations may not set up independent news sites, but they may, upon approval, set up news pages at the websites run by the above-mentioned approved media organizations. If commercial portal sites run by non-news organizations wish to carry news, they may do so only after obtaining permission. After gaining approval, they may only publish news provided by officially approved news organizations. The rules stipulate that such commercial portals may not carry any news items based on their own interviews or from other sources. Other commercial sites run by non-news organizations are not allowed to carry news of any kind. The regulations further stipulate that no China-based websites will be allowed to link to overseas news websites or carry news from overseas news media or websites, without separate approval by the State Council. Besides further inhibiting the free flow of information, the regulations will negatively affect the quality of information provided by legitimate Internet content providers.

IMPORT POLICIES

China, at present restricts imports through a variety of means, including high tariffs and taxes, non-tariff measures, trading rights restrictions, and other barriers. Chinese officials are increasingly aware, however, that such protective measures contribute to endemic economic inefficiencies and encourage smuggling. To address these problems, the Chinese Government has undertaken measures

to reduce these barriers. The number of firms with trading rights is continuing to increase; after WTO accession foreign entities will gain full trading rights after three years. China is reforming its tax system to minimize distinctions between domestic and foreign entities according to the principle of national treatment. In addition, China has substantially reduced the number of goods subject to import quotas and will phase-out other quotas after accession. China also is clarifying its licensing procedures in accordance with the WTO's transparency requirement. Finally, as part of its ongoing preparations for WTO accession, the Chinese Government again cut tariffs on January 1, 2001.

TARIFFS AND TAXES

Tariffs

Under the terms of its bilateral WTO agreement with the United States, once China accedes to the WTO it will cut industrial tariffs from an overall average of about 17 percent at present to 9.4 percent by 2005. Tariffs for U.S. priority agricultural products will fall from an average of 31 percent to 14 percent by January 2004. Tariffs on all goods covered by the Information Technology Agreement – such as semiconductors and computer hardware – are to be eliminated by January 1, 2005.

An analysis of China's tariff schedule shows that import tariffs for products that compete with those of domestic industries the Chinese Government seeks to protect remain especially high. Tariffs for some motor vehicles, for example, are over 100 percent.

Several U.S. exporters have expressed concern with the tariff rates that currently exist on particular products. Some of these products include wine and spirits (65 percent), large motorcycles (60 percent), beef (45 percent), raisins (40 percent), canned peaches and peach pulp, canned fruit mixtures and frozen peaches (25-30 percent), certain steel products (10-40 percent), avocados (25 percent), paper and paperboard products (15-45 percent), potato and potato products (13-25 percent), wood products (0-21 percent), fiber glass and auto glass (20 percent), soda ash (12 percent), semiconductors (6-9 percent), pulp and recovered paper (2 percent), and restaurant equipment. Although many of these tariffs will be reduced or eliminated upon China's accession to the WTO, U.S. exporters of several of these goods would welcome further cuts.

Exporters of potato flakes from the United States have also reported an instance in which China's customs authorities have incorrectly classified this import item, resulting in a higher tariff. As a result, according to the industry, potato flakes are assessed a 40 percent tariff instead of 30 percent.

The U.S. wine industry has expressed its concern about certain customs taxes and the application of a minimum invoice value of $2.70 per 750 ml on all imported wine. This appears to be inconsistent with the WTO Customs Valuation Agreement.

Tariff rates significantly lower than the published MFN rate may be applied in the case of goods that the Chinese Government has identified as necessary to the development of a key industry. This has been particularly true of high technology items. These products benefit from a government policy to encourage investment in high technology manufacturing by domestic and foreign firms. Under the terms of investment policies announced in 1999, foreign investment firms who produce certain types of high technology goods, or who are export-oriented, will no longer have to pay duty on

imported equipment which is not manufactured in China and which is for the enterprise's own use. China's Customs Administration also has occasionally announced preferential tariff rates for items that benefit other key economic sectors, in particular the automobile industry.

In August 1998, the Customs Administration launched an ambitious program to standardize enforcement of customs regulations throughout China as part of a larger campaign to combat smuggling. The program was introduced to control and ultimately eliminate "flexible" application of customs duty rates at the port of entry. While foreign businesses selling goods into China might at times have benefitted from lower import duty rates, lack of uniformity made it difficult to anticipate in advance what the applied duty would be. The scale of the smuggling problem itself is illustrated by the prosecution of China's largest ever smuggling case, in which US $10 billion in automobiles, oil, and other goods were brought in illegally over several years. The anti-smuggling campaign has successfully reduced the flexibility of the local customs officials to "negotiate" duties.

Anti-dumping and Countervailing Duties

As trade barriers come down, China's beleaguered state-owned enterprises increasingly are resorting to anti-dumping measures to address allegedly unfair imports. For example, an internal Sinopec Journal carried an article on "Suggestions for Protecting our Petrochemical Industry by Applying the WTO's Anti-dumping Agreement." Press articles have commented on how Chinese industries should begin filing anti-dumping cases to protect their markets after WTO-mandated tariff cuts. Since China first promulgated Anti-dumping and Anti-subsidy Regulations in 1997, China has applied anti-dumping measures to imports of newsprint, steel, and chemical products. Without exception, the Chinese complainants in these cases have been large state-run firms, employing large numbers of workers, suddenly facing pressure from both domestic reform and imports.

WTO accession – and the accompanying competitive pressure on some outmoded Chinese suppliers – seems set to amplify this new interest in anti-dumping measures. China will need to substantially modify its anti-dumping regulations (as well as its anti-subsidy regulations) to bring them into compliance with WTO rules. Likewise, China's anti-dumping regime lacks the transparency called for by the WTO. Trade officials responsible for investigating dumping allegations have been working to increase transparency and address other technical issues.

Taxation

China made several improvements in its tax system during the year 2000. In January 2000, China Customs announced that it was cutting import taxes on a number of products by as much as 2 percent, effective as of the beginning of the year. The cuts covered several hundred products in the textile, raw material, and production machinery and parts sectors. The State Council has submitted amendments to the national tax law designed to standardize tax collection rates and mechanisms.

Management of the Chinese authorities' single most important revenue source – the value-added tax (VAT) – is, however, weak. Imports are sometimes subject to discriminatory application of the VAT, which ranges between 13 percent and 17 percent, depending on the product. In addition, while the VAT is collected on imports at the border, domestic producers often fail to pay the VAT. For example, when

China re-imposed a 17-percent VAT on soybean meal in July 1999, soybean imports fell by over 50 percent. Allegedly, domestic producers of crushed soybean meal apparently avoided the taxes and passed on the price advantage to buyers.

Tax rebates for exporters, which increased 29 percent in 2000, are also subject to significant abuse. In December, Premier Zhu Rongji held a special work conference to mobilize the authorities to combat false claims for export tax rebates. The State Council – China's cabinet – has organized a group specifically to attack the problem.

Non-tariff Measures

Non-tariff barriers (NTBs) to trade and trade distorting measures persist. NTBs in China include quotas, import licensing, import substitution and local content policies, and unnecessarily restrictive certification and quarantine standards. For example, foreign-invested enterprises (FIEs) continue to report demands for export performance requirements in investment contracts, adding that failure to meet these requirements can result in loss of licenses for foreign exchange or contract termination. Similarly, some firms report being forced to accept contracts mandating increased content from domestic suppliers; government agencies strongly encourage firms to "buy Chinese".

Non-tariff barriers to trade are primarily administered at the national and subnational level by the State Economic and Trade Commission (SETC), the State Development and Planning Commission (SDPC), the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), the Ministry of Information Industries (MII), and the State Administration for Entry-Exit Inspection and Quarantine of the PRC (CIQ). Specific non-tariff barriers result from negotiations between the central government and its various ministries, state-owned corporations, and trading companies.

Firms along China's borders can receive an exemption from quota and licensing requirements based on a regulation issued in 1996. This exemption is intended to allow small-scale traders to operate in border communities. However, larger operators may be taking advantage of this system to trade larger shipments over China's land borders.

Import Quotas

At present, quotas limit imports of over 40 categories of commodities, including watches, automobiles, grains, edible oils, fertilizers, steel, and certain textile products. Quotas on some of these products are scheduled to be phased out as part of China's WTO accession. China's central government sets annual quotas through negotiations held at the end of each year. Officials at local and central levels evaluate the need for quantitative restrictions on particular products. Once demand has been determined, the government allocates a quota to provinces and special economic zones who in turn distribute it to the end-users. Quota amounts are often unannounced and allocation remains opaque to outsiders. Monopoly importers, such as exist for theatrical film imports, are able to establish *de facto* quotas that maximize their monopoly rents.

China has gradually reduced the number of products subject to quotas and other quantitative restrictions, and will be required to eliminate most of them once it accedes to the WTO. Specifically, the bilateral agreement with the United States requires China to eliminate existing quotas for the top U.S. priority products upon accession and phase-out remaining quotas,

generally in two years but no later than January 1, 2005. Quota levels will grow at an annual rate of 15 percent from levels at or above current trade, and will be administered consistent with China's WTO commitments.

Import Licenses

Many products that are subject to import quotas also require import licenses. Since the early 1990s, China has eliminated many import license requirements, a process that is likely to continue as preparations are made for China's WTO accession. Licenses are still required, however, for a number of items important to the United States, including grains, vegetable oil, cotton, iron and steel products, commercial aircraft, passenger vehicles, hauling trucks, and rubber products. China is considering adding more license requirements in an effort to combat smuggling.

Although issuance of licenses may be labeled "automatic," the license applicant must prove that there is "demand" for the import and that there is sufficient foreign exchange available to pay for the transaction. These requirements will be eliminated upon China's accession to the WTO.

Tariff-Rate Quotas

In 1996, China introduced tariff-rate quotas (TRQ) on imports of wheat, corn, rice, soybeans, cotton, barley, and vegetable oils. The regulations governing TRQ Administration have not been made public and TRQ quantities are not announced, inhibiting trade in these goods. Out-of-quota rates are currently as high as 121.6 percent. These issues were addressed in the bilateral market access agreement on China's accession. Once it accedes to the WTO, China will establish large and increasing tariff-rate quotas for these commodities, with low in-quota duties ranging from 1 to 10 percent. A portion of each TRQ will be reserved for importation through entities other than state trading entities. To maximize the likelihood that TRQs will fill, China agreed to specific rules for administration of the TRQs, including increased transparency and reallocation of unused quota to end users that have an interest in importing.

Export Licenses

Export licenses discourage foreign investment in the manufacturing sector and slow the flow of trade. China has progressively reduced the number of products requiring export licenses but still occasionally imposes them on strategically sensitive commodities. For example, China in 1999 imposed export license requirements on tungsten ore to favor the export of semi-processed products. Products still requiring licenses include raw materials, lethal chemicals, and food products. Some manufactured goods, certain types of textiles, electric fans, computers, black and white televisions, and bicycles also require export licenses.

Transparency

Finding information about economic and trade regulations in the print and electronic media has become much easier in recent years. The 1992 bilateral market access Memorandum of Understanding (MOU) laid the foundation for China to improve the transparency of its trade regime. Pursuant to this Agreement, China designated the MOFTEC Gazette as the official register for publication of all laws and regulations relating to international trade. The Gazette is updated as new regulations are announced and is available on a subscription basis. In December 2000, a Chinese trade official stated that China planned to expand the MOFTEC gazette and begin publishing a government journal – somewhat like the federal

register – where all local, provincial, and national laws and regulations related to foreign trade and investment would be printed. He also said the Trade Ministry (MOFTEC) will establish an Inquiry Office to provide information on commercial, investment, and trade laws and regulations. Economic newspapers now routinely carry the texts of government circulars, announcements and regulations. Most government ministries also publish digests or gazettes containing the texts of related laws and regulations, both in hard copy and on their websites. The State Council and MOFTEC websites, cei.gov.cn and moftec.gov.cn, respectively, are particularly good examples of this trend. In addition, there has been a proliferation of online news and information services such as chinaonline.com, sinolaw.com, and sohu.com that routinely offer up-to-date news about and texts of new laws and regulations.

Despite this progress, access to information is still a problem. Chinese ministries routinely implement policies based on internal "guidance" or "opinions" that are not available to foreign firms. Authorities are often not willing to consult with Chinese and foreign industry representatives before new regulations are implemented.

Experimental or informal policies and draft regulations are regarded as internal matters and access to them is tightly controlled. It can be extremely difficult to obtain copies of draft regulations, even when they have a direct effect on a particular industry or investment. The opaque nature of customs and other government procedures also complicates the ability of businesses to take full advantage of commercial opportunities in China. Despite this, some Chinese ministries occasionally circulate unofficial copies of draft regulations to concerned industry representatives for comment. Face-to-face consultations between government agencies and industry representatives on the text of new regulations are also becoming more common. The Chinese government is considering a system to solicit input from interested parties before promulgating commercial laws or regulations. However, government officials have not provided details on the mechanism for soliciting input.

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. In addition, some goods, such as grains, cotton, vegetable oils, petroleum, fertilizers, and related products are imported principally through state trading enterprises.

Restrictions on the type and number of firms with trading rights contribute to systemic inefficiencies in the trading system and create substantial incentives to engage in smuggling and other corrupt practices. The restrictions also inhibit Chinese firms' ability to export their products into foreign markets. Liberalization of the trading system had been proceeding at a gradual pace since 1995. The pace picked up in 1999 when China's Ministry of Foreign Trade and Economic Cooperation (MOFTEC) announced new guidelines allowing a wide variety of Chinese firms to register to conduct foreign trade. The guidelines allow, for the first time, both manufacturing and "nonproduction" firms with annual export volumes valued in excess of $10 million to register for trading privileges. Firms with trading rights must undergo an annual qualifications test and certification process.

As part of its bilateral WTO accession agreement, China committed to phase out

restrictions on trading rights within three years of its accession. This tracks with China's commitment to phase out restrictions on distribution services for most products within three years of accession. To meet these commitments, MOFTEC is working on guidelines to allow foreign-invested companies, subject to certain restrictions, to engage directly in trade. Early descriptions of these regulations indicate that MOFTEC intends to impose on foreign companies registration and capital requirements similar to those specified in the regulations for domestic firms. While the proposed expansion of trading rights to foreign firms would represent a degree of liberalization, it would not address the issue of how firms or individuals who are not established in China could import products. Additional details on how China will implement its commitments on trading rights are being discussed in the WTO accession negotiations.

Local Agents Requirements

China severely limits the ability of foreign firms to market their products effectively. Restrictions have also retarded the development of a functional nationwide distribution system in China. In general, foreign firms are only allowed to distribute products that they manufacture in China. Foreign firms are forced to engage local agents to distribute imported goods. At present, most domestic distributors operate only within a small geographical area. China agreed to eliminate such distribution restrictions as part of its WTO accession.

Import Substitution Policies

Foreign businesses in China face import substitution policies, both informal and formal. While there have been improvements in this area since the early 1990's, instances where China's Government has continued to encourage import substitution still occur. Recent examples include:

Chemical Inputs. A U.S. investor reported in early 2000 that a contract to build an insecticide production facility in central China was held up due to local government requirements that all product inputs be produced in China.

Generic Medicines. In an effort to protect the domestic pharmaceutical industry while lowering prices, China banned the import of nine generic medicines in 1999.

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

Pharmaceutical Pricing. State Council regulations set pricing formulas for imported pharmaceuticals based on whether domestic substitutes exist. The regulations also impose restrictions on profits earned on sales of imported medicines based on whether a domestic substitute exists.

Power Generation. The Chinese Government announced in 1998 that power generation facilities of 600 MW or smaller could not use imported equipment.

As part of its accession to the WTO, China had agreed to eliminate local content requirements and said it will not condition import or investment approvals on whether there are competing domestic suppliers or performance requirements, such as local content, offsets, technology transfer, or the conduct of research and development in China.

STANDARDS, TESTING, LABELING AND CERTIFICATION

It is often difficult to ascertain what inspection requirements apply to a particular import, as China's import standards are not fully developed and often differ substantially from requirements imposed on domestic goods. The United States and other countries have complained that safety and inspection procedures applied to imports are more rigorous and expensive than those applied to domestic products. Furthermore, standards testing and inspection for domestic and imported goods are carried out by separate entities, which sometimes overlap. Once an imported product is on the market in China, it is subject to the conformity assessment requirements of the domestic standards and conformity assessment agency, China State Bureau of Quality and Technical Supervision. Imported goods – especially medical equipment and devices – also often face "double checking": they must be tested (at a price) by both the CIQ and by domestic testing entities. Foreign suppliers have also had difficulty in learning exactly by whom and how inspections are conducted.

The U.S. processed food industry has registered its concerns on a number of standards and labeling requirements that exist for its exports to China. These include restrictive shelf life, food additive and microbiological standards, as well as burdensome production registration and approval regimes. In particular, the U.S. industry has cited China's implementation of a label approval law last year that will likely result in delayed shipments to China. Similarly, the distilled spirits industry is concerned that its products will be required to comply with all existing food labeling regulations, which it believes would be inappropriate to apply to its products. Other U.S. industries, such as the solid woods industry, are similarly concerned that China's decision not to recognize U.S. standards or testing methods hinders their ability to export goods to the Chinese market.

Inspection Standards

Chinese law provides that all goods subject to inspection by law or according to the terms of a contract must be inspected prior to importation. China maintains statutory inspection requirements known as "conformity assessment procedures" on about 800 imported goods and an even greater number of exported products. Chinese buyers or their purchase agents must register for inspection of imported goods at the port of entry. The scope of inspection includes quality, technical specifications, quantity, weight, packaging, and safety requirements.

Quality Licenses

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

Safety Licenses

China also imposes safety licensing requirements on certain products under the terms of the "Import and Export Commodity Inspection Law" of 1989. In addition, national health and quarantine regulations require a product safety sticker on imported (but not domestic) food items. Importers are charged

between five and seven cents for each of these stickers.

Major problems with China's safety licensing system include the lack of transparency and national treatment, and the difficulty of determining relevant standards. Examples include:

Electronic Products. On January 1, 1999, China imposed mandatory safety inspections for imports of electronic products, including personal computers, monitors, printers, switches, television sets, and stereo equipment. As of January 1, 2000, an additional safety test for electromagnetic compatibility (EMC) was added for these same products. Starting January 1, 2001, China will also require an import commodity safety license. CIQ would like to expand the list of electronic products subject to EMC testing.

Phytosanitary and Veterinary Import Quarantine Standards. China's phytosanitary and veterinary import standards are sometimes based on dubious scientific principles and are not always evenly applied. For instance, China currently prohibits access for U.S. exporters of softwood lumber for packaging, fresh potatoes, avocados and peaches for phytosanitary reasons. Nonetheless, China has made some progress in recent years. China has signed several bilateral protocols with the United States governing the import of agricultural items including live horses, apples, ostriches, bovine embryos, swine, cattle, cherries, bovine and swine semen, and grapes. However, for grapes, the U.S. industry remains concerned that China's medfly trapping requirements for such products from California require more than existing U.S. government trapping programs. As part of its bid to join the WTO, China lifted its longstanding barriers on imports of U.S. grain, citrus, and meat and poultry with the signing of the Bilateral Agricultural Cooperation Agreement (ACA) in April 1999. The major provisions of the agreement are as follows:

Meat. China agreed to recognize the U.S. certification system for meat. China will 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. China recently added more counties in the four states mentioned above to the list of approved export origins.

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

In 2000, China began implementation of the ACA; results have been mixed. Citrus imports proceeded from the approved counties, but China delayed before adding additional fruit-fly free counties, as required in the ACA. CIQ approved Pacific Northwest barley imports, but importers reported that quarantine officials applied unnecessary requirements to shipments. Adding new burdens for importers, China introduced a number of new import requirements for poultry. Trade officials have committed to resolving these issues expeditiously in order to demonstrate China's dedication to upholding its international commitments.

GOVERNMENT PROCUREMENT

China is not a member of the WTO Agreement on Government Procurement (GPA), but has expressed an interest in reviewing the possibility for GPA membership sometime after accession to the WTO. Government procurement in China has for many years been an opaque and

noncompetitive process. Even when procurement contracts have been open to foreign bidders, such suppliers have often been discouraged from bidding by the high price of participation. The Chinese government has routinely sought to obtain offsets from foreign bidders in the form of local content requirements, technology transfers, investment requirements, countertrade, or other concessions. For example, regulatory officials have on occasion advised foreign equipment suppliers that they need to transfer technology, establish a joint venture with a local partner, and/or establish manufacturing facilities if they wish to supply equipment to China for certain new telecommunication services. Sometimes, regulatory officials have gone so far as to demand the commercial terms of such technology transfer agreements, which is totally outside the purview of their stated responsibilities. These informal requirements serve as administrative barriers to trade. In addition, payment in foreign exchange is not always guaranteed.

Many Chinese officials are beginning to recognize that by not allowing an open and competitive bidding process for government contracts, China is paying too much. The "Provisional Procedures for the Administration of Government Purchases" – issued by the State Council in 1999 – China's first national law regulating government procurement practices – contained language aimed at relaxing restrictions on foreign participation. It is intended as an interim measure; work on a permanent law is ongoing in the Financial Committee of the National People's Congress. The "provisional procedures" are intended to establish a regulatory framework while work on an omnibus law continues. The interim regulations appoint the Ministry of Finance (MOF) and the provincial and municipal finance bureaus as the governing agencies in the administration and supervision of government procurement. The new regulations call on all government procurement offices to "follow the principles of openness, fairness, equality, effectiveness, and safeguarding of the public interest." The new regulations established rudimentary criteria for the qualification of domestic and foreign suppliers and various categories of procurement, including open tenders, tenders by invitation, competitive negotiation, and sole sourcing. The regulation also set broad standards for publicity, notification, bid scheduling, sealed bidding and bid evaluation. Existing contracts will be grandfathered under the new regulations.

On January 9, 2001, the Ministry of Finance (MOF) issued a document titled "Procedures Concerning Public Bidding for Procurement Companies in Foreign Government Loan Projects." According to the document, the MOF promises to investigate any procurement company suspected of monopolizing the bidding process. The procedures stipulate that financial departments must release all pertinent information regarding qualified foreign government loan projects to procurement companies. Companies responsible for implementing a project must tender bid invitations to more than three procurement companies within 10 working days. If fewer than three companies end up applying for bids, the project must begin again and tender new bids. The entity responsible for offering bids must keep all information that appears in the application forms submitted by procurement companies confidential until after the results of the bidding have been announced.

The procedures stress that noncompetitive or protectionist ploys are strictly prohibited while selecting a procurement company for a loan project. Within any given calendar year, any midlevel company that wins more than 50 percent of that year's loan-project bids may be considered to have "monopolistic inclinations."

Similarly, any local company that wins more than 60 percent of a year's bids in a province, autonomous region, municipality directly under the central government, or in a city with independent planning where the bidding company happens to be located, will be regarded by authorities as having "monopolistic inclinations." The MOF will regularly examine bids put out for loan projects and promises to restrict procurement companies with "monopolistic inclinations".

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

Discrimination in government procurement has a larger effect on trade in China because of the incomplete reform of China's state-owned sector. Many enterprises that would, in other economies, be in private hands are still SOEs subject to government procurement restrictions. For example, a significant share of trade in electronics (often by identified "national champions") is conducted by state-owned firms. In general, the SOEs are bound by China's government procurement practices. However, China has agreed that, after accession to the WTO, commercial transactions conducted by state-owned enterprises will not be deemed government procurement. Accordingly, WTO rules will apply to these transactions.

EXPORT SUBSIDIES

China officially abolished direct budgetary outlays for exports on January 1, 1991. Nonetheless, it is widely believed that many of China's manufactured exports receive other types of export subsidies. These other export subsidies are difficult to identify and quantify since they are most often the result of internal administrative measures and not publicized or they may be provided through mechanisms such as credit allocations or low-interest loans. Other forms of export subsidies involve guaranteed provision of energy, raw materials or labor supplies. U.S. industry has expressed its concern that China is subsidizing such goods as soda ash, fiber glass, auto glass, steel, and flat glass through export and other subsidies. MOF officials claim that the government's financial situation is such that it can no longer afford large-scale export subsidies. China has agreed to stop all industrial export subsidies once it becomes a member of the WTO.

Exports of some agricultural products, such as corn and cotton, still benefit from direct export subsidies. However, China substantially reduced the level of corn export subsidies in 1999 and 2000. Some provincial leaders are pressing the central government to raise subsidies again, but tighter domestic supplies make substantial export subsidies before WTO entry unlikely. After WTO entry, China is prohibited from subsidizing agricultural exports.

*Export requirements***.** Export requirements are imposed on state trading companies and foreign-invested enterprises. This practice has tended to encourage trading companies to over-export, even if doing so is not viable on purely commercial grounds. The ensuing financial losses are often covered by state commercial banks when loans are not repaid.

Tax incentives. Preferential tax incentives are another example of export subsidies. China is attempting to harmonize the system of taxes and duties it imposes on enterprises, domestic and foreign alike. As a result, preferential tax and duty policies that benefit exporters in special economic zones and coastal cities have been targeted for revision. A weakening domestic economy during the late 1990s delayed some of these revisions, since the government was unwilling to impose measures that might reduce exports. An early 1999 experiment in eliminating certain tax rebates for exporters located in special economic zones was abandoned after protests from domestic and foreign export firms.

INTELLECTUAL PROPERTY RIGHTS PROTECTION

China has made substantial progress in some aspects of intellectual property rights (IPR) protection since it signed agreements with the United States on IPR in 1992, 1995 and 1996. However, significant problems remain. In 2000, China improved its legal framework considerably, and is further revising its copyright and trademark laws to bring them into full compliance with TRIPS (Agreement on Trade-Related Aspects of Intellectual Property Rights).

A major nationwide anti-counterfeiting campaign was initiated in October 2000. Furthermore, there is a new focus on IPR as a 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. China's highest executive body, the State Council, issued a strategy paper on high-tech development at the end of June. The paper repeatedly admonished organizations against the use of unauthorized software. The Beijing International Book Festival featured an entire section of books on IPR-related issues.

Inadequate procedures for registering patents, trademarks, and copyrights continue to hinder foreign companies attempting to operate in China. Moreover, poor enforcement of existing laws and regulations, combined with weak punishments, mean that IPR violations are still rampant. Pirating is sophisticated and widespread: pirates find ways to get digital copies of blockbuster films and computer programs into the Chinese market almost immediately after they are released in the United States. Knock-off consumer products are readily available almost everywhere in China, and consumers are often unaware that they are purchasing IPR-infringing goods.

Patents

On August 25, 2000, China's National People's Congress passed a revision of China's patent law. The revised law strengthens patent protection, simplifies patent examination and issuance procedures, and adjusts the law to make it conform more closely to TRIPS provisions. Patent administrations may now confiscate income from infringing products and fine violators. State-owned and non-state-owned enterprises have the same patent rights. TRIPS-related modifications include a prohibition on advertising or marketing of infringing products, judicial review of patent revocations, and a provision allowing a patent holder to request immediate suspension of potentially infringing acts before requesting a formal legal determination. Chinese patent office officials believe the revised law is in full compliance with all TRIPS requirements. U.S. legal experts are still studying the revised law.

Despite the revision, U.S. pharmaceutical companies continue to experience difficulties in obtaining protection for their products. It can take months for an application for administrative protection of a foreign pharmaceutical in China to be approved. Under regulations enacted in 1994, domestic imitation or similar pharmaceuticals can legally be registered while a foreign manufacturer's application for administrative protection is pending. In some cases, administrative protection is never forthcoming. In July, China's State Drug Administration turned down applications for administrative protection for two "blockbuster" pharmaceuticals. Some company executives assert the drugs were denied protection because of their huge market potential. They claim the State Drug Administration used a new and questionable interpretation of regulations to justify the denial.

Trademarks

Counterfeiting, especially of brand name products, remains prevalent; according to Chinese Government and U.S. industry reports, the problem is growing worse. An executive of a large U.S. consumer products company recently complained that in the first five months of 2000 it had seized more fake product than in the preceding two years. Another U.S. executive noted that China had become a major exporter of counterfeit products to Russia, Europe, North America and South America. While regional and interagency cooperation on IPR protection has improved, it is still inadequate. Insufficient administrative sanctions and infrequent use of criminal sanctions remain major enforcement problems.

On June 30, 2000 the State Council Development and Research Center (DRC) publicized a report highlighting the seriousness of trademark violations in China. The report estimated that counterfeiters flooded China with over US $16 billion of fake goods in 1998, and claimed the problem was getting worse. Of the 146 Chinese and foreign firms surveyed, 80 percent said counterfeiting had a negative effect on their investment plans. The report attributed the worsening counterfeiting problem to slack law enforcement, inadequate punishments, and lack of respect for the law. The report received wide media coverage – more than 30 articles appeared in the Chinese press.

One of the report's authors claimed it led to the mid-June revision of China's product quality law. The revision allows for tougher punishment against producers and sellers of fake and shoddy goods. Enforcement agencies can now order inspections, demand business transaction documents, and confiscate counterfeit products. To stop local officials from obstructing enforcement actions, the law added detailed provisions on the responsibilities of local government officials. The law, however, does nothing to facilitate criminal prosecutions of counterfeiters. Guangdong Province's anti-counterfeiting law provides tougher economic sanctions than the national laws.

In a further strike against counterfeiters, on October 26 Vice Premier Wu Bangguo called on all provincial leaders to conduct an intensive three month campaign against counterfeit products. In response to IPR industry praise for the campaign, together with recognition of the need for a more sustained effort, China extended the anti-counterfeiting campaign. A new national anti-counterfeiting coordination committee will report directly to Vice Premier Wu. The State Council circular announcing the campaign specifically identified cases reported by foreign-invested enterprises as a major target of the campaign. Initial U.S. business reaction was positive, with the proviso that the campaign should continue and that China should continue

legal reforms and make more use of criminal sanctions.

A shortage of agents authorized to accept trademark applications from foreign companies makes it difficult for foreigners to register trademarks. The lack of clear procedures to protect well-known unregistered trademarks also makes it extremely difficult to oppose or cancel well-known marks registered by an unauthorized party. In addition, criminal and civil penalties for most kinds of counterfeiting remain too low to deter counterfeiting. At present, there are no procedures that allow aggrieved parties to take civil action during criminal prosecution of a counterfeiter, delaying opportunities to seek civil redress. Enforcement has also been a problem.

Internet domain name piracy is a new IPR problem. In November 2000, a Chinese court ruled that China's trademark law also protects trademarks on the Internet. However, current standards for resolving these disputes are inadequate and must be revised to allow for the cancellation of a trademarked name.

Copyrights

China is gradually recognizing the threat copyright infringement poses to economic development. In September 2000, a Ministry of Information Industry (MII) research group published the results of a year-long review of China's software industry. Over one-fourth of domestic Chinese software companies identified piracy as the main obstacle to their future development. They singled out "end-user copyright infringement" as the domestic software industry's main enemy, followed by "pirated software production" and "pirated software sales."

State Council Document Number 18, Article 34, called for a concerted anti-piracy crackdown effort in the second half of 2000, led by public security authorities and including all relevant ministries. As part of this campaign, MII released new regulations in December 2000 allowing $600 to $6,000 in compensation for each piece of infringed software. In one of China's first actions against end-user piracy of business software, an IPR court in Shanghai ordered a surprise software audit at a Chinese company that had been warned previously against using unauthorized software. The case was later settled out of court.

Likewise, China is taking action against music and video piracy. On July 12, 2000 Chinese and foreign record companies jointly issued a "declaration on protecting copyright and opposing piracy." The 12 record companies announced a campaign against violations of music copyrights on the Internet and listed offending websites in China. In late July, some 630 Anti-Pornography and Piracy officials – in the largest anti-piracy operation in China to date – destroyed seven illegal optical disk production lines and arrested 23 suspects who will be charged under China's Criminal Law. Individuals who assisted in uncovering these underground operations received cash awards. The raids confirmed the presence of DVD production lines in China, a development long feared by the U.S. film industry.

China's growing interest in copyright enforcement aside, there are still profound problems. The software industry lacks clear procedures for addressing corporate end-user software piracy, which continues to cost U.S. companies millions of dollars each year. U.S. software companies have asked the Copyright Administration to issue guidelines for administrative enforcement against this problem.

There is also no noticeable improvement in the market for books and journals in China, with

piracy hampering development of the legitimate market. Industry remains concerned that despite the small, but growing number of publicized actions and fines, piracy of U.S. works continues unabated. According to industry figures, U.S. publishers lost an estimated $130 million to book piracy in China in 2000, continuing a trend of increasing losses over the past few years.

Beyond the piracy problems all content providers in China face, foreign companies are saddled with additional burdens. While domestic copyright owners can deal directly with local copyright bureaus, foreign copyright owners wishing to pursue copyright infringement issues must go through the National Copyright Administration in Beijing. This procedure results in lengthy delays and goes against the principal of national treatment. China has agreed to eliminate this discriminatory requirement when it becomes a WTO member. Regulations on the use of copyright agents by foreign companies have not been finalized; this effectively prevents foreign companies from using agents to license copyrighted works. In addition, U.S. companies report that, to get copyrights enforced, they often must provide resources to China's under-staffed, under-funded enforcement agencies.

ELECTRONIC COMMERCE

China has experienced noticeable growth in Internet usage and e-commerce. The number of people with access to the Internet exceeded 22 million in 2000. Worldwide, Chinese is now the second most used language on the Internet after English. A fall in personal computer prices and the arrival of information appliances tailored for the Chinese market will further expand Internet access.

A government-sponsored nationwide survey found that China had more than 1,100 consumer-related e-commerce websites in early 2000. More than 800 are shopping websites; 100 are auction websites; 180 are distance education websites; and 20 are distance medical and health-related websites. Among the shopping sites, 34 percent also had traditional retail businesses, while 66 percent were pure online shops.

The Chinese government recognizes the potential of e-commerce to promote exports and increase competitiveness. However, the lack of a comprehensive regulatory framework, including laws clarifying online obligations and "rules of the road," has inhibited online growth. In 2000, China made some progress toward establishing such a regulatory environment. The government promulgated the Procedures for the Examination and Approval of Securities Companies for Engaging in Online Brokerage Activities, the Telecommunications Regulations of the PRC, and the Measures for Managing Internet Information Systems. In addition, China is drafting the China E-Commerce Strategic Development Framework and other regulations related to online advertising, e-commerce taxation, online banking, and Internet content.

Some of the Chinese ministries with responsibility for e-commerce have been too enthusiastic about regulating the Internet, thereby stifling the free flow of information and consumer privacy needed for e-commerce to flourish. Content is still controlled, and encryption regulated.

A number of technical problems also inhibit the growth of the industry. High connection rates charged by government-approved Internet service providers make Internet access unaffordable for most Chinese. Slow connection speeds are another major barrier. The lack of a safe and secure payment system requires that Internet transactions in China be

conducted on a cash-on-delivery basis or delayed by a ten- to fifteen-day verification period.

SERVICES BARRIERS

China's services sector has been one of the most heavily regulated and protected parts of the national economy. At present, foreign service providers are largely restricted to operations under the terms of selective "experimental" licenses. Strict operational limits on entry and restrictions on the geographic scope of activities severely constrain the growth and profitability of these operations.

Since China's services sector remains underdeveloped and current foreign participation in the market is minimal, it is difficult to estimate how much such barriers to market access represent in lost U.S. services exports. In some service sectors, such as insurance, even the most conservative estimates predict that total premiums will reach $15-30 billion in the next few years. If China were to lift completely barriers to market access in this sector, U.S. industry estimates that U.S. insurance providers could be expected to capture a portion of the Chinese market that could easily exceed $1-2 billion. In other services sectors, such as legal services, accountancy, and consulting, where potential revenues are likely to be more modest, the lifting of barriers to market access would still result in significant increases in U.S. exports of services.

The service commitments included in the bilateral WTO accession agreement would provide meaningful access of foreign businesses to the full range of services sectors. Those commitments address many of the barriers identified below.

Financial Services (Banking and Securities)

Foreign banks and securities firms continue to face a restrictive, opaque regulatory environment. The market access of foreign banks remains inadequate. The Bank of China enjoys a monopoly on forward foreign exchange contracts. Foreign banks' ratio of customer deposits to domestic loans may not exceed 40 percent. Foreign banks must place 3-5 percent of deposits in non-interest bearing deposits with the People's Bank of China (PBOC). Foreign branch current assets (cash, local bank demand deposits, and PBOC deposits) must be greater than 25 percent of customer deposits. Finally, China calculates prudential ratios and limits based on the local capital of foreign bank branches rather than on the capital base of the entire bank. On the securities front, foreign firms continue to be barred from underwriting or trading domestic stocks or bonds.

The year 2000 brought no dramatic changes in market access for foreign banks. China had been expected to include Tianjin Municipality among the jurisdictions where foreign banks may carry out local currency business, but access to Tianjin remains restricted. The regulations that limit the local currency business of foreign bank branches to Shanghai and Shenzhen remained unchanged. Although local banks may lend medium-term local currency funds to foreign banks, foreign banks are still restricted to taking local currency deposits from, and making local currency loans to, foreign investors registered in the specified geographic area. The liberalization of interest rates on the foreign currency loans and deposits of domestic banks had little impact on the business of foreign banks, but did signal China's continued commitment to gradual reform of its state-controlled financial system.

China has agreed to allow foreign banks to conduct local currency business with Chinese

companies two years after its WTO accession and with Chinese individuals five years after accession. During the first year of WTO membership, China will open two additional cities to foreign banks conducting Renminbi (RMB) business. Every year thereafter it will open four new cities to foreign banks. All non-prudential restrictions on foreign banks are to be removed five years after China's entry to the WTO.

Distribution

Distribution in China is largely reserved for domestic companies. Existing restrictions on distribution services limit the ability of foreign firms and importers to market to, service, and support their customers. In general, foreign importers have limited trading rights, cannot own or operate trucks or warehouses, and must sell and distribute their goods through state-sanctioned foreign trade corporations or import-export agents, who often impose huge markups on the final price.

Current law prohibits foreign companies with multiple operations in China from consolidating shipping and other distribution-related activities. Domestically-manufactured products must be sold, delivered and serviced separately from imported products. These regulations prevent foreign enterprises from selling products from other domestic sources, even when the products concerned are related. These requirements create redundant systems and increase costs for foreign firms. The Chinese have promised to open the distribution sector to foreign firms as part of their WTO accession package. After a phase-in period of three years, foreign enterprises will be able to engage in the full range of distribution services for almost all products.

Retailing

Regulations broadening the scope for foreign investment in the retail sector were announced in June 1999. The regulations aimed at encouraging the development of large retail chain stores along the Wal-Mart model. It was widely believed they were intended as a solution to the moribund condition of many state-owned department stores. The regulations encourage the entry of large international retailers into the Chinese market.

The regulations require foreign investors to have maintained an average annual volume of merchandise sales of at least $2 billion during the three years prior to the application for permission to operate in the Chinese market. They also require the foreign investor to have $200 million in assets. These requirements effectively eliminate medium- and small-sized retailers from participation in the Chinese market. The regulations require chain stores with fewer than three outlets to have minimum local equity ownership of 35 percent; chains with more than three outlets are required to have local equity ownership of no less than 51 percent.

Pyramid schemes operated by a number of direct sales companies, both domestic and foreign, led to a government ban in 1998 on direct sale retailing in China. This severely affected several legitimate U.S. companies that had substantially invested in this sector in the early 1990s. In 1999, some activities were resumed and China has agreed to permit direct selling within three years after accession to the WTO.

Telecommunications

China has made significant progress in increasing competition in telecommunications services over the past few years. China has separated post and telecommunications

services, separated policy and regulatory functions from operator functions, developed a telecom law, and lowered connection costs. The government has split the former state-owned monopoly telecommunications services provider, China Telecom, into separate national telecom services providers. There are currently seven national basic telecommunications companies: China Telecom, China Unicom, China Mobile, China Satellite, Jitong, China Netcom, and Railcom. Reports in the official media state that China Railway Telecom (Railcom) also received a license to provide fixed-line voice and data transmission services in January 2001.

China's new telecommunications regulations, passed this year, allow for interconnection, cost-based pricing, universal service, and foreign investment, and stipulate licensing authority and procedures. However, these regulations are generally vague and lacking in specific and necessary details. For instance, there is no mention of basing prices on long-run incremental costs for interconnection. Rules covering foreign direct investment are pending. At present, except for a few "experiments", there is no direct foreign investment or equity control in telecom services. However, this is expected to change after China joins the WTO.

Progress in opening the market for value-added services – such as Internet service and content providers – has been less clear. The Ministry of Information Industry (MII) has taken an activist posture in updating existing policies. This year the MII announced moves towards convergence in voice, video and data services. China, however, considers communications and information content sensitive, so foreign companies face significant barriers in the Internet services sector. For example, last year China issued a total ban on foreign capital investments in Internet Content Providers (ICPs). The definition of websites as "value-added telecom service" hinders foreign companies from owning China-based websites, even if only for the sole purpose of promotion of their own businesses. The requirement that Internet Service Providers (ISPs) must provide user log-in information and transaction records to authorities upon request, without clear guidelines as to the circumstances and situations that warrant such actions, raises concerns about consumer privacy and prevention of the misuse of data.

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

Insurance Services

The need for a sound regulatory environment and improved solvency among insurance firms has led to gradual reforms in China's insurance industry. The Chinese government passed a new insurance law in 1993 and formed the China Insurance Regulatory Commission in 1998 to oversee the development of the industry in China. The domestic insurance market was opened on an experimental basis to foreign insurers in 1992.

Currently, 16 foreign insurers are licensed to operate in China, mainly in Shanghai or Guangzhou. Decisions on whether to grant additional licenses to foreign insurers have been arbitrary. Foreign insurers are at present not permitted to participate in the group, health, pension, and insurance brokerage markets.

China has indicated that, after WTO accession, it will allow foreign firms to access the Chinese insurance market based solely on prudential criteria, with no economic needs test or quantitative limits on the number of licenses issued. Foreign participation will be allowed in life and non-life sectors, and eventually pension, health, group, reinsurance, and brokerage markets, among others. China has agreed to open the Shanghai and Guangzhou markets upon its WTO accession, add 12 additional major cities within two years after accession, and to eliminate all geographic restrictions within three years of accession. Internal branching will be permitted, consistent with the phase-out of geographic restrictions. China has committed to allow life insurers 50 percent joint venture partnerships upon WTO accession, and non-life insurers 51 percent joint ventures. Non-life insurers will be allowed 100 percent ownership within two years of accession.

Transportation and Logistics

Foreign transportation and logistics service providers face severe regulatory restrictions, high costs, dominance by government-invested agents, and limitations on the scope of activities they are permitted to undertake. The multiple government bodies responsible for this industry include: the State Domestic Trade Bureau, Ministry of Communications, Ministry of Railways, Ministry of Foreign Trade and Economic Cooperation, State Economic and Trade Commission, State Development Planning Commission, and Civil Aviation Administration of China. Overlapping jurisdictions, multiple sets of approval requirements, and opaque regulations hinder market access. Furthermore, government-approved transportation agents, many of which are also government-invested, use their connections to monopolize the industry. Current rules require that a wholly-owned foreign enterprise can only open a branch in another location if it has provided regular services to that city. This makes it impossible for shipping companies to open subsidiaries in inland ports.

Audiovisual Services

China's concerns about politically sensitive materials, and the desire to keep the monopoly rents earned by the state-owned importers and distributors, have led to restrictions in audiovisual services. 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. Distribution of sound recordings, videos, movies, books, and magazines is highly restricted. 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. There is currently a *de facto* quota of ten foreign films that can be imported on this basis each year. China's WTO commitments include allowing at least 20 foreign films annually into China on a revenue-sharing basis. China also agreed to open theaters and distribution to foreign investment. Imported films must be 35mm and include Chinese subtitles; all imported films must be reviewed and approved. Foreign films are banned during holidays and peak viewing seasons. Pirates find ways to get VCDs and DVDs of blockbuster films into the Chinese market almost immediately after the films are released theatrically in the United States.

Education and Training

China faces a shortage of qualified teachers and clearly needs educators in inland regions. However, the Ministry of Education (MOE) continues to restrict participation by foreign educators and trainers. China permits only non-

profit educational activities, and only activities that do not compete with the MOE-supervised nine years of compulsory education, thereby inhibiting much-needed foreign investment in the education sector. In April 2000, the MOE banned foreign companies and organizations from offering educational services via satellite networks. Universities may set up non-profit operations, but foreign universities must have a Chinese university host and partner to ensure that programs bar subversive content and localize imported information. China's training market is unregulated, which discourages potential investors from entering the market.

Legal Services

Foreign law firms are permitted to practice in one city only. Chinese law firms, on the other hand, have been able to open offices freely throughout China since 1996. Unlike their counterparts in other professional services – such as accounting, architecture and insurance – foreign law firms are not permitted to joint venture with Chinese law firms. Foreign attorneys may not take China's bar examination, and they may not hire registered members of the Chinese bar as attorneys. Foreign law firms are not allowed to perform any legal services involving Chinese law. They may only engage in legal services related to the laws of their home country and to international law.

The year 2000 brought some small changes. The State Administration of Taxation (SAT) for the first time permitted foreign law firm representative offices, unlike representative offices in other industries, to provide fee-based services to their clients. The SAT allowed foreign law firm representative offices to provide official tax invoices, allowing clients to claim legal expenses as tax deductions. WTO entry may provide some additional relief. China has agreed to lift the quantitative and geographical restrictions on the establishment of representative offices by foreign law firms effective within one year after China's accession to the WTO and to clarify the type and duration of the contractual relationships between foreign and Chinese law firms.

Accounting and Management Consultancy Services

Over the past year, the Chinese Institute of Certified Public Accountants (CICPA), a government body under the Ministry of Finance, has made significant progress in professionalizing accounting in China. The CICPA has delinked Chinese accounting firms from government agencies and acknowledged the preference to have the CICPA function more like a professional organization than a government agency. It has committed to improving the transparency of regulatory rules and rule making and promised to establish an advisory committee, with participation by international accounting firms. In an effort to raise the quality of accounting reports produced in China, CICPA launched a series of training initiatives, moved to close substandard firms, and reexamined existing licensing procedures.

Despite these positive changes, pervasive problems remain. China's accounting and reporting standards are not harmonized with international accounting standards (IAS). Furthermore, there are different accounting standards for state-owned enterprises, publicly listed companies, and foreign-invested enterprises. Chinese authorities do not yet permit qualified foreign individuals to become partners in domestic CPA firms or Chinese member firms of international organizations. Representative offices of foreign accounting firms are limited to providing consultancy services. Significant tax and foreign exchange disadvantages force firms that want to provide a full range of services to operate in China as joint

ventures with domestic firms. Such firms are often not managed to international standards.

China's entry into the WTO will remove the restriction on representative offices engaging in profit-making activities. For new entities providing taxation, management consulting, computer-related and software implementation services, operations must be conducted through joint ventures. Majority foreign ownership is permitted. Wholly-foreign owned operations will be permitted five years after accession.

Travel and Tourism Services

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

Out-bound individual tourism to the United States is banned because the United States has not signed a bilateral "Authorized Destination" agreement with the Chinese government. The restriction on out-bound tourism is estimated to deter travel by as many as 100,000 people per year. Group travel is tightly controlled by the Chinese National Tourism Administration (CNTA), a government organization, and channeled through government-owned travel agencies. All travelers originating in China must purchase tickets through a CNTA-licensed travel agency. U.S. carriers are not allowed to sell tickets directly to passengers. Even U.S. government travelers departing China on official orders must be ticketed by a CNTA-licensed agency.

Holders of Chinese quasi-official and official passports, approximately 80,000 of whom applied for U.S. visas in FY-2000, are required to use China's state-owned airlines. Most of these individuals (whose itineraries often consist largely of tourism) would not be considered government employees in most countries. This represents a significant loss of business for U.S. airlines.

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.

Foreign firms are restricted to representative offices or minority ownership of joint-venture operations. After its WTO accession, China will allow majority foreign ownership of joint venture advertising companies within two years and wholly-foreign owned subsidiaries after four years.

Construction Services

U.S. engineers, architects and contractors have enjoyed a relatively more 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. China sets extremely low design fees, rather than letting the market set prices. Currently, Chinese architecture and engineering firms must approve and stamp all drawings prior to construction. Foreign firms cannot hire Chinese nationals to practice architecture and engineering services as licensed professionals. Foreign contractors face severe partnering and bidding restrictions. In addition,

China does not have adequate lien laws to protect the rights of engineers, architects, contractors, and material suppliers from non-payment.

INVESTMENT BARRIERS

Foreign investors show interest in China despite significant obstacles. These barriers to investment include opaque and inconsistently enforced laws and regulations and lack of a rules-based legal infrastructure. China's leadership has reaffirmed its commitment to "further open" China to investment and to continue movement towards a rules-based economy. In September 2000, State Councilor Wu Yi posited, "We should enrich and improve the laws, regulations and policies related to foreign investment while enhancing the efficiency and service of government agencies to create a better environment for foreign investment."

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

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 lack transparency. Uncertainty as to which industries are being promoted as investment targets, and how long such designations will be valid, undermines confidence in the investment climate. In 2000, China again published revised lists of sectors in which foreign investment would be encouraged, restricted or prohibited.

Nonetheless, China has taken some steps towards improving the investment climate. The government announced a series of measures in August 1999 that began to decentralize investment approval decisionmaking authority and create new incentives for investments in key sectors and geographic regions. New guidelines allow authorities at the provincial level of government to approve "encouraged" foreign-invested projects.

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. Over the past five years, China has introduced new incentives for investments in high-tech industries and in the less-developed central and western parts of the country.

Investment Restrictions

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

China might restrict investment in order to: protect domestic industries, such as the services sector; guard national and domestic security; limit imports of luxury products; or avoid redundancy or excess capacity.

There are numerous examples of investment restrictions. For example, China bans investment in many telecommunications services, as well as 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. Investment in service industries such as banking, insurance, and distribution are limited because China fears that foreign suppliers would quickly dominate inefficient local companies. Many investments are restricted under the guise of avoiding excess capacity.

Other Investment Issues

Designated Enterprises: Designation of key state enterprises in many industries, in particular the high tech sector, as the exclusive base for the development of critical technologies, limits the choice of joint venture partners. Such designated partners are sometimes unattractive for various business reasons such as lack of experience, inappropriate staffing levels, or weak finances.

Venture Capital: There are currently no laws or regulations that define the legal and organizational structures for domestic private equity funds. Chinese laws concerning foreign private equity firms set limits on corporate structure, share issuance and transfers, and investment exit possibilities. For example, China has no regulations allowing issuance of preferred stock or options. The difficulty of listing on China's stock exchanges, coupled with the bureaucratic approval required to list overseas, limits interest in establishing China-based venture capital firms. As a result, most foreign private equity investments in China are actually housed in offshore investment entities. On October 11, 2000, the Shenzhen municipal government promulgated local interim venture capital regulations aimed at clarifying foreign investors' legal footing, but there are still no national-level laws.

WTO Obligations on Investment

Upon accession, China has promised to implement the WTO Agreement on Trade-Related Investment Measures (TRIMs), eliminate export performance and local content requirements on foreign investors and not enforce contractual provisions on these matters, and only impose or enforce laws related to the transfer of technology if they are in accordance with WTO rules. China also agreed not to condition investment or import approvals on performance requirements of any kind, including: local content requirements, offsets, transfer of technology, or requirements to conduct research and development in China. Notwithstanding the above, concern exists that the government may impose more obligations, perhaps unofficially, to continue such requirements in exchange for extra-legal, quid-pro-quo decisions by government officials at both the national and sub-national level. In the past, these measures have often been used to obtain transfers of technology from foreign firms.

ANTI-COMPETITIVE PRACTICES

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

and inconsistent local and provincial enforcement.

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

OTHER BARRIERS

Legal Framework

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

This lack of a clear and consistent framework of laws and regulations is an effective barrier to the participation of foreign firms in the domestic market. Although China is moving toward a rule of law, many gaps exist. A comprehensive legal framework, coupled with adequate prior notice of proposed changes to laws and regulations, and an opportunity to comment on those changes, greatly enhances business conditions, promotes commerce, and reduces opportunities for corruption.

In China, regulations are promulgated by a host of different ministries and governments at the provincial and local levels, as well as by the National People's Congress. As a result, regulations are frequently at odds with each other. Even though laws and regulations are now routinely published in China, they often leave room for discretionary application either through honest misunderstanding or through selective application or are ignored outright. Officials have sometimes selectively applied regulations against foreign firms.

Dispute Resolution

Skepticism about the independence and professionalism of China's court system and the enforceability of court judgments and awards remains high in the international community. There is a widespread perception that judges, particularly outside China's big cities, are more influenced by local political or business pressures than they are by written regulations or signed contracts. Few judges have any legal training. This has often caused both foreign and domestic companies to avoid enforcement actions through the Chinese courts. The Chinese Government is moving to establish consistent and reliable mechanisms for dispute resolution through the adoption of improved codes of ethics for lawyers and judges and increased emphasis on the consistent and predictable application of laws. The China International Economic and Trade Arbitration Commission (CIETAC) has become, over a short time frame, an effective forum for the arbitration of trade disputes. CIETAC's policies to approve foreign professionals to act as arbitrators and streamline procedural requirements to allow for timely resolution of disputes have been well received by the foreign business community. The business community continues to press, however, for improvements in CIETAC rules, including increased flexibility in choosing arbitrators and enhanced procedural

rules to ensure orderly and fair management of cases.

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

Selective Application

Government bureaucracies have sometimes been accused of selectively applying regulations. China has many strict rules which 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 unfavored investors or make special demands on such investors simply by threatening to wield such power.

Labor and Benefits

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

The cost of labor is low in much of China, but higher in the East and Southeast coastal areas where foreign investment is concentrated. This is due in part to the high demand for skilled labor in these areas, including intense competition for a limited supply of technical and professional manpower. However, higher labor costs are also due to artificial limitations on labor mobility. This is particularly the case where regulation and practice make it difficult for people to resettle outside their home areas. China is gradually easing restrictions on some internal labor mobility, but many are still bound by a household registration system that severely limits schooling and housing possibilities for internal migrants. When government-mandated benefits and subsidies are factored in, labor costs in the coastal areas of China sometimes exceed those for comparable positions in other Asian countries.

Corruption

Chinese officials admit that corruption is one of the most serious problems the country faces. China arrested hundreds of government officials in an ongoing anti-corruption campaign. The execution last year of a former provincial vice governor and a vice chairman of the National People's Congress Standing Committee attested to the extent of the campaign and the severity of the problem. One smuggling and corruption scandal in the southern port city of Xiamen involved official complicity in approximately US $6 billion worth of consumer goods avoiding duties. China's entry into the WTO, which will greatly reduce tariff barriers to imports, will significantly reduce incentives for smuggling and the attendant corruption. Most other official graft in China involves misappropriation of funds, abuse of power, and embezzlement.

China promulgated its first law on unfair competition in December 1993, and the government continues to call for improved self-discipline and anticorruption initiatives at all

levels of government. However, it remains the case that contracts are often not awarded solely on the basis of commercial criteria. U.S. suppliers complain that the widespread existence of such practices in China puts them at a competitive disadvantage. This dilemma is less severe in sectors where the United States holds clear technological preeminence or cost advantages. Corruption nevertheless undermines the long-term competitiveness of both foreign and domestic entities in the Chinese market.

Smuggling

Since Beijing implemented an anti-smuggling campaign in the summer of 1998, more goods have entered China legally, resulting in skyrocketing customs revenues. China's tariff revenues hit a record US $24 billion for the first 11 months of 2000, up 36 percent from the 1999 figure. Over 10,000 smuggling cases, involving US $89 million, were concluded in the first 10 months of 2000, with nearly 3,670 suspects charged under Chinese customs law.

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

Land Issues

Constitutional prohibitions against private land ownership, as well as complex regulations on land usage, can complicate efforts by foreign investors to establish operations in China. By law, urban land is owned by the State, while rural and suburban land is owned by collectives, i.e., residents of the local village or township. The State and collectives can either "grant" or "allocate" land usage rights to enterprises in return for payment. Enterprises that are granted usage rights are guaranteed compensation if the State or collectives expropriate the land, while those with "allocated" usage rights are not. Granted usage rights, of course, cost more than allocated rights.

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.