

CHINA

TRADE SUMMARY

The U.S. goods trade deficit with China was \$256.3 billion in 2007, an increase of \$23.7 billion from \$232.6 billion in 2006. U.S. goods exports in 2007 were \$65.2 billion, up 18.2 percent from the previous year. Corresponding U.S. imports from China were \$321.5 billion, up 11.7 percent. China is currently the third largest export market for U.S. goods.

U.S. exports of private commercial services (*i.e.*, excluding military and government) to China were \$10.9 billion in 2006 (latest data available), and U.S. imports were \$7.2 billion. Sales of services in China by majority U.S.-owned affiliates were \$5.5 billion in 2005 (latest data available), while sales of services in the United States by majority China-owned firms were \$324 million.

The stock of U.S. foreign direct investment (FDI) in China was \$22.2 billion in 2006 (latest data available), up from \$17.0 billion in 2005. U.S. FDI in China is concentrated largely in the manufacturing, wholesale trade, and nonbank holding companies sectors.

When China acceded to the World Trade Organization (WTO) on December 11, 2001, it committed to implement a set of sweeping reforms over time that required it to lower trade barriers in virtually every sector of the economy, provide national treatment and improved market access to goods and services imported from the United States and other WTO Members, and protect intellectual property rights (IPR). Six years later, the deadlines for almost all of China's commitments have passed and China is no longer a new WTO Member. Accordingly, the United States has been working to hold China fully accountable as a mature member of the international trading system, placing a strong emphasis on China's adherence to WTO rules.

Prodded by the United States and other WTO Members since acceding to the WTO, China has taken many impressive steps to reform its economy, making progress in implementing a broad set of commitments that required it to reduce tariff rates, eliminate nontariff barriers, provide national treatment and improved market access to goods and services imported from the United States and other WTO Members, improve transparency and protect IPR. Although not complete in every respect, China's implementation of its WTO commitments has led to significant increases in U.S.-China trade, including U.S. exports to China, while deepening China's integration into the international trading system and facilitating and strengthening the rule of law and economic reforms that China began nearly three decades ago. However, more still needs to be done.

In 2007, U.S. industry began to focus less on the implementation of specific commitments that China made upon entering the WTO and more on China's shortcomings in observing basic obligations of WTO membership, as well as on Chinese policies and practices that undermine previously implemented commitments. At the root of many of these problems is China's continued pursuit of problematic industrial policies that rely on excessive Chinese government intervention in the market through an array of trade distorting measures. This government intervention, evident in many areas of China's economy, is a reflection of China's historic yet unfinished transition from a centrally planned economy to a free-market economy governed by rule of law.

During the 15 years of negotiations leading up to China's WTO accession, the United States and other WTO Members worked hard to address concerns created by China's historic economic structure. Given the state's large role in China's economy, the United States and other WTO Members carefully negotiated conditions for China's WTO accession that would, when implemented, lead to significantly reduced

levels of government intervention in the market and significantly fewer distortions in trade flows. Through the first few years after China's accession to the WTO, China made noteworthy progress in adopting economic reforms that facilitated its transition toward a market economy. However, beginning in 2006 and continuing throughout 2007, progress toward further market liberalization began to slow. It became clear that some Chinese government agencies and officials have not yet fully embraced key WTO principles of market access, nondiscrimination, and transparency. Differences in views and approaches between China's central government and China's provincial and local governments also have continued to frustrate economic reform efforts, while China's difficulties in generating a commitment to the rule of law have exacerbated this situation.

In 2007, the United States intensified its frank bilateral engagement with China. The United States also took enforcement actions at the WTO in key areas where dialogue had not resolved our WTO-related concerns.

The United States brought three new WTO cases against China in 2007. In the first one, the United States challenged several prohibited subsidy programs benefiting a wide cross-section of China's manufactured goods. Constructive engagement during the dispute settlement process facilitated the resolution of this case, as the United States and China were able to reach agreement in November 2007 on the elimination of all of the prohibited subsidies at issue by January 1, 2008. The United States also filed a challenge to key aspects of China's IPR enforcement regime, along with a challenge to market access restrictions affecting the importation and distribution of copyright-intensive products such as theatrical films, DVDs, music, books, and journals. Each of these three WTO cases involves fundamental WTO obligations, as does the WTO case filed by the United States in 2006 challenging China's use of prohibited local content requirements in the automotive sector.

While pursuing these multilateral enforcement initiatives, the United States also pursued intensified, focused, bilateral dialogue with China. Working together, the United States and China pursued a set of formal and informal bilateral dialogues and meetings, including numerous working groups and plenary meetings under the auspices of the United States-China Joint Commission on Commerce and Trade (JCCT) and the United States-China Strategic Economic Dialogue (SED) launched in December 2006. Through these avenues, the United States sought resolutions to particular pressing trade issues and encouraged China to accelerate its movement away from reliance on government intervention and toward full institutionalization of market mechanisms. This bilateral engagement produced near-term results in several areas in 2007, including the suspension of overly burdensome testing and certification requirements for medical devices, the granting of biotechnology safety certificate approvals, increased insurance market access, expansion of the scope of permitted business for foreign banks and securities companies, and a new civil aviation agreement. On other pressing trade issues, the United States and China continue to work together in search of pragmatic solutions.

However, despite extensive dialogue, Chinese policies and practices in several areas continued to cause particular concern for the United States and U.S. industry in 2007, particularly in light of China's WTO commitments, as is detailed below and in the 2007 USTR Report to Congress on China's WTO Compliance. First, the lack of effective IPR enforcement remains a major challenge, as counterfeiting and piracy in China remain at unacceptably high levels and cause serious economic harm to U.S. businesses across the economy. Second, in a number of sectors, China has continued resorting to industrial policies that limit market access for non-Chinese origin goods and foreign service providers, and that offer substantial government resources to support Chinese industries and increase exports. Third, arbitrary practices by Chinese customs and quarantine officials can delay or halt shipments of agricultural products into China, while sanitary and phytosanitary (SPS) standards with questionable scientific bases and a lack of transparency in regulatory regime frequently cause confusion for traders in agricultural commodities. Fourth, while improvements have been made in some areas, in others such as banking,

insurance, telecommunications, construction and engineering, legal, and other services, Chinese regulatory authorities continue to frustrate efforts of U.S. providers to achieve their full market potential in China through the lack of transparency in its regulatory process and overly burdensome licensing and operating requirements. China has also imposed new restrictions on foreign providers of financial information services and it so far has failed to open up its market to foreign credit card companies. Fifth, transparency remains a core concern across industry sectors, as many of China's regulatory regimes continue to lack the necessary transparency, frustrating efforts of foreign and domestic businesses to achieve the full potential benefits of China's WTO accession.

Overall, while China has a significantly more open and competitive economy than 30 years ago, and China's WTO accession has led to the removal of many trade barriers, there are barriers to trade that have yet to be dismantled. The central government continues to implement industrial policies that protect a number of uncompetitive or emerging sectors of the economy from foreign competition. In many sectors, import barriers, opaque and inconsistently applied legal provisions and limitations on foreign direct investment, often combine to make it difficult for foreign firms to operate in China. In addition, some ministries, agencies, and government-sponsored trade associations have renewed efforts to erect new technical barriers to trade. Meanwhile, many provincial governments at times have strongly resisted reforms that would eliminate sheltered markets for local enterprises or reduce jobs and revenues in their jurisdictions, although they have also supported market access for other foreign investors that do not pose a threat to local vested interests.

To more fully meet its obligations as a responsible stakeholder in the world trading system, China will need to further institutionalize market-oriented reforms and eliminate mechanisms that allow government officials to intervene in the Chinese economy in a manner that is inconsistent with market principles. China should also take additional steps to make its trade regime more predictable and transparent. Despite its remarkable transformation over the past three decades, China continues to suffer from its command economy legacy, and Chinese government policymaking often operates in a way that prevents U.S. businesses from achieving their full potential in the China market. Through ongoing bilateral dialogues like the high level SED and JCCT, the United States is pushing China to accelerate its transformation into a more market-based economy.

IMPORT BARRIERS

Prior to its WTO accession in December 2001, China restricted imports through high tariffs and taxes, quotas and other nontariff measures, and restrictions on trading rights. Beginning in 2002, its first year in the WTO, China significantly reduced tariff rates on many products, decreased the number of goods subject to import quotas, expanded trading rights for Chinese enterprises and increased the transparency of its licensing procedures. Subsequently, China has continued to make progress by implementing tariff reductions on schedule, phasing out import quotas and expanding trading rights for foreign enterprises and individuals. Nevertheless, some serious problems remain, such as China's treatment of imported automotive parts and China's refusal to grant trading rights for certain industries that are listed in the following section.

Trading Rights

Prior to its WTO accession, China restricted the types and numbers of entities with the right to trade. Only those domestic and foreign firms with trading rights could import goods into, or export goods out of, China. Restrictions on the type and number of firms with trading rights contributed to systemic inefficiencies in China's trading rights system and created substantial incentives to engage in smuggling and other corrupt practices.

In 1995, liberalization of China's trading rights system began to proceed gradually. The pace accelerated in 1999 when the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), the predecessor to China's existing Ministry of Commerce (MOFCOM), announced new guidelines allowing a wide variety of Chinese firms with annual export volumes valued in excess of \$10 million to register for trading rights. In August 2001, China extended this regulation to allow foreign-invested firms to export their finished products. Import rights for foreign-invested firms were still restricted to the importation of inputs, equipment, and other materials directly related to their manufacturing or processing operations. Firms and individuals without trading rights, including foreign-invested firms with a manufacturing presence in China seeking to import products made outside of China, were required to use a local agent.

In its Protocol of Accession to the WTO, China committed to substantial liberalization in the area of trading rights. Specifically, China committed to eliminate its system of examination and approval of trading rights and to make full trading rights automatically available to all Chinese enterprises, Chinese-foreign joint ventures, wholly foreign-owned enterprises and foreign individuals, including sole proprietorships within 3 years of its accession, or by December 11, 2004, which was the same deadline for China to eliminate most restrictions in the area of distribution services. China further committed to expand the availability of trading rights pursuant to an agreed schedule during the first 3 years of its WTO membership.

Although China did not fully adhere to the agreed phase-in schedule in some instances, it put in place a registration system implementing the required liberalization of trading rights, both for Chinese enterprises and for Chinese-foreign joint ventures, wholly foreign-owned enterprises and foreign individuals, including sole proprietorships. This liberalization is reflected in China's revised Foreign Trade Law, issued in April 2004. It provides for trading rights to be automatically available through a registration process for all domestic and foreign entities and individuals, effective July 1, 2004, almost 6 months ahead of the scheduled full liberalization required by China's Protocol of Accession to the WTO. In June 2004, MOFCOM issued implementing rules establishing the procedures for registering as a foreign trade operator. U.S. companies have reported few problems with the new trading rights registration process.

In December 2004, as required by its Protocol of Accession to the WTO, China also ended its practice of granting import rights or export rights for certain products, including steel, natural rubber, wools, acrylic and plywood, only to designated enterprises. Any domestic or foreign enterprise or individual can now trade in these products.

Consistent with the terms of China's Protocol of Accession to the WTO, the importation of some goods, such as petroleum and sugar, is still reserved for state trading enterprises. In addition, for goods still subject to tariff-rate quotas (TRQ) such as grains, cotton, vegetable oils, and fertilizers, China reserves a portion of the in-quota imports for state trading enterprises, while it committed to make the remaining portion (ranging from 10 percent to 90 percent, depending on the commodity) available for importation through nonstate traders. In some cases, the percentage available to nonstate traders increases annually for a fixed number of years.

Meanwhile, however, China has not yet given foreign entities trading rights for the importation of copyright-intensive products such as theatrical films, DVDs, music, books, and journals. Under the terms of China's Protocol of Accession to the WTO, China's trading rights commitments appear to apply fully to these products, as they are not among the products for which China reserved the right to engage in state trading. As a result, trading rights for these products should have been automatically available to all Chinese enterprises, Chinese-foreign joint ventures, wholly foreign-owned enterprises, and foreign individuals as of December 11, 2004. Nevertheless, China continues to wholly reserve the right to import these products to state trading enterprises. As a result, in April, 2007, the United States filed a request for WTO dispute settlement consultations with China concerning market access restrictions in China on copyright-intensive products such as theatrical films, DVDs, music, books, and journals. The WTO panel was established in late November 2007 and the European Communities (EC), Japan, Korea, Taiwan, and Australia have joined as third parties.

Import Substitution Policies

Throughout the 1990s, China gradually reduced formal import substitution policies. When it acceded to the WTO, China agreed to eliminate all subsidies prohibited under Article III of the WTO Agreement on Subsidies and Countervailing Measures (Subsidies Agreement), including all forms of subsidies contingent on the use of domestic over imported goods. In its Protocol of Accession to the WTO, China also committed that it would not condition import or investment approvals on whether there are competing domestic suppliers or impose other performance requirements. In anticipation of this commitment, China enacted legal changes in 2000 and 2001 to eliminate local content requirements for foreign investments. Under the prevailing rules, however, investors are still "encouraged" to follow some of the formerly mandated practices. Instances in which the Chinese government has reportedly pursued import substitution or similar policies are described below.

Income Tax Preferences

Measures issued by the Ministry of Finance and the State Administration for Taxation (SAT) have made income tax preferences available to foreign-invested firms in connection with their purchases of domestically manufactured equipment. These refunds are not available in connection with purchases of imported equipment or equipment assembled in China from imported parts. A similar measure makes an income tax refund available in connection with domestic firms' purchases of domestically manufactured equipment for technology upgrading. However, China agreed in the Memorandum of Understanding signed with the United States to settle the prohibited subsidies WTO dispute and to end all of these preferences by January 1, 2008.

Automotive Parts

Before China's WTO accession, China's automobile industrial policy offered significant advantages for foreign-invested factories using high levels of local content. In 2001, in anticipation of China's new obligations as a WTO Member, the State Economic and Trade Commission (SETC) issued Bulletin Number 13, which provided that the preferential policy for automobile localization rates would be cancelled upon China's WTO accession. However, U.S. automobile manufacturers reported that some local government officials continued to require local content and cited the old automobile industrial policy's standards. China also committed to issue a revised automotive industrial policy within 2 years of its WTO accession, or by December 11, 2003, but missed this deadline. In May 2004, China issued a new automobile industrial policy. It included provisions discouraging the importation of automotive parts and encouraging the use of domestic technology. It also required new automobile and automobile engine plants to include substantial investment in research and development facilities, even though China

expressly committed in its Protocol of Accession to the WTO not to condition investment rights or approvals on the conduct of research and development in China.

In 2005, China began to issue measures implementing the new automobile industrial policy. One measure that generated strong criticism from the United States, the EU, Japan, and Canada was the *Measures on the Importation of Parts for Entire Automobiles*, which was issued by the National Development and Reform Commission (NDRC) in February 2005 and became effective in April 2005. These rules impose charges that unfairly discriminate against imported automotive parts and discourage automobile manufacturers in China from using imported automotive parts in the assembly of vehicles. Specifically, the rules require all vehicle manufacturers in China that use imported parts to register with China's Customs Administration and provide specific information about each vehicle they assemble, including a list of the imported and domestic parts to be used, and the value and supplier of each part. If the number or value of imported parts in an assembled vehicle exceeds specified thresholds, the regulations imposed on each of the imported parts a charge equal to the tariff on complete automobiles (typically 25 percent) rather than the tariff applicable to automotive parts (typically 10 percent). These rules appear to be inconsistent with several WTO provisions, including Article III of GATT 1994 and Article II of the Agreement on Trade-Related Investment Measures, as well as the commitment in China's Protocol of Accession to the WTO to eliminate all local content requirements relating to importation. In March and April 2006, the United States, the EU, and Canada initiated dispute settlement against China by filing formal WTO consultations requests. Joint consultations were held in May 2006. However, these consultations did not lead to an agreed resolution. In September 2006, the United States, the EC and Canada filed requests for the establishment of a panel to hear the dispute. Since a dispute settlement panel was established in October 2006, the panel has issued a confidential interim report and is expected to issue its final report by spring or early summer 2008.

Steel

China issued a new Steel and Iron Industry Development Policy (Policy) in July 2005. Although many aspects of this new policy have not yet been implemented, it still includes a host of objectives and guidelines that raise serious concerns. For example, this policy requires that foreign enterprises seeking to invest in Chinese iron and steel enterprises possess proprietary technology or intellectual property in the processing of steel. Given that foreign investors are not allowed to have a controlling share in steel and iron enterprises in China, this requirement would seem to constitute a *de facto* technology transfer requirement, calling into question China's implementation of its Protocol of Accession to the WTO commitment not to condition investment rights or approvals on the transfer of technology. This policy also appears to discriminate against foreign equipment and technology imports. Like other measures, this policy encourages the use of local content by calling for a variety of government financial support for steel and iron projects utilizing newly developed domestic equipment. Even more troubling, however, it calls for the use of domestically produced steel manufacturing equipment and domestic technologies whenever domestic suppliers exist, calling into question China's implementation of its Protocol of Accession to the WTO commitment not to condition the right of investment or importation on whether competing domestic suppliers exist. While the steel policy has been in place, China's steel production has grown from 356 million metric tons (MT) in 2005 to about 490 million MT in 2007, while imports of steel products have declined. China also became a major net exporter, with approximately 50 million MT of steel net exports in 2007.

The Policy is troubling because it attempts to dictate industry outcomes and involves the government in making decisions that should be made by the marketplace. It prescribes the number and size of steel producers in China, where they will be located, the types of products that will and will not be produced, and the technology that will be used. This high degree of government direction and decision-making

regarding the allocation of resources into and out of China's steel industry raises concerns not only because of the commitment that China made in its Protocol of Accession to the WTO that the government would not influence, directly or indirectly, commercial decisions on the part of state-owned or state-invested enterprises, but also more generally because it represents another significant example of China reverting to a reliance on government management of market outcomes instead of moving toward a reliance on market mechanisms. Indeed, it is precisely that type of regressive approach that is at the root of many of the United States' WTO concerns.

Semiconductors

China's 10th Five-Year Plan called for an increase in Chinese semiconductor output from \$2 billion in 2000 to \$24 billion in 2010. In pursuit of this policy, China has attempted to encourage the development of China's domestic integrated circuit (IC) industry through, among other things, discriminatory VAT policies. In particular, through a series of measures, China has provided for the rebate of a substantial portion of the 17 percent VAT paid by domestic manufacturers on their locally produced ICs. China, meanwhile, charged the full 17 percent VAT on imported ICs, unless they were designed in China. After bilateral meetings on this issue failed to yield a change in China's policy, in March 2004, the United States filed the first WTO case against China. In the ensuing consultations, China signaled its willingness to discuss a possible resolution. In July 2004, the United States and China reached a settlement in which China agreed to immediately cease certifying new Chinese IC manufacturers or products as eligible for the VAT rebate and to issue the necessary regulations to eliminate the VAT rebate entirely by November 1, 2004, with an effective date no later than April 1, 2005. China also agreed to repeal the relevant implementing rules that had made VAT rebates available for ICs designed in China but manufactured abroad by September 1, 2004, with an effective date no later than October 1, 2004. China followed through on each of these agreed steps in a timely manner, and the two sides notified the WTO in October 2005 that their dispute had been satisfactorily resolved. The United States continues to monitor closely new financial support that China is making available to its domestic producers for consistency with the WTO Subsidies Agreement's disciplines.

Fertilizer

In 2001, China began exempting all phosphate fertilizers except diammonium phosphate (DAP) from the VAT. DAP, a product that the United States exports to China, competes with other phosphate fertilizers produced in China, particularly monoammonium phosphate. Both the United States Government and U.S. producers have complained that China has employed its VAT policies to benefit domestic fertilizer production.

Telecommunications Equipment

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

Tariffs and Other Import Charges

Under the terms of its WTO accession, China committed to substantial annual reductions in its tariff rates, with most of them taking place within 5 years of China's WTO accession. The largest reductions took place in 2002, immediately after China acceded to the WTO, when the overall average tariff rate fell from over 15 percent to 12 percent. By 2006, China's average bound rate had fallen to 10 percent.

China's post-WTO accession tariff rates are "bound," meaning that China cannot raise them above the bound rates without "compensating" WTO trading partners (*i.e.*: re-balancing tariff concessions or, in accordance with WTO rules, being subject to withdrawal of substantially equivalent concessions by other WTO Members). "Bound" rates give importers a more predictable environment. China may also apply tariff rates significantly lower than the WTO-required rate, as in the case of goods that the government has identified as necessary to the development of a key industry. For example, China's Customs Administration has occasionally announced lower applied tariff rates for items that benefit key economic sectors, in particular for the automotive, steel, and chemical industries.

U.S. exports continued to benefit from China's participation in the Information Technology Agreement (ITA), which requires the elimination of tariffs on computers, semiconductors, and other information technology products. China began reducing and eliminating these tariffs in 2002 and continued to do so in the ensuing years, achieving the elimination of all ITA tariffs on January 1, 2005, as the tariffs dropped to zero from a pre-WTO accession average of 13.3 percent.

China completed its timely implementation of another significant tariff initiative, the WTO's Chemical Tariff Harmonization Agreement, in 2005. The United States exported \$8.3 billion in chemicals during 2007, an increase of more than 28 percent over 2006.

However, China still maintains high duties on some products that compete with sensitive domestic industries. For example, the tariff on large motorcycles will only fall from 60 percent to 30 percent. Likewise, most video, digital video, and audio recorders and players still face duties of approximately 30 percent. Raisins face duties of 35 percent.

U.S. exports of some bulk agricultural commodities have increased dramatically in recent years, and continue to perform strongly, especially soybeans and cotton. Exports of soybeans rose to more than \$4.1 billion in 2007, a 62 percent increase over the previous year. Cotton exports in 2007 remained strong at \$1.5 billion, though decreasing from a record \$2.1 billion in 2006. Exports of forestry products such as lumber also continued to perform strongly, increasing by 5 percent over 2006, to reach \$575 million in 2007. Fish and seafood exports rose 21 percent to \$533 million in 2007, a new record. Meanwhile, exports of consumer-oriented agricultural products increased by 45 percent to \$1.1 billion in 2007.

Overall, China's tariff reductions have increased market access for U.S. exporters in a range of industries, as China continued the process of reducing tariffs on goods of greatest importance to U.S. industry from a base average of 25 percent (in 1997) to 7 percent over a period of 5 years, starting on January 1, 2002. It made similar reductions throughout the agricultural sector. These tariff changes contributed to another significant increase in overall U.S. exports, which rose approximately 18 percent in 2007 compared to 2006.

Tariff Classification

Chinese customs officers have wide discretion in classifying a particular import. While foreign businesses might at times have benefited from their ability to negotiate tariff classification into tariff categories with lower import duty rates, lack of uniformity makes it difficult to anticipate border charges.

Customs Valuation

In January 2002, shortly after acceding to the WTO, China's Customs Administration issued the Measures for Examining and Determining Customs Valuation of Imported Goods. These regulations addressed the inconsistencies that had existed between China's customs valuation methodologies and the

WTO Agreement on Customs Valuation. The Customs Administration subsequently issued the *Rules on the Determination of Customs Value of Royalties and License Fees Related to Imported Goods*, effective July 2003. These rules were intended to clarify provisions of the January 2002 regulations that addressed the valuation of royalties and license fees. In addition, by December 11, 2003, China had issued a measure on interest charges and a measure requiring duties on software to be assessed on the basis of the value of the underlying carrier medium, meaning, for example, the CD-ROM or floppy disc itself, rather than the imputed value of the content, which includes, for example, the data recorded on a CD-ROM or floppy disc.

More than 4 years later, China has still not uniformly implemented these various measures. U.S. exporters continue to report that they are encountering valuation problems at many ports. According to U.S. exporters, even though the 2002 regulations and 2003 implementing rules provide that imported goods normally should be valued on the basis of their transaction price, meaning the price the importer actually paid, many Chinese customs officials are still improperly using “reference pricing,” which usually results in a higher dutiable value. For example, imports of wood products are often subjected to reference pricing. In addition, some of China’s customs officials are reportedly not applying the provisions in the 2002 regulations and 2003 implementing rules as they relate to software royalties and license fees. Following their pre-WTO accession practice, these officials are still automatically adding royalties and license fees to the dutiable value (for example, when an imported personal computer includes pre-installed software) even though China’s 2003 implementing rules expressly direct them to add those fees only if they are import-related and a condition of sale for the goods being valued.

U.S. exporters have also continued to express concerns about the Customs Administration’s handling of imports of digital media that contain instructions for the subsequent production of multiple copies of products such as DVDs. The Customs Administration has been inappropriately assessing duties based on the estimated value of the yet-to-be-produced copies.

More generally, U.S. exporters continue to be concerned about inefficient and inconsistent customs clearance procedures in China. These procedures vary from port to port, massive delays are not uncommon, and the fees charged appear to be excessive and are rising rapidly, giving rise to concerns under Article VIII of GATT 1994.

Border Trade

China’s border trade policy continues to generate Most Favored Nation (MFN) and other concerns. China provides preferential import duty and VAT treatment to certain products, often from Russia, apparently even when those products are not confined to frontier traffic as envisioned by Article XXIV of GATT 1994. China addressed some of these concerns in 2003 when it eliminated preferential treatment for boric acid and 19 other products. Nonetheless, it appears that large operators are still able to take advantage of border trade policies to import bulk shipments across China’s land borders into its interior at preferential rates. In addition, U.S. industry reports that China continues to use border trade policies to provide preferential treatment for Russian timber imports, to the detriment of U.S. timber exporters.

Antidumping, Countervailing Duty, and Safeguard Measures

Since acceding to the WTO, China has emerged as a significant user of antidumping measures. At the end of 2007, China had a total of 97 final antidumping measures in place (some of which pre-date China’s membership in the WTO) affecting imports from 18 countries and regions, and seven antidumping investigations in progress. In 2007, China initiated four new investigations, although none of them involved U.S. products. Chemical products remain the most frequent target of Chinese antidumping actions.

MOFCOM's predecessor agencies – MOFTEC and SETC – issued most of the rules and regulations MOFCOM uses to conduct its antidumping investigations. While these measures generally represent good faith efforts to implement the relevant WTO commitments and to improve China's pre-WTO accession measures, they also contain vague language, have gaps in areas of practice and allow inordinate discretion. Meanwhile, China's handling of antidumping investigations and reviews continues to raise concerns in key areas such as transparency and procedural fairness. Concerns with transparency, including access to information, are especially acute with regard to the injury portion of investigations. To date, China has not initiated a countervailing duty investigation. China's only safeguard measure was removed at the end of 2003 after being in place for less than 2 years.

The Supreme People's Court has issued a judicial interpretation covering the review of antidumping and other trade remedy decisions. To date, however, judicial review of these types of decisions remains untested.

In one antidumping investigation involving imports of kraft linerboard from the United States, following an affirmative final determination and the imposition of antidumping duties in September 2005, the affected U.S. exporters filed for administrative reconsideration with MOFCOM. The exporters raised concerns with various aspects of the final determination, particularly the injury finding. In January 2006, immediately after the United States notified China that it intended to commence dispute settlement at the WTO, MOFCOM issued a decision repealing the antidumping order.

Nontariff Barriers

China's Protocol of Accession to the WTO obligated China to address many of the nontariff barriers it had historically used to restrict trade. For example, China is obligated to phase out its import quota system, apply international norms to its testing and standards administration, remove local content requirements, and make its licensing and registration regimes transparent. At the national level, China made progress following its WTO accession in reforming its testing system, revising regulations requiring local content and improving overall regulatory transparency, including in the licensing area. Despite this progress, however, as China's trade liberalization efforts moved forward, some nontariff barriers remained in place and others were added.

Six years after China's WTO accession, many U.S. industries complain that they face significant nontariff barriers to trade, which are discussed in more detail in various sections below. These barriers include, for example, regulations that set high thresholds for entry into service sectors such as banking, insurance, and telecommunications, selective and unwarranted inspection requirements for agricultural imports, and the use of questionable SPS measures to control import volumes. Many U.S. industries have also complained that China manipulates technical regulations and standards to favor domestic industries.

Import Quotas

In the past, China often did not announce import quota amounts or the process for allocating import quotas. China set import quotas through negotiations between central and local government officials at the end of each year. Import quotas on most products were eliminated or are scheduled for phase out under the terms of China's WTO accession. China's Protocol of Accession to the WTO required China to eliminate existing import quotas for the top U.S. priority products upon accession and to phase out remaining import quotas on industrial goods, such as air conditioners, sound and video recording machines, color televisions, cameras, watches, crane lorries and chassis, and motorcycles, by January 1, 2005. While China's post-WTO accession import quota system was beset with problems, China did fully adhere to the agreed schedule for the elimination of all of its import quotas, the last of which China

eliminated on January 1, 2005.

Tariff-Rate Quotas

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

As part of its WTO accession commitments, China was to establish large and increasing TRQs for imports of wheat, corn, rice, cotton, wool, sugar, rapeseed oil, palm oil, soybean oil, and fertilizer, with most in-quota duties ranging from 1 percent to 9 percent. Each year, a portion of each TRQ is to be reserved for importation through nonstate trading entities. China’s Protocol of Accession to the WTO sets forth specific rules for administration of the TRQs, including increased transparency and reallocation of unused quotas to end users that have an interest in importing. China phased out the vegetable oil TRQs in 2006, but currently maintains a TRQ regime on six agricultural products including wheat, cotton, corn, rice, wool, and sugar, as well as three chemical fertilizers including di-ammonium phosphate.

For the first 2 years after China’s WTO accession, China’s implementation of its TRQ systems generated numerous complaints from foreign suppliers, with the most serious problems being a lack of transparency, subdivisions of the TRQ, small allocation sizes, and burdensome licensing procedures. Repeated engagement by U.S. officials led to regulatory and operational changes by the National Development and Reform Commission (NDRC) for shipments beginning January 1, 2004. Key changes included the elimination of separate allocations for general trade and processing trade, the elimination of certain unnecessary licensing requirements, and the creation of a new mechanism for identifying allocation recipients. In 2004, improvements in NDRC’s TRQ administration became evident, although transparency continued to be problematic for some of the commodities subject to TRQs.

While NDRC was implementing the systemic changes in 2004, exports of some bulk agricultural commodities from the United States showed substantial increases, largely due to market conditions. In particular, despite some continuing problems with NDRC's handling of the cotton TRQs, U.S. cotton exports totaled a record \$1.4 billion in both 2004 and 2005, followed by a record of \$2.1 billion in 2006. U.S. cotton exports to China decreased slightly but remained strong in 2007, totaling \$1.5 billion. In addition, U.S. wheat exports totaled \$495 million in 2004, as the TRQ allocations for wheat did not appear to act as a limiting factor, but declined significantly to \$79 million in 2005 and then to \$23 million in 2006 and \$6 million in 2007. The drop in U.S. wheat exports was due to higher production and lower prices in China, which reduced China’s overall import demand.

Meanwhile, the administration of China’s TRQ system for fertilizer, handled by the State Economic and Trade Commission (SETC) and subsequently MOFCOM, has suffered from systemic problems since China’s WTO accession. By 2007, this system was still operating with insufficient transparency and administrative guidance still seemed to be affecting how the allocated quota was used. U.S. fertilizer exports to China have declined throughout the post-WTO accession period, due in part to continuing problems with MOFCOM's administration of the fertilizer TRQ system and in part to increasing subsidization and resulting overcapacity of China's domestic fertilizer industry. U.S. fertilizer exports to China decreased from \$676 million in 2002 to \$355 million in 2005. In 2006, U.S. fertilizer exports to China declined sharply again, totaling \$232 million for the year.

In October 2006, perhaps in an attempt by the central authorities to constrain provincial and local efforts to build further unneeded capacity, the Tariff Policy Commission of the State Council announced a temporary reduction of the in-quota tariff rate for fertilizer from 4 percent to 1 percent, effective November 2006. Although it was initially anticipated that U.S. fertilizer exports to China might increase following this reduction and the scheduled phase in of foreign enterprises' rights to engage in wholesale and retail distribution of fertilizer within China, U.S. fertilizer exports sharply declined again in 2007. The data for January through September 2007 showed a decline of 48 percent, totaling \$97 million compared to \$232 million during the same period in 2006.

Import Licenses

In the early 1990s, China began to reduce substantially the number of products subject to import licensing requirements. With its WTO accession in December 2001, China committed to the fair and nondiscriminatory application of licensing procedures. Among other things, China also committed upon its WTO accession to limit the information that a trader must provide in order to receive a license, in order to ensure that licenses are not unnecessarily burdensome, and to increase transparency and predictability in the licensing process.

MOFTEC issued new regulations and implementing rules to facilitate licensing procedures shortly after China's accession to the WTO. However, license applicants initially reported that they had to provide sensitive business details unnecessary for simple import monitoring. In some sectors, importers also reported that MOFTEC was using a "one-license-per-shipment" system rather than providing licenses to firms for multiple shipments. MOFTEC began to allow more than one shipment per license in late 2002 following U.S. interventions, without modifying the measure authorizing the "one-license-per-shipment" system. In December 2004, MOFCOM issued revised licensing procedures for imported goods. Among other changes, import licenses no longer have quantitative restrictions, provisions related to designated trading were removed, and provisions allowing more than one license per shipment and an "under or over provision" for overloaded or short shipments were added.

China is the world's largest importer of iron ore, accounting for approximately 50 percent of global iron ore imports. Increasing global steel production, led by Chinese growth, has contributed to significant price increases for iron ore over the past several years. In May 2005, after Chinese steel producers negotiated contracts with major foreign iron ore suppliers, the Chinese government began imposing new import licensing procedures for iron ore without prior WTO notification. Even though the WTO's Import Licensing Agreement calls for import licensing procedures that do not have a restrictive effect on trade, China reportedly restricted licenses to 48 traders and 70 steel producers and has not made public a list of the qualified enterprises or the qualifying criteria used. While the Chinese government maintained that it did not impose any qualifying criteria, it did acknowledge that two organizations affiliated with the Chinese government – the China Steel Industry Association and the Commercial Chamber for Metals, Minerals and Chemicals Importers and Exporters – had been discussing a set of rules regarding qualifying criteria such as production capacity and trade performance. In 2007, China further reduced the number of licensed traders from 48 to 42 and reportedly instituted further restrictions on qualifying criteria for iron ore import licenses, including tighter limitations on the size of the enterprises eligible to import iron ore and shipment sizes.

China's inspection and quarantine agency, the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ), has also imposed inspection-related requirements that have led to restrictions on imports of many U.S. agricultural goods. In particular, two AQSIQ measures issued in 2002 require importers to obtain a Quarantine Inspection Permit (QIP) prior to signing purchase contracts for nearly all traded agricultural commodities. QIPs are one of the most important trade policy issues adversely affecting the United States and China's other agricultural trading partners.

AQSIQ sometimes slows down or even suspends issuance of QIPs at its discretion without notifying traders in advance or explaining its reasons, resulting in significant commercial uncertainty. Because of the commercial necessity to contract for commodity shipments when prices are low, combined with the inherent delays in having QIPs issued, many cargos of products such as soybeans, meat, and poultry arrive in Chinese ports without QIPs, creating delays in discharge and resulting in demurrage bills for Chinese purchasers. In addition, traders report that shipments are often closely scrutinized and are at risk for disapproval if they are considered too large in quantity.

Some improvements were made to the QIP system in 2004 following repeated U.S. engagement, both bilaterally and at the WTO. In June 2004, AQSIQ issued Decree 73, the Items on Handling the Review and Approval for Entry Animal and Plant Quarantine, which extended the period of validity for QIPs from 3 months to 6 months. AQSIQ also began issuing QIPs more frequently within the established time limits. Nevertheless, a great deal of uncertainty remains even with the extended period of validity, because a QIP still locks purchasers into a very narrow period to purchase, transport and discharge cargos or containers before the QIP's expiration, and because AQSIQ continues to administer the QIP system in a seemingly arbitrary manner.

Little improvement in the QIP system has taken place over the last 3 years, and in 2007, traders continued to be concerned that the rules and regulations of the QIP system remain available as an administrative tool to limit the quantity of imports. However, traders remain hesitant to press AQSIQ for change because they would risk reprisals. Many of them would at least like AQSIQ to eliminate the quantity requirements that it unofficially places on QIPs. These quantity requirements have been used often by AQSIQ during peak harvest periods to limit the flow of commodity imports. Eliminating this requirement would help to ensure that QIPs do not interfere with the market.

In 2004, China implemented regulations requiring foreign scrap suppliers to register with AQSIQ (see "Scrap Recycling" section below). According to AQSIQ, the registration serves to prevent disreputable foreign scrap suppliers from sending sub-standard or illegal scrap and waste to China. The application process has been opaque, with foreign companies experiencing significant delays in receiving notification from AQSIQ. In 2007, the 3-year license expired for many foreign scrap suppliers, and AQSIQ required them to renew their licenses in a process that lacked transparency and predictability.

INTERNAL POLICIES

Taxation

Income Taxes

In April 2001, the National People's Congress passed long awaited changes to the tax collection law, designed to standardize and increase the transparency of China's tax procedures. The State Council issued detailed regulations for the implementation of this law in September 2002. As part of a broader campaign to "rectify market order" and eliminate inter-provincial barriers to domestic commerce, the Chinese central government also implemented measures to prevent local governments from applying tax treatment that discriminated in favor of locally owned firms.

In order to narrow the widening urban-rural income gap, the Central Committee of the Communist Party of China and the State Council issued Document No. 1 of 2004, which instructed the governments at all levels to gradually reduce the agricultural tax rate of 8.4 percent until it was completely eliminated in January 2006, along with the removal of all taxes on special farm produce except for tobacco. In order to relieve the tax burden on lower and middle-income earners, the National People's Congress in December

2007 adopted an amendment that raised the threshold for income tax collection to approximately \$3,300 annually from approximately \$2,630. This move is expected to reduce the Chinese Government's revenues by more than \$4 billion annually.

Foreign investors, including those who have used investment as an entry point to the Chinese domestic market, have benefited from investment incentives such as tax holidays and grace periods, which allow them to reduce substantially their tax burden. Domestic enterprises have long resented rebates and other tax benefits enjoyed by foreign invested firms and these benefits are gradually being phased out. Until the end of 2007, domestic and foreign invested companies in China had been subject to an income tax rate of 33 percent, but because of various tax waivers and incentives most domestic enterprises paid 24 percent and most foreign businesses paid 15 percent.

In addition, some of the income tax preferences available to domestic and foreign invested enterprises appeared to be prohibited under WTO rules and were challenged by the United States and Mexico in a WTO dispute settlement proceeding initiated in early 2007. As discussed above in the section on Import Substitution Policies and below in the section on Export Subsidies, China committed to eliminate the prohibited subsidies at issue by January 1, 2008.

To move up the value chain and steer the economy away from low-skilled, labor-intensive manufacturing, China passed a new unified *Corporate Income Tax Law* in March 2007 that eliminated many of the tax incentives typically available to foreign invested enterprises. The change took effect on January 1, 2008 and introduces a unified 25 percent corporate tax rate replacing the split between domestic and foreign invested enterprise rates. The Chinese government announced it would phase in the uniform tax rates over a 5 year period during which foreign invested enterprises will see their tax rates increase from 15 percent in 2007, to 18 percent in 2008, 20 percent in 2009, 22 percent in 2010, 24 percent in 2011, and 25 percent in 2012. The law includes two exceptions to the new 25 percent flat rate: one states that income tax rates for small businesses with small profits will be 20 percent, and the other allows qualified high technology companies registered in special economic zones to be exempt from income taxes for the first 2 years for any earnings booked within the recognized zones, after which those earnings will be assessed at 12.5 percent. Additional incentives are available for venture capital and for investments in resource and water conservation, environmental protection, and work safety. Current preferential tax treatment will apply to investments in agriculture, forestry, animal husbandry, fisheries, and infrastructure. The tax changes will likely result in narrower profit margins for foreign invested enterprises in China. The law may also result in a reduction in measured foreign direct investment, as it will close a "round-tripping" loophole in which money from China is sent overseas and brought back to China as "foreign investment" to take advantage of preferential tax treatment policies.

Value Added Taxes (VAT)

Application of China's single most important revenue source – the VAT, which ranges between 13 percent and 17 percent, depending on the product – continues to be uneven. Importers from a wide range of sectors report that, because taxes on imported goods are reliably collected at the border, they are sometimes subject to application of a VAT that their domestic competitors often fail to pay. As discussed above in the section on Import Substitution Policies, the United States was successful in obtaining China's agreement to remove discriminatory VAT policies favoring domestically produced semiconductors. In addition, China's selective exemption of certain fertilizer products from the VAT has operated to the disadvantage of imports from the United States.

Meanwhile, China maintains measures that provide preferential VAT treatment for foreign invested enterprises when purchasing equipment and other products. In the Memorandum of Understanding China signed to settle the WTO prohibited subsidies dispute, China committed to ensuring that imported

products received no less favorable treatment than that accorded domestic products under this preference. In addition, China committed in the Memorandum of Understanding to end VAT exemptions available to foreign invested enterprises with regard to imported equipment used to produce their products, provided that they exported 100 percent of their production, as discussed below in the section on Export Subsidies.

China retains an active VAT rebate program for exports, although rebate payments are often delayed and in some cases have been reduced. In 2003, China announced the reduction of VAT rebates for exports by 3 percentage points, partly in response to foreign complaints about an under-valued renminbi (RMB). Although State Administration of Taxation officials reportedly plan to eliminate rebates eventually in order to increase tax revenues, China has continued this practice in order to spur domestic economic growth. In December 2004, for example, the Ministry of Finance and the State Administration of Taxation issued a circular announcing an increase in the VAT rebate rate from 13 percent to 17 percent for the export of certain information technology products, including integrated circuits (ICs), independent components, mobile telecommunication equipment and terminals, computers and periphery equipment, and numerically controlled machine tools. In 2005, China adjusted the ratio of the share of the export VAT refund burden between the central and local governments, from 75 to 25 to 92.5 to 7.5. China also halted refunds for some products in high demand domestically in order to discourage their export. In September 2006, China sought to discourage exports by eliminating VAT rebates for exports of coal, nonferrous metal and waste and scrap, silicon and certain primary wood products, among other products, and by lowering existing VAT rebates for a variety of steel, nonferrous metal, textiles, and ceramics products.

In 2007, China implemented two additional significant changes to its VAT rebates in an attempt to control overexpansion of production capacity in particular sectors: (1) rebates were reduced on 2,268 commodities (37 percent of all export categories) likely to trigger trade disputes; and (2) VAT refunds were eliminated for 533 other products which were either resource intensive or heavily polluting in the manufacturing process. Exports affected by the partial rebate reduction include: textiles, apparel, shoes, hats, paper products, goods made from plastic and rubber, and furniture. The rebate rates for these products dropped from 13 percent to 17 percent to 5 percent to 11 percent. Exports affected by the VAT refund elimination include: leather, chlorine, dyes and other chemical products, certain industrial chemicals (not including refined chemical products), some fertilizers, metal carbide and activated carbon products, certain lumber and single use wooden products, unalloyed aluminum poles and other nonferrous metal processed goods, segmented ships, and nonmechanical boats. These products had export VAT rebate rates between 5 percent and 13 percent. These adjustments follow VAT rebate adjustments implemented in November 2006 and April 2007 on a wide range of semi-finished and finished steel products, as part of an effort to discourage unneeded creation of production capacity for these products in China. Despite these efforts, however, overall Chinese exports of steel products in 2007 increased significantly over 2006 levels. Moreover, since these export VAT rebate reductions did not target all steel products, there appeared to be a shift in Chinese steel production and exports of steel products for which full export VAT rebates were still available, as discussed below in the section on export duties. China's exports of these value added steel products to the U.S. market increased significantly during 2006 and 2007.

Another significant change to China's VAT policy in 2007 was the elimination of the VAT rebate for 84 grain and oilseed products, ranging from 5 percent to 17 percent. The impetus behind the elimination apparently stems from concerns over food security and inflationary pressures on domestic prices.

In an effort to develop its domestic integrated circuit (IC) industry, China began announcing discriminatory VAT policies in late 2001, although they did not become operational until 2004. Pursuant to a series of measures, China provided for the rebate of a substantial portion of the 17 percent VAT paid by domestic manufacturers on their locally produced ICs. A similar VAT rebate was available to

imported ICs, but only if they had been designed in China. China charged the full 17 percent VAT on all other imported ICs. These policies disadvantaged U.S. exports of ICs to China, which totaled approximately \$2 billion in 2003, and put pressure on foreign enterprises to shift investment in IC manufacturing to China. Following extensive but unsuccessful bilateral engagement, the United States initiated dispute settlement by requesting formal WTO consultations with China in March 2004. In the ensuing consultations, which took place in April 2004 in Geneva with third party participation by Japan, the EC, and Mexico, the United States laid out its claims under Article III of GATT 1994, which sets forth the WTO's national treatment principle. Through these consultations and a series of bilateral meetings in Washington and Beijing, a settlement was reached in July 2004, to which China agreed to withdraw the challenged measures.

Meanwhile, China continues to consider fundamental reform of its VAT regime and, in particular, the transformation from a production based regime to one that is consumption-based. China has pursued a pilot program in the Northeast, but it is unclear when this reform might be extended nationwide.

Consumption Taxes

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

STANDARDS, TESTING, LABELING, AND CERTIFICATION

In its Protocol of Accession to the WTO, China committed to ensure that its regulatory authorities apply the same standards, technical regulations and conformity assessment procedures to both imported and domestic goods and use the same fees, processing periods and complaint procedures for both imported and domestic goods. China also committed that, in order to eliminate unnecessary barriers to trade, it would not maintain multiple or duplicative conformity assessment procedures and would not impose requirements exclusively on imported products. China further committed to ensure that its standards developers, regulatory authorities, and conformity assessment bodies operated with transparency and allowed reasonable opportunities for public comment on proposed standards, technical regulations and conformity assessment procedures.

In anticipation of these commitments, China devoted significant energy to reforming its standards and testing and certification regimes prior to its WTO entry. In April 2001, China merged its domestic standards and conformity assessment agency and entry-exit inspection and quarantine agency into one new organization, the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ). Chinese officials explained that this merger was designed to eliminate discriminatory treatment of imports, including requirements for multiple testing simply because a product was imported rather than domestically produced. China also formed two quasi-independent agencies administratively under AQSIQ: (1) the Certification and Accreditation Administration of China (CNCA), which is charged with the task of unifying, implementing and administering the country's conformity assessment regime; and (2) the Standardization Administration of China (SAC), which is responsible for setting mandatory national standards, unifying China's administration of product standards, administering China's standards system, and aligning its standards and technical regulations with international practices and China's commitments under the WTO Agreement on Technical Barriers to Trade (TBT Agreement).

In January 2002, China began the task of aligning its standards system with international practice with AQSIQ's issuance of rules designed to facilitate China's use and adoption of international standards. In 2003, China also pledged to begin implementation of the Asia Pacific Economic Cooperation (APEC)

conformity assessment Mutual Recognition Arrangement for Telecommunications Equipment. However, China does not appear to have taken any concrete steps. Moreover, the narrow definition of what China views as an international standard continues to be an issue of concern. China subsequently embarked on the task of reviewing all of its existing 21,000 technical regulations to determine their continuing relevance and consistency with international standards. In November 2005, China reported that as of October 2005 it had nullified 1,416 national standards as a result of this review. China has since continued its review of existing standards and technical regulations, but has not provided an update on its progress.

Nevertheless, in a number of sectors, concern has grown that China has pursued the development of unique national standards as the basis for its technical requirements, despite the existence of well-established international standards. Reliance on national standards could serve as a means of protecting domestic companies from competing foreign standards and technologies. The sectors affected include: automobiles, automotive parts, telecommunications equipment, wireless local area networks (see the “WAPI” section below), radio frequency identification technology, audio and video coding, fertilizers, food products, and consumer products, such as cosmetics. These China-specific standards, which sometimes appear to lack a particular technical or scientific basis, could create significant barriers to entry into China’s markets because of the high cost of producing products that comply with the China-specific standards.

The lack of openness and transparency in China’s standards development process troubles many foreign companies. The vast majority of Chinese standards-setting bodies are not fully open to foreign participation, in some cases refusing membership to foreign firms and in other cases refusing to allow companies with majority foreign ownership to vote. In some cases, foreign firms are allowed nonvoting observer status, but are required to pay membership fees far in excess of those paid by the domestic voting members. Nevertheless, in 2005, some U.S. companies and industry groups concluded that China had begun to make progress in reforming its standards development system by strengthening its links with standards-setters in other countries and by moving its standards regime into closer conformity with international practice.

China has designated MOFCOM as its notification authority and MOFCOM has been notifying proposed technical regulations and conformity assessment procedures to WTO Members, as required by the WTO Agreement on Technical Barriers to Trade. Almost all of these notified measures, however, have emanated from AQSIQ, SAC, or CNCA and few of the trade-related technical regulations drafted by other agencies have been notified. Lack of meaningful comment periods also remains an issue. In many cases, an agency provides insufficient time for the submission of comments, and allots little time for the agency’s consideration of those comments, before it finalizes a measure.

Despite China’s commitment to apply the same standards and fees to domestic and imported products upon its accession to the WTO, many U.S. industries have complained that China manipulates technical regulations and standards to favor domestic industries. In fact, SAC issued a strategy report in September 2004 promoting China’s development of standards and technical regulations as a means of protecting domestic industry as tariff rates fall. At the sub-national level, importers have expressed concern that local officials do not understand China’s WTO commitments and apply arbitrary technical regulations and standards to protect local industries. These problems are compounded by the fact that coordination between AQSIQ and its affiliated bodies, CNCA and SAC, is lacking, as is coordination between these bodies and China Customs and other ministries and agencies, at both the central and local government levels, on issues related to standards and technical regulations.

Conformity Assessment Procedures

CNCA's new compulsory product certification system took effect in August 2003. Under this system, there is now one safety mark – the China Compulsory Certification (CCC) mark – issued for both Chinese and foreign products. The CCC mark is now required for more than 130 product categories, such as electrical machinery, information technology equipment, household appliances, and their components. In 2007, as in prior years, U.S. companies continued to complain that the regulations lack clarity regarding the products that require a CCC mark. They also have reported that China is applying the CCC mark requirements inconsistently and that many domestic products required by CNCA's regulations to have the CCC mark are still being sold without it. U.S. companies in some sectors also complained that CCC certification requirements and procedures remain difficult, time consuming, onerous, and costly. For example, the procedures subject manufacturing facilities to on site inspection by CNCA or its designee and require the manufacturing facilities to bear the cost of the inspection. In addition, small and medium sized U.S. companies without a presence in China find it particularly burdensome to apply for CCC mark exemptions, such as for replacement and re-export, because China requires the applications to be done in person in the Beijing offices of CNCA. China also continues to require the CCC mark for products that would no longer seem to warrant mandatory certification, such as low risk products and components.

To date, CNCA has accredited well over 100 Chinese enterprises to test and certify for purposes of the CCC mark. Despite China's commitment that qualifying minority, foreign-owned (upon China's accession to the WTO), and majority foreign-owned (2 years later) joint venture conformity assessment bodies would be eligible for accreditation and would be accorded national treatment, China so far has not accredited any foreign invested conformity assessment bodies. As a result, exporters to China are often required to submit their products to Chinese laboratories for duplicative tests that have already been performed abroad, resulting in greater expense and a longer time to market. One U.S. based conformity assessment body has entered into a Memorandum of Understanding (MOU) with China allowing it to conduct follow-up inspections (but not primary inspections) of manufacturing facilities that make products for export to China requiring the CCC mark. However, China has not been willing to grant similar rights to other U.S. based conformity assessment bodies, claiming that it is only allowing one MOU per country, the rationale for which has not been explained. Many U.S. testing labs, as well as the U.S. exporters that rely on their services, find China's foreign accreditation requirements for CCC mark certification unwarranted and overly restrictive.

The concerns of U.S. exporters about the CCC mark are heightened by the increasing product scope of the CCC mark certification system. Beginning in 2004, several new categories of products have been added to the list of products requiring the CCC mark, including the addition of six categories of toy products, which began on June 1, 2007. Additionally, the "China RoHS" scheme discussed below may utilize the CCC mark certification process for certain products to ensure compliance.

In other conformity assessment contexts, some importers report that foreign companies' products can only be tested in certain designated laboratories and that limited testing and certification capacity means that evaluations sometimes take much longer than international best practice would suggest is appropriate.

U.S. companies also cite problems with a lack of transparency in the certification process, burdensome requirements and long processing times for certifications. Some companies have also expressed concern about business confidential information and intellectual property remaining protected when they submit samples and related information for mandatory testing. Technical committees that evaluate products for certification are generally drawn from a pool of government, academic, and industrial experts that companies fear may be too closely associated with their competitors, and thus also produce an inherent conflict of interest. In some cases, laboratories responsible for testing imported products are affiliated

with domestic competitors, making the possibility of intellectual property theft more likely.

Wireless Local Area Networks (WLAN) Authentication and Privacy Infrastructure (WAPI)

A particularly significant example of China's development of unique technical requirements, despite the existence of well-established international standards, arose in May 2003, when China issued two standards for encryption over WLANs, applicable to domestic and imported equipment containing WLAN (sometimes referred to as Wi-Fi) technologies. Conformance to these standards was scheduled to become mandatory in June 2004. The standards incorporated the WAPI encryption algorithm for secure communications. This component of the standards differed significantly from internationally recognized standards. China sought to enforce the use of WAPI by mandating a particular algorithm (rather than mandating the need for encryption, and leaving the choice of the algorithm to the market) and providing the necessary algorithm only to a limited number of Chinese companies. Had the standard become mandatory, U.S. and other foreign manufacturers would have been compelled to work with and through these companies, some of which were competitors, and provide them with their proprietary technical product specifications. Following high-level bilateral engagement, China agreed in April 2004 to postpone indefinitely implementation of WAPI and to work within international standards bodies on future development of wireless standards. This commitment led China to submit WAPI for consideration in the International Organization for Standardization (ISO) and International Electrotechnical Commission's (IEC) Joint Technical Committee 1 (ISO/IEC JTC1). In 2006, following balloting of ISO/IEC JTC1 members, the proposed WAPI amendment did not get enough votes to be accepted as an international standard.

In December 2005, the Ministry of Finance, MII, and NDRC jointly issued the Opinions for Implementing Government Procurement of Wireless Local Areas Network, which became effective in February 2006. This measure appears to require all government agencies, quasi-government bodies and government-affiliated organizations, when procuring WLAN and related products using fiscal funds, to give priority to WAPI-compliant products.

Third generation (3G) Telecommunications Standards

For some time, the U.S. telecommunications industry has been very concerned about increasing interference from Chinese regulators, both with regard to the selection of 3G telecommunications standards and in the negotiation of contracts between foreign telecommunications service providers and their Chinese counterparts. In response to U.S. pressure to take a market-based and technology neutral approach to the development of next generation wireless standards for computers and mobile telephones, China announced at the April 2004 JCCT meeting that it would support technology neutrality with regard to the adoption of 3G telecommunications standards and that telecommunications service providers in China would be allowed to make their own choices about which standard to adopt, depending on their individual needs. China also announced that Chinese regulators would not be involved in negotiating royalty payment terms with relevant rights holders. However, by the end of 2004, it had become evident that there was still pressure from within the Chinese government to ensure a place for China's home-grown 3G telecommunications standard, known as TD-SCDMA.

In 2005, China's regulators continued to take steps to promote the TD-SCDMA standard. It also became evident that China's regulators had not ceased their attempts to influence negotiations on royalty payments, both for this technology, and the two other 3G technologies, all of which incorporate intellectual property owned by foreign companies. More recently, in February 2006, China declared TD-SCDMA to be a "national standard" for 3G telecommunications, raising concerns among U.S. and other foreign telecommunications service providers that Chinese mobile telecommunications operators will face Chinese government pressure when deciding what technology to employ in their networks. As a result,

the United States again raised the issue of technology neutrality in connection with the April 2006 JCCT meeting. At that meeting, China restated its April 2004 JCCT commitment to technology neutrality for 3G standards, agreeing to ensure that mobile telecommunications operators would be allowed to make their own choices as to which standard to adopt. China also agreed to issue licenses for all technologies employing 3G standards in a technologically neutral manner that does not advantage one standard over others. To date, China has not issued any 3G licenses to any firm, foreign or domestic, yet its test market for the TD-SCDMA standard continues to expand, with central government approval if not direction, involving infrastructure investments specific to technologies based on this standard worth billions of dollars.

Proposed Mandatory Certification for Information Technology Products

In August 2007, China notified to the WTO TBT Committee a series of 13 proposed regulations mandating that various information technology products be certified for information security functions. The proposed regulations appear to require certification to Chinese national standards for information security, which may be different from international standards used in the global market. It is also unclear whether use of the Chinese standards will require access to algorithms held by Chinese regulators, and if so on what basis those algorithms will be made available. The proposed regulations also appear to expand the CCC mark product scope to the area of information security, which is normally not subject to conformity assessment procedures for private sector use under international practice. At the time China notified the proposed regulations to the WTO TBT Committee, China requested that comments be provided within 60 days of the notification, but did not specify implementation dates for the proposed regulations. Subsequently, in a January 28, 2008 announcement, AQSIQ indicated that all of the 13 regulations will be mandatory for all covered products as of May 1, 2009.

These proposed regulations generated immediate concerns for the United States and U.S. industry, in part because of past actions that China has taken in this area, including China's issuance of mandatory encryption standards for Wi-Fi technologies in 2003 (discussed above) and rules that China issued in 1999 requiring the registration of a wide range of hardware and software products containing encryption technology. The United States will continue to press China on this issue in 2008 to ensure that any regulations China develops in the information security area are consistent with WTO obligations to ensure that technical regulations and conformity assessment procedures are no more trade-restrictive than necessary to fulfill a legitimate objective.

Mobile Telephone Battery Standards

In July 2007, U.S. industry became aware that China's Ministry of Information Industry (MII) was developing a standard that would specify requirements for the size, electrical performance, safety performance and labeling of mobile telephone batteries. MII released a draft of this standard to U.S. industry in September 2007.

Although the draft battery standard on its face is voluntary, the United States and U.S. industry are concerned that it will be integrated into a technical regulation, such as MII's type-approval scheme or the CCC mark program, thereby making compliance mandatory. This result would be problematic because the draft standard appears to diverge from international standards. In addition, it would significantly hamper mobile telephone innovation by focusing on the design of the battery rather than its performance, and it would appear to have the opposite effect of MII's stated justification of promoting consumer convenience and reducing electronic waste. In late 2007 and early 2008, Chinese authorities appear to be taking these concerns seriously, but the United States will continue to monitor this issue.

Chemical Registration

In September 2003, China's State Environmental Protection Administration (SEPA) issued a regulation requiring manufacturers and importers of new chemicals (chemicals not previously registered with SEPA) to apply to SEPA's Chemical Registration Center (CRC) for approval and to provide extensive test data to substantiate the physical properties, consumer safety and environmental impact of the new chemical. U.S. industry's primary concerns are that CRC has not been able to make decisions on the approval of new chemicals in a timely manner and that the approval rules and testing requirements are not transparent or accessible. SEPA's CRC acknowledges receipt of more than 40 completed applications for new chemicals since October 2003. According to the most recent information available from U.S. industry, only a small number of new chemical applications have been approved.

U.S. industry notes that a number of applications have been pending well beyond the 120 day time limit set forth in the regulation. U.S. industry also complains of shifting requirements and implementation of those requirements. For example, China recently expanded eco-toxicity testing requirements to mandate that certain ecological toxicity testing, particularly fish ecological toxicity and biodegradation studies, be carried out in one of six SEPA-accredited laboratories in China. These accredited laboratories have all been established since mid-2004 in response to the September 2003 regulation, and U.S. industry fears that if inexperience leads one of these new laboratories to declare a product unsafe, it could affect sales globally. China's lack of a low volume exemption, meaning an exemption where trade in a given chemical falls below an annual volume threshold, also appears to hinder the importation of U.S. chemicals, particularly for high value specialty chemicals sold in small quantities.

Toxic Chemicals

In December 2005, SEPA and the General Administration on Customs issued the Circular on the Highly Restricted Import/Export Toxic Chemicals List 5 days before it entered into force. In response to U.S. complaints that the notice period was too short, SEPA provided a transition period until June 2006 during which the regulation was apparently not enforced against shipments of chemicals imported from the United States. China subsequently notified the measure to the WTO TBT Committee in June 2006, with no opportunity for comment and no transition period. In addition to these problems, U.S. industry has expressed concerns about excessive fees required to register chemical products, as well as a lack of clarity on the scope of coverage of the measure.

Hazardous Substances

MII and six other Chinese agencies jointly issued the *Administrative Measures on the Control of Pollution Caused by Electronic Information Products* (China RoHS) that took effect in March 2007. China notified its broad framework for China RoHS in September 2005 and notified additional regulatory provisions in May 2006.

China RoHS restricts the use of lead, mercury, cadmium, hexavalent chromium, poly-brominated biphenyls (PBB) and poly-brominated di-phenyl ethers (PBDE) in certain electrical, electronics, information technology, and communication products. China RoHS is being implemented in two phases. The Phase I implementation, which became effective in March 2007, involves labeling and marking requirements for a long list of products. The pending Phase II implementation involves in-country testing and certification using China's CCC mark system; however, many details, including the effective date and the product catalogue to which it will be applicable, remain unclear.

China RoHS is similar to a pre-existing European Union measure (EU RoHS Directive). However, China RoHS differs from the EU RoHS Directive in several ways, including a different scope of products,

unique requirements for labeling and marking across a wide range of electronic information products and, with respect to a yet undetermined range of products, a requirement for CCC mark as an indication that the product has been tested and certified for the absence of the restricted substances.

The China RoHS scheme has created substantial concern for U.S. and other foreign companies in several ways. These companies have expressed concerns about the justification for, and the burdensome nature of, China's labeling and marking requirements for a long list of products. Additionally, the issue of how China's labeling and marking requirements will be applied to products containing many electronic information product components has not been adequately addressed by Chinese regulators, nor have the mandated labeling and marking requirements been notified to the WTO TBT Committee for review and comment. Companies have also expressed concern about China's plans to require an in-country testing and certification process using the CCC mark system for a range of products that China has yet to identify. The planned requirement would ban the sale and import of products that exceed the maximum concentration value allowed for the hazardous substances.

Scrap Recycling

Scrap exports from the United States to China exceeded \$6.2 billion in 2007, making scrap one of the United States' largest exports to China by value. In late 2003, China's AQSIQ issued a notice requiring overseas scrap material exporters to register with AQSIQ. The stated purpose of the new requirement was to better monitor the entry of scrap shipments into China reportedly due to high occurrences of receiving dangerous waste and illegal material in past shipments from overseas. It was not until May 2004 that AQSIQ issued the implementing rules. These rules established registration procedures, including an application deadline of July 2004, and set substantive requirements. In response to U.S. and other WTO Members' concerns that the application period was too short, AQSIQ extended the application deadline to August 2004, allowed companies who submitted incomplete applications to supplement required documents and extended the new requirement's effective date from November 2004 to January 2005.

In 2004, AQSIQ made public on its website the names of overseas exporters approved to ship scrap to China in two postings, the first in mid-October and the second at the end of December, only days before the new registration would take effect. In total, about 85 percent of worldwide applicants were granted approval, including hundreds of U.S. exporters. AQSIQ indicated that it would notify applicants that were not approved and that these exporters would be able to apply again 6 months after receiving notice of their rejection.

In July 2005, AQSIQ posted Bulletin No. 103/2005 on its website, announcing the resumption of the review and approval of registration applications for scrap imports. According to the bulletin, as of August 2005, scrap suppliers must wait 3 years to reapply for registration if they are denied eligibility. A December 2005 AQSIQ notice reported that an additional 260 company registrations had been approved, including 55 U.S. companies.

Since Bulletin No. 103/2005 was published, U.S. scrap exporters continue to experience problems in 2007 related to inconsistent and unexplained rejections of licenses, confusing requirements imposed with little or no notice, and rejections of shipments at the point of entry. The United States is also encountering problems as a result of pre-shipment inspection requirements imposed by the Chinese authorities and conducted by Chinese-authorized inspectors at the shipment origin point. EPA is working with AQSIQ to address information exchange on requirements, testing, training, certification programs, protocols, and other procedures related to exports to the United States.

Scrap Waste

In December 2004, China's President Hu Jintao signed Presidential Order No. 31, publishing the amended *Law for the Prevention of Solid Scrap Waste Pollution*, which became effective in April 2005. According to this law, firms manufacturing, selling, and importing items listed in the mandatory reclamation catalogue must recycle these items, and it is illegal to import scrap waste as component materials that cannot be rendered safe. Depending on the particular item, items that can be safely used as component materials are subject to either restricted import procedures or automatic licensing procedures. SEPA is charged with coordinating with MOFCOM, NDRC, China Customs, and AQSIQ to design, adjust, and publish the catalogues of imported solid scrap waste subject to the restricted or automatic licensing regimes. SEPA and MOFCOM, meanwhile, are responsible for reviewing and issuing licenses for the items subject to restricted import procedures. EPA is working with AQSIQ to address information exchange on requirements, testing, training, certification programs, protocols, and other procedures related to exports to the United States.

Medical Devices

AQSIQ issued Decree 95 - the *Administrative Measures on Examination and Supervision of Imported Medical Devices* - in June 2007, with an effective date of December 2007. Decree 95 was a significant measure that would have imposed an onerous examination and supervision regime on imported medical devices, introducing additional testing and inspection redundancy to the certification schemes administered by China's State Food and Drug Administration and in some cases, CNCA. China issued Decree 95 in final form without notifying the proposed Decree 95 to the WTO's TBT Committee or giving WTO Members an opportunity to comment. The United States, working closely with U.S. industry, raised these concerns in meetings with AQSIQ and MOFCOM during the run-up to the December 2007 JCCT meeting, and AQSIQ on November 30, 2007, issued a notice suspending implementation of Decree 95. During the JCCT meeting, China also agreed to eliminate remaining redundancies in its testing and certification requirements for imported medical devices.

Patents Used in Chinese National Standards

In late 2004, concerns arose following the SAC's issuance of a draft measure – the *Interim Regulations for National Standards Relating to Patents* – and public statements by key Chinese government officials that appeared to contemplate compulsory licensing of patented technologies that are used for national standards in China. Standards organizations have varying patent policies depending upon the nature of the standards organizations. Accredited standards developing organizations typically require disclosure of intellectual property in the standards developing process, and support “reasonable and nondiscriminatory” (RAND) policies, requiring that right holders make any intellectual property incorporated in the standards developed within the organizations available to all interested parties on RAND terms. Typically, licensing terms are then negotiated between the right holder and parties interested in implementing the standards. Although the initial draft of this measure did not expressly call for compulsory licensing and subsequent drafts have not been released for public comment, public statements by key Chinese government officials have generated U.S. industry concern that the final version of the measure may require foreign enterprises to share their patented technologies on a royalty-free basis in exchange for the opportunity to participate in developing standards. While the current status of this measure is unclear, the United States has urged China to circulate an updated draft for public comment and will closely monitor developments in this area in 2008. In 2006, the Chinese Electronic Standardization Institute (CESI), a Chinese government institution, released draft intellectual property policy rules for standards-setting organizations (SSOs). These draft rules envisage Chinese government involvement in standard-setting processes, including a requirement that SSOs obtain government approval for patent claims. Such government involvement could be exercised in a way that impacts upon

private party transactions. This could raise concerns under certain circumstances. The United States is following China's treatment of intellectual property in SSOs, including the development and finalization of CESI's rules. The United States also understands that China is developing a new standardization law in 2008. Reportedly, a draft of that law has been circulated among China's ministries and is undergoing vigorous debate before the State Council.

Distilled Spirits Standards

China notified a proposed revision of its distilled spirits standard in August 2006, after several years of bilateral engagement and discussions at the WTO during meetings of the TBT Committee. This proposed revision was welcomed by U.S. industry, as it would eliminate the requirement for tolerance levels of superior alcohols, or fusel oil, and bring China's standard in line with international norms. China issued this same standard in final form and began implementing it in 2007.

Sanitary and Phytosanitary (SPS) Measures

China made little progress in 2007 to resolve high profile issues such as its current import suspension of U.S.-origin beef, beef products, and live cattle related to Bovine Spongiform Encephalopathy (BSE); its avian influenza-related import suspension on poultry and poultry products from seven U.S. states; and its apparent failure to adopt a science based approach for its position on tolerances for pathogens and residues.

China's apparent lack of scientific evidence and transparency for its SPS measures remained a problem in 2007. For example, China failed to notify to the WTO numerous SPS measures, resulting in three specific measures that were adopted without the benefit of comments from other interested WTO Members. In 2006, China failed to notify 22 measures to the SPS Committee, and did not notify them in 2007. In some cases, it is not clear whether the adopted measures were based on sufficient scientific evidence, and/or may raise national treatment concerns. U.S. engagement with China at the WTO and bilaterally, including through the provision of technical assistance, has helped to improve China's compliance with WTO transparency obligations. At the same time, however, various U.S. agricultural exports continue to be subjected to entry, inspection, and labeling requirements that were not notified or face import bans that appear to be maintained without sufficient scientific evidence. In particular, the year 2007 saw a significant increase in problems regarding market access for U.S. meat and poultry products, resulting in the delisting of several U.S. plants for export to China. The most problematic of China's SPS measures are described below.

BSE-Related Bans on Beef and Low-Risk Bovine Products

In December 2003, China and other countries imposed a ban on U.S. cattle, beef and processed beef products in response to a case of BSE found in a dairy cow which had been imported from Canada into the United States. Since that time, the United States has repeatedly provided China with extensive technical information on all aspects of its BSE-related surveillance and mitigation measures, internationally recognized by the World Organization for Animal Health (OIE) as effective and appropriate, for both food safety and animal health.

To date, China still has not provided any scientific justification for continuing to maintain its ban, nor has it identified any of the administrative and regulatory steps necessary to lift the ban, even though the OIE has determined that the United States is a controlled risk country for BSE. The OIE provides for conditions under which trade in all beef and beef products from animals of any age can be safely traded and the United States expects China to provide access to U.S. beef and beef products in accordance with the OIE guidelines. Although China sent a technical team to the United States in October 2005, this visit

did not advance a resolution of the impasse. At the April 2006 JCCT meeting, China agreed to conditionally reopen the Chinese market to U.S. beef, subject to the negotiation and finalization of an import protocol. Jointly negotiated protocols, and accompanying export certificates, are normal measures necessary for the export of any livestock products from the United States to China or other trading partners. At the end of June 2006, after three inconclusive rounds of negotiations, China's food safety regulators unilaterally announced a limited market opening, restricted to the entry of U.S. deboned beef from animals 30 months of age or less. One month later, they followed up that announcement with an announcement of 22 onerous entry conditions, many of which were unrelated to BSE. In May 2007, Vice Premier Wu Yi offered to open China's market to deboned and bone-in beef from animals 30 months or less, although the remaining onerous entry conditions were unchanged. These unilateral announcements had no practical effect, because, as with any trading partners seeking to engage in livestock trade, the United States and China would have had to agree on language for actual export safety certificates before the trade could resume. Since then, the United States has pressed China to reconsider its position and to negotiate an appropriate protocol in light of China's WTO SPS Agreement obligations and relevant OIE guidelines.

At the same time that it banned U.S. cattle, beef and processed beef products, China also banned low-risk or "safe to trade" bovine products (*i.e.*, bovine semen and embryos, protein-free tallow, and nonruminant feeds and fats) even though they are deemed tradable based on OIE guidelines regardless of a country's BSE status. After numerous bilateral meetings and technical discussions in 2004, including a visit to U.S. bovine facilities by Chinese food safety officials, China announced a lifting of its BSE-related ban for low-risk bovine products in late September 2004. However, China conditioned the lifting of the ban on the negotiation of protocol agreements setting technical and certification parameters for incoming low-risk bovine products. In November 2004, U.S. and Chinese officials finalized and signed protocols that would enable the resumption of exports of U.S. origin bovine semen and embryos, contingent on facility certification by China's regulatory authorities, as well as a resumption of exports of U.S.-origin nonruminant feeds and fats. In July 2005, China finally announced the resumption of trade in bovine semen and embryos, following certifications for 52 U.S. facilities made earlier in the year. However, trade in U.S.-origin nonruminant feeds and fats did not resume, as China's regulatory authorities insisted on a series of onerous, detailed, and unnecessary information requirements that do not appear to be consistent with OIE guidelines and contrast sharply with U.S. requirements. As a result of further negotiations in December 2005, export certificates were finalized, and trade resumed in early 2006. Meanwhile, trade in protein-free tallow had not resumed by the end of 2006, as U.S. and Chinese officials had not reached agreement on provisions of a protocol. In February 2007, China notified the WTO that importers no longer had to provide the BSE Cosmetic Certificate to the Cosmetic, Toiletry, and Fragrance Association, removing one hurdle to U.S. cosmetics suppliers.

Avian Influenza (AI)

In February 2004, China imposed a nationwide ban on U.S. poultry in response to cases of low-pathogenic AI (LPAI) found in Delaware. China maintained this import suspension when highly pathogenic AI (HPAI) was subsequently detected in Texas later that month. Throughout 2004, the United States provided technical information to China on the AI situation in the United States, and in August 2004 a high-level Chinese delegation conducted a review of the status of HPAI eradication efforts in the United States. In December 2004, China lifted its nationwide ban on U.S. poultry, but has continued to impose a state ban whenever LPAI was detected in an individual state. As of February 2008, poultry exports to China are banned from Connecticut, Rhode Island, Nebraska, New York, Pennsylvania, Virginia, and West Virginia. Additionally, China bans the importation of U.S. origin poultry products that are transshipped through states where low pathogenic notifiable avian influenza (LPNAI) has been detected. The OIE modified the AI chapter in 2006 to incorporate two types of notifiable LPAI. Prior to 2006, only HPAI was notifiable.

China's current AI related import suspensions appear to be inconsistent with OIE guidelines. OIE guidelines clearly distinguish between requirements for regaining AI free status and requirements for the safe trade in poultry and poultry products. OIE guidelines do not require AI-free status for trade to continue when LPAI detections occur. The United States continues to push for Chinese compliance with OIE guidelines and a total lifting of all bans on the importation of U.S. origin poultry and poultry products due to LPAI detections.

Zero Tolerance for Pathogens and Animal Drug Residues

In recent years, China has intermittently applied SPS-related requirements on imported raw meat and poultry that do not appear to be based on a risk assessment or scientific principles. One requirement establishes a zero tolerance limit for the presence of Salmonella bacteria. A similar zero tolerance limit exists for Escherichia Coli and Listeria pathogens. Meanwhile, the complete elimination of these enteropathogenic bacteria is generally considered unachievable by the international scientific community without first subjecting raw meat and poultry to a process of irradiation. Moreover, China apparently does not apply this same standard to domestic raw poultry and meat.

As of the JCCT meeting in December 2007, 15 U.S. pork and poultry plants had been delisted by China for alleged violations of zero tolerance standards for pathogens or detection of certain chemical residues. Despite extensive technical and political engagement to explain the U.S. approach to regulation of pathogens and residues, China has been reluctant to change its policies that resulted in the delisting of the U.S. plants. During the JCCT meeting in December 2007, China agreed to allow six U.S. pork processing facilities to resume exports to China, but these plants must still meet China's residue requirements, which are not feasible for much of the U.S. pork industry and do not appear to be based on scientific principles.

Meanwhile, China continues to maintain maximum levels (MLs) for certain heavy metals and maximum residue levels (MRLs) for certain veterinary drugs that appear to be inconsistent with Codex Alimentarius Commission standards and appear to lack a scientific basis. U.S. regulatory officials have encouraged their Chinese counterparts to adopt standards that are scientifically based, safe, and minimally trade disruptive. In the case of one particular veterinary drug, ractopamine, which is approved by the U.S. Food and Drug Administration for use in U.S. pork production, China maintains a zero tolerance limit even though it has not conducted a risk assessment. U.S. officials have requested that China quickly complete a risk assessment for this product, and establish MRLs that are scientifically based.

Food Additive Standards

China continues to block many U.S. processed food products from entering the Chinese market by banning certain food additives that are widely used in other countries and have been approved by the World Health Organization. The most recent example is China's proposed *Hygienic Standard for Uses of Food Additives*, notified to the WTO in July 2005. This proposed technical regulation is 237 pages long and covers dozens of residues and additives for nearly 1,000 commodities. In some cases, it employs domestic nomenclature rather than internationally recognized technical terms, making it difficult to assess its impact on specific products. The United States submitted detailed comments on the proposed technical regulation and asked China to delay its adoption until a thorough review could take place.

Biotechnology Regulations

In January 2002, the Ministry of Agriculture (MOA) issued new rules implementing June 2001 regulations on agricultural biotechnology safety, testing, and labeling. The product most affected by these rules was soybeans, while corn and other commodities were also potentially affected. However, the rules did not provide adequate time for completion of required safety assessments before their effective date of March 20, 2002. In response to U.S. interventions, China issued interim rules, which allowed trade to continue while authorities carried out safety assessments of biotechnology products. These interim rules were extended twice and were set to expire in April 2004. In December 2003 talks, MOA officials promised that approval of Round-up Ready soybeans would be completed at least 60 days before expiration of the interim rules in order to prevent any trade disruption. China followed through on this promise and approved Round-up Ready soybeans, along with two cotton events and two corn events, in February 2004. Two months later, China issued final safety certificates for four additional corn events and seven canola events. China issued a formal safety certificate for another corn event later in 2004, leaving only one corn event still awaiting final approval. During the July 2005 JCCT meeting, MOA issued the final safety certificate for the remaining corn event. All of the approvals made in 2004 and 2005 were for 3 year renewable safety certificates. In January 2007, MOA renewed safety certificates for all of the events that had originally been approved 3 years earlier.

In early 2007, MOA issued and implemented some troubling new regulations without circulating them for public comment in advance or consulting with relevant stakeholders, including the United States and U.S. industry. For example, in January 2007, MOA added a new requirement that biotechnology seed companies turn over key intellectual property as part of the application process when seeking safety certificates. In March 2007, MOA halted a pilot program, which had been developed over 2 years of bilateral discussions, aimed at allowing the review of products under development in the United States prior to completion of the U.S. approval process. As a result, the MOA approval process would only begin after the completion of the U.S. approval process. This means that even if the MOA approval process proceeds quickly, trade may still be disrupted, as importers will need time to apply for vessel based safety certificates and Quarantine Inspection Permits, both of which require valid safety certificates for biotechnology products and can take up to 30 working days. At the JCCT meeting in December 2007, in response to U.S. engagement, China agreed to eliminate the requirement that technology companies submit viable biotechnology seeds for the development of testing methodology when applying for import registration.

Despite some progress in China's maturing regulatory and legal systems for biotechnology products, potential disruptions to trade arise due to limited timelines for submission of products, asynchronous approvals, the lack of clarity on assessment requirements for stacked (multiple trait) products and, at times, duplicative testing requirements.

Food Labeling

The U.S. processed food industry has registered concerns with a number of standards and labeling requirements on its exports to China. The meat industry in particular is concerned with labeling regulations issued in late 2002. Chinese agricultural importers and importers of processed foods are also concerned about labeling requirements for products containing material developed through the use of biotechnology, such as soybeans and corn. The June 2001, biotechnology regulations issued by MOA require labeling of bulk commodities, but implementation has been limited and sporadic. Future implementation of these measures remains uncertain.

The distilled spirits industry is concerned that China will require its products to comply with all existing food labeling requirements. The industry believes that some of these requirements are inappropriate. For example, China requires distilled spirits product labels to include a bottling date. According to accepted international practice relating to wines and spirits, however, the date of manufacture (production or bottling date) is not required. Because many spirits products consist of a blend of spirits that are aged for varying periods, a single “date of manufacture” is often not possible to specify, would not represent the actual age of the product and would confuse consumers regarding the actual age of the product. China also requires the labels of distilled spirits products to include a list of ingredients, even though the original ingredients (*e.g.*, corn, wheat, rye, and barley) are completely transformed and are no longer present after distillation. Furthermore, China maintains typeface specifications and translation requirements that may raise questions regarding consistency with international standards.

EXPORT REGULATION

Export Duties, Licenses, and Quotas

Despite China’s commitment since its accession to the WTO to eliminate all taxes and charges on exports, including export duties, except as included in Annex VI to the Protocol of Accession or applied in conformity with Article VIII of GATT 1994, China has continued to impose restrictions on exports of raw materials, including quotas, related licensing requirements, and duties, as China’s state planners have continued to guide the development of downstream industries. These export restrictions are widespread. For example, China maintains export quotas and sometimes export duties on antimony, bauxite, coke, fluorspar, indium, magnesium carbonate, molybdenum, rare earths, silicon, talc, tin, tungsten, and zinc, all of which are of key interest to U.S. downstream producers.

These types of export restrictions can significantly distort trade. In the case of China, the trade-distortive impact is exacerbated because China is the world’s leading producer of each of the raw materials at issue (except for molybdenum and bauxite, for which China is the world’s second leading producer).

China’s export restrictions affect U.S. and other foreign producers of a wide range of downstream products, such as steel, chemicals, ceramics, semiconductor chips, refrigerants, medical imagery, aircraft, refined petroleum products, fiber optic cables, and catalytic converters, among numerous others. The export restrictions can create disadvantages for these foreign producers by artificially increasing China’s export prices for their raw material inputs, which also drives up world prices. At the same time, the export restrictions can artificially lower China’s domestic prices for the raw materials due to significant domestic oversupply, enabling China’s domestic downstream producers to produce lower-priced products from the raw materials and thereby creating significant advantages for China’s domestic downstream producers when competing against foreign downstream producers both in the China market and in export markets.

Despite extensive U.S. engagement in this area, which began shortly after China's WTO accession, China appears to have maintained its policies for these input materials. In fact, over time, China's state planners have increased the artificial advantages afforded to China's downstream producers by making the export quotas more restrictive and by imposing or increasing export duties on many raw materials at issue.

China's state planners also attempt to manage the export of many intermediate and downstream products, often by raising or lowering the VAT rebate available upon export and sometimes by imposing or retracting export duties. These practices have caused tremendous disruption, uncertainty, and unfairness in the markets for particular products.

Sometimes the objective of these adjustments is to make larger quantities of a product available domestically at lower prices than the rest of the world. For example, China decided in 2006 to eliminate the 13 percent VAT rebate available on the export of refined metal lead and then, in 2007, imposed a duty of 10 percent on refined metal lead exports. These actions caused a steep decline in China's exports of this intermediate product and have contributed to a sharp rise in world prices, which have gone from approximately \$1,300 per MT at the time of China's elimination of the export VAT rebate in 2006 to approximately \$3,200 per MT in recent months. Meanwhile, Chinese domestic prices have reportedly declined because of China's captive refined metal lead production, giving China's downstream producers a substantial competitive advantage over foreign downstream producers.

In other recent situations, China has reduced or eliminated VAT export rebates in an attempt to rein in out-of-control expansion of production capacity in particular sectors. China resorts to this practice in part because it has not yet developed a fully functioning market economy and therefore cannot simply leave it to the market to bring about the necessary adjustments. In some instances, the adjustments have benefited U.S. producers by slowing significant increases in low-priced exports from China to the United States. However, the adjustments can also have harmful consequences, whether or not intended. For example, in November 2006 and April 2007, China reduced export VAT rebates that had been available on a wide range of semi-finished and finished steel products, as part of its efforts to discourage further unneeded creation of production capacity for these products in China. At the same time, these export VAT rebate reductions did not target all steel products, and the result was that Chinese steel producers shifted their production to steel products for which full export VAT rebates were still available, particularly steel pipe and tube products, causing a significant increase in exports of these products – many of which found their way into the U.S. market.

To date, China has been willing to take certain steps towards remedying some of the unintended consequences of its measures when the United States has brought them to China's attention. In July 2007, for example, China issued a notice extending export VAT rebate reductions to most steel pipe and tube products, with the notable exception of oil country tubular goods.

Export Subsidies

China officially abolished subsidies in the form of direct budgetary outlays for exports of industrial goods on January 1, 1991. In its Protocol of Accession to the WTO, China committed to eliminate all subsidies prohibited under Article III of the WTO Agreement on Subsidies and Countervailing Measures, including all forms of export subsidies on industrial and agricultural goods, upon its accession to the WTO in December 2001.

A general lack of transparency makes it difficult to identify and quantify possible export subsidies provided by the Chinese government. China's subsidy programs are often the result of internal administrative measures and are not publicized. Sometimes they take the form of income tax reductions

or exemptions. They can also take a variety of other forms, including mechanisms such as debt forgiveness and reduction of freight charges. U.S. industry has alleged that subsidization is a key reason that Chinese exports are undercutting prices in the United States and gaining market share. Of particular concern are China's practices in the steel, petrochemical, high technology, forestry and paper products, textiles, hardwood plywood, machinery and copper, and other nonferrous metals industries.

In April 2006, China finally submitted its long overdue subsidies notification to the WTO's Subsidies Committee. Although the notification is lengthy, with over 70 subsidy programs reported, it is also notably incomplete, as it failed to notify any subsidies provided by China's state owned banks or by provincial and local government authorities. In addition, while China notified several subsidies that appear to be prohibited under WTO rules, it did so without making any commitment to withdraw them, and it failed to notify other subsidies that appear to be prohibited.

Through the remainder of 2006, the United States pressed China to withdraw the subsidies that appear to be prohibited, which include both export subsidies and import substitution subsidies and benefit a wide range of industries in China, principally through income tax and VAT exemptions and reductions. However, China was unwilling to commit to the immediate withdrawal of these subsidies. Accordingly, the United States, with Mexico as a co-complainant, initiated a challenge to these subsidies under the WTO's dispute settlement procedures in early 2007. Following consultations in March and June 2007, the United States and Mexico requested the establishment of a dispute settlement panel in July 2007. The WTO established a panel in August to hear the dispute and, following extensive dialogue with China, the United States and Mexico suspended the dispute settlement case with China on November 29, 2007 when China agreed to eliminate all of the prohibited subsidies at issue by January 1, 2008.

Shortly after China acceded to the WTO, U.S. corn exporters began to express concern that China was subsidizing its corn exports. In 2002 and 2003, it appeared that significant quantities of corn had been exported from China, including corn from Chinese government stocks, at prices that may have been 15 percent to 20 percent below domestic prices in China. As a result, U.S. corn exporters were losing market share for corn in their traditional Asian markets, such as South Korea and Malaysia, while China was exporting record amounts of corn. In 2004, however, trade analysts began to conclude that, because of several economic factors, including changes in the relationship between domestic prices and world prices, China was trending toward becoming a net importer of corn. One result appears to be that China's exports are largely made on a commercial basis. In December, 2007, the Ministry of Finance announced several measures aimed at curbing grain and oilseed exports. The measures that affect corn exports include the elimination of the 13 percent VAT rebate and a temporary export tax of 5 percent, effectively halting corn exports.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

With its acceptance of the TRIPS Agreement, China accepted obligations to adhere to generally accepted international norms to protect and enforce the IPR held by U.S. and other foreign companies and individuals in China. Specifically, the TRIPS Agreement sets minimum standards of protection for copyrights and neighboring rights, trademarks, geographical indications, industrial designs, patents, integrated circuit layout designs, and undisclosed information. Minimum standards are also established by the TRIPS Agreement for IPR enforcement in administrative and civil actions and, in regard to copyright piracy and trademark counterfeiting, in criminal actions and actions at the border. The TRIPS Agreement additionally requires that, with very limited exceptions, WTO Members provide national and Most Favored Nation (MFN) treatment to the nationals of other WTO Members with regard to the protection and enforcement of IPR.

Since its accession to the WTO, China has overhauled its legal regime and put in place a comprehensive set of laws and regulations aimed at protecting the IPR of domestic and foreign entities in China. At the same time, some key improvements in China's legal framework are still needed, and China has continued to demonstrate little success in actually enforcing its laws and regulations to provide deterrence in the face of the challenges created by widespread counterfeiting, piracy and other forms of infringement. As a result, in 2007, the United States' bilateral efforts with China continued to focus on obtaining improvements to multiple aspects of China's system of IPR protection and enforcement so that significant reductions in IPR infringement in China could be realized and sustained over time.

Several weaknesses in all aspects of China's enforcement system—criminal, civil, and administrative—contribute to China's poor IPR enforcement record. For example, one major weakness is China's chronic underutilization of deterrent criminal remedies. In particular, legal measures in China that establish high thresholds for criminal prosecution and/or conviction preclude criminal penalties for many instances of commercial scale counterfeiting and piracy, create a "safe harbor" for pirates and counterfeiters and raise concerns that China may not be complying with its obligations under the TRIPS Agreement. Other procedural burdens, such as an inability to investigate based on suspicion of criminality also weaken the criminal IPR system.

The United States is seeking to resolve its concern about excessive legal thresholds for criminal prosecution, along with concerns regarding border enforcement and deficiencies in the legal protections for copyrights where works do not have China's censorship approval, in a WTO dispute that it filed in April 2007. Viewed as a whole, the case focuses on deficiencies in China's legal regime for protecting and enforcing copyrights and trademarks on a wide range of products.

An exacerbating factor here is China's maintenance of import and distribution restrictions for measures affecting certain types of legitimate copyright-intensive products, such as theatrical films, digital video discs, music, books and journals, as well as related foreign service suppliers. These restrictions inadvertently help to ensure that infringing products continue to dominate those sectors within China. As discussed above in the sections on Trading Rights and Distribution Services, the United States is addressing these restrictions in another WTO dispute filed in April 2007.

China's leaders began to demonstrate a willingness to address U.S. concerns in October 2003 when a new IPR Leading Group was formed, signaling a more focused and sustained effort by China to tackle the IPR enforcement problem. Many officials in China, led by President Hu Jintao, Premier Wen Jiabao, and Vice Premier Wu Yi, continued to voice China's commitment to protecting IPR in subsequent years and work hard to make it a reality. They allocated substantial resources to the effort and attempted to improve not only public awareness but also training and coordination among the numerous Chinese government entities involved in IPR enforcement while simultaneously fighting local protectionism and corruption. Sustained involvement by China's leaders is critical if China is to deliver on the IPR commitments that it made at the April 2004, July 2005, April 2006, and December 2007 JCCT meetings, including China's core commitment to significantly reduce IPR infringement levels across the country.

As previously reported, building on earlier engagement with China, the United States conducted an out-of-cycle review under the Special 301 provisions of U.S. trade law in 2006 and 2007. This review involved a systematic evaluation of China's entire IPR enforcement regime and concluded in April 2007 with the Administration's elevation of China to the Special 301 "Priority Watch" list and the creation of a comprehensive strategy for addressing China's ineffective IPR enforcement regime, which included the possible use of WTO mechanisms, as appropriate.

At the July 2005 JCCT meeting, the United States sought and obtained China's agreement to take a series of specific actions designed to among other things: (1) increase prosecutions of IPR violators; (2) improve

enforcement at the border; (3) counter piracy of movies, audio visual products and software; (4) address Internet-related piracy; and (5) assist small and medium sized U.S. companies experiencing China-related IPR problems. To date, China has taken steps to fulfill many of these commitments. It adopted amended rules governing the transfer of administrative and customs cases to criminal authorities, and it took some steps to pursue administrative actions against end user software piracy. China posted an IPR Ombudsman to its Embassy in Washington, who has facilitated contacts between U.S. Government officials and their counterparts in Beijing and has been a source of information for U.S. businesses, including small and medium size companies. China has also sought to expand enforcement cooperation.

Meanwhile, in October 2005, the United States submitted a request to China under Article 63.3 of the TRIPS Agreement, as did both Japan and Switzerland, seeking more transparency on IPR infringement levels and enforcement activities in China, with the objective of obtaining a better basis for assessing the effectiveness of China's efforts to improve IPR enforcement since China's accession to the WTO. However, despite the United States' extensive efforts to follow up on its Article 63.3 request bilaterally, China provided only limited information in response, hampering the United States' ability to evaluate whether China is taking all necessary steps to address the rampant IPR infringement found throughout China.

In 2006, the United States again used the JCCT process, including the IPR Working Group created at the April 2004 JCCT meeting, to secure new IPR commitments and, in a few instances, specific actions to implement past commitments. In advance of the April 2006 JCCT meeting, China took enforcement actions against plants that produce pirated optical discs and it also issued new rules that require computers to be pre-installed with licensed operating system software. At the meeting itself, China further committed to ensure the use of legal software in Chinese enterprises and to discuss issues of government and enterprise software asset management in the JCCT IPR Working Group. China also agreed to work on cooperating to combat infringing goods displayed at trade fairs in China and to intensify efforts to eliminate infringing products at major consumer markets in China, such as the Silk Street Market in Beijing. The two sides further agreed that they would increase cooperation between their respective law enforcement authorities and customs authorities and that the United States would provide China with additional technical assistance to aid China in fully implementing the World Intellectual Property Organization (WIPO) Internet treaties, *i.e.*, the WIPO Copyright Treaty and the WIPO Performance and Phonograms Treaty. In addition, China reaffirmed its prior commitments to continue efforts to ensure the use of legal software at all levels of government and to adopt procedures to ensure that enterprises use legal software, beginning with state owned enterprises and other large enterprises.

Since the April 2006 JCCT meeting, China has made some progress in implementing its commitments, but its progress has been slower than in the past. One bright spot appears to be China's implementation of the new rules requiring computers to be pre-installed with licensed operating system software, as U.S. industry continues to be pleased with the results of that effort. China's Supreme People's Court and Supreme People's Procuratorate also issued a new judicial interpretation in April 2007 that lowered the volume threshold for criminal prosecution and conviction with respect to certain acts of copyright and related rights infringement.

In 2007, the United States continued to use bilateral discussions to encourage China to improve its IPR enforcement regime. These discussions focused on concrete steps that China could take to improve its legal protections and enforcement efforts. When it was clear, however, that these efforts at dialogue would yield insufficient progress, the United States filed the two IPR-related WTO disputes in April 2007. Later that month, USTR issued its Special 301 report, which left China on the Priority Watch List and subject to Section 306 monitoring. USTR's report was informed by a special review conducted in 2006 and 2007 to examine the adequacy and effectiveness of IPR protection and enforcement at the provincial government level. As the Special 301 report explains, the provincial review revealed strengths,

weaknesses, and inconsistencies in and among China's provinces. After filing of the two WTO disputes and the issuance of the Special 301 report, the United States continued to seek ways to work together with China to improve China's IPR enforcement regime. These efforts yielded some results, such as the signing of a Memorandum on Cooperation in IPR Enforcement between the two countries' customs authorities. However, after the United States filed the IP related WTO disputes, there has been limited cooperation from China on IPR related issues, despite the fact that the issues at the heart of the disputes involve specific legal deficiencies that could not be resolved through dialogue.

At the December 2007 JCCT meeting, China reported on steps it has taken since the previous JCCT meeting in April 2006 to improve protection of IPR in China, including accession to the WIPO Internet treaties, a crackdown on the sale of computers not pre-loaded with legitimate software, enforcement efforts against counterfeit textbooks and teaching materials, and joint enforcement raids conducted by the U.S. Federal Bureau of Investigation and Chinese security agencies. China and the United States agreed to exchange information on customs seizures of counterfeit goods in order to further focus China's enforcement resources on companies exporting such goods. China agreed to strengthen enforcement of laws against company name misuse, a practice in which some Chinese companies have registered legitimate U.S. trademarks and trade names without legal authority to do so. The two sides also agreed to cooperate on case-by-case enforcement against such company name misuse. In addition, China agreed to eliminate the requirement to submit viable bioengineered seeds for testing, a policy change which reduces the possibility of illegal copying of patented agricultural materials.

At the SED meeting in May 2007, the United States and China agreed to Principles and Outcomes for Strengthening Innovation Cooperation (SED Principles and Outcomes), including a decision to "jointly host a seminar on the innovation ecosystem in 2007 that would gather experts to discuss and share experiences on both sides regarding the critical elements of developing an environment conducive to technological innovation." To realize this commitment, the two governments co-hosted an Innovation Conference on December 10, 2007 in Beijing. At this meeting, both sides reaffirmed that innovation is best fostered where there is effective rule of law, and where governments pursue market-oriented policies that encourage merit-based competition, entrepreneurship, commercialization of new technologies, and flexibility for users and producers in choosing among competing technologies. Both sides also confirmed the essential role of a robust intellectual property protection and enforcement regime in supporting an innovation ecosystem.

Legal Framework

In most respects, China's framework of laws, regulations, and implementing rules on IPR remains largely satisfactory. However, reforms are needed in a few key areas, such as further improvement of China's measures for copyright protection on the Internet following the notable achievement of China's accession to the WIPO Internet treaties. In particular, more work is needed at both the national level and the provincial level to meet the challenges of Internet piracy and fully implement the WIPO Internet treaties in the face of the rapid growth of the Internet. Right holders have also pointed to a number of continuing deficiencies in China's criminal measures. Most notably, as discussed above, China's high thresholds for criminal prosecution and/or conviction raise concerns with respect to China's compliance with its obligations under the TRIPS Agreement.

At the time of its accession to the WTO, China was in the process of modifying the full range of IPR laws, regulations, and implementing rules, including those relating to patents, trademarks, and copyrights. China had completed amendments to its Patent Law, Trademark Law, and Copyright Law, along with regulations for the Patent Law. Within several months after its accession, China issued regulations for the Trademark Law and the Copyright Law, followed by implementing rules. China also issued regulations and implementing rules covering specific subject areas, such as integrated circuits, computer software,

and pharmaceuticals. U.S. experts carefully reviewed these measures after their issuance and, together with other WTO Members, participated in a comprehensive review of them as part of the first transitional review of China before the TRIPS Council in 2002.

Since 2003, China has periodically issued new IPR measures. The U.S. Government has reviewed these measures through bilateral discussions and subsequent TRIPS Council reviews. Encouragingly, China has also become more willing to circulate proposed measures for public comment and to discuss proposed measures with interested trading partners and stakeholders. For example, the United States and U.S. right holders provided written comments to China on several drafts of regulations for the protection of copyrights on information networks.

In 2007, China announced a new Action Plan for revising its legal regime in order to better protect IPR. Among other things, this Action Plan sets out China's intentions for revising various laws and other measures, including the Patent Law, the Trademark Law, and related measures. China subsequently released new versions of both the Patent Law and the Trademark Law for public comment. Since then, the United States has been assessing the potential ramifications of the contemplated revisions for U.S. right holders. The United States and U.S. industry groups have also submitted written comments at various stages in the drafting of the proposed laws and regulations, along with invitations to continue dialogue on these important pieces of legislation. It is expected that the release in 2008 of the National IPR Strategy will further guide the drafting of these and other IPR related laws and regulations.

China has also been working on other proposed legal measures that could have significant implications for the IPR of foreign right holders. In particular, China issued an Antimonopoly Law in August 2007 and is considering rules relating to the treatment of IPR by standards setting organizations. The United States has been carefully monitoring these efforts and raised concerns with particular aspects of these proposals, both in bilateral meetings and at the WTO during the annual transitional reviews before the TRIPS Council and the TBT Committee.

The United States, meanwhile, has repeatedly urged China to pursue additional legislative and regulatory changes, using both bilateral meetings and the annual transitional reviews before the TRIPS Council. The focus of the United States' efforts is to persuade China to improve its legal regime in certain critical areas, such as criminal, civil, and administrative IPR enforcement and legislative and regulatory reform. For example, obstacles that have been noted in the area of criminal enforcement include China's high thresholds for prosecution and/or conviction; the lack of criminal liability for certain acts of copyright infringement; the requirement that certain IPR infringement be done with a profit-making purpose in order to be subject to criminal liability; the requirement that a counterfeit trademark must be identical to a legitimate trademark in order for criminal liability to be triggered; and the absence of minimum, proportional sentences and clear standards for initiation of police investigations in cases where there is a reasonable suspicion of criminal activity. At the same time, the United States has also been pressing China to consider a variety of improvements to its administrative and civil enforcement regimes. While some of these issues may not raise specific WTO concerns, all of them will continue to detract from China's enforcement efforts until addressed.

In the Action Plan issued in April 2007, China undertook to "study and further improve" its December 2004 judicial interpretation on the handling of criminal IPR cases and to consider a variety of other steps that could potentially improve the legal framework for criminal, civil, and administrative IPR enforcement. China's Supreme People's Court and Supreme People's Procuratorate also jointly issued a new judicial interpretation that appeared to resolve one issue in a prior judicial interpretation related to China's problematic thresholds, namely, the problem that China's criminal law appeared to provide for the prosecution and/or conviction of unauthorized reproduction of certain copyrighted works only when accompanied by unauthorized distribution. At the same time, however, Chinese government officials

have given no indication whether the study and improvement foreseen in the 2007 Action Plan will lead to the reduction or elimination of China's criminal thresholds—a key concern in light of China's obligations under the TRIPS Agreement. The United States has included this issue in its WTO dispute challenging apparent deficiencies in China's IPR enforcement regime.

The United States has also sought improvements in China's copyright protection in the context of electronic information networks since the April 2004 JCCT meeting. China took an important step at the time of that meeting when the National Copyright Administration (NCA) issued the *Measures for Administrative Protection of Copyright on the Internet*. In advance of the July 2005 JCCT meeting, the United States urged China to accede to the WIPO Internet treaties and to fully harmonize its regulations and implementing rules with them. Accession to these treaties is not required under WTO rules, but they incorporate important international norms for providing copyright protection over the Internet. These treaties have been ratified by many developed and developing countries since they entered into force in 2002. In the case of China, this type of copyright protection is especially important in light of its rapidly increasing number of Internet users, many of whom increasingly have broadband access. At the July 2005 JCCT meeting, the United States obtained China's commitment to submit the legislative package necessary for China's accession to the WIPO Internet treaties to the National People's Congress by June 2006. In June of 2007, China acceded to the WIPO Internet Treaties. China has also moved forward with the harmonization of some of its regulations and implementing rules in 2005 and 2006. In May 2006, for example, the State Council adopted an important Internet related regulation, the *Regulations on the Protection of Copyright over Information Networks*, which went into effect in July 2006. Overall, this regulation represents a welcome step, demonstrating China's determination to improve protection of electronic data. This regulation is not comprehensive, however. A number of gaps remain to be filled for China to meet the challenges of Internet piracy and fully implement the WIPO Internet treaties.

With respect to software piracy, China issued new rules in advance of the 2006 JCCT meeting that require computers to be pre-installed with licensed operating system software and government agencies to purchase only computers satisfying this requirement. Combined with ongoing implementation of previous JCCT commitments on software piracy, it is hoped that these rules will contribute to significant further reductions in industry losses due to software piracy. According to the U.S. software industry, China's software piracy rate has dropped 10 percentage points in the last 3 years, and the legitimate software market grew to nearly \$1.2 billion in 2006 – an increase of over 350 percent since 2003. Achieving sustained reductions in end-user software piracy, however, will require more enforcement by China's authorities, followed by high profile publicity of fines and other remedies imposed.

In the customs area, the United States is encouraged by the Customs Administration's increased efforts to provide effective enforcement against counterfeit and pirated goods destined for export and the Customs Administration's agreement in 2007 to cooperate with U.S. customs authorities to fight exports of counterfeit and pirated goods. Nevertheless, the United States remains concerned about various aspects of the *Regulations on the Customs Protection of Intellectual Property Rights*, issued by the State Council in December 2003, and the Customs Administration's May 2004 implementing rules. These measures were intended to improve border enforcement, by simplifying the process for right holders to secure effective enforcement at the border and strengthening fines and punishments. Disposal of confiscated goods remains a problem under the implementing rules, which, among other concerns, appear in some circumstances to mandate auction of seized products following removal of infringing features, rather than destruction or disposal outside of commerce. The United States raised the customs border enforcement measures as part of its April 2007 WTO case challenging deficiencies in China's IPR enforcement regime. There also continue to be problems in referring customs violations to criminal prosecutions.

The United States also remains concerned about a variety of weaknesses in China's legal framework that do not effectively deter, and may even encourage, certain types of infringing activity, such as the

“squatting” of foreign company names, designs, and trademarks; the theft of trade secrets; the registration of other companies’ trademarks as design patents and vice versa; the use of falsified or misleading license documents or company documentation to create the appearance of legitimacy in counterfeiting operations; and false indications of geographic origin of products. In 2007, the United States continued to discuss these and other problems with China and seek solutions for them. In a positive development, the State Administration of Industry and Commerce (SAIC) announced in August 2007 that it was launching a 6 month campaign targeting the unauthorized use of well-known trademarks and company names in the enterprise registration process. In addition, the State Intellectual Property Office (SIPO) has taken steps to punish patent agents who are involved in “squatting” on the designs or inventions of others.

In the pharmaceutical sector, the United States continues to make measured progress in working with China to address a range of concerns. At the JCCT meeting in December 2007, the two sides noted the signing of a Memorandum of Agreement between the U.S. Department of Health and Human Services and China’s State Food and Drug Administration on active pharmaceutical ingredients (APIs). Beyond this, China agreed in the JCCT to address specific loopholes in its regulation of bulk chemicals used as APIs. Cooperation with industry on many criminal pharmaceutical counterfeiting cases has also reportedly improved. However, a lack of clarity in laws involving generic drug patent infringement appears to be contributing to the continued growth of drug counterfeiting, with corresponding health and safety problems. The United States has concerns about the extent to which China provides adequate protection against unfair commercial use for data generated to obtain marketing approval. The United States also has concerns regarding the limited progress towards patent term restoration to compensate for delays in regulatory approval, and the continuing lack of effective legal mechanisms to resolve patent disputes prior to marketing approval of pharmaceutical products.

With respect to China’s patent-related laws, right holders have noted that the narrow scope of patentable subject matter makes patents for transgenic plants and animals and methods of treatment or diagnosis virtually unobtainable. Concerns have been raised that draft amendments to the Patent Law that were recently made available for public comment will require disclosure of origins of genetic resources used in the completion of an invention, and that claims in a patent application may be rejected on the basis that this disclosure requirement is not met. Also, U.S. industry has expressed frustration over the quality of design patents being issued, due in part to the lack of a better system of examining design patent applications.

Enforcement

Although the central government displayed strong leadership in modifying the full range of China’s IPR laws and regulations in an effort to implement China’s WTO obligations, effective IPR enforcement has not been achieved, and IPR infringement remains a serious problem in China. IPR enforcement is hampered by a lack of coordination among Chinese government ministries and agencies, a lack of training, resource constraints, lack of transparency in the enforcement process and its outcomes, and local protectionism and corruption.

Despite repeated antipiracy campaigns in China and an increasing number of civil IPR cases in Chinese courts, overall piracy and counterfeiting levels in China remained unacceptably high in 2007. IPR infringement continued to affect products, brands, and technologies from a wide range of industries, including films, music and sound recordings, publishing, business and entertainment software, pharmaceuticals, chemicals, information technology, apparel, athletic footwear, textile fabrics and floor coverings, consumer goods, food and beverages, electrical equipment, automotive parts and industrial products, among many others. Furthermore, limitations on the operations of trade associations representing foreign right holders in China, including restrictions on the number of employees, hamper

the ability of those organizations to assist right holders with effectively using China's legal system to support IPR enforcement.

U.S. industry estimates that levels of piracy in China across all lines of copyright business ranged between 80 percent and 95 percent based on data for 2007, which indicates little or no overall improvement over 2006. Trade in pirated optical discs continues to thrive, supplied by both licensed and unlicensed factories and by smugglers. Small retail shops continue to be the major commercial outlets for pirated movies and music (and a variety of counterfeit goods), and roaming vendors offering cheap pirated discs continue to be visible in major cities across China. As a result of a sustained campaign by municipal management authorities and others, some reduction in street sales of pirated goods in well-trafficked areas has been noted. Piracy of books and journals and end user piracy of business software also remain key concerns, although improvements have been seen in business software piracy rates, as discussed above, and there were some positive developments in fighting university textbook piracy. In addition, Internet piracy is increasing, as is piracy over enclosed networks such as those of universities. The NCA also began to undertake campaigns to combat Internet piracy and additional steps may occur in advance of the Olympics.

Although China made a commitment at the July 2005 JCCT meeting to take aggressive action against movie piracy, including enhanced enforcement for titles not yet authorized for distribution, right holders have monitored China's efforts and report little meaningful improvement in piracy of pre-release titles in several major cities. For that reason, the lack of copyright protection for works that have not been approved for release in China is one of the issues raised in the U.S. WTO case challenging deficiencies in China's IPR enforcement regime.

China's widespread counterfeiting not only harms the business interests of foreign right holders, but also includes many products that pose a direct threat to the health and safety of consumers in the United States, China and elsewhere, such as pharmaceuticals, food and beverages, batteries, automobile parts, industrial equipment, and toys, among many other products. At the same time, the harm from counterfeiting is not limited to right holders and consumers. China estimated its own annual tax losses due to counterfeiting at more than \$3.2 billion back in 2002, and this figure could only have grown in the ensuing years. Widespread counterfeiting and piracy also significantly harms China's efforts to become an innovative economy.

The United States places the highest priority on addressing the IPR protection and enforcement problems in China, and since 2004 it has devoted significant additional staff and resources, both in Washington and in Beijing, to address these problems. A domestic Chinese business constituency is also increasingly active in promoting IPR protection and enforcement. In fact, Chinese right holders own the vast majority of design patents, utility models, trademarks, and plant varieties in China and have become the principal filers of invention patents. In addition, most of the IPR enforcement efforts in China are now undertaken at the behest of Chinese right holders seeking to protect their interests. Nevertheless, it is clear that there will continue to be a need for sustained efforts from the United States and other WTO Members and their industries, along with the devotion of considerable resources and political will to IPR protection and enforcement by the Chinese government, if significant improvements are to be achieved.

As in prior years, the United States worked with central, provincial, and local government officials in China in 2007 in a determined and sustained effort to improve China's IPR enforcement, with a particular emphasis on the need for dramatically increased utilization of criminal remedies as well as the need to improve the effectiveness of civil and administrative enforcement mechanisms. A variety of U.S. agencies held regular bilateral discussions with their Chinese counterparts and have conducted numerous technical assistance programs for central, provincial, and local government officials on international IPR standards, IPR enforcement methods, and other rule of law issues. USTR also completed its special

provincial government-level review in 2007, and the results revealed IPR enforcement strengths and weaknesses in key locations. In addition, the United States Embassy organized another annual roundtable meeting in China designed to bring together U.S. and Chinese government and industry officials. The United States also continued to urge China to use the IPR Working Group created at the April 2004 JCCT meeting to address outstanding issues required to make needed changes, although China demonstrated reluctance to pursue this avenue of cooperation after the United States filed two IPR-related WTO disputes in April 2007.

The United States' efforts have also benefited from cooperation with other WTO Members seeking improvements in China's IPR enforcement, both on the ground in China and at the WTO during meetings of the TRIPS Council. For example, the United States, Japan, and Switzerland made coordinated requests under Article 63.3 of the TRIPS Agreement in order to obtain more information about IPR infringement levels and enforcement activities in China and provide a better basis for assessing the effectiveness of China's efforts to improve IPR enforcement since China's accession to the WTO. In addition, the United States and the EC have increased coordination and information sharing on a range of China IPR issues over the last year. The United States also works with APEC members, including China, to develop regional best practices on IPR protection and enforcement. In addition, several WTO Members requested third party status in one or both of the United States' April 2007 IPR related WTO cases against China, underscoring the significance of these disputes.

The United States has also continued to pursue a comprehensive initiative to combat the enormous global trade in counterfeit and pirated goods, including exports of infringing goods from China to the United States and the rest of the world. This initiative, the Strategy Targeting Organized Piracy (STOP!), is a U.S. Government-wide effort to stop fakes at the U.S. border, to empower U.S. businesses to secure and enforce their IPR in overseas markets, to expose international counterfeiters and pirates, to keep global supply chains free of infringing goods, to dismantle criminal enterprises that steal U.S. intellectual property and to reach out to like-minded U.S. trading partners in order to build an international coalition to stop counterfeiting and piracy worldwide. China's share of infringing goods seized at the U.S. border stood at 80 percent in fiscal year 2007, according to data from U.S. customs authorities.

China is making genuine efforts to improve IPR enforcement. U.S. industry has confirmed that some of China's special campaigns, such as the "Mountain Eagle" campaign against trademark infringement crimes that ended in 2006, have in fact resulted in increased arrests and seizures of infringing materials, although the disposition of seized goods and the outcomes of criminal cases remain largely obscured by a lack of transparency. The 2007 Action Plan, which China stated at the JCCT meeting in December 2007 was 80 percent complete, announced that China would launch more special crackdown efforts with regard to various IPR infringement problems. The United States has urged China to use its implementation of such efforts as an opportunity to tackle emerging enforcement challenges, particularly the sale of pirated and counterfeit goods on the Internet. In addition, the United States has suggested that China use this opportunity to examine the potential benefits of specialized national IPR courts and prosecutors, providing quality trademark examinations by maintaining relative examination and faster adjudications for administrative opposition and cancellation proceedings, and ensuring that the resources available to local administrative, police, and judicial authorities charged with protecting and enforcing IPR are adequate to the task.

Nevertheless, despite its many positive efforts to improve IPR enforcement, China pursues other policies that continue to impede effective enforcement. These policies led the United States to resort to the WTO dispute settlement mechanism in 2007, over the claims discussed above. At the same time, other changes are needed on the market access side. As discussed above, China maintains market access barriers, such as import and distribution restrictions, which discourage and delay the introduction of numerous types of legitimate foreign products into China's market. These barriers create additional incentives for

infringement of copyrighted products like theatrical films, DVDs, music, books, and journals and inevitably lead consumers to the black market, again compounding the severe problems already faced by China's enforcement authorities.

SERVICES BARRIERS

Until China's entry into the WTO, China's service sectors were among the most heavily regulated and protected sectors of the national economy. Foreign service providers were largely restricted to operations under the terms of selective "experimental" licenses. However, both as a matter of policy and as a result of its WTO commitments, China decided to significantly liberalize access to its service sectors. At present, the market for services, underdeveloped due to historical attitudes and policies, has significant growth potential in both the short and long term.

However, many challenges remain in securing the benefits of China's services commitments. While China continued to keep pace nominally with the openings required by its Protocol of Accession to the WTO, it also continued to maintain or erect terms of entry in some sectors that were so high or cumbersome as to prevent or discourage foreign suppliers from gaining market access. For example, excessive and often discriminatory capital requirements continued to restrict market entry for foreign suppliers in many sectors, such as telecommunications, construction, and insurance. In other sectors, such as construction services, problematic measures appear to be taking away previously acquired market access rights.

Meanwhile, the Administrative Licensing Law, which took effect in July 2004, has increased transparency in the licensing process, while reducing procedural obstacles and strengthening the legal environment for domestic and foreign enterprises. As a result, the licensing process in many sectors continued to proceed in a regular fashion in 2007, although concerns about unfair discrimination, lack of transparency and delays in licensing remained in key sectors, including financial services, express delivery services, and telecommunications.

Insurance Services

While some progress has been made in transparency and market access, U.S. insurance companies seeking to serve the China market continue to report a number of problems. For example, U.S. and other foreign companies have had difficulty expanding their operations once they have established them in China. China's insurance regulator (CIRC) does not allow foreign life and non-life insurance subsidiaries established in China to apply for and receive multiple, concurrent approvals to expand their operations through internal branches. Foreign companies are limited to consecutive (one-by-one) approvals. In contrast, Chinese insurers do seem to receive such multiple, concurrent approvals. U.S. insurers also are concerned that CIRC imposes additional capital requirements for each additional internal branch beyond the \$200 million registered capital required for each insurers' initial establishment as a subsidiary.

U.S. insurance companies also seek flexibility regarding CIRC's requirements relating to the ability of insurance companies to manage their assets directly and to invest their foreign exchange overseas. U.S. companies also seek credit from CIRC for their global operations, both in terms of meeting "seasoning" requirements and demonstrating an adequate asset base.

In addition, as China continues to grow its overseas investments, political risk insurance will become of greater importance to Chinese companies. However, China does not currently allow the private sector to compete with Sinosure (the Chinese Overseas Investment Company) in providing such insurance products.

U.S. companies also are concerned regarding information that China's postal operator (China Post) may have been granted a license to supply insurance through its existing network of Post facilities. Such a license may have the effect of impeding competition from the private sector, depending on China Post's scope of operations and how it will be regulated. Finally, with regard to the reinsurance sector, China's regulations on the Administration of Insurance Business issued by CIRC in 2005 may require insurance companies that are seeking reinsurance to provide right of first refusal to insurance companies established in China.

U.S. insurance companies seek for China to liberalize its equity restrictions to allow foreign life insurers to establish wholly foreign-owned subsidiaries (they are currently capped at 50 percent joint-ventures) and to expand the scope of brokerage products that can be offered. U.S. insurance companies also would like China to liberalize its third party automobile and related transport insurance regime—China currently closes this type of “statutory” insurance to foreign participation.

Private Pensions—Enterprise Annuities

Several U.S. and foreign companies have found it very difficult to obtain a license to participate in China's market for “enterprise annuities” services (private pensions similar to U.S. 401ks), which will grow in importance as China develops alternatives to China's underfunded social security system. China recently opened up a new window for considering license applications but at the close of that process, China licensed only one foreign joint-venture to provide one component of such services. The United States remains very concerned that China's process for licensing in this sector is not transparent, imposes quotas on the number of licenses granted (rather than approving all qualified suppliers), appears to be discriminatory, and does not allow for a bundled license to cover the various components of enterprise annuities services.

Banking Services

In its Protocol of Accession to the WTO, China committed to a 5 year phase-in for banking services by foreign banks. Immediately upon its accession, China allowed U.S. and other foreign banks to conduct foreign currency business without any market access or national treatment limitations and to conduct domestic currency business with foreign-invested enterprises and foreign individuals, subject to certain geographic restrictions. Two years after accession, foreign banks were allowed to conduct domestic currency business with Chinese enterprises, also subject to certain geographic restrictions, which were lifted gradually over the following 3 years. Prior to the fifth year after accession, the China Banking Regulatory Commission (CBRC) issued new rules to allow foreign banks to conduct domestic currency business with Chinese individuals without any geographic restrictions. China also committed to provide financial leasing services at the same time that Chinese banks were permitted to do so.

By the end of September 2006, 260 foreign banks, including a number of U.S. banks, reportedly had branches or representative offices in China, although only major banks have had enough resources to enter the retail domestic currency business. By the end of 2006, the total assets of foreign banks in China reportedly had reached \$123 billion, representing approximately 2.1 percent of total banking assets in China. In some coastal cities, the amount was higher. For example, in Shanghai, foreign banks' assets reportedly represented 14.02 percent of total banking assets at the end of 2005.

The 5 year phase-in period for banking services by foreign banks ended on December 11, 2006. In November 2006, the State Council issued the Regulations for the Administration of Foreign-Funded Banks as a way to allow foreign banks to compete in all lines of banking business on the same terms as domestic banks. These regulations, however, required foreign banks to incorporate locally. Moreover, the regulations mandate that only foreign-funded banks that have had a representative office in China for

2 years and that have total assets exceeding \$10 billion can apply to incorporate in China. After incorporating, moreover, these banks only become eligible to offer full domestic currency services to Chinese individuals if they can demonstrate that they have operated in China for 3 years and have had 2 consecutive years of profits. Foreign banks seeking to operate in China through branches instead of through subsidiaries saw some relaxation of prior restrictions, but not enough to effectively allow them to compete in the retail domestic currency business. Specifically, foreign bank branches can continue to take deposits from, and make loans to, Chinese enterprises in domestic currency, but they can only take domestic currency deposits of RMB1 million (\$133,000) or more from Chinese individuals and cannot make any domestic currency loans to Chinese individuals. Foreign bank branches also cannot issue domestic currency credit cards to Chinese enterprises or Chinese individuals.

Throughout the drafting process for the regulations, the China Banking Regulatory Commission (CBRC) demonstrated uncommon transparency and allowed domestic banks, foreign banks, and foreign governments to comment. The CBRC addressed many of the key U.S. concerns with early drafts, particularly by allowing transition periods to meet prudential standards for foreign banks choosing to convert to local subsidiaries. In addition, the CBRC fulfilled its commitment to process applications for foreign bank branches to convert to local subsidiaries within 3 months after receipt. To date, five foreign banks have received approval to convert to subsidiaries. However, Chinese regulators have not approved their applications to issue local currency debit and credit cards, nor given them the ability to trade or underwrite commercial paper or long-term listed RMB bonds. (See section on credit cards below). At the SED meeting in December 2007, China agreed to allow locally incorporated foreign banks to issue RMB financial bonds (traded on the interbank market). This is a welcomed move that provides an alternative RMB fundraising method compared to retail deposits and borrowing from foreign affiliates.

A remaining area of concern involves the establishment of Chinese-foreign joint venture banks. China continues to follow a 2003 regulation that defines a “Chinese bank” as one that has less than 25 percent foreign ownership, with no single foreign investor having over 19.9 percent (the so-called 20/25 rule). China draws a distinction between domestic and foreign companies through different regulatory rules and mechanisms. Under this bifurcated regulatory structure, if a Chinese bank were to sell over 25 percent of its shares to foreign investors, it would be classified as a foreign bank and fall under separate rules, which would reduce its permitted scope of business. While the November 2006 State Council regulations virtually eliminate any significant differences in rules for locally-incorporated foreign banks and domestic Chinese banks, the possibility of increasing foreign stakes in Chinese banks above the 25 percent threshold—thus falling under the regulatory scrutiny for foreign banks—and continuing the full range of banking business has not been tested. At the SED meeting in December 2007, the CBRC provided details on a timeframe for a study of foreign participation in China’s banking sector, which is part of its regular policy assessment mechanism. A draft report will be completed in the first quarter of 2008 and the whole process will be completed by December 31, 2008. By that time, based on the policy assessment’s conclusions, the CBRC will make policy recommendations on foreign equity participation.

Securities Services

In December 2005, China instituted a moratorium on foreign investment in the securities sector, claiming the need to better regulate domestic companies and further develop the sector. In December 2007, as follow-up to an SED commitment, China announced that it had lifted the moratorium on the securities sector, and several foreign firms have begun discussions with potential joint venture partners. However, China continues to apply the 33 percent foreign equity limit on the sector that is included in its GATS Services Schedule (as well as a 49 percent foreign equity limit for the asset management sector). China announced at the December 2007 SED meeting that the China Securities Regulatory Commission will conduct an assessment of foreign participation in China’s securities market and make a recommendation on whether foreign equity limits can be raised.

In late 2007, China issued rules that allow foreign joint venture securities firms to gradually expand their scope of business. However, the regulations seem to contain a number of troublesome aspects that will continue to limit competition in the sector, whether for new entrants or for acquisitions of shares in existing companies.

Financial Information Services

In its Protocol of Accession to the WTO, China committed that, for the services included in its Services Schedule, the relevant regulatory authorities would be separate from, and not accountable to any service suppliers they regulated with two specified exceptions. One of the services included in China's Services Schedule—and not listed as an exception—is the “provision and transfer of financial information, and financial data processing and related software by suppliers of other financial services.”

China does not appear to have an independent regulator for financial information services. Xinhua News Agency, the Chinese state news agency, appears to be not only the regulator of, but also a competitor to foreign financial information service providers in China.

In September 2006, Xinhua issued the *Administrative Measures on News and Information Release by Foreign News Agencies* within China. These regulations preclude foreign providers of financial information services from contracting directly with, or providing financial information services directly to, domestic Chinese clients. Instead, foreign financial information service providers would have to operate through a Xinhua-designated agent, and the one agent designated to date is a Xinhua affiliate. These new restrictions do not apply to domestic financial information service providers and, in addition, contrast with the rights previously enjoyed by foreign information service providers since well before China's accession to the WTO in December 2001.

In response to complaints from the United States and the European Union, China's Premier publicly promised in September 2006 that the new rules would not change how foreign financial information service providers did business in China. Shortly thereafter, Xinhua told foreign financial information service providers that the new rules would not be applied to them until after an implementing measure was issued; however, Xinhua subsequently required foreign financial information service providers to conclude agreements with the Xinhua affiliate before renewing their annual licenses. Foreign financial information service providers have continued to operate, but without renewed licenses. In March 2008, the United States filed a request for WTO dispute settlement consultations with China concerning China's restrictions on financial information services. The European Union has filed a similar request.

Credit Cards

In the Services Schedule accompanying its Protocol of Accession to the WTO, China committed to remove market access limitations and provide national treatment for foreign suppliers providing “payment and money transmission services, including credit, charge, and debit cards,” with this commitment becoming effective with regard to the RMB business of retail clients no later than December 11, 2006. China also extended this commitment to cover the provision and transfer of financial information, financial data processing and advisory, intermediation, and other financial services auxiliary to payments and money transmission services.

However, the United States remains concerned that China has not yet issued regulations to allow foreign companies to operate electronic payment systems for single brand, RMB denominated credit cards. China Union Pay is the sole authorized provider of electronic payment services in China. The United States has continued to raise this issue with China since July 2006, in the SED, JCCT, and other fora, without

progress. The People's Bank of China is reportedly drafting implementing regulations but has not provided any timetable for completing this task nor any assurances that the regulations will open up the electronic payments industry to foreign competition.

Wholesaling Services and Commission Agents' Services

MOFCOM's 2006 *Notice on Entrusting National Economic and Technological Development Zones with the Authority to Approve Foreign-Funded Distribution Firms and International Forwarding Agents* solved a number of problems regarding China's regime for licensing providers of wholesaling services. With the issuance of that measure, MOFCOM devolved the right to grant distribution licenses from the central authorities to provincial level authorities, making the application and approval process more efficient and less time-consuming, although some technical challenges remain with regard to, for example, manufacturing enterprises seeking to expand the scope of their business to include distribution activities.

However, the U.S. wholesale industry is still facing certain barriers. U.S. industry remains seriously concerned about continuing restrictions on the rights of foreign enterprises to engage in wholesale (and retail) distribution of books, newspapers, periodicals, electronic publications, and audio and video products. Some measures, such as the April 2004 distribution services regulations, purport to allow foreign enterprises to engage in wholesale (and retail) distribution of these products. However, a host of other measures appear to impose market access or national treatment limitations, such as the July 2005 *Several Opinions on Canvassing Foreign Investment into the Cultural Sector* issued jointly by the Ministry of Culture, the State Administration of Radio, Film, and Television, General Administration of Press and Publication (GAPP), National Development and Reform Commission (NDRC), and the Ministry of Commerce; NDRC's updated November 2007 *Catalogue for the Guidance of Foreign Investment Industries*; the *Provisions on the Administration of the Publication Market*, issued by GAPP in June 2004; the *Rule on Management of Foreign-Invested Book, Magazine and Newspaper Distribution Enterprises*, issued by GAPP and MOFTEC in March 2003; and the *Administrative Regulations on Electronic Publications*, issued by GAPP in December 1997. Under these measures, for some of the products at issue, distribution is limited to Chinese state-owned enterprises. For others, only Chinese-foreign joint ventures with minority foreign ownership are permitted to engage in distribution or foreign enterprises face restrictive requirements not imposed on domestic enterprises. After negotiations on this issue bore no fruit, the United States in April 2007 filed a WTO dispute on measures affecting trading rights, distribution of, and distribution services for certain publications and audio-visual entertainment products.

In addition, while U.S. industry has generally welcomed China's measures to govern distribution of automobiles by foreign enterprises (*Implementing Rules for the Administration of Brand-Specific Automobile Dealerships*, jointly issued by MOFCOM, the NDRC, and SAIC in February 2005; NDRC's *Rules for Auto External Marks* in November 2005; MOFCOM's *Implementing Rules for the Evaluation of Eligibility of Auto General Distributors and Brand-specific Dealers* in January 2006), they do contain some restrictions on foreign enterprises that are not in all cases required of domestic enterprises.

In addition, since China began allowing the acceptance of applications from foreign pharmaceutical companies for wholesale distribution licenses in the second half of 2005, U.S. and other foreign pharmaceutical companies have been able to obtain wholesale distribution licenses under the April 2004 distribution services regulations and the SFDA's *Rules on the Management of Drug Business Licenses*. However, it appears that some provincial-level authorities have not yet begun issuing these licenses because of uncertainty generated by the provision in the April 2004 distribution services regulations indicating that MOFCOM would issue separate regulations covering pharmaceuticals. The United States continues to engage the Chinese regulatory authorities in these areas as part of an effort to promote

comprehensive reform of China's healthcare system and to reduce unnecessary trade barriers.

U.S. industry remains concerned about the uncertainty created by the provision in the April 2004 distribution services regulations that allows the local approving authorities to withhold wholesale (and retail) distribution license approvals when, as is the case in most cities, urban commercial network plans have not yet been formulated. This provision could operate as a *de facto* restriction on the operations of foreign wholesalers (and retailers).

Finally, in early December 2006, China issued the *Measures for the Administration of the Market for Crude Oil and the Measures for the Administration of the Market for Refined Oil Products*. However, these regulations impose high thresholds and other potential impediments on foreign enterprises seeking to enter the wholesale distribution sector, such as requirements relating to levels of storage capacity, pipelines, rail lines, docks, and supply contracts. These requirements appear designed to maintain the monopolies enjoyed by state-owned China National Petroleum Corporation and China Petrochemical Corporation. The United States is working with U.S. industry to assess China's implementation of the regulations on wholesale distribution of crude oil and processed oil.

Retailing Services

Although MOFCOM's issuance of the *Notice on Entrusting National Economic and Technological Development Zones with the Authority to Approve Foreign-Funded Distribution Firms and International Forwarding Agents* in February 2006 vastly improved China's regime for licensing retail services providers, U.S. industry is still facing certain barriers.

First, U.S. industry continues to have concerns with regard to the provision in the April 2004 distribution services regulations allowing the approving authorities to withhold retail distribution license approvals when, as is the case in many cities, urban commercial network plans have not yet been formulated. It appears that China may be applying this provision in a discriminatory manner. In April 2006, MOFCOM issued a notice explaining that foreign-invested enterprises would not be granted approvals for projects in cities that had not yet finalized their urban commercial network plans, while it appears that domestic enterprises continue to receive approvals for their projects.

In addition, the U.S. retail industry is increasingly concerned about other extra burdens that it faces, in comparison to domestic retailers, when attempting to expand their operations in China. For example, the licensing process for a foreign retailer seeking to establish a new store begins with a MOFCOM process, which is multi layered and slow moving, requiring approvals at the local, provincial, and central government levels. Only after the MOFCOM process is completed can the foreign retailer obtain an actual license from SAIC. In contrast, domestic retailers can quickly obtain licenses directly from SAIC. In addition, domestic retailers do not need to satisfy substantive requirements that are imposed on foreign companies, such as an additional minimum capital requirement for each new store or, as discussed above, a requirement that the location city for the new store have an urban commercial network plan in place.

Franchising Services

Starting on May 1, 2007, the *Regulations on the Administration of Commercial Franchises*, promulgated by the State Council, and the *Administrative Rules on Commercial Franchise Filing* and the *Administrative Rules on Commercial Franchising – Information Disclosure*, both issued by MOFCOM, replaced 2005 MOFCOM Measures that were of concern to U.S. industry. The new laws have significantly changed the Chinese legal landscape for franchising and should contribute to a much more accessible market for international franchisors. The new laws greatly relax an earlier rule that severely restricted eligibility to offer franchises in China. In addition, compared to the 2005 MOFCOM Measures,

the new laws make it clear that they also apply to the cross border franchise business. Unlike the 2005 MOFCOM Measures, the franchisor is not required to bear joint and several liability for the quality of products provided by its designated suppliers. The new law imposes a filing requirement on franchisors and failure to comply with that requirement could result in penalties, including orders for rectification and fines and public criticism. However, failure to file with the Chinese government will not lead to the concerned franchisor losing its legal capacity to sell franchises in China. Finally, the new law provides the franchisee the ability to rescind the franchise contract if the franchisor conceals relevant information or provides false information. The government also reserves the authority to request additional disclosures from franchisors.

Sales Away From a Fixed Location

In 2005, the Chinese authorities issued the measures designed to implement China's direct selling commitments – the *Measures for the Administration of Direct Selling* and the *Regulations on the Administration of Anti-Pyramid Sales Scams*. These measures contain several problematic provisions. For example, one provision outlaws the standard industry practice of paying compensation based on team sales, where upstream personnel are compensated based on downstream sales. In addition, the measures contain a cap limiting the amount of compensation based on sales revenue to 30 percent, which inhibits direct selling companies from employing compensation as a tool to motivate their sales representatives. Other problematic provisions include onerous and vague requirements to establish fixed location “service centers” in each urban district where direct sellers operate; a 3 year experience requirement that only applies to foreign enterprises; restrictions on the cross-border supply of direct selling services; limitations on product categories permitted for direct sales; and high capital requirements that may limit smaller direct sellers' access to the market. The measures also impose burdensome education and certification requirements for salespersons and trainers, forbidding foreigners from working in either capacity.

In September 2006, China issued implementing rules governing the establishment of direct selling service centers. These rules, while clarifying some aspects of the earlier measures, also include vague provisions that could lead to undue local requirements being placed on service centers. Nonetheless, the rules should result in the streamlining of service center requirements at the national level.

Under the 2005 measures, a direct selling company must receive approvals from both MOFCOM and SAIC before beginning operations. MOFCOM had approved 18 licenses to Chinese and foreign companies by the end of 2007; other license requests are in various stages of the process. Despite this progress, the MOFCOM licensing process has been characterized by a lack of transparency and significant delays. The 2005 measures establish a 90-day license approval process, but most of the MOFCOM approvals took between 4 months and 11 months. The scope of licenses approved by MOFCOM has also been limited, with many companies finding it difficult to obtain approvals to conduct direct selling in more than one province in China. At times, the SAIC's role in the approval process has been problematic.

Express Delivery Services

Although several foreign, including U.S., express delivery companies are expanding their operations in China, a number of aspects of China's postal and express delivery regime continue to cause concerns. U.S. concerns break down into two main areas: transparency or the ability to comment on draft laws and regulations before they enter into force; and ensuring that the substance of any such legal instruments does not discriminate against foreign companies and is not overly burdensome.

Regarding transparency, the industry was not given sufficient time to review or comment on the latest draft of the Postal Law (the ninth draft) on new “Express Delivery Standards” issued in September 2007 or on other related postal and express documents.

The United States is concerned that the ninth draft of the Postal Law includes language that could severely limit the ability of private express delivery firms to operate in China by reserving delivery of certain letters to China Post and other documents to China Post and Chinese domestic express delivery companies. The draft, which has not been made public, may also include an unfair imposition of a universal postal services tax that would be extended beyond the postal realm to private sector express providers.

The new Express Delivery Standards also may negatively affect foreign express delivery providers. In most economies express delivery is not regulated directly. In contrast, the Chinese standards cover many operational issues including many commercial decisions such as weight, transit time, and personnel requirements that would normally remain within the purview of individual companies in the marketplace. China has affirmed that such standards are voluntary but there is concern that they could become mandatory under law or in practice. Industry also is concerned that many provinces are establishing industry associations with certain regulatory powers.

On the related issue of air freight forwarding, wholly-foreign owned express delivery companies cannot qualify for an Air Transport Agency license and therefore do not have the ability to directly load cargo on Chinese domestic or international flights, but instead must work through a Chinese agent.

Construction, Engineering, Architectural, and Contracting Services

In September 2002, the Ministry of Construction and the Ministry of Foreign Trade and Economic Cooperation (now MOFCOM) issued the *Rules on Administration of Foreign-Invested Construction Enterprises* (known as Decree 113) and *Rules on the Administration of Foreign-Invested Construction Engineering and Design Enterprises* (known as Decree 114). Decrees 113 and 114 create concerns for foreign firms by imposing new and more restrictive conditions than existed prior to China's WTO accession, when they were permitted to work in China on a project-by-project basis pursuant to Ministry of Construction rules. These Decrees for the first time require foreign-invested enterprises to incorporate in China, and they impose high minimum registered capital requirements and technical personnel staff requirements that are difficult for many foreign-invested enterprises to satisfy. Decree 113 also limits the scope of projects (in terms of size and scale) permitted to foreign-invested enterprises in comparison with the rights enjoyed by domestic companies.

Regarding Decree 113, the United States has urged China to broaden the scope of projects that can be undertaken. The United States also is asking China to reduce its minimum capital requirements and/or consider bonding and other guarantee arrangements in lieu of minimum capital. Although China issued implementing rules for Decree 114 in late 2006 that address some of the concerns of foreign construction engineering and design enterprises, other aspects of these rules are troubling. For example, the United States is asking China to consider the experience of parent and affiliated firms when considering qualifications to carry out certain “grades” of projects. The United States also is asking that the Decree 114 implementing rules be made permanent.

In a related measure, Circular 200 imposes certain overly burdensome qualification requirements on foreign suppliers of project management services. Specifically, China does not allow foreign companies to provide project management services without already holding construction or design enterprise approvals.

Logistics Services

China has multiple agencies overseeing each mode of transportation that results in overlapping jurisdictions, multiple sets of approval requirements, and opaque or conflicting regulations, all of which hinders market access. Among the government bodies with some responsibility for this sector are the Ministry of Communications (MOC), Ministry of Railways, MOFCOM, Customs, the State Post Bureau, and the Civil Aviation authorities. China is giving some consideration to consolidating such regulatory authority.

MOC has been slow to approve applications by foreign logistics firms and is unwilling to issue nationwide trucking licenses, which limits the ability of foreign firms to build economies of scale. In addition, according to local regulations, trucks are not allowed daytime city access in almost all major Chinese cities. China's enforcement efforts are often targeted at foreign transport/logistics firms, while local firms are permitted to operate without full compliance.

There also are growing concerns about the use of inappropriate standards that may hinder market access for logistics firms. Companies have complained about AQSIQ standards issued in April 2005 that are unnecessarily burdensome since they establish artificial classifications of transport, warehousing, and multi-purpose activities. In addition, freight forwarding firms are concerned about their exclusion from these regulatory categories because it may prevent their participation in standards-setting activities.

Aviation and Maritime Services

Robust bilateral engagement with China through multiple rounds of negotiations between January and May 2007—under the auspices of the SED—yielded an amended bilateral air services agreement that was signed in July 2007. The new agreement will bring significant economic benefits to the U.S. aviation industry, passengers, shippers, and local communities. It is an important step to facilitate trade, investment, tourism, and cultural exchanges between the U.S. and China. It allows for significantly expanded air service between the United States and China. The agreement will add 12 new daily passenger flights that U.S. carriers may operate to the Chinese gateway cities of Beijing, Shanghai, and Guangzhou through 2012, more than doubling the number of flights currently operating. The new agreement also provides for unlimited cargo flights to any point in China and allows an unlimited number of U.S. cargo carriers to serve the market as of 2011. Finally, it will also increase the available opportunities for U.S. carriers to code-share on other U.S. carriers' flights to China, and it commits the U.S. and China to launch Open Skies negotiations in 2010.

In 2003, China took steps to liberalize the maritime services sector. The United States and China signed a far-reaching, 5 year bilateral maritime agreement, which gave U.S. registered companies the legal flexibility to perform an extensive range of additional shipping and logistics activities in China. U.S. shipping and container transport services companies, along with their subsidiaries, affiliates and joint ventures are also able to establish branch offices in China without geographic limitation. Under the framework of the 2003 agreement, the United States and China have annual consultations. The first annual consultations were held in Washington, DC in March 2006 and the second round was held in Shanghai in November 2007.

Telecommunications

In addition to market access commitments in the WTO, which came into full effect in 2007, China also accepted key pro-competitive regulatory principles from the WTO Reference Paper. As a result, China became obligated among other things to separate the regulatory and operating functions of MII (which had been both the telecommunications regulatory agency in China and the operator of China Telecom)

and to implement its regulations in an impartial manner. While the formal separation of regulator and operator has occurred, evidence of continued MII influence over operational decisions of the telecommunications operators (*e.g.*, relating to personnel, corporate organization, allocation of spectrum and standards) suggests that regulatory independence may be far from complete. In addition, while shares are not directly held by MII, the government maintains a controlling stake in all major basic telecommunications operators, creating a potential conflict of interest between the government's role as regulator (and guarantor of trade commitments) and owner of these companies.

China also became obligated to ensure transparency in licensing and the allocation of spectrum and interconnection with major suppliers on reasonable, transparent, and nondiscriminatory terms and conditions and at cost-based rates as well as to maintain measure to prevent anticompetitive behavior. There is concern that China may be lagging in implementing these commitments, however. For example, with respect to anticompetitive behavior, both Chinese authorities and the two major fixed line operators have confirmed that the operators entered into an agreement to limit competing in each others' home territory. Although the governmental role in promoting such arrangements is unclear, the regulator has spoken favorably about the benefits of this agreement as reducing "unhealthy" competition. In terms of China's obligation to ensure the public availability of interconnection agreements, there is no sign that major suppliers in China have made their interconnection arrangements public.

With limited foreign participation in the market, it has been difficult to assess China's compliance with its regulatory commitments. For example, 5 years after China indicated that it would license advanced wireless services, it has yet to make any specific plans public. The lack of foreign participation in the telecommunications sector, however, is indicative of a licensing regime that has generally, with few exceptions, not been conducive to foreign investment.

China's *Regulations on Foreign-Invested Telecommunications Enterprises* went into effect in January 2002. These regulations define registered-capital requirements, equity caps, requirements for Chinese and foreign partners, and licensing procedures. The regulations stipulate that foreign-invested telecommunications enterprises can undertake either basic or value added telecommunications services. Foreign ownership may not exceed 49 percent in the case of basic telecommunications services (excluding wireless paging) and 50 percent in the case of value added services (including wireless paging, which is otherwise categorized as a basic service). While China committed to giving foreign applicants freedom to choose potential joint venture partners, it appears that MII may be interpreting requirements regarding technical qualifications to effectively exclude all but incumbent operators, foreclosing additional competition in the market. For foreign operators interested in offering international services, requirements to use a gateway operated by a state-owned operator appear excessive and unjustified. The capitalization requirement established for new entrants, which exceeds \$260 million, is another major impediment to market access. There appears to be no justification for such a requirement, particularly for companies interested in leasing, rather than building facilities, while specific licensing terms for resale-based operators do not appear to exist. Meanwhile, MII continues to process applications very slowly for the few foreign-invested telecommunications enterprises that have attempted to satisfy MII's licensing requirements. The results have been predictable: no new joint ventures appear to have been formed in the basic telecommunications sector since China introduced the January 2002 regulations and foreign investment has taken the form of minority stakes in existing operators.

China's categorization of services as either basic or value added services remains confusing with clear negative effects on foreign service suppliers. For example, China classifies certain private network services ("IP-VPN" services) as value added when offered domestically, but as basic (and thus subject to lower foreign equity limits) when offered internationally.

Only limited progress has been made in opening the market for value added services to foreign

participation for services such as Internet access, search, and Internet-delivered content services, in part due to governmental sensitivities regarding anything related to information. MII announced moves toward convergence in voice, video, and data services in 2000, but China considers information content sensitive, so foreign companies face significant barriers in the Internet services sector. New rules regarding sectors where foreign investment is subject to specific limitations (a revised investment “catalog”) appeared in November 2007. The communications sector appears to be one sector particularly affected by these new rules but their implementation remains unclear.

The United States is aware that MII has issued 11 value added services licenses to foreign invested enterprises, including licenses to three U.S. companies. Although more foreign companies are registering “.com.cn” websites in China, these sites are still often blocked, which hinders companies’ abilities to maintain a stable Internet presence. (Many plain “.com” sites servicing global audiences also report periodic blocking in China, also a significant trade concern). The requirement that Internet service providers (ISPs) must provide user login information and transaction records to authorities upon request, without clear guidelines as to the circumstances and situations that warrant such actions, raises concerns about consumer privacy and prevention of data misuse.

In 2004, China reduced its foreign equity investment limitation to 50 percent for ISP and Internet content providers (ICPs) in accordance with the timetable to which it agreed in its Protocol of Accession to the WTO (the same timetable to which it agreed for value added services). However, ICPs must still win the approval of MII and/or local telecommunications administrations depending on the geographic coverage of their services before they can receive foreign capital, cooperate with foreign businesses, or attempt domestic or overseas stock listings. Their services, including even simple commercial websites, are also subject to excessive capitalization requirements (approximately \$1 million) that appear to bear little relation to any legitimate licensing goals.

In 2004, a draft of the long awaited Telecommunications Law began to circulate among Chinese ministries and agencies. If China takes the initiative, this law could be a vehicle for addressing existing market access barriers and other problematic aspects of China’s current telecommunications regime. The current status and content of this legislation is unclear, despite repeated U.S. efforts to obtain this information, and formal comments submitted in 2005.

Meanwhile, even though China committed in its Protocol of Accession to the WTO that further liberalization of this sector would be discussed in the current round of WTO negotiations, China has yet to make an improved services offer. Since the combination of modest commitments and weak implementation in this sector in China has so far failed to facilitate effective market entry for foreign firms, further liberalization, bound through the current round of WTO negotiations, appears critical to improving market access prospects for this sector.

At the April 2006 JCCT meeting, and again at the December 2007 JCCT meetings, China committed to lowering registered capital requirements for telecommunications service providers. In a November 2007 meeting of the JCCT Telecom Working Group, China said requirements would be lowered “a large amount,” and that such a measure was in the final stages of approval in the State Council Legislative Affairs Office, but gave no indication of what specific reduction was proposed and when it might take effect. China’s continued imposition of excessive capital requirements, taken together with MII’s reclassification of certain value added services as basic services and MII’s slow license application process, result in formidable barriers to market entry for foreign enterprises.

On-Line Services

China operates the world's most comprehensive and technologically advanced Internet filtering regime, which affects a broad range of commercial activity conducted via the Internet. Chinese authorities routinely filter Internet traffic entering China, focusing primarily on the content they deem objectionable on political, social, or religious grounds. In 2002, China lifted filters on most major western news sites. Nevertheless, since then, foreign news websites have periodically been blocked, as happened, for example, for several weeks during the 16th National Congress of the Communist Party of China in 2003. More generally, according to a Harvard University study published in 2002, China had still blocked 19,032 sites on multiple occasions. This study was updated in 2005, and identified routinely blocked sites that relate to Taiwan, the Falungong spiritual movement, Tibet, the Tiananmen Square incident and Chinese opposition political parties. The updated study also identified routinely blocked sites that relate to various political topics including "boycott," "human rights," "pro-democracy," and "opposition."

Changes to Internet filtering can occur without warning or public explanation. For example, the popular Internet search engine Google was blocked completely in China for a few weeks starting in late August 2002, and again in late 2007. When Google became available again in September 2002, its "cached pages" feature remained blocked; that feature had previously allowed users in China to access "snapshots" of some web pages that were otherwise blocked in China. While all of these practices remain prevalent, the updated study found that China's filtering regime had become more targeted and fine-tuned than in 2002. For example, sites relating to specific topics such as Falungong and the Tiananmen Square incident were less accessible in 2005 while sites relating vaguely to topics such as revolution and Taiwan were more accessible. Although numbers appear limited, some websites related strictly to economic and business matters are also blocked.

China's Internet regulation regime is exceedingly complex. Internet content restrictions for ICPs, electronic commerce sites and application service providers located in China are governed by a number of measures, not all of which are public. Since 2000, these measures have increased greatly, and it is reported that at least 12 government entities have authority over Internet access and content. Some of these measures restrict who may report news and place limits on what exactly may constitute news. The most important of these measures was issued in September 2000 and updated in September 2005. In addition to interfering with news reporting in the traditional sense, this measure may provide a basis for Chinese authorities to interfere with the normal business reporting operations of non-news organizations, such as multinational corporations, if they use the Internet to keep clients, members, their headquarters and other interested parties informed about events in China.

Audio-Visual Services

China's desire to protect the revenues earned by the state-owned audiovisual and print media importers and distributors, and China's concerns about politically sensitive materials, result in continued restrictions on foreign providers of audiovisual services. Importation and distribution of sound recordings, videos, films, and television remain highly restricted. Inconsistent and subjective application of censorship regulations further impedes market growth for foreign providers. China's large black market for foreign digital video discs and other home entertainment video products continues to grow because these market access restrictions create a demand for pirated goods in the absence of legitimately licensed home or theatrical entertainment.

At both the central and regional levels, inter-connected agencies under the State Administration for Radio, Film, and Television (SARFT) dictate the terms under which films can be produced and distributed. SARFT permits only one film importer and two film distributors (which are both components of the same monopoly managed by SARFT) to operate in China. For theatrical releases, the monopoly

importer and distributor dictate the films that will be imported (currently limited to 20 revenue-sharing films a year), when they will be released in the market, and the box office revenue-sharing terms in a master contract agreement imposed unilaterally and uniformly on foreign distributors by the Chinese government. In addition, the government sets strict guidelines in the public screening of foreign films. Under *Regulations for the Administration of Films* Decree No. 342, Article 44, issued by the State Council in 2001, the total annual screening time for foreign films must not exceed one-third of the total screening time of all films (domestic and foreign). Domestic films may not be less than two-thirds of total annual film screening time.

Television quotas are also highly restrictive. The *Administrative Measures on the Import and Broadcast of Extraterritorial Television Programs* (No. 42), effective October 23, 2004, restricts foreign television drama and film programming to no more than 25 percent of total airtime, and other foreign programming to no more than 15 percent of total air time. Foreign programming, including animated programs, is banned on prime time between 7:00 P.M. and 10:00 P.M. on terrestrial stations. SARFT's *Interim Regulation on Digital Cable TV Pay Channels* (November 14, 2003) restricts foreign programming to a maximum of 30 percent of total airtime on pay television channels.

In addition to censorship reviews by Chinese authorities, which can delay the arrival of imported foreign films on Chinese movie screens, the Chinese government has historically decreed "black-out periods" which no new revenue-sharing blockbuster foreign films may be released in order to prevent competition with Chinese films being released during the same period. Banning the release of new foreign titles during peak seasons creates not only a detrimental affect on theatrical revenues but also contributes to increased piracy, as pirates meet immediate consumer demand for foreign titles by offering illegal downloads through the Internet, on pirate optical discs, and pirate video-on-demand channels.

Regulations against direct distribution by non-Chinese companies of foreign theatrical films, home video, public performance video, and television product remain in force. China Film dictates the contractual terms, play dates, and other aspects of film exhibition. When Chinese entities contract for the rights to distribute titles in various home video formats, the differentiation between video rights and rights for home use or public use is often ignored; home video products are often used for public performance exhibitions in mini-cinemas and by some pay-television operators providing to hotels.

China Film also continues to require that film prints be made in local laboratories. The requirement pertains to theatrical distribution in most cases, and it applies to home video distribution in all cases. Local printing and duplication requirements reduce rights holders' ability to control the quality of a film copy and may result in increased costs.

For sound recordings, China limits market access opportunities for imported sound recordings in a manner similar to the limitations imposed on films for theatrical release or home viewing. In addition, new barriers have recently been erected. The Ministry of Culture's *Opinion on the Development and Regulation of Internet Music* bans foreign ownership of firms supplying digital music services, requiring that entities engaging in the online distribution of sound recordings in China be wholly Chinese-owned entities. This regulation was amplified in new rules established jointly by MII and SARFT in late 2007, explicitly restricting audio and video distribution services (including over electronic networks such as the Internet) to State-owned entities. Furthermore, foreign recordings are subject to conditions not required of domestic recordings, including the requirement that foreign recordings go through censorship review and be approved for online distribution even after being approved for physical distribution.

Investment in China's audiovisual sector is highly restricted. For video distribution companies and cinemas, joint ventures or cooperative firms must have at least RMB5 million (\$688,000) of registered capital and foreign capital cannot make up more than 49 percent of the total share, except in certain cities

where cinema investment is capped at 75 percent. For television production, joint ventures, or cooperative firms must have a minimum capital requirement of RMB 2 million (\$275,000) and foreign capital is capped at 49 percent. In February 2005, SARFT issued a circular placing further restrictions on foreign partners and requiring two-thirds of the programs of a joint venture or cooperative firm to have Chinese themes.

In August 2005, the State Council issued a directive stating that nonpublic capital cannot be used to establish or operate a news agency, newspaper, publishing house, radio station, or television station. The directive also stated that radio and television signal broadcasting and relay station, satellite, and backbone networks are closed to nonpublic capital.

Tourism and Travel Services

In December 2007, the United States and China signed a memorandum of understanding (MOU) to facilitate Chinese group leisure travel to the United States and the marketing in China of U.S. destinations. However, foreign travel and tourism firms in China are still restricted from competing under the same conditions as Chinese firms. For example, wholly-foreign owned enterprises and Chinese-foreign joint ventures continue to be restricted in selling outbound airline tickets. In addition, China requires all travel agents and airlines to connect into China's nationally owned and operated computer reservation system when booking airline tickets. China also continues to apply an annual sales requirement on foreign travel agencies, although there are no such requirements for domestic agencies.

Education and Training Services

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 nonprofit educational activities that do not compete with the MOE-supervised 9 years of compulsory education, thereby inhibiting much-needed foreign investment in the education sector. China also bans foreign companies and organizations from offering educational services via satellite networks.

The MOE's *Implementing Rules for China-Foreign Cooperative Education Projects (2004)* limit foreign educators' participation to certain activities, including education offering academic certificates, supplementary education, and pre-school education. These activities cannot take the form of activities at actual educational institutions.

Foreign universities may set up nonprofit operations. However, they must have a Chinese university host and partner to ensure that programs bar subversive content and that information that is imported is adapted to suit local conditions.

Meanwhile, China's training market is unregulated, which discourages potential investors from entering the market.

Legal Services

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

As part of its Protocol of Accession to the WTO, China agreed to lift quantitative and geographical restrictions on the establishment of representative offices by foreign law firms within 1 year after accession. In addition, foreign representative offices are to be able to engage in profit-making business, to advise clients on foreign legal matters and to provide information on the impact of the Chinese legal environment, among other things. They also are to be able to maintain long-term “entrustment” relationships with Chinese law firms and to instruct lawyers in the Chinese law firm as agreed between the two law firms.

The State Council issued the *Regulations on the Administration of Foreign Law Firm Representative Offices* in December 2001, and the Ministry of Justice (MOJ) issued implementing rules in July 2002. While these measures removed some market access barriers, they also generated concern among foreign law firms doing business in China. In many areas, these measures are ambiguous. For example, the measures appear to create an economic needs test for foreign law firms wanting to establish offices in China, which could raise concerns regarding China’s compliance with its GATS commitments. The measures also seem to take an overly restrictive view of the types of legal services that foreign law firms may provide. In addition, the procedures for establishing a new office or an additional office are unnecessarily time-consuming. For example, a foreign law firm may not establish an additional representative office until its most recently established representative office has been in practice for 3 consecutive years. Foreign attorneys also may not take China’s bar examination, and they may not hire registered members of the Chinese bar as attorneys, thus prohibiting them from providing advice on Chinese law to clients.

Although a number of U.S. and other foreign law firms have been able to open a second office in China, little progress has been made on the other problematic aspects of these measures, particularly the economic needs test, the unreasonable restrictions on the types of legal services that can be provided and the unnecessary delays that must be endured when seeking to establish new offices. Additionally, foreign law firms are placed at a considerable disadvantage even after they are established in China. A foreign firm’s area of practice is severely restricted while domestic firms do not face similar restrictions. While domestic firms are only taxed as partnerships, foreign firms are subject to taxes at both the firm and individual levels. They are also not permitted to repatriate profits earned, since as representative offices, they are not permitted to convert profits in RMB into foreign currency. Furthermore, new foreign representatives must go through a lengthy approval process that can take more than 1 year, during which they must leave the country monthly to file for a renewal visa. Finally, the MOJ refuses to fully license Chinese attorneys that work in foreign firms and prohibits foreign law firms from providing advice on Chinese law even if they hire qualified Chinese lawyers, thus preventing foreign law firms from participating fully in China’s legal market.

INVESTMENT BARRIERS

The volume of foreign investment in China remained high in 2006 despite the introduction of significant new investment barriers. According to the United Nations Conference on Trade and Development, China received \$72.4 billion in FDI in 2006. China was the world’s third-largest investment destination, after the United States and the United Kingdom. Foreign investors also continued to earn high rates of return in 2007, indicating that China remains an attractive market in which to invest despite the continuing challenges of doing business there. The World Bank Doing Business Report 2008 gave China a global ranking for “ease of doing business” of 83, an improvement of 9 spots from the previous year’s report. In 2007, investors continued to complain of a lack of transparency, inconsistently enforced laws and regulations, weak intellectual property protection, corruption, a lack of transparency, and an unreliable legal system incapable of enforcing contracts and judgments.

China's leadership has repeatedly affirmed its commitment to further open China to foreign investment, including a strong statement at the JCCT meeting in December 2007 in which China reiterated its commitment to open investment and to the principle of nondiscrimination in investment regulation. However, there is rising concern that recent steps China has taken may increasingly discriminate against foreign investment. For example, the State Assets Supervision and Administration Commission (SASAC) in December 2006 issued the *Guiding Opinion Concerning the Advancement of Adjustments of State Capital and the Restructuring of State-Owned Enterprises*. Statements accompanying its release identified an expansive list of sectors deemed critical to the national economy including "pillar" industries such as equipment manufacturing, automotive, electronic information, construction, iron and steel, nonferrous metal, chemical, survey and design, and science and technology industries. SASAC committed to restrict foreign participation in these sectors by preventing further foreign investment in state-owned enterprises operating in these sectors. Furthermore, vague new language about economic security in China's *Provision on the Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* adopted in 2006 that includes terms such as "national economic security" and "critical industries" raises concerns that such language could forebode increased protectionist policies. The *Foreign Investment Catalogue* issued in November 2007, further suggests China's investment policies may be becoming more selective in encouraging foreign investment, actively targeting higher value added sectors (including high technology research and development, advanced manufacturing, energy efficiency, and modern agriculture and services) rather than basic manufacturing. It also appears that China is seeking to spread the benefits of foreign investment beyond China's comparatively wealthy coastal area by encouraging multinational businesses to establish regional headquarters and operations in Central, Western, and Northeast China.

The United States is concerned about the recent increase in proposed and adopted measures that restrict investment. Often, these restrictions are accompanied by other problematic industrial policies, such as the increased use of subsidies and the development of China-specific standards. Many of these developments appear to represent protectionist tools by industrial planners to shield inefficient or monopolistic enterprises from competition, counter to the market-oriented principles that have been the basis for much of China's economic success.

Investment Requirements

Upon its accession to the WTO, China assumed the obligations of the Agreement on Trade Related Investment Measures (TRIMS Agreement), which prohibits investment measures that violate GATT Article III obligations to treat imports no less favorably than domestic products or the GATT Article XI obligation not to impose quantitative restrictions on imports. The TRIMS Agreement thus expressly requires elimination of measures such as those that require or provide benefits for the incorporation of local inputs (known as local content requirements) in the manufacturing process, or measures that restrict a firm's imports to an amount related to its exports or related to the amount of foreign exchange a firm earns (known as trade balancing requirements). In its Protocol of Accession to the WTO, China also specifically agreed to eliminate export performance, local content, and foreign exchange balancing requirements from its laws, regulations and other measures, and not to enforce the terms of any contracts imposing these requirements. In addition, China agreed that it would no longer condition importation or investment approvals on these requirements or on requirements such as technology transfer and offsets.

Although China has revised many laws and regulations to conform to its WTO investment commitments, some of the revised laws and regulations continue to "encourage" technology transfer, without formally requiring it. U.S. companies remain concerned that this "encouragement" in practice can amount to a "requirement" in many cases, particularly in light of the high degree of discretion provided to Chinese government officials when reviewing investment applications. Similarly, some laws and regulations "encourage" exportation or the use of local content. Moreover, according to U.S. companies, some

Chinese government officials in 2007 – even in the absence of encouraging language in a law or regulation – still consider factors such as export performance and local content when deciding whether to approve an investment or to recommend approval of a loan from a Chinese policy bank, which is often essential to the success of an investment project. The United States and other WTO Members, including the EC and Japan, have raised concerns in this area during the annual transitional reviews conducted by the TRIMS Committee.

Investment Guidelines

Foreign Investment Catalogue

China's foreign investment objectives are primarily defined through its Foreign Investment Catalogue, which is revised every few years and was most recently updated in November 2007. The new Catalogue promulgated by the NDRC and MOFCOM, with State Council approval, took effect December 1, 2007. While lists of encouraged and restricted sectors grew substantially, China did not meaningfully expand market access in sectors that are United States priorities, such as telecommunications and finance. Instead, the bulk of new encouraged items are in the nonmetallic mineral products and general machinery and special equipment manufacturing sectors, especially products that limit pollution or increase energy efficiency. Even in these sectors, the Catalogue often confines foreign investors to minority stakes. New restricted sectors of potential United States concern include bio-fuel production, soy crushing, and rare earth processing. New blanket prohibitions on foreign investment in movie production, news websites, audio visual, and Internet services appear similar to previous measures; as our WTO dispute on market access for copyright intensive industries demonstrates, these measures also raise WTO concerns. The Catalogue reiterates China's encouragement of foreign investment in business services outsourcing. Among positive developments, the Catalogue encourages foreign investment in highway cargo transport and modern logistics, and no longer encourages investment in projects whose products are wholly exported.

Administrative Measures to Restrict Investment

In 2006 and 2007, Chinese regulators announced several measures that limit the ability of foreign firms to participate in investment in China's market.

For example, in June 2006, the State Council issued the *Opinions on the Revitalization of the Industrial Machinery Manufacturing Industries*, which calls for China to expand the market share of domestic companies involved in 16 types of equipment manufacturing, including large equipment for clean and efficient power generation, critical semiconductor manufacturing equipment, civilian aircraft and aircraft engines, pollution control equipment, textiles machinery, and large excavators. This measure advocates a variety of policy supports, such as preferential import duties on parts needed for research and development, encouraging domestic procurement of major technical equipment, a dedicated capital market financing fund for domestic firms and strict review of imports. This measure also suggests that China will implement controls on foreign investments in the industrial machinery manufacturing industries, including a requirement for administrative approval when foreign entities seek majority ownership or control of leading domestic firms.

In August 2006, MOFCOM and five other government agencies issued the *Provisions of Acquisition of Domestic Enterprises by Foreign Investment*, which became effective September 2006. This measure revised existing rules for mergers and acquisitions involving foreign investors and, among other things, established a legal basis for a "national economic security" review process that can block proposed transactions. Under the rules, foreign mergers and acquisitions of domestic enterprises that would result in "actual control" of a domestic enterprise in a "key industry" with "potential impact on national

economic security” or that would alter control of a famous Chinese trademark or brand require MOFCOM approval. The rules also place MOFCOM in the role of determining if the domestic acquisition target has been appropriately valued and allow MOFCOM to initiate an antimonopoly review of certain acquisitions by foreign companies. In March 2007, MOFCOM published guidelines setting out the requirements for the contents of the antimonopoly notifications under these rules. MOFCOM has rendered the notification and clearance process cumbersome, however, by refusing to meet with lawyers from foreign law firms representing the company who may be most familiar with the transaction. As of December 2007, no foreign merger or acquisition had been formally blocked based on the antimonopoly review provisions in these rules. Although implementing measures have not yet been issued, foreign investors have already found that they face greater difficulties purchasing controlling stakes in prominent Chinese firms in light of the other provisions of these regulations, and several proposed transactions have stalled. In one positive development, the rules now permit the use of foreign shares as consideration for the acquisition of Chinese companies, a change that could facilitate foreign investment in China. MOFCOM officials have indicated that the new Antimonopoly Law, set to come into effect August 1, 2008, will supersede the 2006 rules with respect to the antimonopoly review of mergers and acquisitions.

In November 2006, the NDRC released a 5 Year Plan on foreign investment, which promised greater scrutiny over foreign capital utilization. The plan calls for the realization of a “fundamental shift” from “quantity” to “quality” in foreign investment during the period from 2006 to 2010. The state’s focus would change from shoring up domestic capital and foreign exchange shortfalls to introducing advanced technology, management expertise, and talent. In addition, more attention would be paid to ecology, the environment, and energy efficiency. The plan also demands tighter tax supervision of foreign enterprises, and it seeks to restrict foreign firms’ acquisition of “dragon head” enterprises to prevent the “emergence or expansion of foreign capital monopolies,” to protect national economic security and to prevent the “abuse of intellectual property.”

In December 2006, SASAC issued the *Guiding Opinion Concerning the Advancement of Adjustments of State Capital and the Restructuring of State-Owned Enterprises*. Statements accompanying its release identified an expansive list of sectors deemed critical to the national economy. This measure explained that “pillar” and “backbone” industries such as automotive, chemical, construction, electronic information, equipment manufacturing, iron and steel, nonferrous metal, science and technology, and survey and design must maintain relatively strong state control. Reportedly, SASAC officials also identified a separate set of seven strategic sectors in which state capital must play a leading role, including aviation, coal, defense, electric power and grid, oil and petrochemicals, shipping, and telecommunications. It remains unclear how SASAC will implement these policies.

In 2007, China also continued to employ various sector-specific measures designed to impose new requirements on foreign investors. Measures affecting foreign investment in the automotive and steel sectors are discussed above in the section on import substitution policies. In August 2007, after several years of development, China issued its *Antimonopoly Law*, which is scheduled to become effective in August 2008. Although the final version of the law contained many improvements over drafts that had been previously circulated, some provisions are of concern. For example, one provision provides for the protection of the lawful operations of state-owned enterprises and government monopolies in industries deemed nationally important. At present, it is not clear how China will implement this policy. As China works on implementing measures, the United States has been urging China not to use its *Antimonopoly Law* to enforce industrial policy objectives. The United States has also specifically pressed China to ensure that any implementing measures do not create disguised or unreasonable barriers to trade and do not provide less favorable treatment to foreign goods and services or foreign investors and their investments.

Other Investment Issues

Venture Capital and Private Equity

In March 2003, new regulations took effect permitting the establishment of foreign-invested venture capital firms, including wholly foreign-owned enterprises aimed at funding high technology and new technology startups. These regulations lowered capital requirements, allowed foreign-invested firms to manage funds directly invested from overseas, and offered the option of establishing venture capital firms in a form similar to the limited liability partnerships used in other countries. Meanwhile, regulations that took effect in April 2001 allowed investment by foreign private equity firms, subject to limits on corporate structure, share issuance and transfers, and investment exit options.

Investment exit options have to some extent curbed foreign participation in China's venture capital and private equity sectors, though both forms of investment enjoy high growth rates. Most foreign venture capital and private equity investments in China are actually housed in offshore holding companies, which, as with other offshore FDI, could be transferred without Chinese government approval in the past. The Chinese Government issued new regulations in September 2006, however, that effectively shut down this method of transferring local assets to offshore "special purpose vehicles." The 2006 regulations require pre-approval by no less than six agencies for a Chinese company to transfer assets offshore to a foreign entity. Since the issuance of these rules, no approvals have been granted.

China in September 2006 also implemented regulations that made it more difficult to list on foreign stock exchanges, but at the same time facilitated listing on the domestic A-share market. Though private equity investors have had success in listing in the A-shares market, these investors face a 3 year lock up period during which they may not cash in on their listed holdings.

The Chinese government issued new regulations for domestic venture capital firms in the fall of 2005, which took effect on March 1, 2006. The regulations aimed at cultivating China's domestic venture capital industry, streamlined the incorporation process, and relaxed capital requirements for venture capital firms. Though some restrictions remained in place for foreign-invested firms, the provisions eased overall foreign venture capital investment in China.

In June 2007, an amended Partnership Law took effect, which allowed the formation of limited partnership enterprises. The law limits investor liability and exempts partnership enterprises from corporate income tax. It governs only domestic partnership enterprises, however, and calls for foreign partnerships to be guided by Foreign Investment Partnership Regulations, which are currently in draft and in circulation with relevant government agencies. It is expected that the new regulations will have a negligible effect on foreign invested partnerships, including private equity and venture capital firms.

Holding Companies

China has relaxed some restrictions on the scope and operations of holding companies, although minimum capital requirements normally make the establishment of a holding company suitable only for corporations with several large investments. Holding companies may manage human resources across their affiliates and also provide certain market research and other services. However, some restrictions on services provided by holding companies and on holding companies' financial operations and the ability to balance foreign exchange internally remain in place. Profit and loss consolidation within holding companies also remains prohibited.

China has begun to open its domestic equity markets to investments from foreign firms. Through the Qualified Foreign Institutional Investor (QFII) program, foreign securities firms may apply for QFII

status, which permits limited access to the RMB-denominated A-share market. As of October 2007, China had granted QFII status to 52 foreign entities, with total quotas allotted totaling \$9.9 billion. The Chinese government committed during the May 2007 SED meeting to announce an expansion of the quota to \$30 billion, and did so on December 11, 2007.

Access to Capital Markets

Foreign-invested firms in China are often unable to access domestic and international stock markets, to sell corporate bonds and equity, or to engage in normal merger, acquisition, and divestment activity. However, at the SED meeting in December 2007, China agreed to allow, in accordance with relevant prudential regulations, qualified foreign-invested companies to issue RMB denominated stocks, and qualified listed companies to issue RMB denominated corporate bonds. This move should ease some of the capital inflow pressure from foreign investment, a major concern of Chinese policy makers given excess liquidity and the recent rise in inflation in the domestic economy. Foreign exchange transactions on China's capital account can be concluded only with case-by-case official review and approvals are tightly regulated. Recent regulations permitting greater capital outflows and pronouncements by Chinese government officials encouraging Chinese firms to invest abroad suggest that China now recognizes that continued large capital inflows are not sustainable. To date, foreign firms remain generally satisfied because they are able to repatriate profits. At the same time, most major foreign firms prefer to reinvest their profits, not exit the Chinese market.

GOVERNMENT PROCUREMENT

China is not a signatory to the WTO Agreement on Government Procurement (GPA). In accordance with its commitment upon accession to the WTO, China became an observer to the WTO Committee on Government Procurement in February 2002. China also committed, in its Protocol of Accession to the WTO, to initiate negotiations for accession to the GPA "as soon as possible." Following sustained U.S. engagement, China committed at the April 2006 JCCT meeting to initiate GPA negotiations by no later than the end of December 2007. China submitted its application for accession and initial offer of coverage on December 28, 2007.

Until it completes its accession to the GPA, China has committed in its Protocol of Accession to the WTO that all of its central and local government entities will conduct their procurements in a transparent manner. China also agreed that, if it opened procurement to foreign suppliers, it would provide MFN treatment by allowing all foreign suppliers an equal opportunity to participate in the bidding process.

In 2002, China adopted a Government Procurement Law (GPL), which became effective in 2003. This law directs central and sub-central government entities to give priority to "local" goods and services, with limited exceptions. The GPL does not cover tendering and bidding for public works projects, which represent at least one-half of China's government procurement market. Those projects are subject to China's 2000 Bidding and Tendering Law.

China has issued various regulations and other measures implementing the GPL and the Bidding and Tendering Law. For the GPL, these include the *Measures on the Administration of Bidding for Government-Procured Goods and Services* (2004), which set out detailed procedures for the solicitation, submission, and evaluation of bids in government procurement of goods and services and help to clarify the scope and coverage of the GPL. Implementation rules for the GPL and the *Bidding and Tendering Law* are being developed. MOF also issued several sets of measures relating to the announcement of government procurements, the catalog of centralized procurement, and the handling of complaints by

suppliers relating to government procurement.

Concerns with the application of domestic preferences in government procurement have arisen repeatedly. In 2003, U.S. companies raised concerns that implementing rules on government software procurement being drafted by MOF would mandate that central and local governments – the largest purchasers of software in China – purchase only software developed in China to the extent possible. In response, the United States expressed its concerns to the Chinese government. At the July 2005 JCCT meeting, China took note of the United States’ strong concerns and indicated that it would indefinitely suspend drafting implementing rules on government software procurement.

In 2005, China issued a measure that required preferences for products incorporating the WAPI standards in government procurement (see discussion above in the Standards, Technical Regulations, and Conformity Assessment Procedures section.) In 2006, the State Council issued China’s Medium-to-Long-Term Science and Technology Master Plan. The NDRC and other ministries and agencies are in charge of developing regulations to implement this strategy, which includes preferences for the purchase of domestic goods as an important industrial policy tool. On August 13, 2007, the NDRC issued provisional rules for government-supported electronic government projects, which became effective on September 1, 2007, that mandate priority purchasing of domestic goods and services in national electronic government projects. The most recent preferential measures, which were adopted at the end of December 2007, govern the government procurement of imported products (Administrative Measures on the Government Procurement of Imported Products) and of indigenous innovation products developed by domestic enterprises or research institutions (Administrative Measures for Government Procurement on Initial Procurement and Initial Procurement and Ordering of Indigenous Innovation Products). The United States is concerned that these various regulations may unfairly discriminate against U.S. firms and is closely monitoring developments.

ELECTRONIC COMMERCE

China has experienced dramatic growth in Internet usage since 1999. According to the 20th Internet survey recently published by the China Internet Network Information Center (CNNIC), the number of Internet users in China reached approximately 210 million at the end of 2007, representing an increase of 53 percent over the previous year. Falling personal computer prices and the arrival of devices tailored for the Chinese market will further expand Internet access.

China has also experienced a dramatic increase in the number of domain names established. By the end of 2007, there were more than nine million domain names registered under “.cn,” representing a five fold increase over the previous year. CNNIC also reported that by the end of 2007, there were 73 million blogs in China, representing a dramatically growing source of online interaction. However, despite these developments, CNNIC reported that only 28 percent of surveyed Chinese Internet users frequently use the Internet for online shopping services. China is experiencing the rapid development of online businesses such as search engines, network education, online advertisements, audio-video service, paid electronic mail, short message, online job searches, Internet consulting, electronic trading, and online gaming.

The Chinese government recognizes the potential of electronic commerce to promote exports and increase competitiveness and has made some progress toward establishing a viable commercial environment. However, Chinese ministries have jurisdiction over electronic commerce and impose a range of burdensome restrictions on use of the Internet (*e.g.*, registration requirements for web pages and arbitrary and nontransparent content controls), stifling the free flow of information and the consumer privacy needed for electronic commerce to flourish. Content is still controlled and encryption is also regulated, as discussed more fully above (in the “Online Services” section), and the frequent blocking of websites

(even those of a commercial nature) inhibits the predictability and reliability of using electronic networks as a medium of commerce.

A number of technical problems also inhibit the growth of electronic commerce in China. Rates charged by government-approved Internet service providers make Internet access expensive for most Chinese citizens. Slow connection speeds are another problem, although this is changing quickly as broadband connections become more readily available. By the end of 2006, nearly 76 percent of China's Internet users had broadband connections, representing an increase of 18 percentage points over 2005, and China Telecom is now reportedly the world's largest digital subscriber line, or DSL operator. There are now 104 million broadband subscribers in China. China surpassed Japan in 2004 as the country with the second most broadband lines after the United States. At the same time, Internet penetration remains relatively low in China, and there is a large urban/rural divide in penetration rates (the urban penetration rate is six times higher than the rural penetration rate as of July 2006), so there is still significant room for growth.

Other impediments to Chinese businesses and consumers conducting online transactions include the paucity of credit payment systems, consumer reluctance to trust online merchants, lack of secure online payment systems, and inefficient delivery systems. China has also yet to develop a legal framework conducive to the rapid growth of electronic commerce. Laws recognizing the validity of "electronic contracting" tools and stressing the importance of online privacy and security have been proposed, but not yet issued. Despite these obstacles, however, a large and growing percentage of Chinese Internet users reportedly have made online purchases.

In August 2004, China passed its first electronic commerce legislation, which addressed, among other things, electronic signatures. China is reportedly drafting data privacy legislation and regulations that will address online transactions and payments.

ANTICOMPETITIVE PRACTICES

Competition Policy Laws and Regulations

China maintains many laws and regulations in the competition policy area. One of China's principal laws is the Antiunfair Competition Law, enacted by the National People's Congress (NPC) in 1993. This law addresses a variety of matters, as it (a) prohibits firms from using a trademark, name or packaging without a license, as well as false advertising and other practices intended to confuse consumers; (b) outlaws bribery, the purchase or sale of business secrets, and predatory pricing; (c) restricts a firm's ability to tie the sale of one product to another or impose "unreasonable conditions" on purchases; (d) bans collusion and outlaws "spreading false facts" that damage a competitor; and (e) in theory, limits the business practices of legally-authorized monopolies and restricts the government's ability to require that private firms engage in certain commercial transactions with state-owned enterprises.

China maintains some laws and regulations that limit competition. For example, the national government has legislated that production in certain sectors be concentrated in or near monopolies or authorized oligopolies. As in some other countries, these enterprises are concentrated in capital intensive sectors, like electricity and transportation, or in industries such as fixed-line telephony and postal services, in which this approach may be used to ensure national coverage. Some of the key laws and regulations include the Law on Electricity (1996), Civil Aviation Law (1995), Regulations on Telecommunication (2000), Postal Law (1986), Railroad Law (1991), and Commercial Bank Law (amended in 2003), among others. The enforcement of these laws and regulations is uneven as a result of the challenges inherent in attempting to coordinate their implementation nationally and as a result of inconsistent local and provincial enforcement. As China further reforms its economy, it is expected that many of these laws will

be revised.

More troubling are efforts by government authorities at all levels in China to regulate competition with specific firms, often state-owned enterprises. Official statements often suggest that these efforts are tied primarily to employment concerns. However, the ultimate beneficiaries of the resulting protectionist measures are often unclear. In addition, local governments frequently enact rules that restrict interprovincial trade. Since the central government has difficulty enforcing its own competition policy measures at the local level, these local government rules continue to restrict market access for certain imported products, raise production costs, and limit market opportunities for foreign-invested enterprises.

The NPC in August 2007 passed China's first Antimonopoly Law (AML), which takes effect in August 2008, and China is in the midst of drafting implementing regulations. The law is ambiguous about the ability of China's anti-monopoly enforcement authorities to tackle restraints on trade that are permitted by laws or administrative regulations, which remain common in China. In addition, late in the adoption process, the NPC added new language in Articles IV and VII that potentially can be relied upon to protect state-affiliated enterprises that are determined to be important to the national economy, and to make decisions based on macroeconomic factors (*e.g.*, social and employment goals) other than consumer welfare. Finally, Article XXXI of the AML states that China will establish a review process to review proposed inward investments for national security concerns. Some experts have expressed concern that the law could be used as a tool to target foreign firms and ironically shield local companies from competition. Implementation of the law will be key and the United States is seeking to work with China, including through the provision of technical assistance, to ensure that the law is implemented in a transparent, market-driven, and nondiscriminatory manner.

Measures Restricting Inward Investment

In 2006, China began to revise its policies toward inward investment. While insisting that it remains open to foreign investment, China adopted policies that restrict inward investment in a range of "strategic" sectors, which appear designed to shield domestic enterprises from foreign competition.

As discussed above in the Investment Barriers section, these policies include the State Council's June 2006 *Opinions on the Revitalization of the Industrial Machinery Manufacturing Industries*, which calls for China to expand the market share of domestic companies in 16 equipment manufacturing industries. In August 2006, the Ministry of Commerce and five other agencies issued revised rules for foreign mergers and acquisitions, which, among other things, establish a vague "national economic security" basis for rejecting proposed transactions as well as an antimonopoly review for foreign transactions. In November 2006, the NDRC issued a 5 Year Plan on foreign investment that seeks to restrict foreign acquisitions of leading Chinese enterprises, prevent the emergence of foreign capital monopolies, protect industrial security, and prevent abuse of intellectual property. In December 2006, SASAC published an expansive list of "critical economic sectors" in which China should restrict foreign participation. Finally, the Foreign Investment Catalogue issued in November 2007 suggests China's policies toward inward investment may be more selective, actively targeting higher value added sectors (including high technology research and development, advanced manufacturing, energy efficiency, and modern agriculture and services) rather than basic manufacturing.

Some of these measures maintain or create conflicts of interest by assigning regulatory power to agencies that administer state-owned enterprises competing in the same sectors. In addition, key terms in the new policies, such as "national economic security," remain undefined. The opaque standards and ill-defined processes in these measures have introduced additional ambiguity into China's investment policy.

OTHER BARRIERS

Transparency

In its Protocol of Accession to the WTO, China committed to publish all laws, regulations, and other measures that relate to trade matters, including those that affect imports, and generally to provide a reasonable period for commenting on them before implementation. China also agreed to establish or designate an official journal for the publication of these trade related measures. In addition, China agreed to provide a copy of new trade-related laws, regulations, and other measures to the WTO Secretariat in Geneva, translated into one or more of the WTO's official languages (English, French, and Spanish) no later than 90 days after implementation. China further agreed to create various enquiry points for its WTO trading partners and foreign businesses to obtain information about these measures.

In accordance with State Council regulations issued in December 2001, which require the publication of new or amended regulations 30 days before their implementation, almost all new or revised laws and regulations have been published (in Chinese) soon after issuance and prior to their effective date, an improvement over pre-WTO accession practice. These laws and regulations have been published in a wide variety of journals and on the Internet.

In late 2002, China designated the *China Foreign Economic and Trade Gazette* as the official journal for publishing trade-related measures. Published by MOFCOM, it came out on a trial basis in October 2002 and as an official publication in January 2003. In March 2006, the State Council issued a notice directing all central, provincial, and local government entities to begin sending copies of all of their trade-related measures to MOFCOM for immediate publication in the MOFCOM Gazette. The United States has been monitoring the effectiveness of this notice, both to assess whether all government entities regularly publish their trade-related measures in the MOFCOM Gazette and whether all types of measures are being published. So far, adherence to the State Council's notice is far from complete.

In December 2001, the State Council issued regulations explicitly allowing comment periods and hearings. However, many of China's ministries and agencies continued to follow the practice prior to China's accession to the WTO. The ministry or agency responsible for drafting a new or revised law or regulation will normally consult with and submit drafts to other ministries and agencies, Chinese experts, and affected Chinese companies. At times, the responsible ministry or agency will also consult with select foreign companies, although it will not necessarily share drafts with them. As a result, only a small proportion of new or revised laws and regulations have been issued after a period for public comment, and even in these cases the amount of time provided for public comment has generally been short.

At the December 2007 SED meeting, the United States and China agreed to build upon their international obligations on transparency, including their APEC and WTO commitments. For its part, China agreed, when possible, to publish proposed trade-related measures in advance, and to provide interested parties a reasonable opportunity to comment on them. China further agreed to publish final trade-related measures in its official journal before implementation or enforcement.

Legal Framework

Laws and Regulations

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

In China, regulations are also promulgated by a host of different ministries and governments at the central, provincial, and local levels, and it is not unusual for the resulting regulations to be at odds with one another. Even though finalized regulations are now routinely published in China, they often leave room for discretionary application and inconsistencies, either through honest misunderstanding or by design. Indeed, government bureaucracies have sometimes been accused of selectively applying regulations. China has many strict rules that are often ignored in practice until a person or entity falls out of official favor. Governmental authorities can wield their discretionary power on foreign or disfavored investors or make special demands on them simply by threatening to crack down.

This lack of a clear and consistent framework of laws and regulations can be a barrier to the participation of foreign firms in the Chinese domestic market. A comprehensive legal framework, coupled with adequate prior notice of proposed changes to laws and regulations and an opportunity to comment on those changes, would greatly enhance business conditions, promote commerce, and reduce opportunities for corruption. The U.S. Government has provided technical assistance, at the central, provincial, and local levels of government in China, in an effort to promote improvements in China's legislative and regulatory drafting process. In its Protocol of Accession to the WTO, China committed to establish tribunals for the review of all administrative actions relating to the implementation of trade-related laws, regulations, judicial decisions, and administrative rulings. These tribunals must be impartial and independent of the government authorities entrusted with the administrative enforcement in question, and their review procedures must include the right of appeal. To date, little information is publicly available regarding the frequency or outcomes of review before these tribunals.

China also committed, at all levels of government, to apply, implement, and administer all of its laws, regulations, and other measures relating to trade in goods and services in a uniform and impartial manner throughout China, including in special economic areas. In connection with this commitment, in 2002, China also established an internal review mechanism, now overseen by MOFCOM's Department of WTO Affairs, to handle cases of nonuniform application of laws. The actual workings of this mechanism remain unclear, however.

Commercial Dispute Resolution

Both foreign and domestic companies often avoid seeking resolution of commercial disputes through the Chinese courts, as skepticism about the independence and professionalism of China's court system and the enforceability of court judgments and awards remains high. There is a widespread perception that judges, particularly outside of China's big cities, are subject to influence by local political or business pressures. Most judges are not trained in the law and/or lack higher education, although this problem decreases at the higher levels of the judiciary.

At the same time, the Chinese government is moving to establish consistent and reliable mechanisms for dispute resolution through the adoption of improved codes of ethics for judges and lawyers and increased emphasis on the consistent and predictable application of laws. The Judges' Law, issued by the Standing Committee of the National People's Congress in 1995, requires judges to have degrees in law or in other subjects where they have acquired specialized legal knowledge, and permits judges appointed before the law's implementation who do not meet these standards to undergo necessary training. In 1999, the Supreme People's Court began requiring judges to be appointed based on merit and educational background and experience, rather than through politics or favoritism. In 2002, the Supreme People's Court issued rules designating certain higher level courts to hear cases involving administrative agency decisions relating to international trade in goods or services or IPR. According to the Supreme People's Court, China's more experienced judges sit on the designated courts, and the geographic area under the jurisdiction of each of these designated courts has been broadened in an attempt to minimize local

protectionism. The rules provide that foreign or Chinese enterprises and individuals may bring cases in the designated courts raising challenges under the Administrative Litigation Law to decisions made by China's administrative agencies relating to international trade matters. The rules also state that when there is more than one reasonable interpretation of a law or regulation, the courts should choose an interpretation that is consistent with the provisions of international agreements to which China has committed, such as the WTO rules.

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

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

Labor Issues

In recent years, China has expanded the scope of its national labor laws and regulations. In 2007, the National People's Congress passed the Labor Contract Law, which is meant to clarify the rights and obligations of workers and employers and to promote better labor relations by making it more difficult for employers to summarily dismiss workers, and the Employment Promotion Law, which, among other things, expands the definition of illegal discrimination. Even with these changes, China does not adhere to certain internationally recognized labor standards with respect to freedom of association and the right to engage in collective bargaining. There are many reports indicating that China does not effectively enforce its labor laws and regulations concerning such issues as minimum wages, hours of work, occupational safety and health, and participation in social insurance programs. There are also persistent concerns about the use of forced prison labor and an increasing incidence of child labor.

The Chinese government is slowly developing a national pension system, unemployment insurance, medical insurance, and workplace injury insurance systems that require substantial employer contributions. These systems are still rudimentary and characterized by serious funding shortfalls, in part due to widespread noncompliance among domestic firms. A Chinese government audit report published in November 2006 revealed that more than RMB7 billion (\$875 million) of China's RMB2 trillion (\$250 billion) social security funds had been misappropriated. These insurance programs serve mainly urban residents. Rural residents and migrant workers, who make up the bulk of the work force, enjoy minimal social insurance coverage. This revelation has made social security the primary concern for many Chinese citizens, according to a subsequent survey.

The cost of labor is low but rising in much of China. The existence of a large pool of surplus rural workers, many of whom seek work in urban areas, has kept wage growth for unskilled workers low, but wages for skilled workers are rising rapidly. Some companies offering substandard wages and working conditions have experienced shortages of unskilled labor. Where competition for workers is intense and the supply is limited, as in the case of technical, managerial, and professional staff in China's coastal areas, wages are rising rapidly. Restrictions on labor mobility distort labor costs. China is gradually easing restrictions under the country's household registration system, which has traditionally limited the movement of workers within the country, in part due to the recognition that labor mobility is essential to the continued growth of the economy. Reportedly, wages for many migrant workers, especially construction workers, are often not paid on a monthly basis as required by China's national labor laws

and regulations. These workers also remain vulnerable to wage arrearages.

A growing number of Chinese firms are embracing the concept of corporate social responsibility, and the government actively encourages this trend. In 2005, for example, the China National Textile and Apparel Council established the Committee for the Promotion of Corporate Social Accountability System for Chinese Textile Enterprises corporate social responsibility standard to promote among Chinese textile and apparel firms. The standards are based on relevant Chinese legislation and regulations and reference international practices, but do not include references to freedom of association.

Corruption

Many people expected that China's entry into the WTO, which mandated a significant reduction in tariffs, would in turn reduce incentives for smuggling-related corruption. While WTO membership has increased China's exposure to international best practices and resulted in some overall improvements in transparency, corruption remains endemic. Chinese officials themselves admit that corruption is one of the most serious problems the country faces, and China's new leadership has called for an acceleration of the country's anticorruption drive with a focus on closer monitoring of provincial-level officials. According to Chinese state media sources, China launched an anticorruption campaign in 2006 targeting Communist Party of China officials and so far has punished more than 97,000 party officials.

In July 2004, China implemented a new Administrative Licensing Law. This law is designed to increase transparency in the licensing process, an area that has long served as a source of official corruption. This law seeks to ensure the reasonable use of administrative licensing powers to protect the interests of corporations and individuals and to promote efficient administrative management by requiring government agencies to set up special offices for issuing licenses and to respond to applications within 20 days. Since its 2004 implementation, the law has increased transparency in the licensing process, while reducing procedural obstacles and strengthening the legal environment for domestic and foreign enterprises.

China issued its first law on unfair competition in 1993, and the central government continues to call for improved self-discipline and anticorruption initiatives at all levels of government. While the central government in recent years has pledged to begin awarding contracts solely on the basis of commercial criteria, it is unclear how quickly and to what extent the government will be able to follow through on this commitment. U.S. suppliers complain that the widespread existence of unfair bidding practices in China puts them at a competitive disadvantage. This dilemma is less severe in sectors where the United States holds clear technological or cost advantages. Corruption nevertheless undermines the long term competitiveness of both foreign and domestic entities in the Chinese market.

Land Issues

China's constitution specifies that all land is owned in common by all the people. In practice, agricultural collectives, under the firm control of local Communist Party chairmen, distribute agricultural land to the rural poor, while city governments distribute land for residential and industrial use. The State and collectives can either "grant" or "allocate" land use rights to enterprises in return for the payment of fees. Enterprises granted land-use rights are guaranteed compensation if the State asserts eminent domain over the land, while those with allocated rights are not. Granted land-use rights cost more, not surprisingly, than allocated rights. However, the law does not define standards for compensation when eminent domain supersedes granted land-use rights. This situation creates considerable uncertainty when foreign investors are ordered to vacate. The absence of public hearings on planned public projects, moreover, can give affected parties, including foreign investors, little advance warning.

The time limit for land-use rights acquired by foreign investors for both industrial and commercial enterprises is 50 years. A major 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, and prohibited practices may occur in one area while they are enforced in another. Most wholly-owned foreign enterprises seek granted land-use rights to state-owned urban land as the most reliable protection for their operations. Chinese-foreign joint ventures usually attempt to acquire granted land-use rights through lease or contribution arrangements with the local partners.

China's current rural land law, which took effect in 2003, gives peasants fixed contracts for periods of 30 years to 50 years and permits peasants to exchange or rent out their land-use rights while their use contract remains in force. There is no immediate prospect for changing from land-use rights to direct ownership of rural land. However, since 2004, China's leadership has pressed for sturdier land rights for farmers along with stricter controls over the legal process for converting farmland from agricultural to industrial or residential use. Local governments are no longer supposed to expropriate land for commercial use, as farmers are now supposed to be able to negotiate a compensation price for land directly with commercial users. However, implementation of these provisions lags.

China's National People's Congress passed a Property Rights Law on March 16, 2007, the first comprehensive legal protection for private property since the founding of the People's Republic in 1949. The property law, which generated years of controversy in the Chinese government but was never published in draft form, reportedly grants equal legal protection to private, state, and collectively owned property. This protection would cover the "means of production," such as factories, but agricultural land would remain a collective possession subject to 30 year leases. It is unclear at this time how the law will be implemented.