

# CHINA

## TRADE SUMMARY

The U.S. goods trade deficit with China was \$266.3 billion in 2008, an increase of \$10.1 billion from \$256.2 billion in 2007. U.S. goods exports in 2008 were \$71.5 billion, up 9.5 percent from the previous year. Corresponding U.S. imports from China were \$337.8 billion, up 5.1 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 \$14.2 billion in 2007 (latest data available), and U.S. imports were \$8.8 billion. Sales of services in China by majority U.S.-owned affiliates were \$10.0 billion in 2006 (latest data available), while sales of services in the United States by majority China-owned firms were \$167 million.

The stock of U.S. foreign direct investment (FDI) in China was \$28.3 billion in 2007 (latest data available), up from \$23.4 billion in 2006. U.S. FDI in China is concentrated largely in the manufacturing sector.

When China acceded to the 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). All of China's key commitments should have been phased in by December 11, 2006, two years ago. Consequently, China is no longer a new WTO member, and 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.

Aided, at times, by prodding from the United States and other WTO Members since acceding to the WTO, China has taken steps to reform its economy, making progress in implementing a broad set of commitments. 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 2008, U.S. industry focused 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 repeated and extensive Chinese government intervention intended to promote or protect China's domestic industries. 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 the 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.

## FOREIGN TRADE BARRIERS

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 and 2008, 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 2008, the United States further 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 U.S. WTO-related concerns.

The United States brought two new WTO cases against China in 2008. In March 2008, the United States challenged restrictions that China had placed on foreign suppliers of financial information services, as well as China's failure to establish an independent regulator in this sector. The European Communities (EC) and later Canada joined in this challenge. In November 2008, following several months of constructive discussions, the parties welcomed China's agreement to resolve all of their concerns through a settlement. Joined by Mexico, the United States initiated another WTO case against China in December 2008, challenging an industrial policy that generated a vast number of central, provincial, and local government programs promoting increased worldwide recognition and sales of famous brands of Chinese merchandise, as well as other favored Chinese products through what appear to be prohibited export subsidies.

In addition, the United States continued to pursue four other WTO cases in 2008. In one of those cases, a challenge brought by the United States, the EC, and Canada to China's use of prohibited local content requirements in the automobile sector, a WTO panel ruled in favor of the United States and other complaining parties in March 2008, and the WTO's Appellate Body upheld that ruling on appeal in December 2008. In a WTO challenge to several prohibited tax subsidy programs, China followed through on the parties' earlier settlement by eliminating all of the subsidies at issue by January 1, 2008. In January 2009, the WTO issued a ruling supporting most elements of the U.S. challenge to key aspects of China's IPR enforcement regime. The fourth WTO case active in 2008 is a challenge to market access restrictions affecting the importation and distribution of copyright-intensive products such as books, newspapers, journals, theatrical films, DVDs, and music. The United States expects the WTO panel to make its decision in 2009.

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), established in 1983, 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 more near-term results in 2008 than in 2007, largely because China's leadership displayed an increased willingness to work constructively and cooperatively with the United States. In fact, the two sides were able to achieve incremental but important progress in numerous areas. For example, China agreed to delay publication of final rules on information security certification that would have potentially barred several types of U.S. high-technology products from China's market, so that experts from both sides could discuss the best way forward. China confirmed that state-owned enterprises would base their

## **FOREIGN TRADE BARRIERS**

software purchases solely on market terms without Chinese government intervention or directives favoring domestic software. China agreed to eliminate all remaining duplicative testing and inspection requirements for imported medical devices. China lifted long standing Avian Influenza-related bans on poultry imports from several U.S. states, and China also agreed to allow several U.S. pork processing plants to resume exports to China. China committed to submit an improved offer as soon as possible in connection with its accession to the WTO's Government Procurement Agreement. China agreed to additional market access for foreign suppliers in the banking and securities sectors. China also established notice-and-comment procedures for trade-related and economic-related regulations. At the same time, the United States and China agreed to continue discussions in a number of other important areas, including, for example, IPR, steel trade, insurance, medical device pricing and tendering policies, sanitary and phytosanitary (SPS) measures, and transportation and environmental goods and services, among other areas. The two sides also launched bilateral investment treaty negotiations.

However, despite extensive dialogue, Chinese policies and practices in several areas continued to cause concern for the United States and U.S. stakeholders in 2008, as is detailed below and in the 2008 USTR Report to Congress on China's WTO Compliance. USTR is concerned that since 2006, China is trending toward a less open trade regime with diverse new measures that signal new restrictions on market access and foreign investment in China. In 2008, U.S. stakeholders have pointed to further evidence of such a trend, including the setting of unique Chinese national standards, the tremendous expansion of the test market for China's home-grown 3G telecommunications standard, China's government procurement practices, an array of policies promoting and protecting "pillar industries," the promotion of famous Chinese brands of merchandise using what appear to be prohibited export subsidies, the continued and incrementally more restrictive use of export quotas and export duties on a large number of raw materials, additional restrictions on foreign investment in China, and the continuing consideration of "national economic security" when evaluating mergers and acquisitions, among other significant restrictive practices.

In addition to the new restrictions indicated above, several areas of past concern continue to cause concern for the United States and U.S. stakeholders. 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. stakeholders across the economy. U.S. industries hesitate to market leading edge technology in China due to the high probability of piracy. 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; SPS standards with questionable scientific bases and a lack of transparency in the 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 overly burdensome licensing and operating requirements. China has also so far failed to open up its market to foreign credit card companies and resisted calls to further liberalize in many other service sectors. Fifth, transparency remains a core concern across virtually all service and 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 it did 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. Meanwhile, many provincial governments have, at times, strongly resisted reforms

## **FOREIGN TRADE BARRIERS**

that would eliminate sheltered markets for local enterprises or reduce jobs and revenues in their jurisdictions, although they have also supported market access for 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 JCCT and SED, 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**

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 three 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 three 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 six 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,

## **FOREIGN TRADE BARRIERS**

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 makes the remaining portion (ranging from 10 percent to 90 percent, depending on the commodity) available for importation through non-state traders. In some cases, the percentage available to non-state traders increases annually for a fixed number of years. (For further information, please refer to the section below on Tariff-Rate Quotas.)

However, China has not yet given foreign entities trading rights for the importation of copyright-intensive products such as theatrical films, DVDs, music and sound recordings, books, newspapers, 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, since 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, newspapers, and journals. The WTO panel was established in late November 2007, and the European Communities (EC), Japan, Korea, Taiwan, and Australia joined as third parties. Proceedings before the WTO panel took place in July and September 2008, and the panel is expected to issue its decision in 2009. (For further information, please refer to the section below on Audiovisual and Related Services.)

### **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) made income tax preferences available to foreign-invested firms in connection with their purchases of domestically manufactured equipment. These refunds were not available in connection with purchases of imported equipment or equipment assembled in China from imported parts. A similar measure made an income tax refund available in connection with domestic firms' purchases of domestically manufactured equipment for technology upgrading. However, in the Memorandum of Understanding signed with the United States to settle the prohibited subsidies WTO dispute, China agreed to end all of these preferences by January 1, 2008.

## **FOREIGN TRADE BARRIERS**

### *Automotive Parts*

In May 2004, China issued a new automobile industrial policy, the *Policy on Development of the Automotive Industry*, which included provisions discouraging the importation of automotive parts and encouraging the use of domestic technology in new vehicles assembled in China.

In 2005, China issued regulations implementing the new automobile industrial policy. One measure that generated strong criticism from the United States, the EU, Japan, and Canada was the *Administrative Rules on Importation of Automobile Parts Characterized as Complete Vehicles*, which was issued 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. In March and April 2006, the United States, the EU, and Canada initiated dispute settlement proceedings against China at the WTO. In March 2008, a WTO panel ruled in favor of the United States and the other complaining parties, finding that China's rules discriminate against imported auto parts and are inconsistent with several WTO provisions, including Article III of the GATT 1994. China appealed the panel's decision to the WTO's Appellate Body, and in December 2008 the Appellate Body upheld the panel's finding that the measures are inconsistent with China's WTO obligations. In January 2009, China stated that it would comply with the recommendations and rulings of the WTO.

### *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 includes a host of objectives and guidelines that raise serious concerns. For example, the 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, raising questions given China's commitments under its Protocol of Accession to the WTO not to condition investment rights or approvals on the transfer of technology. The Policy also appears to discriminate against foreign equipment and technology imports. Like other measures, the Policy encourages the use of local content by calling for a variety of government financial supports 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, raising questions, given China's commitment under its Protocol of Accession to the WTO not to condition the right of investment or importation on whether competing domestic suppliers exist. The Policy is also troubling because 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 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.

China's steel production has grown rapidly and at a faster rate than the growth in its domestic steel consumption. China became the largest steel exporting economy in 2006 and its steel exports have increasingly become subject to trade remedy actions by other economies in the past two years.

In March 2006, the United States and China held the inaugural meeting of a new JCCT dialogue on the steel industry. Since then, the two sides have held three more Steel Dialogue meetings, with the most recent one taking place in October 2008. In bilateral and multilateral meetings, the United States has argued that China has acted to impose different levels of taxes on different exports of steel products and steelmaking inputs in a manner that appears to encourage the export of certain value added steel products. In response to the financial downturn in the fall of 2008, China rapidly reduced or removed export duties on many, but not all, steel products. The United States has cautioned China that accelerating efforts to offset falling steel demand in China using these policies is likely to increase trade tensions.

### *Semiconductors*

China's Tenth 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. As discussed below in the section on value added taxes, the United States initiated formal WTO consultations with China in March 2004 to address this problem. The United States continues to monitor closely new financial support that China is making available to its domestic IC 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 Industry and Information Technology (MIIT) and China Telecom adopting policies to discourage the use of imported components or equipment. For example, MIIT 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 five 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.

U.S. exports continue 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. U.S. exports of ITA goods performed well in 2008. They were projected to total \$13 billion by the end of the year, increasing by 3 percent from January through September 2008, when compared to the same time period in 2007.

## **FOREIGN TRADE BARRIERS**

China completed its timely implementation of another significant tariff initiative, the WTO's Chemical Tariff Harmonization Agreement, in 2005. U.S. exports of chemicals covered by this agreement increased by more than 23 percent from January through September 2008, when compared to the same time period in 2007, and were on pace to surpass the 2007 total of \$8.3 billion.

China still maintains high duties on some products that compete with sensitive domestic industries. For example, the tariff on large motorcycles has fallen only 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, especially soybeans and cotton, have increased dramatically in recent years, and continue to perform strongly.. Exports of soybeans rose to more than \$7.2 billion in 2008, a 76 percent increase over the previous year. Higher prices in 2008 account for some of this increase. Cotton exports in 2008 remained strong at \$1.6 billion, though decreasing from a record \$2.1 billion in 2006. Exports of forestry products such as lumber decreased by 9 percent over 2007 to \$520 million in 2008. Fish and seafood exports rose 3 percent to \$553 million in 2008, and set another new record. Meanwhile, exports of consumer-oriented agricultural products increased by 26 percent to \$1.3 billion in 2008.

### **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 five 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 (e.g., 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 reportedly 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 rising rapidly, giving rise to concerns under Article VIII of the 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 the 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 2008, China had a total of 108 antidumping measures in place (some of which predate China's membership in the WTO) affecting imports from 18 countries and regions, and 14 antidumping investigations in progress. Chemical products remain the most frequent target of Chinese antidumping actions.

The Ministry of Commerce's (MOFCOM) 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 in their application. In addition, with China now conducting several expiry reviews of measures involving U.S. and other products, it is essential that it issue regulations governing such proceedings. 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 two 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.

## **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, as detailed in the sections below.

Seven 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 sanitary and phytosanitary measures to control import volumes. Many U.S. industries have also complained that China manipulates technical regulations and standards to favor domestic industries.

### *Tariff-Rate Quotas (TRQs)*

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. Under these TRQ systems, China places quantitative restrictions on the amount of these commodities that can enter at a low "in quota" tariff rate, and any imports over that quantity are charged a prohibitively high duty. Each year, a portion of each TRQ is to be reserved for importation through non-state 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 two 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 remained strong in 2008, totaling \$1.6 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 exports declined significantly to \$79 million in 2005 and to less than \$150,000 in 2008. The

## **FOREIGN TRADE BARRIERS**

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 \$232 million in 2006.

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 and 2008.

### **Import Licenses**

China's inspection and quarantine agency, the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ), has 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.

Additionally, China's Ministry of Agriculture (MOA) mandates the registration licensing procedure for animal feed ingredients and feed additives. The license applicants have reported that in order to secure licenses, they had to provide product or manufacturing details, which can be business confidential information. MOA's registration period can be unpredictable, and license applicants complain that the evaluation process often lacks transparency.

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.

Little improvement in the QIP system has taken place over the last six years, and in 2008, 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 believe 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.

## **FOREIGN TRADE BARRIERS**

In 2004, China implemented regulations requiring foreign scrap suppliers to register with AQSIQ (see the "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 three-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**

### **Non-discrimination**

#### *All China Federation of Trade Union (ACFTU) Fees*

In 2008, the ACFTU, China's only legal trade union, intensified a campaign to organize ACFTU chapters in foreign-invested enterprises, particularly large multinational corporations. The enterprises being targeted operate both in industries in which the employees are highly-skilled, high-wage, white-collar professionals performing high-end services like consulting, software development, accounting, and financial services, as well as in manufacturing and service industries with a physical component to their work. The workers at these enterprises are required to accept the ACFTU as their representative; they cannot instead select another union or decide not to have any union representation.

At present, the principal motivation for the ACFTU's campaign seems to be monetary. When a chapter is established, the enterprise is required to pay fees to the ACFTU, often through the local tax bureau, equaling 2 percent of total payroll, regardless of the number of union members in the enterprise. The ACFTU's campaign may also be discriminatory. This is both because it does not appear to be directed at private Chinese companies and because it appears to specifically target Fortune 500 companies, creating a disproportionate impact on U.S.-invested companies. The United States is currently trying to better understand this situation and assess its effects on U.S.-invested companies and their workers.

### **Taxation**

#### *Income Taxes*

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.

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.

In fact, China passed a new unified *Corporate Income Tax Law* in March 2007 that came into effect on January 1, 2008 and eliminated many of the tax incentives previously available to foreign invested enterprises. The new tax law introduced a unified 25 percent corporate tax rate, replacing the two different rates that had applied to domestic and foreign invested enterprises. The Chinese government announced it would phase in the uniform tax rates over a five year period during which foreign invested

## **FOREIGN TRADE BARRIERS**

enterprises would 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: the first states that income tax rates for small businesses with small profits will be 20 percent, and the second allows qualified high technology companies registered in special economic zones to be exempt from income taxes for any earnings booked within the recognized zones for the first two years, after which earnings are 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. Preferential tax treatment will also apply, as it had under the old law, 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 5 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 (MOU) 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. China has 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) deemed 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 between 13 percent and 17 percent to between 5 percent and 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

## **FOREIGN TRADE BARRIERS**

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, Licenses, and Quotas. 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.

However, in 2008, China reversed course amidst an economic slowdown and raised VAT rebates on labor-intensive products such as clothing, textiles, and high value added electrical machinery products. On July 30, 2008, VAT rebates for certain textile and bamboo products were increased. On October 21, 2008, the Ministry of Finance (MOF) and the State Administration of Taxation (SAT) announced that VAT rebates for selected products for export would be increased with effect from 1 November 2008. Rebates were raised on 3,486 products including textiles, toys, garments, furniture, and some high value added electrical machinery. The products affected represent approximately one quarter of China's total exports. This represents the largest number of changes since 2004 with most of the rebates increasing from 9 to 13 percent. Specifically, the rebate on toys was raised from 11 to 14 percent, the rebate for high-technology and high value added electrical machinery products increased from 11 to 13 percent, and the rebate on clothing and textiles increased from 13 to 14 percent. On November 17, 2008, the Government announced VAT rebate increases for another 3,770 products effective 1 December 2008. On 19 November, the SAT and MOF promulgated another rebate increase for selected textile products, and on 29 December for another tranche of garment and textile products.

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, in 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.

## **FOREIGN TRADE BARRIERS**

## *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 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. China 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.

## **FOREIGN TRADE BARRIERS**

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. Despite these concerns, 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 TBT Agreement. 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 favors indigenous standards and technical regulations developed by 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 subnational 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*

In August 2003, China required that the China Compulsory Certification (CCC) mark be applied to both Chinese and foreign products, covering more than 159 categories, such as electrical machinery, information technology equipment, household appliances, and their components. Since then, U.S. companies continue 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 regulations 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 complain 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 14 certification and 153 testing bodies 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 (two years later) joint venture conformity

## **FOREIGN TRADE BARRIERS**



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 MOU with China allowing it to conduct follow-up factory 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 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 could 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 the International Electrotechnical Commission's (IEC) Joint Technical Committee 1 (ISO/IEC JTC1). In 2006, following balloting of

## **FOREIGN TRADE BARRIERS**

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, MIIT, 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 right 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 and continued 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. On January 7, 2009, China issued 3G licenses for each of the three major standards, including the homegrown TD-SCDMA standard, as well as the wideband-CDMA (W-CDMA) standard, popular in Europe, and the CDMA-2000 standard that is popular in the United States. However, the test market for the TD-SCDMA standard had previously received central government approval, if not direction, for infrastructure investments specific to technologies based on this standard worth billions of dollars. (For further information, please refer to the section below on Telecommunications Services.)

### *Proposed Mandatory Testing and Certification for Certain Information Technology Products*

In August 2007, China notified to the WTO TBT Committee a series of 13 proposed regulations mandating that certain information technology products be certified for information security functions. The proposed regulations appear to require testing and 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 would be mandatory for all covered products as of May 1, 2009.

The United States and other WTO members expressed serious concerns to China about these proposed regulations in numerous bilateral meetings, including during the run-up to the September 2008 JCCT meeting, as well as at meetings of the TBT Committee in March, June, and November 2008 and during China's second Trade Policy Review, held in May 2008. At the September 2008 JCCT meeting, China announced that it would delay publication of final implementing regulations while Chinese and foreign experts continue to discuss the best ways to ensure information security in China. The United States continues to monitor this issue.

#### *New Chemical Registration*

In September 2003, China's State Environmental Protection Administration (SEPA), since renamed the Ministry of Environmental Protection in 2008, 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. 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.

#### *Restriction of 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 to the WTO TBT Committee 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

## **FOREIGN TRADE BARRIERS**

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.

U.S. companies have expressed concern about China's plans to require in-country testing and certification using the CCC mark system for products listed in the catalogue (currently under development). 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, 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 frequent receipt of dangerous waste and illegal material in past overseas shipments. At the start of the registration program, foreign scrap suppliers faced problems with short application periods and lack of clarity in the requirements for registration. Since then, AQSIQ has improved the registration process, including by establishing a website for foreign suppliers to apply and receive notification of their registration status. In 2008, U.S. scrap suppliers continued to report unexplained delays in application approvals and faced problems with new requirements imposed with little or no notice. To assist U.S. exporters in better understanding and navigating China's registration program, the United States and China convened a transparency dialogue under the auspices of the SED to share information on this process and to discuss ways to make the licensing and inspection process more transparent and predictable. The United States is also encountering problems with China's pre-shipment inspection requirements for scrap exports conducted by Chinese-authorized inspectors at the shipment origin point.

### *Medical Devices*

In China, two separate authorities — the State Food and Drug Administration (SFDA) and AQSIQ — enforce regulations with similar, but not identical, requirements for selected medical devices. This potential overlapping and unclear delineation of responsibilities can result in additional and unnecessary regulatory procedures with no demonstrable public health benefit. For example, Decree 95, issued by the AQSIQ in June 2007, 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 the SFDA and in some cases, CNCA. 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. In a further step to streamline the registration process, in September 2008 the SFDA and AQSIQ jointly announced they will require only one test, one report, one fee, and one factory inspection for medical devices. Industry welcomed this commitment, as the reduction of redundancies should cut the medical device approval time in half, providing U.S. industry with more timely access to China's medical device market.

Despite China's general WTO commitment to base its regulations on international standards, the SFDA has not adopted a quality systems approach, which focuses on design and manufacturing systems, processes, and procedures for ensuring quality products, but relies on product testing to determine the safety and efficacy of medical devices, which does not address key safety issues like consistency of good manufacturing processes. China should adopt a system based on quality systems inspections in which a single product registration license is issued by a single regulatory authority. Adopting a quality systems

## **FOREIGN TRADE BARRIERS**

approach will reduce redundancies, streamline work processes, and reduce errors and waste when accompanied by a process of continuous monitoring and improvement.

#### *Patents Used in Chinese National Standards*

In late 2004, concerns arose following the SAC's issuance of the draft *Provisional Regulations for National Standards Relating to Patents (Provisional Regulations)* 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. The initial draft Provisional Regulations excluded compulsory national standards in patents; however, it remains unclear whether subsequent drafts also exclude such language, since no other drafts have been released for public comment. U.S. stakeholders continue to be concerned due to recent Chinese government officials' public comments suggesting that patent holders might be required to share their patented technologies on a royalty-free basis in order to participate in the standards development process. Standards organizations have varying patent policies depending upon the nature of the organization. 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.

The United States urged China to circulate an updated draft of the Provisional Regulations for public comment and will continue to monitor developments in this area, including future revision of China's Standardization Law. 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 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 as well as the development of SAC's revised Provisional Regulations. The United States is also following with interest recent court decisions regarding patents in standards, including the July 2008 response letter from the Supreme People's Court to the Liaoning Higher People's Court suggesting that when a patent holder engages in a standard setting process, others' use of a patented technology incorporated into a standard should not be considered infringing and that fees paid to the patent holder under such circumstances should be significantly lower than the normal license fee. The United States also understands that China is revising its new standardization law and will continue to monitor developments in this area in 2009. (See also, the section below on Intellectual Property Rights Protection.)

#### **Sanitary and Phytosanitary (SPS) Measures**

In 2008, China's SPS measures continued to pose serious problems for U.S. agricultural producers exporting to China. While market access for U.S. soybeans was maintained, little progress was made in 2008 in addressing SPS barriers for raw beef, poultry, and pork products, while market entry requirements for processed foods and horticultural products remain burdensome. In 2008, China's market continued to be closed to U.S.-origin beef and beef products because of China's Bovine Spongiform Encephalopathy (BSE)-related import ban. China also continued to maintain several state-level Avian Influenza bans on poultry, imposing two additional state-level bans while lifting six others.

## **FOREIGN TRADE BARRIERS**

The United States has concerns about China's failure to provide adequate risk assessments and a science based rationale for its SPS measures, as required by the WTO SPS Agreement. For example, in 2008, China was unable to provide a science-based rationale for import restrictions on U.S. beef products and some U.S. poultry and pork products, as described below. In addition, China's regulatory authorities continued to issue significant new SPS measures without first notifying them to the SPS Committee and providing WTO Members with an opportunity to comment.

#### *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 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 and the United States' OIE classification as "controlled risk". 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. 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. 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 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 non-ruminant feeds and fats) even though they are deemed safe to trade by the OIE, irrespective of a country's BSE status. 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 non-ruminant 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)*

As of January 2009, poultry exports to China are banned from Arkansas, Idaho, and 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 LPNAI. Prior to 2006, only high pathogenic avian influenza 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, raising potential national treatment concerns.

In 2008, despite assurances from China's regulatory authorities that they were in the process of revising China's pathogen standards, little progress was seen. At the September 2008 JCCT, China did agree to re-list several U.S. poultry plants that had earlier been de-listed for alleged violations of zero tolerance standards for pathogens or detection of certain chemical residues. Although this step did not address the important underlying need for China to revise its pathogen standards, it did enable some U.S. poultry plants to resume shipment to China. Currently, four U.S. pork plants and one U.S. poultry plant remain de-listed by China for alleged violations of zero tolerance standards for pathogens or detection of certain chemical residues. Despite positive results from USDA Food Safety and Inspection Service investigations of the plants, and extensive follow-up efforts by U.S. regulatory officials, these plants have not been re-listed as approved to ship product to China.

Meanwhile, China continues to maintain 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 herbicide tolerant 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 herbicide tolerant 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 three year renewable safety certificates. In January 2007, MOA renewed safety certificates for all of the events that had originally been approved three 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. While many of these requirements were eliminated in 2008, the Chinese application process still includes information and technology requests that appear to go beyond the information needed to complete safety and environmental assessments. In March 2007, MOA halted a pilot program, which had been developed over two 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 to process. 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. In 2008, MOA also increased the number of times that technology developers can submit new dossiers or information from two to three times per year, which has improved companies' ability to submit information and data in a timely manner. In September 2008, China also approved the first foreign "second generation" biotechnology event. Several other second generation biotechnology events are in the application pipeline at MOA.

## **FOREIGN TRADE BARRIERS**



Despite some progress in China's maturing regulatory and legal systems for biotechnology products, potential disruptions to trade arise due to an asynchronous approval process, excessive data requests, and at times, duplicative testing requirements, an onerous process for extension of existing certificates, and duplicative requirements for discontinued products. Investment restrictions also constrain foreign companies' ability to increase product development in China and maintain control over important genetic resources.

## **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 the Chinese government has 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. Furthermore, effective August 2008, China temporarily raised the export tariff on coke from 25 to 40 percent.

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 (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

## **FOREIGN TRADE BARRIERS**

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 has increased the artificial advantages afforded to its downstream producers by making the export quotas more restrictive and by imposing or increasing export duties on many raw materials at issue.

As discussed above in the section on Value Added Taxes, China also attempts to manage the export of many intermediate and downstream products by raising or lowering the VAT rebate available upon export and sometimes by imposing or retracting export duties. These practices have caused disruption, uncertainty, and unfairness in the markets for particular products.

Sometimes the objective of these adjustments appears to be 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 metric ton (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. 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 toward 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**

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.

## **FOREIGN TRADE BARRIERS**

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 notified subsidies that appeared to be prohibited, which included both export subsidies and import substitution subsidies, benefiting 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. The WTO established a panel in August to hear the dispute. Following extensive dialogue with China, the United States and Mexico suspended the dispute settlement proceedings 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.

Concerns about other potential export subsidies have emerged. The United States has developed serious concerns regarding China's "Famous Brand" initiatives, designed to promote the development of global Chinese brand names and increase sales of Chinese branded merchandise around the world. These initiatives appear to incorporate export subsidies (generally prohibited by applicable WTO rules) that unfairly disadvantages U.S. manufacturers, farmers, ranchers, and workers. In December 2008, the United States requested WTO dispute settlement consultations regarding these programs, with Mexico and subsequently Guatemala joining as co-complainants. Under WTO rules, parties that do not resolve a matter through consultations within 60 days may request the establishment of a WTO dispute settlement panel.

## **FOREIGN TRADE BARRIERS**

## **INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION**

With its accession to the WTO, China assumed obligations to adhere to international standards for the protection and enforcement of IPR held by U.S. and other foreign companies and individuals in China.

As part of the WTO accession process, China 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. Many officials in China, led by President Hu Jintao, Premier Wen Jiabao, and then Vice Premier Wu Yi, continued to voice China's commitment to protecting IPR, and China has taken steps to address a number of specific concerns raised by the United States.

At the same time, improvements in China's legal framework are still needed. In addition, China has continued to demonstrate little success in actually enforcing its IPR laws and regulations, thereby depriving its legal regime of the deterrence needed to face the challenges created by widespread counterfeiting and piracy, as well as other forms of IPR infringement.

Weaknesses in China's enforcement system—criminal, civil, and administrative—contribute to China's poor IPR enforcement record. The United States sought to resolve specific concerns about China's high legal thresholds for criminal enforcement along with other concerns regarding weaknesses in China's laws concerning border enforcement and the enforceability of copyrights during the period before works obtain censorship approval. When bilateral attempts to address these concerns did not succeed, the United States requested WTO dispute settlement consultation in April 2007. A WTO panel was composed in December 2007, and it circulated its decision in January 2009, finding for the United States on two out of three claims.

An exacerbating factor contributing to China's poor IPR protection is China's maintenance of import and distribution restrictions affecting legitimate copyright-intensive products, such as theatrical films, digital video discs, music, books, newspapers, and journals, as well as related foreign service suppliers. These restrictions create a time delay for introduction of IPR protected goods that 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.

In 2008, the United States retained China on the Special 301 Priority Watch List because of continuing concerns regarding IPR protection and enforcement. China's share of infringing goods seized at the U.S. border, for example, stood at 85 percent in 2008, according to U.S. customs data. The United States was able to use the JCCT process in September 2008 to secure a renewed commitment from China to engage in cooperative discussions, including through regular meetings of the JCCT IPR Working Group, on a range of IPR issues, such as IPR and innovation, China's development of guidelines on IPR and standards, public-private discussions on copyright and Internet piracy challenges including infringement on user-generated content sites, and reduction of the sale of pirated and counterfeit goods at wholesale and retail markets, among other areas of mutual interest. China and the United States also agreed at the JCCT to sign two memoranda of understanding on strategic cooperation to improve the administration and effectiveness of copyright and trademark protection and enforcement in October 2008.

### **Legal Framework for IPR**

In most respects, China's framework of laws, regulations, and implementing rules on IPR remains largely satisfactory. Notably, China has recently acceded to the WIPO Internet treaties. However, reforms are needed in a number of key areas. In particular, more work is needed at both the national level and the

## **FOREIGN TRADE BARRIERS**

provincial level to meet the challenges of Internet piracy in the face of the rapid growth of Internet access in China. Right holders have pointed to a number of continuing deficiencies in China's criminal measures. For example, procedural burdens, such as an inability to investigate based on suspicion of criminality, also weaken the criminal IPR system. China's thresholds for criminal enforcement also create concerns although China did lower one important threshold in the run up to the WTO dispute brought by the United States.

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, and along with U.S. right holders, the United States has provided written comments to China on many of these proposed measures, including regulations for the protection of copyrights on information networks and on drafts of the *Patent Law* amendments.

In 2008, China announced an updated 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*, which passed the National People's Congress in December 2008, the *Trademark Law*, and related measures. The United States has been assessing the potential ramifications of the contemplated revisions for U.S. right holders. China has also been working on other proposed legal measures that could have significant implications for the intellectual property rights of foreign right holders. In particular, China issued an *Anti-monopoly Law* in August 2007, which became effective in August 2008, and under this law is considering issuing rules relating to the treatment of IPR by standards setting organizations. (See section on "Patents Used in Chinese National Standards").

In June 2008, China also issued its long-awaited National IP Strategy, a policy document intended to encourage and facilitate the effective creation, development, and management of intellectual property in China. The document addresses strengthening IPR protection, preventing IPR abuses, and fostering a culture of IPR in China. The strategy also identifies key sectors in which China seeks to obtain foreign patents and technology standards. Other goals include improving patent quality and improving protection for geographical indications, genetic resources, traditional knowledge, folklore, and layout-designs of integrated circuits. Notably, the document mentions that China will explore the establishment of courts of appeal for IP cases.

The United States has repeatedly urged China to pursue additional legislative and regulatory changes. Using both bilateral meetings and the annual transitional reviews before the WTO's TRIPS Council, the United States' efforts have focused on persuading China to improve its legal regime in 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 criminal thresholds, the lack of criminal liability for certain acts of copyright infringement, the profit motive requirement in copyright cases, the requirement of identical trademarks in counterfeiting cases, and the absence of minimum, proportional sentences and clear standards for initiation of police investigations in

## **FOREIGN TRADE BARRIERS**

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 do not raise specific WTO concerns, all of them will continue to detract from China's enforcement efforts until addressed.

Given the modern challenges of piracy in the digital environment, the United States has also sought improvements in China's copyright protection in the context of electronic information networks. China took an important step in May 2006, when the State Council adopted an important Internet-related measure, the *Regulations on the Protection of Copyright Over Information Networks*, which went into effect in July 2006. This measure demonstrates China's determination to improve protection of the Internet-based right of communication to the public. Several aspects of this measure nevertheless would benefit from further clarification. For example, China could clarify that certain Internet "deep linking" and other services that effectively encourage or induce infringements are unlawful. The promulgation of this measure was a welcome addition to the National Copyright Administration's *Measures for Administrative Protection of Copyright on the Internet*, which requires Internet service providers to take remedial actions to delete contents that infringe on copyrights upon receipt of a complaint from the right holder, or face administrative penalties ranging from confiscation of illegal gains to fines of up to RMB 100,000 (approximately \$14,600).

Moreover, while the United States is pleased that China acceded to the WIPO Internet treaties in 2007, China still needs to fully implement those obligations into its domestic regime. These treaties still reflect important international norms for providing copyright protection over the Internet, and in the case of China, are especially important, given the rapidly increasing number of Internet users in China, many of whom have broadband access.

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. The United States has 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 six month campaign targeting the unauthorized use of well-known trademarks and company names in the enterprise registration process.

In the pharmaceuticals sector, the United States continues to have a range of concerns. The United States has urged China to provide greater protection against unfair commercial use of undisclosed test and other data submitted by foreign pharmaceuticals companies seeking marketing approval for their products. The United States has also encouraged China to undertake a more robust system of patent linkage and to consider the adoption of a system of patent term restoration. In addition, built-in delays in China's marketing approval system for pharmaceuticals continue to create incentives for counterfeiting, as does China's inadequate regulatory oversight of the production of active pharmaceutical ingredients by domestic chemical manufacturers. In 2008, as in prior years, the United States sought to address all of these issues as part of its broader effort to work with China to improve China's regulatory regime for the pharmaceuticals sector.

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 changes in the recently enacted Patent Law will

## **FOREIGN TRADE BARRIERS**

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.

### **IPR Enforcement**

Although China's 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, and between sub-national authorities and the central government, 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 filed in Chinese courts, overall piracy and counterfeiting levels in China remained unacceptably high in 2008. 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 in effectively using China's legal system to support IPR enforcement.

U.S. industry estimates that levels of piracy in China across most lines of copyright products for the recording/music industry remains at 90 percent based on data for 2008, while business software piracy rates were approximately 80 percent. These figures indicate little or no overall improvement over 2007. 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). 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. China's regulatory authorities did take initial steps to address text book piracy on university campuses in late 2006 and 2007, and there were some positive developments in fighting university textbook piracy in 2008. However, Internet piracy is increasing, as is piracy over dedicated networks such as those of universities, although the National Copyright Administration (NCA) began to undertake campaigns to combat Internet piracy.

With respect to software piracy, China issued new rules during the run up to the 2006 JCCT meeting that require computers to be pre-installed with licensed operating system software and that require government agencies to purchase only computers satisfying this requirement. Combined with ongoing implementation of previous JCCT commitments on software piracy, the hope is 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 dropped 10 percentage points between 2003 and 2007. However, the U.S. software industry also reports that compliance with these rules has fallen from approximately 65 percent in 2006 to 50 percent in 2008. Achieving sustained reductions in end user software piracy will therefore require more enforcement by China's authorities, followed by high profile publicity of fines and other remedies imposed.

## **FOREIGN TRADE BARRIERS**

Although China has committed to taking 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 was one of the issues raised in the United States' 2007 WTO dispute challenging deficiencies in China's IPR enforcement regime.

In the customs enforcement 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, which were intended to improve border enforcement. These rules allow seized counterfeit trademark goods to be publicly auctioned only after removing the infringing mark. Returning these goods to the marketplace with only the infringing mark removed, however, could confuse consumers and harm the reputation of the legitimate product, facilitating, rather than deterring, further acts of infringement involving these goods.

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.

As in prior years, the United States worked with central, provincial, and local government officials throughout China in 2008 in a 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. In addition, in September 2008, the United States and China resumed work under the JCCT IPR working group. The United States also organized another annual roundtable meeting in China in November 2008 designed to bring together U.S. and Chinese government and industry officials.

The United States' efforts to seek improvements in China's IPR enforcement have also benefited from cooperation with other WTO Members both on the ground in China and at the WTO during meetings of the TRIPS Council. For example, several WTO Members participated as supportive third parties in the United States' two April 2007 IPR-related WTO cases against China. Previously, Japan and Switzerland had joined the United States in making 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. In addition, the United States and the EC have increased coordination and information sharing on a range of China IPR issues over the last two years. China's membership in the Asia-Pacific Economic Cooperation (APEC) forum also brings increased importance to APEC's work to develop regional IPR best practices.

## **FOREIGN TRADE BARRIERS**



China is also making genuine efforts to improve IPR enforcement, and cooperation between the United States and China has resulted in some successful enforcement actions. For example, China's Ministry of Public Security (MPS) has engaged with U.S. law enforcement authorities on enforcement initiatives as part of the Intellectual Property Criminal Enforcement Working Group of the U.S.-China Joint Liaison Group for Law Enforcement Cooperation. This working group focuses on the development of joint U.S.-China operations to combat transnational IPR crimes, particularly crimes committed by organized criminal groups and crimes that threaten public health and safety. In July 2007, this collaboration with MPS resulted in the largest ever joint U.S.-China piracy investigation and prosecution, code named "Operation Summer Solstice." This joint operation netted seizures of more than 290,000 counterfeit software discs worth more than \$500 million and arrests of more than 25 Chinese nationals, and it also eliminated numerous illicit manufacturing plants in China. This joint operation is believed to have dismantled the largest piracy syndicate of its kind in the world, estimated to have distributed more than 2 billion copies of counterfeit Microsoft software.

Moreover, a domestic Chinese business constituency is also increasingly active in promoting IPR protection and enforcement in China. 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.

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 lack of transparency. The 2008 Action Plan announced that China will 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 applauded China's aim to use this opportunity to examine the potential benefits of specialized national IPR courts and has suggested that China also consider the benefits of specialized prosecutors, providing faster trademark examination, and ensuring that the resources available to local administrative, police, and judicial authorities charged with protecting and enforcing intellectual property rights are adequate to the task. The United States will continue to pursue these efforts in 2009.

Despite its many positive efforts to improve IPR enforcement, however, 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 April 2007 where, as discussed above, the United States is seeking needed changes to China's legal framework. These changes should be an important objective for China, given the need for greater deterrence in China's current enforcement regime. 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 books, newspapers, journals, theatrical films, DVDs, and music, which inevitably lead consumers to the black market, again compounding the severe problems already faced by China's enforcement authorities.

## **SERVICES BARRIERS**

The market for services in China has significant growth potential in both the short and long term.

## **FOREIGN TRADE BARRIERS**

However, China imposes restrictions in a number of services sectors that prevent or discourage foreign suppliers from gaining or further expanding market access. For example, for certain sectors, China does not grant new licenses or maintains a licensing review process that is opaque or slow-moving. In certain cases, China imposes foreign equity limitations or other discriminatory measures on foreign suppliers. High minimum capital requirements plague other sectors. China also sometimes applies overly burdensome regulatory regimes or other restrictions.

### **Insurance Services**

China continues to maintain certain market access barriers for the insurance sector. Foreign life insurance companies can only be established as joint ventures, with foreign equity capped at 50 percent. In addition, China's markets for third party liability automobile insurance and for political risk insurance are closed to foreign participation.

In addition, although the situation has shown some recent improvement, U.S. and other foreign companies continue to have difficulty expanding their operations (internal branches) once they have established an initial presence in China. The Chinese Insurance Regulatory Commission (CIRC) is not always consistent in following its own deadlines for reviewing and approving internal branch applications from foreign life and non-life companies. Foreign companies also report difficulties in applying for and receiving multiple, concurrent internal branch approvals. In September 2008, CIRC imposed a moratorium on new sales offices for insurance companies (domestic and foreign) which further restricts opportunities for internal expansion.

The United States also has expressed concerns to the Chinese government regarding a draft CIRC regulation, the "Administrative Method of the Equity Interest in Insurance Companies," which would unfairly shut out foreign insurance companies from holding multiple investments in Chinese domestic insurance companies.

In addition, the United States has urged the relevant Chinese authorities to ensure that China Post, which has been granted a license to supply insurance through its existing network of Post facilities, is not given advantages in terms of how it is regulated and is required to provide distribution possibilities for insurance products of other companies.

### **Private Pensions—Enterprise Annuities**

U.S. and other foreign companies have found it difficult to obtain a license to participate in China's market for "enterprise annuities" services (private pensions similar to the U.S. 401(k) system), which will grow in importance as China develops alternatives to its underfunded social security system. China has licensed very few foreign operators and only for limited elements of the full package of enterprise annuities services. The United States remains very concerned that China's licensing process has been closed again and has urged China to re-open its licensing process and ensure that such licensing procedures do not impose quotas on the number of licenses granted to qualified suppliers.

### **Banking Services**

The Regulations for the Administration of Foreign-Funded Banks, issued in November 2006, allow foreign banks to compete in all lines of banking business on the same terms as domestic banks. These regulations, however, require foreign banks to incorporate in China. Moreover, the regulations mandate that only foreign-funded banks that have had a representative office in China for two years and that have total assets exceeding \$10 billion can apply to incorporate in China. After incorporating, 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 three years and have had two consecutive years of profits.

To date, numerous foreign banks have received approval to convert to subsidiaries. In 2008, the first application to issue local currency debit and credit cards was approved, though administrative barriers have hindered the approval of other applications and the actual issuance of RMB cards. Also in 2008, the CBRC announced that foreign banks would be allowed to trade and underwrite bonds on the interbank market, albeit via a gradual phasing-in process.

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.

The rules on the establishment of Chinese-foreign joint venture banks remain a concern. 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 ownership (the so-called 20/25 rule). China draws a distinction between domestic and foreign companies through different treatment and seasoning rules. 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.

### **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. Since that time, China has begun to license some new Chinese-foreign joint ventures. However, China continues to apply a 33 percent foreign equity limit on the sector (as well as a 49 percent foreign equity limit for the asset management sector).

In late 2007, China issued rules that allow foreign joint venture securities firms to gradually expand their scope of business over an extended timeframe. However, the regulations 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 September 2006, Xinhua issued the *Administrative Measures on News and Information Release by Foreign News Agencies* within China. These regulations precluded foreign suppliers of financial information services from contracting directly with, or providing financial information services directly

## **FOREIGN TRADE BARRIERS**

to, domestic Chinese clients. Instead, foreign financial information service suppliers would have to operate through a Xinhua-designated agent, and the one agent designated to date is a Xinhua affiliate.

Xinhua told foreign financial information service suppliers 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 suppliers to conclude agreements with the Xinhua affiliate before renewing their annual licenses. Foreign financial information service suppliers continued to operate, but without renewed licenses.

In 2008, the United States and the EC initiated WTO dispute settlement proceedings against China (later joined by Canada), after it had become clear that Xinhua was not prepared to remove the 2006 rules. In November 2008, an MOU was signed in which China committed to address all of the concerns that had been raised by the United States, the EC, and Canada. Among other things, China has agreed to establish an independent regulator, to eliminate the agency requirement for foreign suppliers, and to permit foreign suppliers to establish local operations in China, with all necessary implementing measures issued by April 30, 2009, effective no later than June 1, 2009. In January 2009, China took a step to fulfilling its commitment by formally changing the regulator of these financial information services from Xinhua to the State Council.

### **Electronic Payments Processing**

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 domestic (RMB) currency business of retail clients. China also committed to allow the provision and transfer of financial information; financial data processing; and advisory, intermediation, and other financial services auxiliary to payments and money transmission services. These electronic payments and related commitments were to be implemented by no later than December 11, 2006.

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 (CUP), an entity created by the People's Bank of China and owned by participating Chinese banks, remains the sole authorized provider of electronic payment services in China.

### **Retailing Services**

In September 2008, China announced that it had delegated authority for foreign retail outlet approvals to the provincial government level, a positive step in streamlining and facilitating approvals for foreign retail outlets. The United States will monitor how this new licensing process works in practice. In addition, the United States has explained the importance of China applying any zoning requirements on a non-discriminatory basis and not imposing additional "informal" minimum capital requirements on foreign retailers.

### **Sales Away From a Fixed Location**

Since 2005, China has significantly liberalized its regime for direct selling services, and a number of foreign direct sellers have received licenses to operate. However, a number of concerns remain. First, since May 2007, China has not approved any new applications for direct selling licenses, even though a number of companies (both foreign and domestic) have applied for such licenses. In addition, China

## **FOREIGN TRADE BARRIERS**

maintains unduly burdensome "service center" establishment requirements, caps and other restrictions on sales force compensation, and discriminatory qualification requirements.

### **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 express delivery regime continue to cause concerns. The United States is seeking assurances that China's laws and regulations for the express delivery sector do not discriminate against foreign companies and are not overly burdensome on their operations.

U.S and other foreign companies recently have been confronted with new developments relating to China's draft *Postal Law* that would severely hinder their growth in China's domestic express market (pick-up and delivery within China). The draft *Postal Law*, under consideration by the National People's Congress, would exclude foreign express delivery companies from China's domestic market for express delivery of documents. If that element of the Law is retained, it would place foreign companies at a severe disadvantage *vis-a-vis* Chinese domestic express delivery companies which are permitted to provide a full scope of business, including both package and document delivery. The draft *Postal Law* also includes other troubling elements, including the lack of a clear definition of the postal monopoly, the imposition of universal postal fund taxes on express delivery companies (rather than on the users of the postal system), and a licensing system for express delivery companies that seems overly burdensome.

In most economies, express delivery services are not regulated directly or subject to licensure. For this reason, foreign companies also have raised concerns about how the China State Postal Bureau's (SPB) new authority to license and regulate the express delivery sector will be implemented. Although China has asserted that SPB's express delivery "standards" (promulgated in September 2007) are "voluntary," recent actions by the SPB, including work to establish a first ever China Express Association (CEA), which may be given certain delegated regulatory authority, suggest otherwise. U.S. and other foreign express delivery companies are concerned that any express delivery standards may cover operational issues, including many commercial decisions such as weight, package examination, transit time, and personnel requirements, which would normally remain within the purview of individual companies in the marketplace.

U.S. and other foreign express delivery companies also are concerned about the proliferation of provincial level express delivery industry associations, including the interest of such associations in "self-discipline agreements" that may contain troubling provisions on pricing and competition.

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 (re-named the Ministry of Housing and Urban-Rural Development in 2008) 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 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

## **FOREIGN TRADE BARRIERS**

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. Implementing rules for Decree 114 became effective in January 2007. These rules are important, as U.S. companies have a very strong interest in providing engineering and design services in China. The implementing rules were generally positive, in that they temporarily lifted foreign personnel residency requirements imposed by Decree 114, and recognized the foreign qualifications of technical experts for licensing purposes. U.S. and other foreign companies would like to see these improvements in the implementation of Decree 114 made permanent. In addition, the United States has urged China to continue improvements to allow foreign design companies the same rights as domestic design companies to immediately apply for a comprehensive "Grade A" license (rather than being subject to more restrictive procedures under Circular 202).

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.

Finally, like Decrees 113 and 114, the *Regulation on the Management of Foreign Invested Urban Planning Service Enterprises* (Decree 116) includes burdensome personnel requirements. Such restrictions effectively keep out smaller foreign urban design firms wishing to work in China. To encourage the further development of Chinese urban planning, foreign firms of all sizes should be welcomed to compete in China.

### **Logistics Services**

In March 2008, China announced the establishment of a new Ministry of Transport (MOT) that would combine activities formerly conducted by the Ministry of Communication, the Civil Aviation Administration of China (CAAC), and the State Postal Bureau. The MOT does not include rail transport; which is administered separately by the Ministry of Railways.

MOT 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 being in 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 categories of transport, warehousing, and multi-purpose activities. In addition, freight forwarding firms are concerned that their exclusion from these regulatory categories may prevent their participation in standards-setting activities.

## **Aviation and Maritime Services**

Under the auspices of the SED, the United States and China negotiated an amended bilateral air services agreement that was signed in July 2007. The new agreement brings 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 United States and China. By 2012, 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, more than doubling the number of flights allowed. 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 increases the available opportunities for U.S. carriers to code-share on other U.S. carriers' flights to China, and it commits China to begin negotiations, by 2010, on a timetable for the full liberalization of the bilateral civil aviation relationship.

In September 2008, the United States held technical consultations to discuss China's interpretation of the cargo hub provision in the aviation agreement, which was creating difficulties for a U.S. cargo carrier. While differences in interpretation remain, China agreed to approve the carrier's cargo schedule in a manner consistent with the aviation agreement.

In 2003, China took steps to liberalize the maritime services sector. The United States and China signed a far-reaching, five year bilateral maritime agreement, extended automatically for successive one year periods, which gives 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 most recent round of negotiations was held in December 2008.

## **Telecommunications**

Foreign participation in China's telecommunications market, including for both basic and value added telecommunications services, remains very limited. China maintains foreign equity restrictions and a multitude of other barriers in the telecommunications sector, including investment approval procedures that are non-transparent and lengthy. Although China has the world's largest fixed landline, mobile, and broadband markets measured by subscribership, the lack of opportunities for foreign service suppliers is striking. China's regulator for the sector, the Ministry of Information Industries and Technology (MIIT), while nominally separate from current telecommunications operators, maintains extensive influence and control over their operations and the overall structure of the market and continues to use its regulatory authority to disadvantage foreign firms.

China's foreign equity restrictions (a maximum of 49 percent foreign equity for basic telecommunications and 50 percent for value added telecommunications) severely diminish commercial opportunities in the sector.

Regarding basic telecommunications, not only has there been no new market entry in that sector over the past decade, China actually forced a consolidation of this sector in 2008, reducing the number of operators from seven to four operators—China Mobile, China Telecom, China Unicom and China Satcom. Since China's policy is to only permit foreign joint ventures with existing licensees, and these licensees are all majority state-owned enterprises, this has further reduced market access opportunities and has ensured that the market structure is entirely determined by governmental policy. Although not explicitly stated in rule or policy, China appears to apply an economic needs test to new entry in this

## **FOREIGN TRADE BARRIERS**

sector to avoid "unhealthy competition." China also shows reluctance to authorize new services or technologies which might compete with the revenue of incumbent operators, such as voice over the Internet or WiFi over a mobile handset.

In September 2008, in response to a long-standing U.S. request and through State Council Decree 534, China reduced basic telecommunications capitalization requirements. However, they reduced them to RMB 1 billion (approximately \$145 million), a level that is still excessively high and makes it commercially unattractive for most foreign operators to invest in the sector, particularly for leased line, resale, and corporate data services, which require no new building of facilities.

After years of delay and sustained U.S. pressure, MIIT finally issued licenses in January 2009 for third-generation (3G) mobile telecommunications services to the country's three state-owned telecommunications operators. There was no public announcement or details available regarding the application process for these licenses and the Chinese government clearly dictated the choice of technology for each company. China Mobile received a license to operate TD-SCDMA, the Chinese-developed 3G standard. China Telecom received a license for CDMA2000, the U.S. standard, and China Unicom received a license to operate W-CDMA, the European standard. Although this development provides significant opportunities for U.S. equipment and services suppliers, continued reports on plans to support and favor China's domestic 3G standard are troubling. As China considers making new spectrum available for new wireless services, improving the transparency of its licensing process will be a priority. (For further information, please refer to the section above on Third Generation (3G) Telecommunications Standards.)

Regarding value added telecommunications, although there are over 20,000 licensed domestic telecommunications value added suppliers in China, MIIT has issued only eleven value added licenses to foreign companies, including licenses to three U.S. companies. One difficulty foreign companies face in obtaining a license is the lack of clarity regarding which services a foreign-affiliated firm is permitted to offer. In addition, MIIT inexplicably seems to classify certain value added private network services ("IP-VPN") as value added when offered domestically, but as basic (and thus subject to lower foreign equity caps and higher capitalization requirements) when offered internationally. Chinese officials have indicated that they are open to liberalizing foreign participation in IP-VPN service; nevertheless, no foreign joint-venture has yet been licensed to offer this service.

The United States also has pressed China to make available its draft *Telecom Law* for review and comment. The most recent version made available for public comment was in 2005. China has been working on the draft Law for over 10 years, and it may be a vehicle for addressing certain market access and regulatory issues. MIIT still lacks a specific authorizing statute for its powers.

### **On-Line Services**

China operates the world's most comprehensive 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, a 2005 Harvard University study reported that China has blocked sites on multiple occasions and identified routinely blocked sites that relate to Taiwan, the Falungong spiritual movement, Tibet, the Tiananmen Square incident, and Chinese opposition political parties. The study also identified routinely blocked sites that relate to various political topics including "boycott," "human rights," "pro-democracy," and "opposition."

## **FOREIGN TRADE BARRIERS**



Purely commercial sites that may simply be hosted on the same computer server as an unrelated site that is deemed objectionable also appear subjected to periodic blocking. Such practices can impede the ability of legitimate businesses to conduct cross-border trade.

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 Harvard 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 Internet Content Providers, 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, and press reports note 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.

### **Audiovisual and Related Services**

China's desire to protect the revenues earned by the state-owned audiovisual and print media importers and distributors and concerns about politically sensitive materials result in continued restrictions on foreign providers of audiovisual services. Importation and distribution of books, newspapers, journals, 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. As discussed above in the section on Trading Rights, the United States initiated a WTO dispute settlement case against China in April 2007 covering the importation and distribution restrictions applicable to certain copyright-intensive products. A decision by the WTO dispute settlement panel is pending.

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 by China 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 studios by the Chinese government. In addition, the government sets strict guidelines with respect to 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).

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" during 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 not only hurts 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 restricting direct distribution by non-Chinese companies of imported theatrical films, home video, public performance video, and television products 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 right 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 Network 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 (re-named the Ministry of Industry and Information Technology in 2008) 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 RMB 5 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

## **FOREIGN TRADE BARRIERS**

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 private 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 private capital.

### **Tourism and Travel Services**

In December 2007, the United States and China signed an 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 travel packages and 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 for domestic flights and outbound international flights. 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**

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 nine 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.

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 informational material that is imported is adapted to suit local conditions.

### **Legal Services**

Foreign law firms face numerous restrictions on the scope and structure of their activities in China, as well as other barriers affecting market access. Current Chinese law prohibits foreign firms from practicing Chinese law, which means that they are unable to hire Chinese-qualified lawyers to practice Chinese law. China also maintains restrictions on cooperation with Chinese law firms (including investment and profit-sharing restrictions) that further limit market opportunities. In addition, foreign law firms are concerned that China may make it more difficult to provide other legal services (such as advisory and consultation services) that are currently widely regarded as permissible.

China also maintains separate, discriminatory regulatory requirements for foreign representative legal offices that are not applied to Chinese law firms (*Regulations on the Administration of Foreign Firm Representative Offices* of December 2001 and implementing regulations of July 2002). The measures appear to create an economic needs test for foreign law firms seeking to establish representative offices in China. In addition, a foreign law firm may not establish an additional representative office until its most recently established office has been in practice for three consecutive years. China also requires that representatives of foreign law firms must have practiced for no less than two years outside of China. New

foreign representatives must undergo a lengthy approval process that can take more than one year, during which they must leave the country monthly to file for a renewal visa.

Substantial differences in official tax policies applied to the representative offices of foreign law firms in comparison with taxes applied to Chinese law firms, coupled with inconsistent enforcement policies, represent an additional hurdle to supplying legal services in China.

## **INVESTMENT BARRIERS**

The volume of foreign investment in China grew by 14.8 percent in 2007 despite the introduction of significant new investment barriers. According to the United Nations Conference on Trade and Development's *2008 World Investment Report*, China received \$83.5 billion in FDI in 2007 [latest data available]. China was the world's third-largest investment destination, after the United States and the United Kingdom. The World Bank's *Doing Business Report 2009* gave China a global ranking for "ease of doing business" of 83. In 2008, 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, 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 allowing foreign investment by 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 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.

## **FOREIGN TRADE BARRIERS**

## **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 GATT Article XI obligations not to impose quantitative restrictions on imports. 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 raise WTO concerns, including ones that "encourage" technology transfers to China, 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 2008, 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, without an opportunity for any public comment. The November 2007 catalogue placed new restrictions on several industries, including chemicals, auto parts, rare earths processing, biofuel production, and edible oil processing, while the prohibitions and restrictions facing copyright-intensive products and genetically modified plant seeds remain in place. It also moved the mining of raw materials such as antimony, fluorite, molybdenum, tin, and tungsten from the "restricted" category to the "prohibited" category. From a positive standpoint, the catalogue encouraged foreign investment in highway cargo transport and modern logistics, while it removed from the "encouraged" category projects of foreign-invested enterprises that export all of their production.

### *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 allowing 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 2008, 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, which came into effect on 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 Five 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 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."

As noted above, 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.

## **FOREIGN TRADE BARRIERS**

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 became 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. The law also indicates that China will establish a review process to screen inward investment for national security implications. U.S. industry has expressed serious concern about China's increasing use of these and other investment restrictions, which can be used as protectionist tools by China's economic planners to shield inefficient or monopolistic Chinese enterprises from foreign competition.

## **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 three 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, in addition to 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 December 2008, China had granted QFII status to 72 foreign entities, with total quotas allotted totaling \$12.8 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 2002. China also committed, in its Protocol of Accession to the WTO, to initiate negotiations for accession to the GPA "as soon as possible." Based on its commitment at the April 2006 JCCT meeting, China initiated GPA accession by submitting its application for accession and initial offer of coverage in December 2007. In May 2008, the United States submitted its Initial Request for Improvements in China's Initial Appendix I Offer. At the JCCT meeting in September 2008, China committed to submit an improved offer as soon as possible. The United States and other GPA Parties have noted that significant improvements will be needed in China's initial offer to bring China's coverage to the level of other Parties' coverage. China submitted its responses to the Checklist of Issues for Provision of Information relating to its accession to the GPA in September 2008. In 2008, the United States and China held three rounds of negotiations on the terms and conditions of China's GPA accession and agreed to exchange information relating to their respective procurement systems in order to facilitate China's accession to the GPA. In December 2008, the United States responded to China's questions on the U.S. procurement system and U.S. coverage under the GPA.

## **FOREIGN TRADE BARRIERS**



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 January 2003, China implemented a *Government Procurement Law* (GPL), which generally reflects the disciplines of the GPA and incorporates provisions from the United Nations Model Law on Procurement of Goods. However, the GPL also directs central and sub-central government entities to give priority to "local" goods and services, with limited exceptions. Since the adoption of the GPL, the Ministry of Finance (MOF) has issued various implementing measures, including regulations that set out detailed procedures for the solicitation, submission, and evaluation of bids for government procurement of goods and services and has helped to clarify the scope and coverage of the GPL. MOF also issued measures relating to the announcement of government procurement opportunities and the handling of complaints by suppliers relating to government procurement. 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 *Bidding and Tendering Law* of 2000.

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. In September 2007, the NDRC implemented provisional rules for electronic government projects, which mandate priority purchasing of domestic goods and services in national electronic government projects.

In December 2007, MOF issued two measures that would substantially restrict the Chinese government's purchase of foreign goods and services. One, the Administrative Measures on the Government Procurement of Imported Products, severely restricts government procurement of imported foreign products and technologies. The second measure, Administrative Measures for Government Procurement on Initial Procurement and Ordering of Indigenous Innovation Products, is directed at restricting government procurement of indigenous innovation products to Chinese products developed by domestic enterprises or research institutions. While China may maintain these measures until it completes its GPA accession, the United States has raised strong concerns with regard to them. The United States is closely monitoring developments and will continue to work with China and other GPA parties in an effort to ensure that China's accession to the GPA takes place expeditiously and on robust terms.

## **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 298 million at the end of 2008, representing an increase of 42 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 fivefold increase over the previous year. CNNIC also reported that by the end of 2008, there were more than 100 million blogs in China, representing a dramatically growing source of online interaction. However,

## **FOREIGN TRADE BARRIERS**

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 2008, nearly 90 percent of China's Internet users had broadband connections, representing an increase of 14 percentage points over 2006, and China Telecom is now reportedly the world's largest digital subscriber line, or DSL, operator. There are now more than 120 million broadband subscribers in China. 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), 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 Anti-Unfair 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

## **FOREIGN TRADE BARRIERS**

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 frequently suggest that these efforts are tied primarily to employment concerns. However, the ultimate beneficiaries of the resulting 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 took 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 Five Year Plan on foreign investment that seeks to restrict foreign

## **FOREIGN TRADE BARRIERS**

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. 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. 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 that had been followed 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 June 2008 SED meeting, China agreed to publish in advance for public comment, subject to specified exceptions, all trade and economic-related administrative regulations and departmental rules that

## **FOREIGN TRADE BARRIERS**

are proposed for adoption, and provide a public comment period of not less than 30 days from the date of publication. China further agreed to publish such measures for comment in a single location: the Chinese Government Legislative Information Website of the Legislative Affairs Office of the State Council. Since then, the United States has been monitoring the effectiveness of this commitment, and has found that publication of proposed measures has improved, but notes that China has yet to fully implement this commitment and publish all such proposed measures for comment in a single location.

## **Legal Framework**

### *Laws and Regulations*

Laws and regulations in China often contain provisions that are relatively general and ambiguous. 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. 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 processes. 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. Many 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. Two important new labor laws went into effect in 2008; the *Labor Contract Law*, which clarifies the rights and obligations of workers and employers to promote better labor relations, and the *Labor Dispute Mediation and Arbitration Law*, which improves and streamlines the labor dispute resolution process. Despite legislative 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 issues such as minimum wages, hours of work, occupational safety and health, bans on child labor, and participation in social insurance programs. There are also persistent concerns about the use of forced prison 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 RMB 7 billion (\$875 million) of China's RMB 2 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.

The cost of labor is low but rose steadily in 2008, until the onset of the global financial crisis.. There remains a large pool of surplus rural workers, many of whom seek work in urban areas, but skilled workers are in relatively short supply. 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. Rising unemployment following the onset of the global economic crisis will likely lead to a leveling off of wages, and an increase in wage arrearages. The government response has been to stabilize employment by adopting policies to reduce financial burdens on employers and provide job placement and training services to laid-off workers.

### *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. Nevertheless, 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, 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.

Given the scarcity of land resources in China, the price of land-use rights and land allocation are important considerations from both a market access and competition standpoint and from the perspective of their effect on production and trade. It is therefore of some concern to the United States that the PRC government is recentralizing control over land administration, with the objective, in part, to ensure that land use-rights are allocated in accordance with a compulsory national land-use plan and state industrial development policies.