

China in the WTO – Year 3

**A Research Report
Prepared for the**

**U.S.-China Economic and
Security Review Commission**

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I. Review of China's WTO Compliance in 2004

In many respects, China made significant progress in 2004 in meeting the obligations and commitments it assumed upon accession to the World Trade Organization (WTO). In a number of areas, however, China's compliance has fallen short of its commitments. The following sections review WTO compliance issues identified in the reports issued by the U.S. Trade Representative and selected private sector groups.

A. Major Compliance Concerns

In 2004, the primary areas of compliance concerns noted by the U.S. and private sector interested parties were the following:

- Intellectual property rights
 - While China has undertaken major efforts to revise its laws and regulations regarding patents, trademarks, and copyrights to comply with the requirements of the TRIPS Agreement, enforcement of intellectual property rights, while improved, is far from adequate. All observers state that counterfeiting and piracy in China remained rampant in 2004. China's failure to adequately enforce IPR is a major problem for many WTO members and has had enormous economic impact on U.S. businesses.
- Trading and distribution rights
 - While China implemented its commitment to full trading rights (right to import and export) ahead of schedule in 2004, concerns remain regarding distribution rights in China. China issued regulations providing for implementation of distribution rights but U.S. businesses are concerned that China has not issued rules clarifying how the application and approval process for acquiring distribution rights will work.
 - Regarding sales away from a fixed location (direct selling), China failed to meet its commitment to open this market to foreign providers by December 11, 2004.

- Services

- In many services sectors, China has met the letter of its liberalization commitments but has frustrated market openings with new burdensome licensing and operating requirements.
- Such regulatory burdens as the imposition of high capital requirements, prudential rule requirements that exceed international norms, branching restrictions, and threshold criteria that are more restrictive of the scope of activities permitted than existed before accession, have affected U.S. providers of insurance services, express delivery services, telecommunications services, and construction services, among others.

- Agriculture

- While China has become a growing market for U.S. agricultural exports (2003 exports amounted to \$5.4 billion), there were continuing problems with market access and transparency.
- In particular, some notable concerns were:
 - biotechnology regulations regarding risk assessment, labeling and field trials
 - transparency deficiencies in China's tariff rate quota regime for bulk agricultural commodities (such as wheat, corn, cotton and vegetable oils)
 - sanitary and phytosanitary (SPS) regulations that are overly restrictive or not based on sound science

- Industrial policies

- In a number of areas, China has employed policies that effectively limit market access, impose conditions on market access, or give preferential treatment.
- Examples include:
 - discriminatory VAT policies affecting semiconductors (issue was resolved bilaterally) and fertilizer
 - failure to provide national treatment with respect to price controls on medicines and drug reimbursement
 - preferential import duties and VAT treatment to certain products (particularly from Russia)
 - discriminatory application of SPS measures
 - disparate standards testing of foreign products compared to domestic products
 - inadequate transparency regarding proposed technical regulations and conformity assessment procedures

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- development of unique standards for products where international standards already exist (affecting such areas as autos, telecommunications equipment, wireless local area networks, radio frequency identification tag technology, audio video coding, whiskey and other distilled spirits, and fertilizer)
 - inconsistent application of the China Compulsory Certification (CCC) mark requirement and failure, so far, to accredit any foreign-invested conformity assessment enterprise capable of testing and certifying the CCC mark
 - investment laws and regulations that continue to “encourage” technology transfer
 - auto industrial policy that discourages imports of auto parts and encourages use of domestic technology
 - government procurement policy that mandates purchases of Chinese-produced software to the extent possible

B. USTR’s 2004 Report on China’s WTO Compliance

On December 11, 2004, the Office of the U.S. Trade Representative (USTR) issued its third annual review of China’s compliance with its WTO accession commitments and obligations. The USTR conducted its monitoring of China’s compliance efforts and published its report, *2004 Report to Congress on China’s WTO Compliance*, pursuant to Congress’ statutory directive and mandate.¹ See U.S.-China Relations Act of 2000, P.L. 106-286, section 421; 22 U.S.C. § 6951. The USTR’s China Compliance Report examines nine broad categories of China’s WTO commitments. In its report, USTR notes both progress achieved since China’s accession as well as continuing shortcomings regarding China’s performance of its commitments. While USTR’s report is comprehensive, its main focus is on the trade concerns that have been raised by U.S. business interests (“stakeholders”), with particular emphasis upon continuing shortcomings regarding China’s performance of its commitments, rather than upon

¹ The USTR 2004 report is available at http://www.ustr.gov/assets/Document_Library/Reports_Publications/2004/asset_upload_file281_6986.pdf.

the many non-controversial areas where China has satisfactorily complied with WTO commitments. As identified and singled out in USTR's report, the following tables highlight China's compliance deficiencies (as well as some important successes) in the third year of its WTO membership (2004) that most affected U.S. stakeholders.

1. Trading Rights and Distribution Services²
<p><i>Trading Rights</i></p> <ul style="list-style-type: none">• “Trading rights” involves two elements: the right to import goods (into China) and the right to export goods (from China). “Trading rights” are critical to the ability of U.S. businesses to operate and expand in China and to be able to receive the value of other commitments made by China.• China had committed to fully grant trading rights to all entities (both domestic and foreign) by the end of the third year after accession (<i>i.e.</i>, by December 11, 2004).• In the first two years of membership, however, China fell behind in granting phased-in trading rights to foreign-invested enterprises. Even up to mid-2004, China limited trading rights by retaining certain conditions on trading rights (<i>e.g.</i>, minimum registered capital requirements, import levels, export levels, and prior experience) that China had committed to eliminate.• In January 2004, China drafted a revised Foreign Trade Law that included provisions meeting its trading rights commitments. The final revised Foreign Trade Law was issued in April 2004. It provided for the automatic grant of trading rights through a registration process.• At the JCCT meeting in April 2004, China agreed to implement its trading rights commitments six months ahead of schedule, that is, by July 1, 2004.• In June 2004, China's MOFCOM issued final implementing rules and the grant of full trading rights became effective on July 1, 2004.• USTR reports that U.S. companies have reported few problems regarding the new trading rights registration process.
<p><i>Distribution Services</i></p> <ul style="list-style-type: none">• With limited exceptions, China committed to end national treatment and market access restrictions on foreign enterprises providing distribution services through a local presence within three years of China's accession.• In the first two years of membership, China fell behind in liberalizing distribution services. China did not begin to liberalize until mid-2004, when MOFCOM issued regulations that eliminated national treatment and market access restrictions on joint ventures providing wholesaling services, commission agents' services, direct retailing services (other than sales away from a fixed location) and franchising services. China provided that these services would be allowed through an approval certificate process. The regulations also provided that liberalization would extend to wholly foreign-owned enterprises on December 11, 2004.• USTR notes the following deficiencies:<ul style="list-style-type: none">▪ MOFCOM has delayed issuing implementing regulations, with the result that the procedures for securing the necessary approval certificates are not clear and foreign enterprises have so far

² See USTR, *2004 Report to Congress on China's WTO Compliance*, December 11, 2004, at pages 11-21.

- been prevented from providing wholesaling, commission agents', and franchising services.
- **MOFCOM has delayed issuing regulations on sales away from a fixed location, or direct selling, with the result that foreign enterprises have been prevented from starting up direct selling activities.**

Wholesaling Services and Commission Agents' Services

- China committed to a gradual phase-in of wholesaling services and commission agents' services by foreign-invested enterprises regarding goods made by other enterprises in China or imported goods, beginning December 2002, with full services allowed to wholly-foreign invested enterprises by December 11, 2004.
- China, however, did not comply with its timetable. In 2003 and into 2004, China continued to restrict these services to joint ventures with minority foreign ownership and continued to impose restrictions such as stringent qualification requirements.
- In April 2004, MOFCOM issued regulations that eliminated market access and national treatment restrictions on wholly foreign-owned enterprises and reduced capital requirements as of the scheduled phase-in date of December 11, 2004. Under the regulations, enterprises must obtain central or provincial-level MOFCOM approval before providing these services.
- **USTR notes the following deficiencies:**
 - **MOFCOM has not yet provided guidance or implementing rules as to how the central or provincial-level approval system will work.**

Retailing Services

- China committed to a gradual phase-out of restrictions (such as geographic and quantitative limitations) on retailing services by foreign enterprises, with wholly-foreign invested enterprises permitted full retailing services by December 11, 2004.
- China, however, did not comply with its phase-in schedule. In 2003 and into 2004, China continued to restrict retailing services through burdensome conditions (such as minimum threshold requirements as to volume, imports/exports, assets, registered capital, and prior experience).
- In April 2004, MOFCOM issued regulations that eliminated market access and national treatment restrictions on wholly foreign-owned enterprises and reduced capital requirements as of the scheduled phase-in date of December 11, 2004. Under the regulations, enterprises must obtain central or provincial-level MOFCOM approval before providing retailing services.
- **USTR notes the following deficiencies:**
 - **As with wholesaling services, MOFCOM has not yet issued guiding rules as to how its approval system will operate.**

Sales away from a fixed location

- China committed to end market access and national treatment restrictions for sales away from a fixed location (direct selling) by December 11, 2004.
- During 2004, MOFCOM drafted three regulations to implement the direct selling commitment, but China did not make these draft regulations available for public comment.
- **Based on its knowledge of the draft regulations, USTR notes the following potential problems:**
 - **National treatment: the draft regulation permits direct selling of domestically-produced goods, but restricts selling of imported goods to a fixed location.**

- Other provisions have requirements that appear to make direct selling commercially unviable.

2. Import Regulation³

Tariffs

- In general, USTR found that China complied with its commitment to make the tariff reductions in both agricultural and industrial goods that were required as of January 1, 2004.

Customs and Trade Administration

Customs Valuation

- Upon accession, China assumed the obligations of the WTO Agreement on Customs Valuation and agreed to implement these without a transition period. In January 2002, China issued customs valuation regulations. In addition, by December 11, 2003, China had committed to value digital products (*e.g.*, floppy disk, cd-rom) based on the value of the underlying carrier medium, rather than the imputed value of the content.
- **USTR notes the following deficiencies:**
 - **China has not uniformly implemented its regulations with the result that U.S. exporters are still encountering valuation problems at Chinese ports. These problems include: (1) valuation based on reference pricing instead of transaction value; (2) addition of royalties and license fees to the dutiable value of imported software; (3) non-uniform valuation by ports of particular digital products; and (4) valuation of high-value electronic media to be used to produce multiple copies of products (*e.g.*, DVDs) based on the estimated value of the future copies instead of the value of the carrier medium itself.**

Rules of Origin

- Upon accession, China became subject to the WTO Agreement on Rules of Origin.
- USTR has not raised concerns about China's implementation of its rules of origin obligations, except to note that China has not been adequately transparent in drafting and issuing its implementing regulations (*e.g.*, China did not circulate draft regulations for comment).

Import Licensing

- Respecting China's adherence to the WTO Import Licensing Agreement, USTR reports that it has raised various concerns regarding MOFCOM's automatic and non-automatic licensing regulations in order to promote clarity and to ensure no trade-distorting effects.

Non-tariff Measures

- China agreed to eliminate numerous nontariff measures (NTMs), including import quotas, licenses and tendering requirements covering numerous products. For some products, the NTMs were ended upon accession. For other products, China agreed to a transitional phase out of NTMs (*e.g.*, on autos and auto parts, crude oil, refined oil, and tires), with all NTMs ended by January 1, 2005.

³ See USTR, *2004 Report to Congress on China's WTO Compliance*, December 11, 2004, at pages 21-32.

- China agreed to provide detailed procedures for allocating import quotas during the phase-out period, but, during the transition period, China's quota system had many problems. USTR notes that necessary regulations were issued late, quotas were allocated late, and lack of transparency prevented knowing if the quotas were allocated properly.
- As of January 1, 2005, China committed to have no import quotas in place.

Tariff-rate Quotas on Industrial Products

- China agreed to implement a transparent system of TRQs to give access for three industrial products, including fertilizer, a major U.S. export.
- **USTR notes the following deficiencies:**
 - **China was slow to implement its TRQ system in 2002, and there was a lack of transparency.**
 - **In 2003, China issued the quota allocations on time but discouraged TRQ holders from freely using their quotas. U.S. fertilizer exports decreased by 47% in 2003 and by 18% in 2004 (Jan-Sept).**

Other Import Regulation

Antidumping

- China agreed to conform its regulations and procedures to the WTO Antidumping Agreement.
- **USTR notes the following deficiencies:**
 - **China's AD practice has not been adequate with respect to transparency and fair procedures. For example, the Chinese authorities have not provided parties with sufficiently detailed information or provided adequate disclosure of the facts and calculations on which the AD determination is based.**

Countervailing Duties

- China agreed to conform its regulations and procedures to the WTO Agreement on Subsidies and Countervailing Measures.
- USTR finds that China's regulations and procedural rules generally accord with the Subsidies Agreement, but that certain provisions are not implemented.
- China has not yet initiated any subsidies proceeding.

Safeguards

- China agreed to conform its regulations and procedures to the WTO Safeguards Agreement.
- USTR finds that China's regulations and procedural rules generally accord with the Safeguards Agreement, but that certain provisions have not been implemented.
- China has initiated one safeguards proceeding (steel products). The safeguard measure was terminated in December 2003.

3. Export Regulation⁴

- China agreed to maintain export restrictions in accordance with WTO rules, which generally prohibit (with exceptions) export restrictions (other than duties, taxes or other charges) (GATT Article XI).
- **USTR notes the following deficiencies:**
 - **China has continued to impose export restrictions on certain products, most notably blast furnace coke and fluorspar.**
 - **In 2004, export restrictions on coke adversely affected U.S. integrated steel producers and their customers. China's quota, and the illegal sale of export quota certificates, caused a significant increase in the export price of coke.**
 - **Although, in late July 2004, China increased the quota and the export price declined, USTR continues to urge China to end export quotas on coke.**
 - **Regarding fluorspar, China imposes quotas and license fees on fluorspar exports, but does not restrict domestic users of fluorspar.**

4. Internal Policies Affecting Trade⁵

Non-discrimination

- China agreed to abide by the core GATT 1994 principles of Most-Favored Nation (MFN) (nondiscrimination) and national treatment, and to repeal or revise laws inconsistent with those principles.
- **USTR notes the following deficiencies:**
 - **Although China revised many of its laws that conflicted with MFN and national treatment, China has not applied MFN and national treatment in all areas.**
 - **U.S. pharmaceutical manufacturers have noted national treatment problems regarding price controls on medicines and drug reimbursement.**
 - **China has applied preferential import duties and VAT treatment to certain products (particularly from Russia).**
 - **From accession, China has continued to discriminate in applying SPS measures.**

Taxation

- China agreed that its tax laws would conform to MFN and national treatment principles.

VAT Policies

- **USTR notes the following national treatment deficiencies in China's VAT system:**
 - **In 2004, China applied discriminatory VAT rates to imports of semiconductors and fertilizer but not to domestically-produced semiconductors and fertilizer.**
 - **With respect to semiconductors, the U.S. initiated the dispute settlement process in March 2004. In July 2004, the issue was resolved when China agreed to eliminate the VAT on semiconductors.**

⁴ See USTR, *2004 Report to Congress on China's WTO Compliance*, December 11, 2004, at pages 32-34.

⁵ See USTR, *2004 Report to Congress on China's WTO Compliance*, December 11, 2004, at pages 34-47.

- With respect to fertilizer, China exempts all phosphate fertilizers except DAP (a fertilizer the U.S. exports to China) from a 13% VAT. So far, China has not changed this policy.
- Generally, some U.S. industries complain that Chinese producers can avoid VAT payments (through poor collection procedures, special deals or even fraud), while importers must pay the VAT.

Consumption Taxes

- USTR notes the following national treatment deficiencies in China's consumption taxes:
 - The effective consumption tax rate on imported products (*e.g.*, spirits/alcoholic beverages, tobacco, cosmetics and skin/hair care preparations, jewelry, fireworks, rubber, motorcycles and automobiles) is substantially higher than the rate applied to domestic products because China uses different tax bases to compute consumption taxes for domestic and imported products.

Subsidies

- Upon accession, China assumed the obligations of the WTO Subsidies Agreement, including the elimination of prohibited subsidies (export subsidies and import substitution subsidies).
- USTR notes the following deficiencies:
 - Since accession, China has failed to submit to the WTO Subsidies Committee any notifications of its subsidy programs (an annual requirement). (However, in November 2004, in the Goods Council TRM, China committed to submit its subsidies notification within 2005.)

Price Controls

- An annex to China's accession agreement listed products and services subject to price control or government guidance pricing. In 2004, China maintained its price controls and guidelines on the listed products and services (*e.g.*, pharmaceuticals, natural gas, transportation (including freight transportation), tobacco, and other agricultural products).

Standards, Technical Regulations and Conformity Assessment Procedures

- China assumed the obligations of the Agreement on Technical Barriers to Trade which sets rules and procedures regarding the development, adoption and application of voluntary product standards, mandatory technical regulations, and testing/certification procedures. The TBT Agreement is directed to preventing the use of technical requirements as unnecessary barriers to trade.

Restructuring of Regulators

- China has made significant changes to its standards and technical regulations regime.
- USTR notes the following deficiencies:
 - Despite China's changes to its standards testing regime, in some sectors, foreign products are tested in specially designated laboratories that are separate from those laboratories used to test domestic products. This disparate testing can lead to uneven treatment.

Transparency

- USTR notes the following deficiencies:
 - China's notifications of proposed technical regulations and conformity assessment procedures have been submitted by two agencies (AQSIQ or SAC). TBT measures from other Chinese

agencies have not been notified.

- When TBT measures have been notified, in some cases, the comment periods have been unacceptably short, or the comments disregarded.

Standards and Technical Regulations

- China has made progress in conforming its technical regulations to international standards.
- USTR notes the following deficiencies:
 - In some sectors, China has been developing unique requirements even where there are well-established international standards (*e.g.*, autos, telecommunications equipment, wireless local area networks, radio frequency identification tag technology, audio video coding, whiskey and other distilled spirits, and fertilizer).
 - These unique standards will create significant barriers to market entry and make the cost of compliance high for foreign companies.
 - One example was China's issuance in May 2003 of two mandatory standards for encryption over Wireless Local Area Networks (WLANs) (which incorporated the WLAN Authentication and Privacy Infrastructure (WAPI) encryption technique), applicable to domestic and imported equipment containing WLAN (also known as Wi-Fi) technologies. In April 2004, the US and China resolved the WAPI issue when China said it would suspend indefinitely its proposed implementation of WAPI as a mandatory standard.
 - Another example is continuing pressure from within the Chinese government to select China's 3G telecommunications standard.

Conformity Assessment Procedures

- China has established one safety mark ("China Compulsory Certification" or "CCC" mark), issued to both Chinese and foreign products.
- USTR notes the following deficiencies:
 - In 2004, U.S. companies continued to complain that the CCC mark regulations lack clarity.
 - China is applying the CCC mark requirements inconsistently, *i.e.*, many domestic products that require the CCC mark are still being sold without the mark.
 - In addition, in some sectors, U.S. companies complained in 2004 about duplication in certification requirements (particularly for telecommunications products).
 - Despite national treatment commitments, to date, China has accredited 68 Chinese enterprises to test for and certify the CCC mark, but has not accredited any foreign-invested conformity assessment bodies.

Other Internal Policies

State-Owned and State-Invested Enterprises

- China agreed that purchases of goods and services by state-owned and state-invested enterprises for commercial non-governmental purposes would be subject to WTO rules, in particular that they would be based on commercial considerations.
- USTR notes that U.S. companies have not complained regarding WTO compliance in this area.

State Trading Enterprises

- China agreed that state trading enterprises would provide full information on their pricing mechanisms and ensure transparent and WTO-consistent import purchasing procedures.
- USTR notes the following deficiencies:
 - So far, in response to requests for information regarding the pricing and purchasing practices of

state trading enterprises, China has only provided general information, not sufficient to meaningfully assess China's compliance efforts.

Government Procurement

- China is not a member of the WTO Agreement on Government Procurement (GPA) but committed to initiate negotiations to accede to the GPA. In the interim, China agreed that central and local governments would conduct procurement in a transparent manner.
- USTR notes that U.S. companies have expressed concern regarding implementing rules on government software procurement that are being drafted by MOF. The draft reportedly mandated that central and local governments should purchase domestic software to the extent possible. The concern is focused on China's apparent restrictive definition of "domestic products."

5. Investment⁶

- China committed to eliminate export performance, local content and foreign exchange balancing requirements from its laws, regulations and other measures. China agreed that importation or investment approvals would not be conditioned on these requirements or other requirements such as technology transfer and offsets.
- **USTR notes the following deficiencies:**
 - **Although not formally requiring it, some of China's revised laws and regulations continue to "encourage" technology transfer. In practice this "encouragement" will effectively be a "requirement" in many cases.**
 - **In 2004, U.S. companies report that some Chinese officials still consider factors such as export performance and local content when making investment approval decisions.**
- Although China had committed, by accession, to revise its Industrial Policy for the Automotive Sector to make it WTO-consistent, China missed the deadline. China circulated a draft revised automobile industrial policy in 2003 and issued the final version in May 2004.
- **USTR notes the following deficiencies:**
 - **The new auto industrial policy contains discriminatory provisions that discourage the importation of auto parts and encourage the use of domestic technology.**
 - **The new policy also contains some provisions too vague to assess (e.g., regarding complete knocked-down auto kits).**
- In 2004, the State Council made no changes to the 2002 *Sectoral Guidelines Catalogue for Foreign Investment*.
- **USTR notes the following concern:**
 - **China's placement of the production and development of genetically-modified plant seeds in the "prohibited" category for foreign investment is an exception to China's progress in opening up other sectors to foreign investment.**

⁶ See USTR, *2004 Report to Congress on China's WTO Compliance*, December 11, 2004, at pages 47-49.

6. Agriculture⁷

Tariffs

- In 2004, China implemented required tariff changes on agricultural goods on schedule.

China's Biotechnology Regulations

- In 2002 and 2003, the U.S. had serious concerns with China's regulations and procedures for issuing final safety certificates, particularly for U.S. exports of soybeans, corn and other commodities. The U.S. and China agreed to a series of interim solutions through issuance of temporary safety certificates so as to avoid disrupting trade. This issue appears to have been resolved when, in February 2004, China issued a final safety certificate for biotech soybeans and subsequently issued safety certificates for corn, canola, and cotton.
- **USTR notes the following concerns:**
 - **Despite the resolution of the safety certificate issue, USTR notes that concerns remain regarding other areas covered by China's biotechnology regulations, particularly risk assessment, labeling and field trials.**

Tariff-Rate Quotas on Bulk Agricultural Commodities

- China committed to replace quotas on certain bulk commodities (*e.g.*, wheat, corn, cotton and vegetable oils) and to provide market access through a transparent system of TRQs, with established rules regarding quota applications, allocations and re-allocations.
- Initially, in 2002, China's operation of its TRQ system was plagued with problems including regulations that provided inadequate transparency, imposed burdensome licensing procedures, and appeared to provide separate sub-quotas for the processing and re-export trade. In addition, China's allocation of the TRQs showed favoritism to domestic farm interests. Because of its concerns, the U.S. requested formal consultations with China.
- Subsequently, in 2003, China's bettered its performance but the U.S. noted that the problems of transparency, sub-division of the TRQ, small allocation sizes, and burdensome licensing persisted.
- China issued new regulations in 2004 and its operation of the TRQ system generally improved.
- **USTR notes the following concerns:**
 - **USTR notes that, despite much improvement, transparency continues to be a problem.**

Sanitary and Phytosanitary Issues

- Through the SPS Agreement, China committed that SPS measures would address legitimate scientific-based concerns, not discriminate arbitrarily, and not be disguised restrictions on trade.
- **USTR notes the following concerns:**
 - **In 2004, U.S. agricultural exports faced increased SPS measures that raised WTO concerns, in particular, measures covering BSE (Bovine Spongiform Encephalopathy, known as "mad cow" disease) and AI (Avian Influenza).**
 - **BSE: in December 2003, China banned U.S. bovine products after a case of BSE found in**

⁷ See USTR, *2004 Report to Congress on China's WTO Compliance*, December 11, 2004, at pages 49-58.

the U.S. China banned not only beef but low-risk bovine products as well (which do not pose a risk of BSE and should not have been banned under international standards). In September/November 2004, China agreed to allow resumption of imports of most low-risk bovine products but, as of December 2004, imports of these products had not yet resumed.

- AI: in February 2004, China banned U.S. poultry due to cases of low-pathogenic AI in Delaware. In November 2004, China lifted the general ban (but retained a ban on poultry products from Connecticut and Rhode Island).
- Regarding wheat: (1) China's imposition of a maximum residue level (MRL) for selenium that is below the international standard threatens all U.S. wheat exports to China; (2) although there is no international standard, China imposed a MRL for vomitoxin in wheat. {However, USTR notes that China appears not to be enforcing these measures.}
- Regarding raw poultry and meat, China applies certain non-science-based standards (*e.g.*, zero tolerance for pathogens) to imports that are not applied to domestic raw poultry and meat. This violates national treatment and has slowed imports from the U.S.
- Regarding food additives, China imposes overly restrictive standards that block imports of many U.S. processed food products. The banned food additives are widely used in other countries and are approved by the World Health Organization (WHO).
- USTR notes that, except for BSE and AI, little progress has been achieved on the foregoing issues.

Inspection-related Requirements

- During 2002 and 2003, the U.S. expressed concerns about AQSIQ's administration of import licensing procedures, in particular about arbitrary use of inspection-related requirements (*e.g.*, import inspection permits; quarantine inspection permits) to restrict, delay and increase the cost of such U.S. exports as soybeans, cotton, meat and poultry.
- In 2004, the U.S. continued to raise these concerns.
- In June 2004, China issued a new regulation (Decree 73) that made quarantine inspection permits more workable.
- USTR notes the following deficiencies:
 - Decree 73 raised new concerns regarding required contract terms and commercial risk.
 - U.S. shippers complained that Decree 73 increased the financial risk for exporters shipping commodities to China.
 - With respect to soybeans, although U.S. soybean exports to China continued to go forward, Decree 73 appears to have created uncertainty in the market and contributed to general downward pressure on world soybean prices.

Export Subsidies

- China committed to eliminate all export subsidies upon accession.
- In 2002 and 2003, U.S. industry expressed concerns that China was providing export subsidies on corn, as China was exporting significant quantities of corn at prices 15-20% below domestic prices.
- In 2004, USTR notes that it appeared China was becoming a net importer of corn and its corn exports were being made on a commercial basis.

7. Intellectual Property Rights⁸

Legal Framework

- At the time of accession and thereafter, China modified its IPR laws, regulations and implementing rules regarding patents, trademarks and copyrights. In 2003, China issued additional new measures on patents, trademarks and copyright.
- USTR observes that, overall, China's IPR laws are generally in compliance with the TRIPS Agreement, although some improvements still need to be made.
- China continued to make improvements to its laws and regulations in 2004, such as in the recognition of foreign well-known marks. China also issued a series of new Customs Administration regulations and implementing rules regarding protections against the import and export of IPR infringing products
- **USTR notes the following concerns:**
 - **In some areas, China's new regulations and implementing rules are not clear or need revision, such as regarding the storage/disposition of infringing goods and transferring cases for possible criminal prosecution.**
 - **Although not required to do so, at the April 2004 JCCT meeting, China agreed to ratify and implement the WIPO treaties as soon as possible. By December 2004, China had not yet acceded to the 1996 WIPO Internet-related treaties.**

Enforcement

- Under the WTO TRIPS Agreement, China is obligated to implement effective IPR enforcement procedures, including deterrent-effective civil and criminal remedies.
- **USTR notes the following concerns:**
 - **In 2004, IPR infringement was rampant and, in the view of some U.S. businesses, had worsened. U.S. losses due to IPR piracy are estimated to be between \$2.5-\$3.8 billion annually.**
 - **In 2004, IPR infringement affected a wide range industries. Examples include films, music, publishing, software, pharmaceuticals, chemicals, information technology, consumer goods, electrical equipment, automotive parts and industrial products.**
 - **China has failed to provide effective IPR enforcement. This is the result of lack of coordination between government ministries and agencies, local protectionism and corruption, high thresholds for criminal prosecution, lack of training and weak sanctions for infringement.**

Administrative Enforcement

- **USTR notes the following concerns:**
 - **Although China continues to take administrative enforcement actions against IPR violators, the actions have been largely ineffective in deterring IPR violations for a number of reasons including:**
 - **Extremely low fines are imposed (because value of infringing goods is based on price for the infringing goods, not the genuine goods).**
 - **Evidence of warehousing infringing goods is not sufficient to prove an intent to sell them.**
 - **Rarely are administrative cases forwarded to the Ministry of Public Security for criminal investigation.**

⁸ See USTR, *2004 Report to Congress on China's WTO Compliance*, December 11, 2004, at pages 58-67.

- **Although China Customs issued new regulations on administrative penalties in September 2004, the fines to be imposed are too low (the lower of 30% of the value of the goods confiscated, or RMB 50,000 (\$6,030)).**

Criminal Enforcement

- Presently, criminal enforcement has virtually no deterrent effect.
- At the April 2004 JCCT meeting, China agreed to apply criminal sanctions to a wider range of IPR-infringing activities and to increase the penalties for IPR violations. China also pledged that, by the end of 2004, it would issue judicial interpretations that lower the value thresholds for criminal investigations/prosecutions, and apply criminal sanctions to the import, export, distribution and storage of counterfeit goods and to on-line piracy. (NOTE: As of the date of USTR's report, China was still drafting these judicial interpretations. They were issued in late December 2004).
- **USTR notes the following concerns:**
 - **China needs to revise its laws, including judicial interpretations, and investigate, prosecute, convict and sentence a much higher percentage of IPR infringers, as well as increase criminal penalties.**
 - **Prosecution of IPR crimes requires coordination between national and local agencies, but coordination remains problematic.**
 - **Criminal liability thresholds have been very high and seldom met. They also require proof of sales of the infringing goods, which is often not available.**

Civil Enforcement

- IPR civil actions in Chinese courts are increasing due to the ineffectiveness of administrative and criminal enforcement.
- **USTR notes the following concerns:**
 - **In 2004, U.S. companies still complained that Chinese courts did not provide consistent and fair IPR enforcement, due to factors such as inadequate technical training and ineffective court rules regarding evidence, expert witnesses, and protection of confidential information.**
 - **Enforcement of IPR rights in Chinese courts is slow. For example, a patent rights case can take between four to seven years to complete.**

8. Services⁹

Financial Services -- Banking

- China committed to phase in banking services by foreign banks over 5 years.
- Although China has generally met its WTO commitments to liberalize, it has also imposed restrictions that have made it difficult for foreign banks to set up in China.
- **USTR notes the following concerns:**
 - **Following accession, the People's Bank of China imposed, on foreign banks' headquarters and branches, working capital requirements and other prudential rules that went beyond international norms, and which made it more difficult for foreign banks to set up in China.**
 - **Although China made reductions in capital requirements in December 2003 and July 2004, the**

⁹ See USTR, *2004 Report to Congress on China's WTO Compliance*, December 11, 2004, at pages 67-80.

U.S. continued to urge China to align its prudential requirements with international norms.

Financial Services – Insurance

- China committed that, within three years of accession, it would phase out geographic restrictions on all types of insurance operations, and expand ownership rights and scope of activities for foreign firms.
- The China Insurance Regulatory Commission (CIRC) issued regulations after accession that created problems in three areas – unreasonably high capitalization requirements, inadequate transparency, and vague rules regarding branching rights (China has required existing non-life insurer branches that seek to branch in China to set up as a subsidiary, which is both costly and unnecessary).
- **USTR notes the following concerns:**
 - **Following consultations with the U.S. in 2002 and 2003, China issued final implementing rules in May 2004. While the new rules lowered capital requirements for national licenses and branches, they did not adequately deal with China’s conditions on branching rights. In addition, in at least one instance, China waived this requirement for a foreign firm but has not stated how or whether other firms can obtain the same waiver.**
 - **It appears that China has been issuing concurrent branch approvals (more than one at a time) for Chinese insurers, but only approving branches of foreign firms consecutively (one at a time).**

Financial Services – Motor Vehicle Financing

- Upon accession, China agreed to open the motor vehicle financing sector to foreign non-bank financial enterprises without any limitations on market access or national treatment.
- Initially, in the first two year after accession, China failed to meet this obligation.
- In October 2003, the China Banking Regulatory Commission (CBRC) issued regulations implementing its commitments.
- **USTR notes the following concerns:**
 - **The regulations imposed relatively high capital requirements that make it difficult for small and medium-sized enterprises to enter the market.**

Legal Services

- On accession, China committed to allow foreign law firms to provide legal services through one profit-making representative office, and to end quantitative and geographical restrictions after one year.
- Regulations issued in 2001-2002 appeared to impose a needs test for foreign law firms wanting to set up offices in China (contrary to GATS), appeared to restrict the types of legal services that could be provided, and required unnecessarily time-consuming procedures in setting up an office or branch.
- **USTR notes the following concerns:**
 - **There has been little progress in addressing the problems cited previously -- economic needs test, unreasonable restrictions on types of legal services, and unnecessary time-consuming procedures.**

Telecommunications Services

- Upon accession, China committed to open its telecommunications services market to foreign suppliers through JVs with Chinese companies, to increase the foreign stake over time, and to end geographic restrictions within

2-6 years. China also committed to have an independent regulator, by separating the regulatory and operating functions of the Ministry of Information Industry (MII), and to adopt pro-competitive regulatory principles.

- China issued regulations in December 2001 implementing China's commitments.
- **USTR notes the following concerns:**
 - **China's regulations established high capital requirements (especially for basic telecommunications services) that effectively bar entry for many potential foreign suppliers.**
 - **China has not established an independent regulator. While MII is nominally separate from the current telecommunications operators, MII has extensive influence and control over their operations and uses its regulatory authority to disadvantage foreign firms.**
 - **In contrast to international norms, MII reclassified several telecommunications services from the "value-added" category to the "basic" category (slower liberalization; higher capitalization) and restricted what new services could be classed as "value added." As a result, U.S. firms' access has been limited.**
 - **MII's licensing process is very slow. USTR is unaware that any application to provide value-added services has been completed.**

Express Delivery Services

- China agreed to permit foreign express delivery companies in JVs with Chinese companies to increase their stake over time, and to allow wholly foreign-owned subsidiaries within four years of accession.
- China also agreed to provide an independent regulator by separating the regulatory and operations functions of China Post.
- Following accession, two measures issued by China raised problems. China required foreign service providers to obtain "entrustment" authority from China Post (their competitor) and China imposed weight/rate restrictions on letters the foreign providers could handle. These problems were addressed and resolved in September 2002 when China issued revised regulations.
- **USTR notes the following concerns:**
 - **In July-November 2003, China circulated draft amendments to the postal services law, which (1) gave China Post a monopoly on letters under 500 grams (a horizontal commitment violation as it restricted existing scope of activities), and (2) failed to establish an independent regulator. At the April 2004 JCCT, China indicated that the weight restriction would not resurface as a problem. However, the July 2004 draft amendment still contained a weight restriction (reduced to 350 grams).**

Construction and Related Engineering Services

- On accession, China agreed to permit foreign companies to provide construction and related engineering services in JVs with Chinese companies, limited to foreign-invested projects and subject to capitalization requirement. Within three years of accession, China committed to remove these restrictions and to allow wholly foreign-owned subsidiaries provide services in four types of projects.
- **USTR notes the following concerns:**
 - **China issued regulations in September 2002 that raised a number of problems, including imposing new and more restrictive conditions than existed prior to accession when foreign companies could work on a project-by-project basis. The regulations also required foreign firms to obtain qualification certificates; required foreign-invested enterprises to incorporate in China; and imposed high minimum registered capital requirements and foreign personnel residency requirements. Except for the incorporation requirement, these rules went into effect in April 2004. The incorporation requirement is to be effective in July 2005, and foreign companies will**

<p>face uncertainty after that date.</p> <ul style="list-style-type: none">▪ In November 2004, China issued another problematic regulation. It states that a company providing project management services on a project may not provide both construction services and related construction engineering design services on the same project. U.S. companies often provide all of these services in combination.
<p><i>Aviation Services</i></p> <ul style="list-style-type: none">• Although China made no WTO commitments regarding aviation services, China signed an agreement with the U.S. in July 2004 to increase market access for U.S. providers of aviation services.
<p><i>Maritime Services</i></p> <ul style="list-style-type: none">• Although China made no WTO commitments regarding maritime services, China signed an agreement with the U.S. in December 2003 to increase market access for U.S. providers of maritime services.
<p><i>Other Services</i></p> <ul style="list-style-type: none">• In some sectors (<i>e.g.</i>, several types of professional services, tourism and travel-related services, educational services and environmental services), China has implemented its commitments to phase in market access.• In its audio-visual services commitments, China agreed to permit 20 foreign films per year for theatrical release.• USTR notes the following deficiencies:<ul style="list-style-type: none">▪ China has applied a restrictive interpretation to its market access commitments. China treats its commitment to permit 20 foreign films per year as an upper limit rather than as a minimum. This interpretation has encouraged illegal copying and sale of foreign films in China.• China revised Foreign Trade Law (April 2004) appears to provide broad authority for services safeguards.• USTR notes the following deficiencies:<ul style="list-style-type: none">▪ The WTO Services Agreement does not provide for safeguard measures on services.

9. Legal Framework¹⁰

Transparency

- China committed to providing, before implementation, a reasonable period for public comment on new or modified laws and regulations.
- China also committed to translating its trade-related laws and regulations into one (or more) of the WTO languages (English; French; Spanish) and to publish them in an official journal.

¹⁰ See USTR, *2004 Report to Congress on China's WTO Compliance*, December 11, 2004, at pages 80-84.

Public Comment

- Following accession, China repealed, revised, or enacted many trade-related laws and regulations. In 2002 and 2003, China was deficient in providing opportunity for public comment before new or modified laws and regulations were implemented.
- **USTR notes the following deficiencies:**
 - **Despite progress, in 2004, provision for public comment continued to be uneven. For example, drafts of the *Foreign Trade Law*, automobile industrial policy, rules of origin regulations, and customs regulations were either selectively circulated or not circulated at all.**
 - **China has been deficient in providing translations of its trade-related laws and regulations.**

Enquiry Points

- China has established various enquiry points where WTO members, foreign companies or individual can obtain information. USTR notes that U.S. companies have generally found China's enquiry points to be responsive and helpful.

Official Journal

- China committed to establish or designate an official journal for publication of its trade-related laws, regulations and other measures.
- **USTR notes the following deficiencies:**
 - **China has yet to either establish or designate an official journal for publication of its trade-related laws, regulations and other measures**

Uniform Application of Laws

- China committed to apply, implement and administer its trade laws, regulations and other measures in a uniform and impartial manner throughout China. China also agreed to establish an internal review mechanism to examine instances of non-uniform application.
- **USTR notes the following deficiencies:**
 - **China established an internal review mechanism in 2002. However, in 2004, USTR notes that the actual operation of this mechanism still is unclear.**
 - **In 2004, as in prior years, some problems with uniformity continued (reviewed in sections on Customs, Taxation, Investment and Intellectual Property Rights).**

Judicial Review

- China agreed to establish independent and impartial tribunals to review administrative actions on trade-related matters. China has designated certain courts to handle administrative decisions related international trade issues and intellectual property rights, but, so far, foreign companies have not had much experience with these courts.
- China had made progress in improving the quality of its judges, but there are still many judges with little legal training.
- **USTR notes the following deficiencies:**
 - **In 2004, many U.S. companies still are concerned about the independence of China's judiciary, as they are often influenced by political, government or business pressures.**

C. Other Reports on China’s WTO Compliance

1. American Chamber of Commerce – PRC

In September 2004, the American Chamber of Commerce in China issued its 2004 White Paper: American Business in China, which covers a range of issues concerning the business climate in China including the impact and implementation of China’s WTO commitments. In general, the 2004 White Paper strikes a positive note about China’s efforts to comply with its WTO obligations, as indicated by the following:

With the exception of intellectual property rights, we believe China is substantially in compliance with its WTO deadlines and specific obligations. While some commitments remain problematic and there continue to be many areas where the market access opportunities anticipated still have not been realized, China has taken noteworthy steps this year to comply with its basic commitments in the areas of trading rights, insurance, auto finance, and agriculture, among others.

* * *

As we are essentially at the mid-point of the five-year WTO implementation timetable, our members indicate that China needs to complement its overall solid 2004 WTO performance with greater transparency in the drafting of its commercial laws and regulations and ensuring that local and provincial governments do not thwart market access commitments made at the national level.¹¹

Despite the White Paper’s broad optimistic note, it focuses specific attention on intellectual property rights (IPR) and acknowledges China’s shortcomings in that area: “Our

¹¹ American Chamber of Commerce-PRC, 2004 White Paper: American Business in China (September 2004) at 4.

members report that the situation in IPR seems to be worsening, with over three-quarters reporting that they are negatively affected by IPR infringement.¹²

In its review of China’s WTO compliance, the White Paper identifies the following major areas of concern, among others.

Intellectual Property Rights	“Widespread infringement of intellectual property rights in China continues to impact a broad variety of products and technologies, across sectors such as media and entertainment, pharmaceuticals, information technology, consumer goods, electrical equipment, automotive parts, and many others. While China has put in place a sound basic legal and regulatory framework designed to address this problem, it lacks an effective enforcement system and, overall, we believe the situation in the marketplace is worsening, not improving. * * * Few counterfeiters or copyright pirates are subject to criminal sanctions in China, and the administrative sanctions imposed on them fall short of the TRIPS-mandated standard of effective enforcement that has a ‘deterrent’ impact.” ¹³
Regulatory Transparency	“Of great importance to the American business community . . . is the opportunity to review and comment on ‘all laws, regulations, and other measures pertaining to or affecting trade in goods, services, TRIPs, or the control of foreign exchange before such measures are enforced.’ * * * Chinese ministries have from time to time asked our individual member companies to comment on draft regulations that affect their respective industries. Nonetheless, such consultation between the Chinese government and the foreign business community remains carefully managed and selective, with widely varying practices among different ministries.” ¹⁴
Agricultural Market Access	“China committed to make systemic changes designed to create fairness, predictability, and transparency in agricultural trade. China has only partially fulfilled these commitments. * * * Another problematic area is China’s use of a tariff rate quota (TRQ) system on agricultural products, which acted as a non-tariff barrier on imports of foreign agricultural goods.” ¹⁵

¹² American Chamber of Commerce-PRC, 2004 White Paper: American Business in China (September 2004) at 4-5.

¹³ American Chamber of Commerce-PRC, 2004 White Paper: American Business in China (September 2004) at 28.

¹⁴ American Chamber of Commerce-PRC, 2004 White Paper: American Business in China (September 2004) at 28, quoting China’s Protocol of Accession, Part 1, Sec. 2(c)1.

¹⁵ American Chamber of Commerce-PRC, 2004 White Paper: American Business in China (September 2004) at 30.

Value-Added Taxes	“China uses value-added tax (VAT) policies to encourage or protect domestic production in a number of industrial and agricultural sectors.” ¹⁶
Trade and Distribution	MOFCOM issued the regulations specifying “how foreign-invested commercial enterprises may conduct retail, wholesale, franchise, or commission agency business. Overall, the regulation satisfies China's WTO commitments in the distribution sector. However, the regulation states that new stores opened by foreign-invested distribution companies must suit the urban and commercial development plans of the city in which the store will be located and present local government documentation to that effect when submitting an application. Given the discretionary latitude possessed by local officials in this regard, this requirement could be used as a market-entry barrier to restrict the number of foreign distribution operations in a given city. Additionally, the regulations failed to address direct selling, which China's WTO commitments define as one type of distribution service” ¹⁷
National Treatment	“In express delivery, the U.S. industry has significant reservations regarding the proposed extension of China Post's monopoly to deliveries of domestic letters weighing less than 500 grams, according to the draft postal regulations. These draft regulations create a new unspecified charge on express industry revenues to help support China Post's universal service, as well as a new, unworkable licensing regime that gives new powers of supervision, inspection, and punishment to the postal regulator.” ¹⁸

2. U.S. Chamber of Commerce

In September 2004, the U.S. Chamber of Commerce issued a report assessing China’s WTO compliance.¹⁹ The report noted that China has made progress in meeting its WTO commitments in many areas, “particularly in tariff reduction, revising existing laws and drafting

¹⁶ American Chamber of Commerce-PRC, 2004 White Paper: American Business in China (September 2004) at 30.

¹⁷ American Chamber of Commerce-PRC, 2004 White Paper: American Business in China (September 2004) at 32.

¹⁸ American Chamber of Commerce-PRC, 2004 White Paper: American Business in China (September 2004) at 32.

¹⁹ U.S. Chamber of Commerce, China’s WTO Implementation: A Three-Year Assessment (September 2004); <http://www.uschamber.com/NR/rdonlyres/egs772a3dr2jt6mv5stek2wsrq3loxvurxmurefam36o4r7aqnw77uexc zfojybzyt3ku3q6xifyt4pegdslllsw4f/WTOFINAL9%2e21FINAL.docPress.pdf>

and passing new ones to comply with its WTO requirements, and educating its officials and companies about its WTO obligations.” Notwithstanding China’s compliance positives, the Chamber’s report highlights areas where China has not fully met its commitments. Some of the areas noted include the following sampling:

Market Access	<p>“China has made positive regulatory changes that appear to presage greater market access for foreign companies as specified under its WTO commitments. At the same time, however, China appears to be adopting new policies that undercut these changes. China’s continuing reliance on high capitalization requirements to restrict the market access that it promised in its accession agreements and use of proprietary standards that discount foreign IPR and shield emerging domestic players from global competition are examples where China appears to be undercutting meaningful implementation of its WTO commitments.”²⁰</p> <p>“Excessive capitalization requirements to enter or expand in many key sectors, including insurance, telecommunications, auto finance, and banking, remain a major concern for many U.S. Chamber members.”²¹</p> <p>“China should actively adopt measures that open its market in ways that comply with the spirit of its WTO obligations, even if it is not strictly bound to do so under its WTO commitments. New PRC policy directives that affect sectors of strong interest to U.S. Chamber member companies could greatly limit their ability to provide goods and services in the China market. . . . China should refrain from adopting policies that are more restrictive than those in place prior to its WTO accession, as it has done in the case of construction and engineering services and as it appears to be doing in the area of government procurement. In these cases, U.S. goods and service providers face a rolling back of the market access they have enjoyed.”²²</p>
IPR	<p>“China’s intellectual property rights (IPR) enforcement and broader protection efforts are inadequate.”²³</p> <p>“After nearly three years as a member of the global trading body, it is clear that China has not addressed key weaknesses in its IPR enforcement system and the protection that is</p>

²⁰ U.S. Chamber of Commerce, China’s WTO Implementation: A Three-Year Assessment (September 2004) at 2.

²¹ U.S. Chamber of Commerce, China’s WTO Implementation: A Three-Year Assessment (September 2004) at 13.

²² U.S. Chamber of Commerce, China’s WTO Implementation: A Three-Year Assessment (September 2004) at 3-4.

²³ U.S. Chamber of Commerce, China’s WTO Implementation: A Three-Year Assessment (September 2004) at 2.

	<p>accorded to companies of all sizes fails on the whole to meet the standards of effectiveness and deterrence set out in the TRIPS Agreement.”²⁴</p> <p>“Counterfeit pharmaceuticals are a significant and increasing problem in China, especially over-the-counter products sold outside of hospitals, and the agriculture sector reports evidence of counterfeit fertilizer. Pirated music, books, business software, movies, and video games are also readily available on the market, and unauthorized use of software by business is rampant, hindering the ability of both indigenous and U.S. creators and rights holders to build successful businesses.”²⁵</p> <p>“Full protection under PRC law and enforcement of IPR in China as set forth in China’s TRIPS obligations are critical to the interests of foreign and PRC companies in China, as well as to China’s public health and safety, the integrity and attractiveness of China’s investment regime, and its broader economic development goals.”²⁶</p> <p>“Protection and enforcement of IPR, as defined in the WTO TRIPS agreement, is of increasing importance to automakers operating in China. Since China’s accession to the WTO, there has been an increase in IPR violations of autos and automotive products, such as automotive braking, steering, and emissions systems.”²⁷</p>
Transparency	<p>“Regulatory transparency remains a key concern of U.S. Chamber member companies. The U.S. Chamber applauds the measures that MOFCOM adopted at the end of 2003 that promote the ministry’s compliance with China’s WTO transparency commitments, specifically those that require People’s Republic of China (PRC) authorities to provide a “reasonable period for comment to the appropriate authorities” before trade-related measures are implemented. Other PRC ministries and agencies, however, have been far less progressive in their approaches to circulating draft regulations to foreign companies and in providing a reasonable window for comment. We urge the Chinese government to have all its rulemaking ministries and agencies follow MOFCOM’s example in fulfilling China’s transparency obligations under the WTO. China also needs to fulfill its recent promise to fully separate the regulatory and commercial functions in the express delivery and telecommunications sectors.”²⁸</p> <p>“PRC ministries outside of MOFCOM continue to circulate draft regulations to foreign companies in ad hoc fashion. In instances when PRC authorities circulate regulations to the foreign business community, comment periods for foreign companies remain woefully short. Many companies report cases of receiving regulations only through their PRC joint venture partners. And, while new trade-related regulations are increasingly available via</p>

²⁴ U.S. Chamber of Commerce, China’s WTO Implementation: A Three-Year Assessment (September 2004) at 7.

²⁵ U.S. Chamber of Commerce, China’s WTO Implementation: A Three-Year Assessment (September 2004) at 8.

²⁶ U.S. Chamber of Commerce, China’s WTO Implementation: A Three-Year Assessment (September 2004) at 8.

²⁷ U.S. Chamber of Commerce, China’s WTO Implementation: A Three-Year Assessment (September 2004) at 20.

²⁸ U.S. Chamber of Commerce, China’s WTO Implementation: A Three-Year Assessment (September 2004) at 3.

	<p>online, trade gazettes, and other sources, PRC agencies continue to lag in translating such regulations into WTO-authorized languages.”²⁹</p>
Trading and distribution rights	<p>“China’s full and consistent implementation of its trading rights and distribution services obligations by December 11, 2004, is of critical interest to foreign companies. The U.S. Chamber applauds China’s early phase-in of trading rights for wholly foreign-owned companies on July 1. Further, it hopes that MOFCOM will release implementing regulations soon that clarify how new and existing wholly foreign-owned businesses in China can acquire distribution rights to allow foreign businesses to begin distribution services on the December 11, 2004, phase-in date.”³⁰</p> <p>“<i>The Regulations on Management of Foreign Investment in the Commercial Sector</i>, issued in mid-April, provide new guidance to foreign companies on how they may conduct retail, wholesale, franchise, and commission agency services in the China market. But, the regulations fail to offer details on how existing foreign-invested companies in China can incorporate distribution services into their existing scopes of business.”³¹</p>
Standards	<p>The U.S. Chamber is concerned about China’s use of discriminatory standards to erect barriers to fair competition and in violation of its WTO obligations. * * * China has moved to develop, adopt, and increasingly mandate unique national technology standards across a wide range of technology products. Examples include a mandated encryption standard for wireless communications devices and the development of unique national standards for AVS for media/TV, IGRS for connectivity, and EVD for recording media. * * * China’s adoption of mandatory national technology standards that are out of step with international standards efforts and that don’t consistently respect intellectual property are troubling to U.S. Chamber members, many of whom have made significant investments in China.</p> <p>China also continues to maintain for certain imported products a tiered conformity assessment process that is incompatible with its WTO obligations under Article 13.4(a) of the Agreement on Technical Barriers to Trade, which requires that China maintain no more than one conformity assessment process for all imported goods.</p> <p>China’s implementation of its new certification regime, centered on the China Compulsory Certification (CCC) mark, remains a work in progress, with many imported products still facing additional inspection processes beyond the CCC-qualifying process.</p>
National treatment	<p>“U.S. Chamber members continue to harbor concerns over China’s lackluster application of the WTO’s national treatment and nondiscrimination principles in the areas of price</p>

²⁹ U.S. Chamber of Commerce, *China’s WTO Implementation: A Three-Year Assessment* (September 2004) at 10-11.

³⁰ U.S. Chamber of Commerce, *China’s WTO Implementation: A Three-Year Assessment* (September 2004) at 3.

³¹ U.S. Chamber of Commerce, *China’s WTO Implementation: A Three-Year Assessment* (September 2004) at 17.

	controls on medicines and drug reimbursement. China's actions in this area appear designed to benefit domestic pharmaceutical manufacturers at the expense of their foreign counterparts." ³²
Agriculture	<p>“While China has eliminated or reduced some tariff barriers, foreign companies are experiencing problems with several nontariff barriers that restrict trade into China, create significant marketplace uncertainty, and discourage further foreign investment.”³³</p> <p>These include such measures as:</p> <ul style="list-style-type: none"> • a new animal and plant quarantine regulation that “requires that Quarantine Import Permits (QIPs) be approved prior to signing contracts, which appears to provide China’s AQSIQ with blanket authority to annul or void import permits in the case of a government-issued warning or ban.”³⁴ • “U.S. soybean, cotton, and meat traders have reported significant restrictions on exports of products to China stemming from AQSIQ’s issuance of Import of Animal and Plant Quarantine permits and its inspection procedures.”³⁵

3. US-China Business Council

The US-China Business Council has compiled a WTO Scorecard covering China’s “Year Three Commitments.”³⁶ The USCBC observes that China has fulfilled the bulk of its market opening commitments but that China's fulfillment of its commitments is “not always clear-cut.”³⁷ Some of the areas in which the Scorecard notes compliance concerns are the following.

³² U.S. Chamber of Commerce, China’s WTO Implementation: A Three-Year Assessment (September 2004) at 31.

³³ U.S. Chamber of Commerce, China’s WTO Implementation: A Three-Year Assessment (September 2004) at 22.

³⁴ U.S. Chamber of Commerce, China’s WTO Implementation: A Three-Year Assessment (September 2004) at 22.

³⁵ U.S. Chamber of Commerce, China’s WTO Implementation: A Three-Year Assessment (September 2004) at 23.

³⁶ See US-China Business Council, WTO SCORECARD: CHINA'S YEAR THREE COMMITMENTS (December 15, 2004); <http://www.uschina.org/public/documents/2005/01/wtoscorecard.html>.

³⁷ See US-China Business Council, WTO SCORECARD: CHINA'S YEAR THREE COMMITMENTS (December 15, 2004); <http://www.uschina.org/public/documents/2005/01/wtoscorecard.html>.

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- Trading Rights: China issued regulations but no companies have been approved.
 - Distribution: China issued regulations regarding wholesale, retail, and commission agents' services, but implementation remains unclear. China is late in issuing regulations regarding retailing and wholesaling of pharmaceuticals and retailing of refined fuels.
 - Telecom: China met its commitment to open this market but has imposed strict conditions which effectively block foreign entry.
 - Construction: China met its commitment to open this market but has imposed strict conditions which effectively block foreign entry.
 - Freight Transport Services: China is late in opening market to wholly foreign-owned road enterprises and storage and warehousing enterprises.
 - Repair, Maintenance, and Leasing: China is late in issuing regulations to permit wholly foreign-owned enterprises to enter this market.
 - Autos: China is late in raising to \$90 million the level of foreign investment in auto manufacturing that requires provincial approval.³⁸

II. China WTO Issues and U.S. Enforcement

A. The Use of China-Specific Safeguards in the United States

1. China Accession Provisions

China's protocol of accession, as well as the working party report, included two special safeguard provisions that are available to all WTO Members during transitional periods and that are applicable to China specifically. First, WTO members may apply a product-specific transitional safeguard to deal with import surges of particular products from China that cause market disruption. Second, WTO members may apply a special textile safeguard provision in order to deal with market disruption due to increased imports of Chinese textile and apparel products.

³⁸ See US-China Business Council, WTO SCORECARD: CHINA'S YEAR THREE COMMITMENTS (December 15, 2004); <http://www.uschina.org/public/documents/2005/01/wtoscorecard.html>.

a. Product-Specific Safeguards

China's accession protocol provides for a general "product-specific special safeguard" measure, which is applicable to any type of product (*i.e.*, industrial and agricultural goods) and is available to the U.S. (and other WTO Members) for 12 years following China's accession to the WTO (until December 11, 2013).³⁹ This provision allows WTO Members to take action to restrain imports of Chinese goods that cause or threaten to cause "market disruption" to the domestic industry producing such goods.

The transitional product-specific safeguard is unique to China. No other acceding country (either to GATT or the WTO) has been subject to a transitional product-specific safeguard. Members insisted, however, that because China acceded to the WTO before it had achieved all necessary trade reforms or met all WTO obligations, a product-specific safeguard mechanism was necessary to protect other WTO Members from increased imports from China during China's transitional period.

The product-specific safeguard's injury standard is "market disruption," which exists wherever imports of an article, like or directly competitive with an article produced by the domestic industry, are increasing rapidly, either absolutely or relatively, so as to be a significant cause of material injury, or threat of material injury to the domestic industry.⁴⁰ This standard is substantially less than the "serious injury" standard of a typical safeguard action.

³⁹ *Protocol on the Accession of the People's Republic of China*, WT/L/432 (23 November 2001), art. 16.

⁴⁰ *Protocol on the Accession of the People's Republic of China*, WT/L/432 (23 November 2001), art. 16.4.

The Protocol provides that before a product-specific safeguard measure is applied, a consultation process should take place to see if the parties can reach a mutually satisfactory solution.⁴¹ If consultations succeed, China "shall take such action as to prevent or remedy the market disruption."⁴² If, however, consultations do not succeed within 60 days, the WTO member may take action to prevent or remedy the market disruption by imposing a product-specific safeguard measure.⁴³

Product-specific safeguard measures may be in place for two years where there has been a relative increase in imports, and three years where the increase is absolute. After these respective periods, however, China may "retaliate" by suspending substantially equivalent concessions or obligations under the WTO Agreement.⁴⁴

b. Textile Safeguards

The working party report to China's accession established a special textile safeguard mechanism that is available to WTO Members through December 31, 2008.⁴⁵ The safeguard is applicable to textile and apparel products covered by the Agreement on Textiles and Clothing ATC as of the date the WTO Agreement entered into force (January 1, 1995).

⁴¹ *Protocol on the Accession of the People's Republic of China*, WT/L/432 (23 November 2001), art. 16.1.

⁴² *Protocol on the Accession of the People's Republic of China*, WT/L/432 (23 November 2001), art. 16.2.

⁴³ *Protocol on the Accession of the People's Republic of China*, WT/L/432 (23 November 2001), art. 16.3.

⁴⁴ *Protocol on the Accession of the People's Republic of China*, WT/L/432 (23 November 2001), art. 16.6.

⁴⁵ *Report of the Working Party on the Accession of China*, WT/MIN(01)/3 (10 November 2001), paras. 241-242.

Paragraph 242 of the working party report sets out the⁴⁶ terms of the special textile safeguard. If a WTO Member believes (and can show) that imports of certain Chinese textile and apparel products are “threatening to impede orderly development of trade in these products” due to “market disruption,” the WTO Member can request consultations with China “with a view to easing or avoiding such market disruption.”⁴⁷ The injury standard (“market disruption”) is less stringent than the “serious injury” test of a regular safeguard action.

Upon receipt of a request, China will “hold its shipments ... to a level no greater than 7.5 per cent (6 per cent for wool product categories) above the amount entered during the first 12 months of the most recent 14 months preceding” the request.⁴⁸ Consultations would be held within 30 days of the request with the aim of reaching a "mutually satisfactory solution" within 90 days of the request.⁴⁹ If no solution can be reached, consultations, and export restraints, continue.⁵⁰ Textile safeguards may be applied from the date that consultations are requested through December 31 of that year.⁵¹ In general, no textile safeguard may last longer than one year unless it is reapplied through further consultations, or otherwise agreed to by China and the WTO member.⁵²

⁴⁶ *Report of the Working Party on the Accession of China*, WT/MIN(01)/3 (10 November 2001), para. 242.

⁴⁷ *Report of the Working Party on the Accession of China*, WT/MIN(01)/3 (10 November 2001), para. 242(a).

⁴⁸ *Report of the Working Party on the Accession of China*, WT/MIN(01)/3 (10 November 2001), para. 242(c).

⁴⁹ *Report of the Working Party on the Accession of China*, WT/MIN(01)/3 (10 November 2001), para. 242(b).

⁵⁰ *Report of the Working Party on the Accession of China*, WT/MIN(01)/3 (10 November 2001), para. 242(d).

⁵¹ *Report of the Working Party on the Accession of China*, WT/MIN(01)/3 (10 November 2001), para. 242(e). If, however, three or fewer months remain in that year, then the export restraints may stay in place for up to one year from the date of the request for consultations.

⁵² *Report of the Working Party on the Accession of China*, WT/MIN(01)/3 (10 November 2001), para. 242(f).

2. U.S. Application of China-Specific Safeguards

a. Product-Specific Safeguards

The China product-specific safeguard was enacted in U.S. law by Section 421 of the Trade Act of 1974, as amended, 19 U.S.C. § 2451. Section 421 permits U.S. domestic industries and workers adversely affected by increased imports from China to seek relief.⁵³

As of January 2005, there have been only five Section 421 investigations. The last active investigation was completed in March 2004. Of the five Section 421 investigations, the ITC made an affirmative injury determination and recommended relief in three cases and made a negative determination in two cases. No case has resulted in relief to a domestic industry, however, as the President denied relief in the three affirmative cases.

Section 421 Investigations

Product	Investigation Initiated	ITC Determination	Recommended Relief	President's Determination
Pedestal actuators	August 19, 2002	Affirmative (3-2) October 18, 2002	Quotas	Denied relief on grounds of national economic interest (January 17, 2003)
Steel wire garment hangers	November 27, 2002	Affirmative (5-0) January 27, 2003	Additional duties	Denied relief on grounds of national economic interest (April 25, 2003)
Brake drums and rotors	June 6, 2003	Negative (5-0) August 5, 2003	Not applicable	Not applicable
Ductile iron waterworks fittings (DIWF)	September 5, 2003	Affirmative (6-0) December 4, 2003	3-year tariff-rate quota	Denied relief on grounds of national economic interest (March 3, 2004)
Innersprings	January 6, 2004	Negative (6-0) March 8, 2004	Not applicable	Not applicable

⁵³ For a description of the substantive and procedural provisions of Section 421, see Terence P. Stewart, *China's Compliance With World Trade Organization Obligations: A Review Of China's 1st Two Years Of*

The following tables summarize the five Section 421 actions that have been completed as of January 2005.

TA-421-01: PEDESTAL ACTUATORS FROM CHINA
<p><u>Petition Filed:</u> August 19, 2002, on behalf of Motion Systems Corp., Eatontown, NJ.</p> <p><u>Investigation Instituted:</u> effective August 19, 2002; <i>Pedestal Actuators from China</i>, 67 Fed. Reg. 54822 (Institution) (ITC August 26, 2002).</p> <p><u>ITC Injury Determination:</u> Affirmative. On October 18, 2002, by a vote of 3-2, the USITC determined that pedestal actuators from the People's Republic of China are being imported into the United States in such increased quantities or under such conditions as to cause market disruption to the domestic producers of like or directly competitive products. See <i>Pedestal Actuators from China</i>, 67 Fed. Reg. 69557 (Determination) (ITC November 18, 2002).</p> <p><u>ITC Remedy Recommendation:</u> October 29, 2002. The Commission recommended import relief in the form of a quota.</p> <ul style="list-style-type: none">• Commissioners Hillman and Miller recommended a quantitative import restriction for 3 years in the amount of 5,626 units in year 1; 6,470 units in year 2; and 7,440 units in year 3.• Commissioner Koplan recommended a quantitative import restriction for 3 years in the amount of 4,425 units in year 1; 4,514 units in year 2; and 4,604 units in year 3. <p>The Commission transmitted its remedy proposals to the President and U.S. Trade Representative on November 7, 2002. See <i>Pedestal Actuators from China</i>, 67 Fed. Reg. 69557 (Determination) (ITC November 18, 2002).</p> <p><u>Views of Commission:</u> <i>Pedestal Actuators from China</i>, TA-421-1, USITC Pub. 3557 (November 2002).</p> <p><u>President's Decision:</u> On January 17, 2003, the President announced that he was not providing relief because he had determined that import relief was not in the national economic interest and that import relief would have an adverse impact on the United States economy clearly greater than the benefits of such action. The President provided the following reasons for his decision not to grant relief:</p> <p style="padding-left: 40px;">In determining not to provide import relief, I considered its overall costs to the U.S. economy. The facts of this case indicate that imposing the USITC's recommended quota would not likely benefit the domestic producing industry and instead would cause imports to shift from China to other offshore sources.</p> <p style="padding-left: 40px;">Even if the quota were to benefit the primary domestic producer, the cost of the quota to consumers, both the downstream purchasing industry and users of the downstream products, would substantially outweigh any benefit to producers' income. The USITC's analysis confirms this conclusion.</p>

TA-421-01: PEDESTAL ACTUATORS FROM CHINA

In addition, downstream industries are already under pressure to migrate production offshore to compete with lower-cost imports of finished products. Higher component costs resulting from import relief would add to this pressure. Given the significantly larger number of workers in the downstream purchasing industry when compared with the domestic pedestal actuator industry, I find that imposing import restrictions would do more economic harm than good.

Finally, a quota would negatively affect the many disabled and elderly purchasers of mobility scooters and electric wheelchairs, the primary ultimate consumers of pedestal actuators.

Memorandum of January 17, 2003--Presidential Determination on Pedestal Actuator Imports From the People's Republic of China, 68 Fed. Reg. 3155 (Presidential Document January 22, 2003).

TA-421-02: STEEL WIRE GARMENT HANGERS FROM CHINA

Petition Filed: November 27, 2002, on behalf of CHC Industries, Inc., Palm Harbor, FL; M&B Hangers Co., Leeds, AL; and United Wire Hanger Corp., South Hackensack, NJ.

Investigation Instituted: effective November 27, 2002; *Certain Steel Wire Garment Hangers from China*, 67 Fed. Reg. 72700 (Institution) (ITC December 6, 2002).

ITC Injury Determination: Affirmative. On January 27, 2003, by a vote of 5-0, the USITC determined that certain steel wire garment hangers from the People's Republic of China are being imported into the United States in such increased quantities or under such conditions as to cause market disruption to the domestic producers of like or directly competitive products. See *Certain Steel Wire Garment Hangers from China*, 68 Fed. Reg. 8926 (Determination) (ITC February 26, 2003).

ITC Remedy Recommendation: February 5, 2003. The Commission recommended import relief in the form of an additional duty.

- Commissioners Okun, Hillman, and Miller recommended relief in the form of an additional duty for 3 years: 25% year 1; 20% in year 2; and 15% in year 3. In addition, they recommended expedited consideration of trade adjustment assistance for firms and/or workers affected by the subject imports.
- Commissioner Bragg recommended relief in the form of an additional duty for 2 years: 20% year 1; 15% in year 2.
- Commissioner Koplan recommended relief in the form of an additional duty of 30% for 3 years. In addition, he recommended expedited consideration of trade adjustment assistance for firms and/or workers affected by the subject imports. See *Certain Steel Wire Garment Hangers from China*, 68 Fed. Reg. 8926 (Determination) (ITC February 26, 2003).

The Commission transmitted its remedy proposals to the President and U.S. Trade Representative on February 14, 2003. See *Notice of Proposed Measure and Opportunity for Public Comment Pursuant to Section 421 of the Trade Act of 1974: Certain Steel Wire Garment Hangers From the People's Republic of China*, 68 Fed. Reg. 10765 (USTR March 6, 2003).

Views of Commission: *Certain Steel Wire Garment Hangers from China*, TA-421-2, USITC Pub. 3575 (February 2003).

TA-421-02: STEEL WIRE GARMENT HANGERS FROM CHINA

President's Decision: On April 25, 2003, the President announced that he was not providing relief because he had determined that import relief was not in the national economic interest and that import relief would have an adverse impact on the United States economy clearly greater than the benefits of such action. The President provided the following reasons for his decision not to grant relief:

The facts of this case indicate that imposing additional tariffs on Chinese imports would affect domestic producers unevenly, favoring one business strategy over another. While most of the producers would likely realize some income benefits, additional tariffs would disrupt the long-term adjustment strategy of one major producer, which is based in part on distribution of imported hangers, and cause that producer to incur substantial costs.

In addition, most domestic producers, including the petitioners, have begun to pursue adjustment strategies. While these strategies have included consolidation, modernization of production facilities, and expansion into complementary products and services, domestic producers are also expanding their use of imports. Indeed, a substantial part of the surge in imports during the most recent period measured was brought in by domestic producers themselves, including the petitioners.

Moreover, after 6 years of competing with Chinese imports, domestic producers still account for over 85 percent of the U.S. wire hanger market. With this dominant share of the market, domestic producers have the opportunity to adjust to competition from Chinese imports even without import relief.

Furthermore, there is a strong possibility that if additional tariffs on Chinese wire hangers were imposed, production would simply shift to third countries, which could not be subject to section 421's China-specific restrictions. In that event, import relief would have little or no benefit for any domestic producer.

Additional tariffs would have an uneven impact on domestic distributors of wire hangers. For some distributors, the tariffs would likely lead to some income benefits. However, the tariffs would likely harm other distributors in light of their business models.

Additional tariffs would also likely have a negative effect on the thousands of small, family-owned dry-cleaning businesses across the United States that would either have to absorb the resulting increased costs or pass them on to their customers.

Memorandum of April 25, 2003--Presidential Determination on Wire Hanger Imports from the People's Republic of China, 68 Fed. Reg. 23017 (Presidential Document April 29, 2003).

TA-421-03: BRAKE DRUMS AND ROTORS FROM CHINA

Petition Filed: June 6, 2003, on behalf of the Coalition for the Preservation of American Brake Drum and Rotor Aftermarket Manufacturers (consisting of Dana Corp. (Brake and Chassis Division)/Brake Parts, Inc.; Federal Mogul Corp.; and Thyssen Krupp Waupaca/Waupaca Foundry, Inc.).

Investigation Instituted: effective June 6, 2003; *Certain Brake Drums and Rotors from China*, 68 Fed. Reg.

TA-421-03: BRAKE DRUMS AND ROTORS FROM CHINA

35702 (Institution) (ITC June 16, 2003).

ITC Injury Determination: Negative. On August 5, 2003, by a vote of 5-0, the USITC determined that certain brake drums and rotors from the People's Republic of China are not being imported into the United States in such increased quantities or under such conditions as to cause market disruption to the domestic producers of like or directly competitive products. See *Certain Brake Drums and Rotors from China*, 68 Fed. Reg. 48938 (Determination) (ITC August 15, 2003).

ITC Remedy Recommendation: None.

Views of Commission: *Certain Brake Drums and Rotors from China*, TA-421-3, USITC Pub. 3622 (August 2003).

President's Decision: None.

TA-421-04: DUCTILE IRON WATERWORKS FITTINGS FROM CHINA

Petition Filed: September 5, 2003, on behalf of McWane, Inc., Birmingham, AL, and three subsidiaries: Clow Water Systems Co., Coshocton, OH, Tyler Pipe Co., Tyler, TX, and Union Foundry Co., Anniston, AL.

Investigation Instituted: effective September 5, 2003; *Certain Ductile Iron Waterworks Fittings from China*, 68 Fed. Reg. 54010 (Institution) (ITC September 15, 2003).

ITC Injury Determination: December 4, 2003. By a vote of 6-0, the USITC determined that certain ductile iron waterworks fittings from the People's Republic of China are being imported into the United States in such increased quantities or under such conditions as to cause market disruption to the domestic producers of like or directly competitive products. See *Certain Ductile Iron Waterworks Fittings from China*, 68 Fed. Reg. 69421 (Determination) (ITC December 12, 2003).

ITC Remedy Recommendation: December 15, 2003. The Commission recommended import relief in the form of a tariff-rate quota for a three-year period:

- 50% tariff on imports exceeding 14,324 short tons in year 1;
- 40% tariff on imports exceeding 15,398 short tons in year 2; and
- 30% tariff on imports exceeding 16,553 short tons in year 3.

The Commission further recommended expedited consideration of trade adjustment assistance for firms and/or workers affected by the subject imports.

The Commission transmitted a report on its determination, as well as its remedy proposals, to USTR on December 24, 2003.

Views of Commission: *Certain Ductile Iron Waterworks Fittings from China*, TA-421-4, USITC Pub. 3657 (December 2003).

President's Decision: On March 3, 2004, the President announced that he was not providing relief because he had determined that import relief was not in the national economic interest and that import relief would have an

TA-421-04: DUCTILE IRON WATERWORKS FITTINGS FROM CHINA

adverse impact on the United States economy clearly greater than the benefits of such action. The President provided the following reasons for his decision not to grant relief:

The facts of this case indicate that imposing the USITC's recommended tariff-rate quota remedy or any other import relief available under section 421 would be ineffective because imports from third countries would likely replace curtailed Chinese imports. The switch to third country imports could occur quickly because the major U.S. importers already import substantial quantities from countries such as India, Brazil, Korea, and Mexico. Because importers' existing inventories of imports will likely cover demand for approximately 6 to 12 months from the imposition of import relief, a switch from China to alternative import sources would not likely lead to significant additional demand for domestically produced pipe fittings, even accounting for a time lag in making that switch. Under these circumstances, import relief would provide no meaningful benefit to domestic producers.

In addition, import relief would cost U.S. consumers substantially more than the increased income that could be realized by domestic producers. Indeed, the USITC estimated that its recommended remedy would generate a negative net domestic welfare effect of between \$2.3 million and \$3.7 million in the first year alone.

While not necessary in reaching my determination that imposing import relief would have an adverse impact on the United States economy clearly greater than the benefits, it is also worth noting two additional points:

- First, evidence suggests that domestic producers enjoy a strong competitive position in the U.S. market, and in fact the largest domestic producer recently announced price increases nationwide ranging from 8 to 35 percent. The two smaller domestic producers and the major U.S. importers have publicly indicated that they would follow these price increases.
- Second, in 2002 and 2003, imports of this product have been relatively stable in volume terms and have shown a slight decline in value terms.

The circumstances of this case make clear that the U.S. national economic interest would not be served by the imposition of import relief under section 421. I remain fully committed to exercising the important authority granted to me under section 421 when the circumstances of a particular case warrant it.

Memorandum of March 3, 2004--Presidential Determination on Imports of Certain Ductile Iron Waterworks Fittings From the People's Republic of China, 69 Fed. Reg. 10597 (Presidential Document March 8, 2004).

TA-421-05: INNERSPRINGS FROM CHINA

Petition Filed: January 6, 2004, on behalf of the U.S. member companies of The American Innerspring Manufacturers (AIM), Memphis, TN. Petitioning firms include Atlas Spring, Gardena, CA; Hickory Springs Manufacturing Co., Hickory, NC; Leggett & Platt, Carthage, MO; and Joseph Saval Spring & Wire Co., Inc., Taylor, MI.

TA-421-05: INNERSPRINGS FROM CHINA

Investigation Instituted: effective January 6, 2004; *Innersprings from China*, 69 Fed. Reg. 2002 (Institution) (ITC January 13, 2004).

ITC Injury Determination: Negative. On March 8, 2004, by a vote of 6-0, the USITC determined that uncovered innerspring units from the People’s Republic of China are not being imported into the United States in such increased quantities or under such conditions as to cause market disruption to the domestic producers of like or directly competitive products. See ITC News Release 04-022: ITC Announces Determination in China Safeguard Investigation Concerning Uncovered Innerspring Units from China (March 8, 2004).

ITC Remedy Recommendation: None.

Views of Commission: Uncovered Innerspring Units from China, TA-421-5, USITC Pub. 3676 (March 2004).

President’s Decision: None.

b. Textile Safeguards

The special China textile safeguard set out in the Working Party Report to China's WTO accession became effective upon China's entry into the WTO on December 11, 2001. In the United States, the textile safeguard was not implemented by statute. Rather, the textile safeguard was implemented by procedural rules issued by the Committee to Implement Textile Agreements (“CITA”), the official U.S. government entity responsible for administering the *Agreement on Textiles and Clothing* (“ATC”). In May 2003, CITA issued the procedural rules for bringing a special safeguard action to seek relief from Chinese imports.^{54 55}

The following summarizes the China textile safeguard requests made and government actions taken in the U.S. since China’s accession.

⁵⁴ See *Procedures for Considering Requests from the Public for Textile and Apparel Safeguard Actions on Imports from China*, 68 Fed. Reg. 27787 (CITA, May 21, 2003).

⁵⁵ For a description of CITA’s procedural rules for a China textile safeguard action, see Terence P. Stewart, *China's Compliance With World Trade Organization Obligations: A Review Of China's 1st Two Years Of*

- **September 2002**

The American Textile Manufacturers Institute (ATMI) petitioned CITA to impose special textile quotas on five product categories: (1) knit fabric; (2) gloves; (3) dressing gowns; (4) brassieres; and (5) textile luggage.⁵⁶ In addition, ATMI identified a sixth product, textured filament yarn from China, and asked CITA to prepare a case for the possible imposition of quota restraints on imports of that product in the event that imports continued to increase.⁵⁷ In making its request, ATMI cited a 119% increase in textile imports from China in the first six months of 2002 and stated that imports of Chinese textile products were "experiencing their greatest surge in history."⁵⁸

During the first six months of the year, Chinese exports of textile and apparel products to the United States increased by almost 900 million square meters, with the textile portion increasing by more than 700 million square meters. On the strength of this increase, China surpassed both Pakistan and Canada to become the second largest textile and apparel exporter to the United States, shipping 1.9 billion square meters during the first six months of the year. China accounted for 60 percent of the increase in world-wide imports of textile and apparel products during the first half of the year.⁵⁹

ATMI also presented the following data with respect to the product categories identified in its petition.

- 1) Knit fabric – Chinese knit fabric exports rose 22 thousand percent and the average price of Chinese knit fabric dropped by 60 percent, catapulting China from being the 26th largest supplier of such exports to the U.S. to the 5th place among all foreign suppliers;
- 2) Gloves – China's exports of gloves to the United States tripled over the last six months, with the result that Chinese exports are now twice as large as those from the next largest supplier;
- 3) Nightwear/Dressing Gowns – Chinese exports of nightwear more than quadrupled, vaulting China from seventh to first place among

Membership; A Report Prepared for the U.S.-China Economic and Security Review Commission (March 19, 2004) at pages 202-206.

⁵⁶ ATMI press release, *ATMI Calls for New Quotas on Surging Chinese Imports*, September 5, 2002.

⁵⁷ ATMI press release, *ATMI Calls for New Quotas on Surging Chinese Imports*, September 5, 2002.

⁵⁸ ATMI press release, *ATMI Calls for New Quotas on Surging Chinese Imports*, September 5, 2002.

⁵⁹ ATMI press release, *ATMI Calls for New Quotas on Surging Chinese Imports*, September 5, 2002.

- supplying countries. The Chinese surge was accompanied by a 47% drop in Chinese prices;
- 4) Brassieres – In less than six months, China leapfrogged the top two long-standing largest suppliers – Mexico and the Dominican Republic – as China’s price per dozen dropped to \$29, by far the lowest of any major supplier;
 - 5) Luggage – Chinese exports of textile luggage have quadrupled to 71 million kilograms while imports from every other supplier have simultaneously dropped, some by as much as 60 percent. Chinese prices fell by 62% during the same period of time. China now ships more than five times as much as the next largest supplier;
 - 6) Textured filament yarn – Chinese exports have only recently begun to surge and remain relatively small. However, over the past two months, Chinese exports increased at a rate of 400,000 kilograms a month.⁶⁰

At the time the petitions were filed, importers questioned whether ATMI was eligible to request textile safeguards with respect to certain of the products identified because ATMI members do not make four of the five products for which ATMI petitioned for relief (*i.e.*, dressing gowns, brassieres, gloves, and textile luggage).⁶¹ However, ATMI members do produce and supply the fabric used in making these products. A press article noted at the time that:

For CITA to impose a safeguard, it would have to apply an expansive definition of market disruption that would cover upstream suppliers of a given product, an ATMI source said. Under this definition, quotas could be imposed on a given product if it disrupted U.S. exports of fabric used to make these items, he said. This would be consistent with the market disruption definition CITA has applied in the past to invoke quotas under the Multifiber Arrangement (MFA), he said.

* * *

A Commerce Dept. official said this week that given this first request, CITA is looking at both the specific categories as well as the whole process for evaluating the request. This includes questions of whether upstream suppliers can claim market disruption or whether petitioners

⁶⁰ ATMI press release, *ATMI Calls for New Quotas on Surging Chinese Imports*, September 5, 2002.

⁶¹ *ATMI Seeks Relief Under China-Specific Safeguard on Five Import Categories*, Inside US-China Trade, September 11, 2002.

have to meet a standing requirement, he said. He said that CITA would “at some point” decide how to proceed on the request.⁶²

- **May 2003**

Prior to CITA's issuance of procedural rules applicable to special textile safeguard requests in May 2003, CITA took no official action with respect to ATMI's September 2002 petitions.⁶³ When CITA issued its procedural rules, however, it resolved the question about ATMI's standing by determining that, in accord with past CITA practice, domestic producers of components used in producing like or directly competitive products were eligible to request safeguards:

Consistent with longstanding Committee practice in considering textile safeguard actions, requests may be filed by an entity (which may be a trade association, firm, certified or recognized union, or group of workers) that is representative of either: (A) a domestic producer or producers of a product that is a like or directly competitive with the subject Chinese textile or apparel product; or (B) a domestic producer or producers of a component used in the production of a product that is like or directly competitive with the subject Chinese textile or apparel product.⁶⁴

Once the new procedural rules were issued, it was determined that ATMI (the only petitioner for a China-specific textile safeguard so far) would need to re-file the petitions it had initially filed in September 2002.

. . . Commerce has indicated that it will have to re-file a petition on Chinese safeguards now that the regulations outlining the process have been published One source said that while some officials have said a new petition is not needed, ATMI will need to include new information,

⁶² *ATMI Seeks Relief Under China-Specific Safeguard on Five Import Categories*, Inside US-China Trade, September 11, 2002.

⁶³ A press report noted: "The [ATMI's] petition has so far been held in abeyance because there are no rules governing the process of receiving and deciding on petitions under the safeguards." *China Seeks Meeting to Convince ATMI to Drop Safeguard Petition*, Inside US-China Trade, May 7, 2003.

⁶⁴ *See Procedures for Considering Requests from the Public for Textile and Apparel Safeguard Actions on Imports from China*, 68 Fed. Reg. at 27788.

which means it will effectively have to file a new document with CITA before the process begins.⁶⁵

- **July 2003**

On July 24, 2003, ATMI, together with certain other textile groups, filed petitions requesting that a textile and apparel safeguard action be taken against China with respect to four product categories.

- **August 2003**

In August 2003, CITA accepted three of the petitions filed by ATMI (knit fabric, dressing gowns, and brassieres) and rejected the fourth (gloves). The following summarizes the petitioners, product categories, and status of and the four petitions:

Petitioners	Product	Category	Status
<ul style="list-style-type: none"> • American Yarn Spinners Association • American Manufacturing Trade Action Coalition • American Textile Manufacturers Institute • National Textile Association 	Knit fabric	222	Accepted by CITA
<ul style="list-style-type: none"> • American Manufacturing Trade Action Coalition • American Textile Manufacturers Institute • National Textile Association 	Cotton and man-made fiber dressing gowns	350/650	Accepted by CITA
<ul style="list-style-type: none"> • American Manufacturing Trade Action Coalition • American Textile Manufacturers Institute • National Textile Association 	Cotton and man-made fiber brassieres	349/649	Accepted by CITA
<ul style="list-style-type: none"> • American Manufacturing Trade Action Coalition • American Textile Manufacturers Institute • National Textile Association 	Cotton and man-made fiber gloves	331/631	Rejected by CITA

⁶⁵ ATMI May File Limited Petition In Light Of New China Textile Safeguard, Inside US-China Trade, May 29, 2003.

On August 18, 2003, CIT published a notice in the *Federal Register* soliciting public comments on the three safeguard requests that it had accepted.⁶⁶ The petitions on these three product categories showed substantial increases in imports of various textile and apparel products from China. For example, the petition on certain knit fabrics showed an increase in imports from a little over 31,000 kilograms in 2001 to more than 7 million kilograms in 2002, accompanied by price declines of more than 50 percent.⁶⁷ The petitions on the other products also showed increases in imports from China of 300 to more than 500% and price declines of 44-50 percent between 2001 and 2002.⁶⁸ The public comment period for the three textile petitions ended on September 17, 2003.

- **December 2003**

On December 23, 2003, CITA determined that Chinese-origin knit fabric, dressing gowns, and brassieres are, due to market disruption (and the threat thereof), threatening to impede the orderly development of trade in such products, and that imports of such products from China play a significant role in the existence (and threat) of market disruption. Pursuant to these findings, on December 29, 2003, CITA issued notices in the *Federal Register* announcing that it had (1) established import limits for knit fabric, dressing gowns, and brassieres, and (2) requested consultations with China.⁶⁹ The import

⁶⁶ See *Solicitation of Public Comments on Request for Textile and Apparel Safeguard Action on Imports from China*, 68 Fed. Reg. 49440 (knit fabric; category 222) (CITA, August 18, 2003); *Solicitation of Public Comments on Request for Textile and Apparel Safeguard Action on Imports from China*, 68 Fed. Reg. 49444 (dressing gowns; category 350/650) (CITA, August 18, 2003); *Solicitation of Public Comments on Request for Textile and Apparel Safeguard Action on Imports from China*, 68 Fed. Reg. 49448 (brassieres; category 349/649) (CITA, August 18, 2003).

⁶⁷ See *Solicitation of Public Comments on Request for Textile and Apparel Safeguard Action on Imports from China*, 68 Fed. Reg. at 49444.

⁶⁸ See *Solicitation of Public Comments on Request for Textile and Apparel Safeguard Action on Imports from China*, 68 Fed. Reg. at 49448 and 49452.

⁶⁹ See *Announcement of Request for Bilateral Textile Consultations with the Government of the People's Republic of China and the Establishment of an Import Limit for Knit Fabric, Category 222, Produced or Manufactured in the People's Republic of China*, 68 Fed. Reg. 74944 (CITA, December 29, 2003); *Announcement of Request for Bilateral Textile Consultations with the Government of the People's Republic of China and the Establishment of an Import Limit for Brassieres and Other Body Supporting Garments, Category 349/649, Produced or Manufactured in the People's Republic of China*, 68 Fed. Reg. 74945 (CITA, December 29, 2003); *Announcement of Request for Bilateral Textile Consultations with the Government of the People's Republic of China and the Establishment of an Import Limit for Cotton and Man-Made Fiber Dressing Gowns and Robes, Category 350/650, Produced or Manufactured in the People's Republic of China*, 68 Fed. Reg. 74947 (CITA, December 29, 2003).

limits established by CITA on these textile products from China became effective on December 24, 2003 and be in effect until December 23, 2004.⁷⁰

- **June 2004**

On June 28, 2004, U.S. producers of socks and other textile producers filed a safeguard petition covering cotton, wool, and man-made fiber socks (categories 332/432 and 632 part).

- **October 2004**

Up to October 2004, CITA had imposed 3 textile safeguards. On October 8, 2004, a U.S. textile industry coalition filed a new special textile safeguard petition covering product categories 347 and 348 (men's and boys' and women's and girls' cotton trousers) and based upon a "threat" of increased imports.⁷¹

Upon the filing of the new petitions, U.S. retailer and importer groups argued that there was no basis in CITA's rules for accepting a safeguard petition based only on the "threat" of increased imports rather than actual increased imports.⁷²

On October 12, 2004, U.S. textile and apparel groups filed 4 new threat-based safeguard petitions covering man-made fiber trousers (categories 647/648), man-made fiber knit shirts (categories 638/639), man-made fiber and cotton shirts (categories 340/640), and cotton knit shirts and blouses (categories 338/339).⁷³

On October 15, 2004, U.S. textile and apparel groups filed a threat-based safeguard petition covering cotton and man-made fiber underwear (categories 352/652).⁷⁴

⁷⁰ *Id.*

⁷¹ American Manufacturing Trade Action Council (AMTAC) press release, *Threat-Based Special Textile China Safeguard Petition Filings Announced*, October 12, 2004; available at www.amtacdc.org/media/041012.asp.

⁷² *U.S. Textile Groups File Threat-Based Safeguards Against China*, Inside US-China Trade, October 6, 2004 at 1.

⁷³ See the website of the U.S. Department of Commerce, International Trade Administration, Office of Textiles and Apparel for copies of the safeguard petitions: http://www.otexa.ita.doc.gov/Safeguard_intro.htm. CITA published requests for public comments in the Federal Register: 69 Fed. Reg. 64911, 64912, 64913, 64915 (November 9, 2004).

⁷⁴ CITA published a request for public comments in the Federal Register: 69 Fed. Reg. 64914 (November 9, 2004).

On October 27, 2004, U.S. textile and apparel groups filed a threat-based safeguard petition covering combed cotton yarn (category 301).⁷⁵

On October 29, 2004, as provided for under paragraph 242 of the Report of the Working Party on China's WTO accession,⁷⁶ the U.S. requested consultations with China with respect to imports of Chinese origin cotton, wool, and man-made fiber socks. The U.S. established a 12-month limit on socks from China, beginning on October 29, 2004, and extending through October 28, 2005.⁷⁷

- **November 2004**

On November 8, 2004, U.S. textile and apparel groups filed a threat-based safeguard petition covering synthetic filament fabric (category 620).⁷⁸

On November 10, 2004, U.S. textile and apparel groups filed a threat-based safeguard petition covering wool trousers (category 447).⁷⁹

On November 19, 24, and 30, 2004, respectively, U.S. textile and apparel groups filed new safeguard petitions requesting extension of the current safeguards on the 3 products that would expire on December 24, 2004 (*i.e.*, knit fabric, dressing gowns, and brassieres).⁸⁰

⁷⁵ CITA published a request for public comments in the Federal Register: 69 Fed. Reg. 68133 (November 23, 2004).

⁷⁶ Paragraph 242 of the Working Party Report allows WTO Members that believe imports of Chinese origin textile and apparel products are, due to market disruption, threatening to impede the orderly development of trade in these products to request consultations with the People's Republic of China with a view to easing or avoiding such market disruption. Consultations with China will be held within 30 days of receipt of the request for consultations, and every effort will be made to reach agreement on a mutually satisfactory solution within 90 days of receipt of the request for consultations.

⁷⁷ 69 Fed. Reg. 63371 (CITA November 1, 2004).

⁷⁸ CITA published a request for public comments in the Federal Register: 69 Fed. Reg. 70661 (December 7, 2004).

⁷⁹ CITA published a request for public comments in the Federal Register: 69 Fed. Reg. 71781 (December 10, 2004).

⁸⁰ CITA published requests for public comments in the Federal Register: 69 Fed. Reg. 77516 (December 17, 2004), 69 Fed. Reg. 77232 (December 27, 2004), 69 Fed. Reg. 77998 (December 29, 2004).

The following table identifies the textile safeguard petitions filed with CITA since October 8, 2004.

Requests for China Textile Safeguard Action Filed with the Committee for the Implementation of Textile Agreements (CITA)
Since October 8, 2004

Category	Description	Date Request Received by CITA	Requestors
349/649	Brassieres and other body supporting garments	December 1, 2004	AMTAC ¹ SEAMS NCTO ² UNITE ⁴ NTA ³
350/650	Dressing gowns and robes	November 24, 2004	AMTAC ¹ SEAMS NCTO ² UNITE ⁴ NTA ³
222	Knit fabric	November 19, 2004	AMTAC ¹ NTA ³ NCTO ² UNITE ⁴
447	Wool trousers	November 12, 2004	AMTAC ¹ SEAMS NCTO ² UNITE ⁴ NTA ³
620	Other synthetic filament fabric	November 8, 2004	AMTAC ¹ NTA ³ NCTO ² UNITE ⁴
301	Combed cotton yarn	October 27, 2004	AMTAC ¹ NCTO ² NTA ³
352/652	Cotton and man-made fiber underwear	October 15, 2004	AMTAC ¹ NTA ³ NCTO ² UNITE ⁴
338/339	Men's & boys' and women's & girls' cotton knit shirts and blouses	October 13, 2004	AMTAC ¹ NCTO ² NTA ³ SEAMS UNITE ⁴
340/640	Men's & boys' cotton and man-made fiber shirts, not knit		
638/639	Men's & boys' and women's & girls' man-made fiber knit shirts and blouses		
647/648	Men's & boys' and women's & girls' man-made fiber trousers		
347/348	Men's & boys' and women's & girls' cotton trousers	October 8, 2004	AMTAC ¹ SEAMS NCTO ² UNITE ⁴ NTA ³

¹American Manufacturing Trade Action Coalition.

²National Council of Textile Organizations

³National Textile Association

⁴UNITE HERE!

Source: <http://www.otexa.ita.doc.gov/chinare1dec1.pdf>

- **December 2004**

On December 1, 2004, the U.S. Association of Importers of Textiles and Apparel filed suit in the U.S. Court of International Trade challenging CITA's acceptance of textile safeguard petitions on the basis of a "threat" of increased imports and requested that the CIT issue preliminary injunction enjoining CITA from granting relief. The CIT case

name and court number are: U.S. Association of Importers of Textiles and Apparel v. United States, Court No. 04-00598.

Following briefing and oral argument on the plaintiff's motion for a preliminary injunction, on December 30, 2004, CIT Judge Goldberg granted the motion for a preliminary injunction and issued an order enjoining CITA from proceeding on the threat-based safeguard requests during the pendency of the court action. The court's order is set out below:

ORDER
Court No. 04-00598

Upon consideration of plaintiff U.S. Association of Importers of Textiles and Apparel's Motion for a Preliminary Injunction and the accompanying Memorandum of Points and Authorities in support thereof, defendant's Motion to Dismiss and Opposition to Plaintiffs' Motion for a Preliminary Injunction and the accompanying Memorandum in support thereof, the Declarations filed by plaintiff in support of its Motion for a Preliminary Injunction, Defendant's Response in Opposition to Declarations Filed by USA-ITA in Support of its Motion for a Preliminary Injunction, upon all other papers and proceedings had herein, and upon due deliberation, it is hereby

ORDERED that plaintiff's Motion for a Preliminary Injunction is granted; and it is further

ORDERED that defendant United States, together with its delegates, officers, agents, servants, and employees, including defendants Secretary of Commerce Donald Evans, Secretary of State Colin L. Powell, Secretary of the Treasury John W. Snow, U.S. Trade Representative Robert B. Zoellick, Secretary of Labor Elaine L. Chao, and all officers, agents, servants, and employees of the United States, the U.S. Department of Commerce, the U.S. Department of State, the U.S. Department of the Treasury, the Office of the U.S. Trade Representative, and the U.S. Department of Labor, shall be, and hereby are, enjoined, during the pendency of this action, from accepting, considering, or taking any further action on petitions filed pursuant to the procedures published at 68 Fed. Reg. 27787 (May 21, 2003), and the clarification thereto published at 68 Fed. Reg. 49440 (Aug. 18, 2003), that are based on the threat of market disruption by Chinese textile or textile products; and it is further

ORDERED that the Committee for the Implementation of Textile Agreements shall be, and hereby is, enjoined, during the pendency of this action, from self-initiating consideration of whether to impose safeguards pursuant to the procedures published at 68 Fed. Reg. 27787 (May 21, 2003), and the clarification thereto published at 68 Fed. Reg. 49440 (Aug. 18, 2003), based on the threat of market disruption by Chinese textile or textile products; and it is further

ORDERED that plaintiff will not be required to post a bond or security in conjunction with the issuance of this preliminary injunction.

3. Effectiveness and Possible Modifications to China-Specific Safeguards

a. Product-Specific Safeguards

To date, the China-specific product-specific safeguard remedy (Section 421 action) has not provided relief to any U.S. industry. The expectations of its utility as a measure to provide relief to U.S. industries injured from a surge in Chinese imports have not been realized.

Of the five cases brought so far, the International Trade Commission found in three cases that the domestic industry was injured by a surge in Chinese imports and recommended relief. However, the President chose in each instance to deny relief.

It has been more than a year since the last Section 421 petition was filed. It is likely that the paucity of cases in the last year is due, not to a decrease in Chinese imports (which have continued to increase rapidly), but because U.S. industries have observed the results of the first five cases and have judged that the prospective relief to be gained from a petition is not worth the costs and time to bring it.

Moreover, domestic parties may also have been discouraged from bringing 421 petitions by the political tenor of the ultimate decision making process as they have seen the effect of lobbying by China in each of the affirmative 421 determinations to discourage the President from granting relief.⁸¹ The apparent political nature of the 421 determinations by the President to date has been criticized by legal observers and legislators.⁸²

⁸¹ See, e.g., *Chinese Official Complains about China-Specific Safeguards*, ChinaTradeExtra.com, posted December 6, 2002 (China's Vice-Minister for Trade, Long Yongtu, came to Washington and met with Commerce Department officials in December 2002, arguing that the use of Section 421 would undermine China's market access to the United States); *U.S. Holds Door Open to Settlement in First China-Specific Safeguard Case*, Inside US-China Trade, November 13, 2002 (indicating that some administration officials believed imposition of a safeguard measure on Chinese imports could have negative political consequences in

As to possible modifications in the 421 statute to make it more effective toward its purpose, one constant uncertainty is the element of discretion granted to the President as the ultimate decision maker regarding relief. However, one possible statutory modification that should be considered is legislation to provide monetary relief (at least to the extent of covering legal costs) to those U.S. industries that bring a 421 petition, receive an affirmative determination and a recommendation for relief from the ITC but are then denied relief by the President. This small measure of compensation would assist U.S. industries (particularly those comprised of small and medium-sized companies) to benefit from the Section 421 remedy.

More substantive modifications, such as making relief if proposed by the USITC mandatory as long as consistent with WTO durational limits (without retaliation rights) are more desirable but would presumably be resisted institutionally by the Administration since it reduces its role/discretion in the process.

that "a decision to impose the ITC remedy could lead to increased use of the China-specific safeguard, which could further complicate the bilateral trade relationship"); *Chinese Officials Meet in U.S. to Argue Against 421, Furniture AD Case*, Inside US-China Trade, January 14, 2004 ("Officials from China's Ministry of Commerce met this week with officials in the U.S. Trade Representative's Office in an effort to convince them to reject recommendations from the International Trade Commission that the U.S. impose a tariff, a quota or a combination of both in order to limit imports of Chinese ductile iron waterworks fittings (DIWF). Informed sources said MOFCOM officials would meet with USTR yesterday (Jan. 13), and said the MOFCOM delegation consisted of officials from its Bureau of Fair Trade.").

⁸² See, e.g., Eliza Patterson, *The U.S. President, Once Again, Rejects Import Sanctions Against China*, ASIL Insights (May 2003) (observing that the President's denial of relief in the second Section 421 case concerning steel wire garment hangers could be viewed as "an overtly political decision by the President made under pressure from the Chinese government and a signal that this administration has no intention of ever granting relief under Section 421."); *Administration Keeps Unbroken Record of Not Standing Up for American Workers and Businesses Against Injurious Imports from China - Puts Another 5000 U.S. Manufacturing Jobs at Peril*, Comments of Rep. Sander Levin criticizing President Bush's decision to deny relief in the DIWF 421 case (March 5, 2004), available at http://www.insidetrade.com/secure/pdf5/wto2004_1302.pdf.

Separately, the USITC itself appears to add obligations on domestic petitioning industries that are not contained in the statute and which appear to misapprehend the purpose of Section 421. The Commission requires domestic industries to supply adjustment plans similar to a section 201 action even though the premise of the statute is implementing rights under the accession protocol to deal with the transitional period when China is undergoing further significant legal and economic reform. Bringing USITC practice into conformity with the underlying purpose and intent of the statute doesn't require legislative activity but possibly Congressional oversight.

b. Textile Safeguards

Since China's accession in December 2001, CITA has imposed only four textile safeguard measures, and the nine petitions filed since October 8, 2004 are now suspended as the result of a preliminary injunction issued by the Court of International Trade. Thus, the track record so far of the textile safeguard is very limited and it would be premature at this stage to pronounce an assessment of the effectiveness of the textile safeguard as a remedial measure. However, the fact that, of the five petitions that were filed prior to October 8, 2004, CITA rejected only one (cotton and man-made fiber gloves) is an indication that the textile safeguard is working as envisioned – by the U.S. and other WTO Members. Of course, the outcome of the present challenge in the CIT to CITA's authority to accept petitions based upon the threat of increased imports will be relevant in the short term to the ability of U.S. companies and their workers to obtain relief before a significant track record of increased imports for remaining products being reintegrated. While the preliminary injunction may delay the merits being considered (and hence may cost workers their jobs and some companies their continued

viability), the industry and workers will be able to file cases certainly by the second half of 2005 if imports surge as anticipated.

B. China's Exchange Rate Policy and the Likelihood of a Successful WTO Challenge

1. China's Exchange Rate Policy

For ten years, China has maintained a fixed exchange rate for their currency relative to the dollar. As noted in the latest Treasury Department report to Congress, "China kept its fixed exchange rate of 8.28 renminbi to the U.S. dollar throughout the reporting period, a rate it has maintained since 1995, through periods of both upward and downward pressures on the balance of payments."⁸³ Although the U.S. has urged China to move toward a flexible, market-based exchange rate regime and to reduce controls on capital flows, and although China has indicated publicly and at senior levels that it will move to a flexible exchange rate regime, China has not done so to date.⁸⁴

⁸³ U.S. Department of Treasury, *Report to Congress on International Economic and Exchange Rate Policies*, December 3, 2004; <http://www.ustreas.gov/press/releases/js2127.htm>.

⁸⁴ See U.S. Department of Treasury, *Report to Congress on International Economic and Exchange Rate Policies*, December 3, 2004; <http://www.ustreas.gov/press/releases/js2127.htm>:

The Administration has urged Chinese leaders to move as soon as possible to greater flexibility, and has initiated an unprecedented level of engagement with the Chinese government and other major trading partners of the United States to help bring this about. * * * China has publicly stated its commitment to move to a flexible exchange rate regime. * * * China is laying the groundwork for a shift to a market-based, flexible exchange rate. * * * The U.S. Government will pursue persistently and firmly its approach to promote economic, financial and market reforms in China and assist China to move as soon as possible to a flexible exchange rate regime.

Many economists have estimated that China's currency is undervalued by as much as 40% or more.⁸⁵ As a result, Chinese goods compete domestically and internationally at prices that are artificially low hurting U.S. producers in the U.S. market, in the Chinese market and in third country markets. It is argued that China's pegged exchange rate effectively acts as a tax on U.S. exports and a subsidy to China's exports, which causes the loss of U.S. manufacturing jobs. Concern about China's undervalued currency and its effects on U.S. manufacturing and increased imports led to a number of proposals in the 108th Congress to address this problem. For example, Senator Schumer introduced a bill (S. 1586)⁸⁶ that would have found that:

- (1) China's currency is artificially pegged below its market value by 15-40 percent, or an average of 27.5 percent;
- (2) the undervaluation of the yuan makes exports from China less expensive for foreign consumers and foreign products more expensive for Chinese consumers, which effectively result is a subsidy to China's exports and a virtual tariff on foreign imports;
- (3) China's undervalued currency and the U.S. trade deficit with China is contributing to significant U.S. job losses and harming U.S. businesses;
- (4) China has intervened in the foreign exchange markets to hold the value of the yuan within an artificial trading range; and
- (5) China's undervalued currency and intervention in the value of its currency violates the spirit and letter of the world trading system.

The Schumer bill would have imposed a 27.5% additional rate of duty on Chinese imports unless the President certified to Congress that China was no longer manipulating its exchange rate and that its currency was valued in accordance with accepted market-based trading policies.

⁸⁵ See Testimony of Franklin J. Vargo, National Association of Manufacturers, before the House Committee on International Relations, *Hearing on U.S.-China Ties: Reassessing the Economic Relationship* at 4 (October 21, 2003).

⁸⁶ The text of S. 1586 is available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=108_cong_bills&docid=f:s1586is.txt.pdf.

In 2004, other attempts were made to address China's exchange rate policy. In particular, two Section 301 petitions were filed with the U.S. Trade Representative seeking U.S. action regarding China's exchange rate policy. Initially, the Fair Currency Alliance, a group of trade associations and unions representing manufacturing, agriculture and labor, prepared a Section 301 petition⁸⁷ to address the problem of Chinese currency manipulation but eventually chose not to file the petition with USTR.

Thereafter, on September 9, 2004, the China Currency Coalition, another coalition of U.S. industrial, service, agricultural, and labor organizations, filed a Section 301 petition seeking immediate elimination of the Chinese currency's undervaluation.⁸⁸ On the same day it was filed, USTR rejected the petition.

On September 30, 2004, another Section 301 petition on China's currency policy (nearly identical to the CCC's petition) was filed by 30 members of the House and Senate.⁸⁹ On November 12, 2004, USTR rejected the 301 petition filed by the 30 members of Congress.⁹⁰

2. Possible Grounds for a WTO Challenge to China's Exchange Rate Policy

Various bases for a WTO challenge to China's exchange rate policy have been proposed. The primary grounds for challenging China's exchange rate policy are that China's

⁸⁷ See *Fair Currency Alliance Says China Understating Global Trade Surplus*, Inside US-China Trade, June 16, 2004 ("Zoellick and other cabinet officials said in late April that they would reject a Section 301 petition on China's currency policies if it were filed. However, the Alliance has said it might still file the petition, and will monitor the Bush Administration's progress on the issue over the summer before deciding how to proceed.").

⁸⁸ See <http://www.aflcio.org/issues/politics/manufacturing/upload/petition.pdf>.

⁸⁹ See *USTR Delays China Currency 301 Decision Until Meeting With Congress*, Inside US-China Trade, October 6, 2004 at 3-4.

⁹⁰ See *USTR Rejects Currency 301; Schumer, Levin Blast Lack of Consultations*, Inside US-China Trade, November 17, 2004 at 1.

undervaluation of the yuan constitutes a prohibited export subsidy within the meaning of various GATT articles and WTO Agreements, violates GATT Article XV:4, and violates China's obligations under the International Monetary Fund's Articles of Agreement.. In brief, these potential grounds to a WTO challenge are:

Prohibited Export Subsidy:

- WTO SCM Agreement: Article 3.1(a) of the SCM Agreement prohibits “subsidies, contingent in law or in fact, ... upon export performance....” Article 3.2 of the SCM Agreement states that WTO Members States “shall neither grant nor maintain” prohibited export subsidies. In its accession protocol, China committed to “eliminate all subsidy programmes falling within the scope of Article 3 of the SCM Agreement upon accession.”⁹¹
- GATT Article VI: The *Ad Note* to GATT Articles VI:2 and VI:3 provides that “multiple currency practices can in certain circumstances constitute a subsidy to exports which may be met by countervailing duties By ‘multiple currency practices’ is meant practices by governments or sanctioned by governments.” GATT, Ad. Article VI, paras. 2-3, note 2.⁹²
- GATT Article XVI: This article expressly recognizes that export subsidies “. . . may cause undue disturbance to . . . normal commercial interests, and may hinder the achievement of the objectives of this Agreement.” GATT Article XVI:2. Paragraph 4 prohibits export subsidies by directing that “contracting parties shall cease to grant either directly or indirectly any form of subsidy on the export of any product other than a primary product which subsidy results in the sale of such product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market.” GATT Article XVI:4.
- WTO Agriculture Agreement: According to Article 3.2 of the Agriculture Agreement, Members shall not provide export subsidies in excess of those specified in their schedule of commitments. Article 9.1 identifies specific types of export

⁹¹ *Protocol on the Accession of the People's Republic of China*, WT/L/432 (23 November 2001) at art. 10.3.

⁹² Some U.S. industry groups have stated that one way to address the effect of China's exchange rate policy is by changing U.S. policy regarding the application of CVD law to China and other NME countries. Such a change would enable U.S. industries to argue that China's exchange rate policy acts as a countervailable subsidy. See, e.g., *China CVD Bill Increasingly Seen as Way to Attack China Currency*, Inside US-China Trade, June 30, 2004 at 1.

subsidies subject to reduction commitments, and Article 10.1 further specifies that export subsidies not identified in Article 9.1 shall not be applied in contravention of Members' export subsidy commitments. In the working party report to China's accession, China expressly committed that "by the date of accession, China would not maintain or introduce any export subsidies on agricultural products."⁹³

Violation of GATT Article XV:4:

- GATT Article XV:4 states: "Contracting parties shall not, by exchange action, frustrate* the intent of the provisions of this Agreement, nor, by trade action, the intent of the provisions of the Articles of Agreement of the International Monetary Fund."⁹⁴ China's undervaluation of its yuan constitutes an "exchange action" that frustrates the intent of various provisions of the GATT Agreement, particularly Article I (MFN), Article II (tariff bindings), Article III (national treatment), Articles VI and XVI (export subsidies prohibited), and Article XI (bars taxes & charges (other than duties) that restrict imports).
- China's undervaluation also constitutes a "trade action" that frustrates the intent of the IMF's Articles of Agreement, particularly Article IV, Section 1(iii) (each IMF member shall "avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members.").

IMF Agreement Violation:

- China's undervaluation of the yuan violates China's obligations under IMF Article IV (each IMF member shall: "(iii) avoid manipulating exchange rates or the international monetary system in order to . . . gain an unfair competitive advantage over other members.") by giving China's exports an unfair competitive advantage in trade with the U.S. and other IMF members.
- China's undervaluation of the yuan violates China's obligations under IMF Article VIII, section 3 ("No member shall engage in, or permit any of its fiscal agencies ... to engage in any discriminatory currency arrangements or multiple currency practices") by discriminating against U.S. products to China's benefit.

⁹³ *Report of the Working Party on the Accession of China*, WT/MIN(01)/3 (10 November 2001) at para. 234.

⁹⁴ The *Ad Note* states: "The word 'frustrate' is intended to indicate, for example, that infringements of the letter of any Article of this Agreement by exchange action shall not be regarded as a violation of that Article if, in practice, there is no appreciable departure from the intent of the Article...."

3. Likelihood of a Successful WTO Challenge to China's Exchange Rate Policy

On substance, the potential grounds for challenging China's exchange rate policy at the WTO have prima facie merit. Although currency practices have not commonly been challenged at the WTO (or the predecessor GATT) as export subsidies or as actions frustrating the intent of the GATT and IMF Agreements, there has long been an acknowledgement that currency manipulation practices could constitute export subsidies. Notwithstanding the inherent merit of these arguments, however, a realistic assessment must recognize that, given that the Administration has twice rejected Section 301 petitions that were based on the complaints that China's manipulation of its exchange rate policy constituted a prohibited export subsidy within the meaning of GATT Article VI and XVI, the SCM Agreement, and the WTO Agriculture Agreement, as well as an exchange and a trade action that frustrates the intent of the GATT and IMF Agreements, it is not likely that the same Administration would favor a WTO challenge of China's exchange rate policy on the same grounds that it rejected in the Section 301 petitions.⁹⁵

Separately, US antidumping law could be modified to permit currency manipulation to be treated as a form of dumping consistent with the original GATT notes.

⁹⁵ See *Bush Re-Election Dampens Hopes for Progress on China Currency*, Inside US-China Trade, November 10, 2004 at 1 ("Supporters of efforts to get China to re-value its renminbi in order to reduce what they consider an unfair trade advantage over the U.S. said it is highly unlikely that the Bush Administration in its second term would change its strategy in this area. As a result, they said, it seems unlikely that any real progress would be made with China in the near future.")

C. **Non-Market Economy Status of China in U.S. Antidumping Proceedings and Prospects for Change**

For purposes of U.S. antidumping duty proceedings, the U.S. Department of Commerce has determined that China is a non-market economy (NME) country. NME status means that, in antidumping duty investigations concerning imports from China, the Department of Commerce uses a special NME methodology to calculate antidumping duty margins because Commerce considers Chinese exporters to be operating within a centrally planned economy in which the government controls pricing and production decisions. Therefore, except in cases where individual companies can demonstrate an absence of government control over their export activities, Commerce treats all exporters as a single enterprise for dumping purposes. Exporters who show an absence of government control, however, are eligible to receive a separate dumping margin specific to their imports.

1. **NME Country Definition**

A “non-market economy country” is defined by statute in Section 771(18) of the Tariff Act of 1930, as amended; 19 U.S.C. § 1677(18):

(18) Nonmarket economy country.

(A) In general.

The term ‘nonmarket economy country’ means any foreign country that the administering authority determines does not operate on market principles of cost or pricing structures, so that sales of merchandise in such country do not reflect the fair value of the merchandise.

(B) Factors to be considered.

In making determinations under subparagraph (A) the administering authority shall take into account –

- (i) the extent to which the currency of the foreign country is convertible into the currency of other countries;
- (ii) the extent to which wage rates in the foreign country are determined by free bargaining between labor and management,
- (iii) the extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country,
- (iv) the extent of government ownership or control of the means of production,
- (v) the extent of government control over the allocation of resources and over the price and output decisions of enterprises, and
- (vi) such other factors as the administering authority considers appropriate.

The statute also states that any determination of NME country status “shall remain in effect until revoked by the administering authority” (Commerce).⁹⁶ Thus, China’s NME country status shall remain in effect until Commerce changes that status. This does not mean, however, that Commerce may change China’s NME status without a full on the record consideration of the issue in a specific case context. Rather, as noted by James J. Jochum, then Assistant Secretary for Import Administration of the U.S. Department of Commerce:

Any decision to graduate China to market economy status, whenever that decision is made, must be made in the context of a formal, quasi-judicial proceeding in accordance with Section 771, subparagraph 18(b) of the Tariff Act of 1930, as amended, and would be based solely on facts in evidence placed on the

⁹⁶ See 19 U.S.C. § 1677(18)(C).

administrative record of such proceeding. As in previous proceedings undertaken pursuant to this statute, the record would be developed from data and information gathered from expert third party sources such as the OECD and World Bank, as well as from comments received from interested parties and the public.⁹⁷

2. NME Methodology

Normally, Commerce calculates antidumping duty margins based on the amount by which the “normal value” (*i.e.*, the price in the foreign market) exceeds the “export price” (*i.e.*, U.S. price) for the merchandise at issue. However, in antidumping duty cases concerning imports from an NME country such as China, Commerce does not base “normal value” on prices of the merchandise in the NME but rather uses a “factors of production” methodology for determining normal value.⁹⁸

The “factors of production” typically are comprised of the labor hours, energy amounts, and quantities of raw materials needed to make the product.⁹⁹ Commerce values these factors (except for labor) for the NME country based on costs from a “surrogate country.” Commerce selects a “surrogate country” (or countries) that is at a level of economic development comparable to the NME country. For example, in numerous past cases, Commerce has used India as a surrogate country for China. For labor, Commerce publishes the rate that will be used. Commerce often uses imports into the surrogate country to value raw materials and energy prices

⁹⁷ U.S. Department of Commerce, International Trade Administration, Import Administration, Hearing before the US-China Joint Commission on Commerce and Trade Working Group on Structural Issues, June 3, 2004 at 6-7 (opening remarks of James J. Jochum).

⁹⁸ See 19 U.S.C. § 1677b(c) (nonmarket economy countries).

⁹⁹ See 19 U.S.C. § 1677b(c)(4) (valuation of factors of production); see also 19 C.F.R. § 351.408.

in the surrogate country to value energy. Commerce calculates the “normal value” by summing the products of the factors of production times their surrogate-country values and then adding to that sum an amount for factory overhead, selling, general, and administrative expenses (GS&A), and profit. The values for producers' factory overhead, GS&A and profit are taken from public sources in the surrogate country for producers of the same or similar types of products. There are a number of exceptions to the above that have developed over time and many domestic petitioners perceive that Commerce has developed a methodology that in many cases will result in a gross understatement of a realistic normal value.

Once the NME's normal value is calculated, it is compared to the export price, and if the export price is less than the normal value, then Commerce determines that the product has been sold for less than fair value (dumped). For NME investigations, Commerce determines a “country-wide” dumping margin for imports from the NME country that have been manufactured by state-controlled enterprises and an individual company dumping margin for NME imports that have been manufactured by a particular company (provided that company has demonstrated that its export operations are not controlled by the government).

3. U.S.-China Working Group on China's NME Status

China has been seeking a change in its NME status under U.S. antidumping duty law.¹⁰⁰ This issue was a topic at the 15th session of the U.S.-China Joint Commission on Commerce and

¹⁰⁰ See, e.g., *Aldonas Says IPR Main Focus of JCCT, Seeks Talks to Change China's NME Status*, Inside US-China Trade, April 14, 2004 at 1.

Trade (JCCT)¹⁰¹ which took place on April 21, 2004, in Washington, DC. The JCCT was chaired by Commerce Secretary Donald Evans, U.S. Trade Representative Robert Zoellick and Chinese Vice Premier Wu Yi and resulted in a number of agreements, including the establishment of a working group on China's NME status and the steps necessary for China to become a market economy, as described below.

Leveling the Playing Field -- Structural Issues and Market Economy Status

One of President Bush's key goals in the trade arena is to ensure that the playing field is level, meaning that competition is determined by the market, rather than government intervention. In prior decisions, the Commerce Department has found that China does not yet qualify as a market economy under the U.S. antidumping law. In the case of China, the surest means to ensure that the playing field is level is to encourage China's ongoing structural reforms, which are intended to create a market economy.

In order to assess China's reforms to date, as well as to identify the steps China would have to take, under U.S. law, to achieve market economy status, China and the U.S. agreed during the JCCT meetings to the establishment of a working group, to be jointly chaired by James Jochum, Assistant Secretary for Import Administration from the Department of Commerce, and the appropriate Director General from MOFCOM. The immediate goals of the group will be to:

- o Consult closely regarding the criteria under U.S. law needed to achieve market economy status;
- o Review, under the framework established by U.S. law, the broad spectrum of policies and practices that are a part of the ongoing structural reform in China ; and

¹⁰¹ The U.S.-China Joint Commission on Commerce and Trade (JCCT) is a government-to-government consultative mechanism that provides a forum to resolve trade concerns and promote bilateral commercial opportunities. The JCCT was established in 1983 and has provided a formal process whereby the U.S. and China are able to meet and discuss trade issues of mutual interest and concern, generally on a yearly basis.

- o Identify the steps necessary for China to qualify as a market economy under U.S. law.¹⁰²

In May 2003, the Department of Commerce requested public comments concerning the identification of relevant topics and issues for discussion in the working group on China’s NME status.¹⁰³ In response, U.S. industry groups generally argued that China must make substantial changes in its economic structure before the U.S. makes any change to China’s NME status.¹⁰⁴

The press described the tenor of these responses as follows:

¹⁰² See *The U.S.-China JCCT: Outcomes*, <http://www.mac.doc.gov/china/JCCT%20outcomes%20-%20Commerce.pdf>.

¹⁰³ See 69 Fed. Reg. 24132-33 (May 3, 2004).

¹⁰⁴ The Law Offices of Stewart and Stewart submitted comments to Commerce regarding China’s NME status and recommended a list of benchmarks that Commerce should employ to assess whether China has made the changes to its economy necessary to achieve designation as a market economy. See Stewart and Stewart Comments (May 19, 2004); <http://ia.ita.doc.gov/download/us-china-jcctwg/comments/stewart-stewart-jcctwg-cmt.pdf>. The recommended benchmarks are summarized in the following table.

Recommended Benchmarks that the Commerce Department should use for determining whether China’s economy is properly categorized as a market economy:

1. Currency convertibility	<ul style="list-style-type: none"> • whether China has dismantled the currency exchange/controls and has obtained a freely floating currency. • At a minimum, the currency should be valued at a level that approximates the underlying value vis-à-vis the U.S. dollar.
2. Wages freely set	<ul style="list-style-type: none"> • whether China has fully implemented ILO core labor standards (and the related topic of dramatic improvement in its record on human rights).
3. Joint ventures and other investments	<ul style="list-style-type: none"> • whether China has fully implemented its WTO trading rights obligations, • whether China has removed restrictions on foreign investments on industries where such restrictions do not exist in the United States, • whether, based on surveys of U.S. producers, China is directly or indirectly forcing technology transfer for companies investing in China, and • whether China is in full compliance with its TRIMs obligations.
4. The extent of government ownership or control of the means of production	<ul style="list-style-type: none"> • whether China’s extent of government ownership or control of the means of production (including central, provincial and local governments) is at or below the average for OECD countries.
5. The extent of government control over the allocation of resources and over the price and output decisions of enterprises	<ul style="list-style-type: none"> • whether China’s extent of government control over the allocation of resources and over the price and output decisions of enterprises is at or below the average for OECD countries.

Commerce largely received comments from U.S. industry groups arguing that the U.S. must ensure that China takes real steps to address the six [statutory] factors ... before market economy status is granted. Some argued that China is so far from a market economy determination that it is just too early to consider changing China's status

* * *

Regardless of the level of opposition to a change in China's economic status, these groups and several others noted that China must address U.S. complaints in several areas before the U.S. could consider such a change. These areas include the pegging of the renminbi to the dollar, wage rate controls, investment restrictions, government control of prices and resources, banking restrictions, the absence of the rule of law in China, subsidies, transparency, discriminatory taxes, and the existence and practices of state-owned companies.¹⁰⁵

<p>6. Such other factors as the Department of Commerce may consider relevant</p> <p>a. Effective enforcement of intellectual property rights</p>	<ul style="list-style-type: none"> • whether China's enforcement of intellectual property rights results in a level of piracy/counterfeit goods being present in the market which is at or below the average for OECD countries, as well as • whether effective enforcement exists for claims against other forms of IP rights losses.
<p>b. Elimination of limitations on trading rights for all products and controls on pricing of goods and services</p>	<ul style="list-style-type: none"> • whether China has eliminated state trading and designated trading for all goods.
<p>c. Clean up of banking sector and elimination of all government interference/control on the banking activities within China</p>	<ul style="list-style-type: none"> • whether Chinese banks and companies are operating on commercial principles including making loans based on commercial considerations reflecting the risk of a particular enterprise, and • whether the level of bad debts by Chinese companies is at or below the average for OECD countries.
<p>d. Compliance with WTO subsidy obligations contained in China's protocol of accession and Working Party Report</p>	<ul style="list-style-type: none"> • whether China is in full compliance with its subsidy obligations undertaken as part of its WTO accession
<p>e. State-owned and state invested enterprises</p>	<ul style="list-style-type: none"> • whether the level of state-owned and state-invested enterprises in China is at or below the average for OECD countries.
<p>f. Discrimination against foreign goods</p>	<ul style="list-style-type: none"> • whether China has eliminated all forms of discrimination against foreign goods that are not expressly permitted by the WTO.

¹⁰⁵ See *China Downplays Market Distortions in Bid to Convince U.S. of Market Status*, Inside US-China Trade, May 26, 2004 at 1, 6-7.

Subsequent to the agreement to establish a working group, U.S. and China officials met in July 2004 to set up procedures for the operation of the working group. The U.S. and China agreed that the working group on China's NME status would meet twice a year with the next meeting to occur in Washington D.C. in either January or February 2005.¹⁰⁶ Concerning the substantive issues that the working group will address, the press reported the views of the U.S. Assistant Secretary of Commerce for Import Administration, James J. Jochum:

In terms of substance, Jochum said he expects the market economy group would likely discuss the six statutory criteria under U.S. law that describe the conditions of a country must meet in order to be considered a market economy country in trade remedy cases. Those factors are the degree of currency convertibility, free wage rate determination, foreign investment, government ownership or control of production, government ownership over the allocation of resources, and a sixth catch-all category that allows Commerce to look at "other appropriate factors."¹⁰⁷

4. Prospects for Change in China's NME Status

It is more likely than not that China's status as a NME country for purposes of antidumping duty law will not change in the near future.

First, the U.S. negotiated the right to apply the NME antidumping methodology to Chinese imports subject to antidumping investigations for 15 years after China's WTO accession in the U.S.-China Bilateral Trade Agreement (signed November 15, 1999). This right was

¹⁰⁶ See U.S., *China Agree to Format of Market Economy, Trade Remedy Groups*, Inside US-China Trade, August 4, 2004 at 1.

¹⁰⁷ See U.S., *China Agree to Format of Market Economy, Trade Remedy Groups*, Inside US-China Trade, August 4, 2004 at 1, 7.

subsequently included in China's Protocol of Accession.¹⁰⁸ Thus, China agreed that WTO Members could use an NME antidumping methodology through December 11, 2016. China is, however, permitted to demonstrate that market conditions prevail in its economy as a whole or in a particular industry, and, if such a demonstration is accepted by a WTO Member's investigating authority and it concludes that China is a market economy country, the Member must thereafter employ the normal rules in determining price comparability in antidumping duty cases.¹⁰⁹

Second, in June 2004, Commerce Secretary Evans "strongly downplayed the idea that the Bush Administration is moving rapidly toward giving China market economy status (MES) ... and said China among other things still must relinquish its tight control over its economy and state ownership of assets before the U.S. could consider changing its designation."¹¹⁰ In particular, Secretary Evans identified the following factors that supported maintaining the current NME status of China:

We are well aware that achieving market economy status is a high priority for China. The Structural Issue working group, also established at the April JCCT, is the place where we will engage on the range of non-market-based policies and practices present in the Chinese economy -- such as currency convertibility, labor and wage issues, and the extent of government intervention in the market.

China must significantly reduce government micromanagement of its economy and introduce a far higher level of transparency-- among many other changes-- before it can achieve a full transition to a market-driven economy.

¹⁰⁸ See *Protocol of Accession of the Peoples Republic of China*, WT/L/432 (23 November 2001), art. 15.

¹⁰⁹ See *Protocol of Accession of the Peoples Republic of China*, WT/L/432 (23 November 2001), art. 15(d).

¹¹⁰ See *Evans Downplays Idea That China is Nearing Market Economy Status*, Inside US-China Trade, June 30, 2004, at 1.

Only then will China be able to make meaningful and sustainable progress.

Even today, far too many key assets and means of production within the Chinese economy are owned and operated by the state. We have seen too few “for sale” signs on the commanding heights of the Chinese economy. We need to see them.

We need to see them because market forces won’t control China’s economy until there is a substantial rollback of its control over raw materials, financial system, real estate, utilities, and large enterprises within China. When a government controls the means of production, it radically distorts economic conditions, undermines efficient capital usage, and compromises long-term potential and stability.

For example, I just returned from North Eastern China where the state still owns outright or controls a majority interest of roughly 90 percent of all manufacturing enterprises. None of us should be surprised that the region now supplies only eight percent of China’s output—down from 14 percent in 1981.

When markets operate with accurate information, they send price signals about risk and reward in a marketplace.

China’s leaders realize that treating the symptoms may buy time, but it won’t cure the structural flaws that are inviting insolvency and only grow worse with time. But they have huge obstacles ahead.

There continues to be a troubling level of non-performing loans in the portfolios of China’s state-run banking system.

Last year, I advised China to lift its capital controls so that the Chinese entrepreneurs could experience greater financial freedom. These controls undermine opportunities for entrepreneurship and expanded prosperity. The hopes, dreams, and aspirations of the Chinese people depend on an open financial system that offers the promise of financial security and independence.

China’s capital controls misallocate the country’s wealth and compromise the widespread prosperity that an industrious and

entrepreneurial people like the Chinese would otherwise be creating.

The unsound banking practices that are funded through the fruits of the capital controls are equally troubling.

China's state-run banks have routinely extended loans to state-owned-enterprises that are not expected to be repaid. And right now, the big four state banks in China are, for all practical purposes, insolvent.

This month, the Commerce Department held preliminary hearings to gather information about China's economy.

Based on multiple submissions and testimony, it's clear that U.S. industry feels that many of China's policies, including its currency practices, place American companies at a significant competitive disadvantage.

We also heard testimony that Chinese enterprises were operating without bearing the costs associated with operating in a market economy. Under state control, many Chinese state-owned manufacturers are operating with the benefit of state sponsored subsidies, including: rent, utilities, raw materials, transportation, and telecommunications services. That is not how we define a level playing field.

China has a lot of work to do but we know they are moving in the right direction. We're committed to working with the Chinese leadership to adopt the sweeping changes that can begin the first steps on the path toward free-market principles. It won't be easy. It won't happen overnight.

But we're committed to staying the course because the day that market forces govern China's economy will be a great day for both the Chinese and the American people.¹¹¹

¹¹¹ Remarks by Secretary Donald L. Evans to the President's Export Council - American Chamber Of Commerce in Beijing, China, June 23, 2004. The full text of Secretary Evans' speech is available at the website of the

In addition, Commerce Assistant Secretary Jochum indicated in July 2004 that China was aware that it had to make extensive changes to its economy before the U.S. would change China's NME status. Jochum stated that, in June 2004:

[China had presented] to the U.S. a number of internal reforms China has undertaken, after which Chinese officials implied that China is well on its way toward creating a market economy. However, Jochum said China did not press for an immediate decision from the U.S., and seemed to understand that the U.S. is not ready to consider China a market economy until much deeper reforms are made.¹¹²

D. Status of U.S. Policy Regarding Application of Countervailing Duty Law to China and Other Non-Market Economy Countries

Current U.S. Commerce Department policy is that countervailing duty law is not applicable to non-market economy countries. The United States considers China to be a non-market economy country. Therefore, at present the Commerce Department views U.S. countervailing duty law is not applicable to China. This means that, at present, U.S. industries cannot petition for the imposition of countervailing duties when they are injured by reason of Chinese imports benefiting from government subsidies.

The current position of the U.S. Department of Commerce is not required by the statute. Rather, it was established by an administrative determination (which determination was affirmed in court litigation) and could be reversed or changed by administrative action.

U.S. Department of Commerce: http://www.commerce.gov/opa/speeches/Evans/2004/June_23_Evans_ChinaBeijingAmcham.htm.

¹¹² See U.S., *China Agree to Format of Market Economy, Trade Remedy Groups*, Inside US-China Trade, August 4, 2004 at 7.

1. Definition of a Non-Market Economy Country

A “non-market economy country” is defined by statute in Section 771(18) of the Tariff Act of 1930, as amended; 19 U.S.C. § 1677(18). It provides:

(18) Nonmarket economy country.

(C) In General.

The term ‘nonmarket economy country’ means any foreign country that the administering authority determines does not operate on market principles of cost or pricing structures, so that sales of merchandise in such country do not reflect the fair value of the merchandise.

(D) Factors to be considered.

In making determinations under subparagraph (A) the administering authority shall take into account –

- (i) the extent to which the currency of the foreign country is convertible into the currency of other countries;
- (ii) the extent to which wage rates in the foreign country are determined by free bargaining between labor and management,
- (iii) the extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country,
- (iv) the extent of government ownership or control of the means of production,
- (v) the extent of government control over the allocation of resources and over the price and output decisions of enterprises, and
- (vi) such other factors as the administering authority considers appropriate.

2. Background to Current Policy

Since 1984, the U.S. Department of Commerce, International Trade Administration, the administering authority of U.S. countervailing duty (CVD) law, has considered that CVD law is

not applicable to exports from a Non-Market Economy (NME) country because subsidization is a market economy phenomenon and cannot exist in an NME.

The two proceedings in which Commerce first made this determination were *Carbon Steel Wire Rod from Czechoslovakia*, 49 Fed. Reg. 19370 (May 7, 1984) (final negative CVD determination) and *Carbon Steel Wire Rod from Poland*, 49 Fed. Reg. 19374 (May 7, 1984) (final negative CVD determination). As a result of its determination in the *Wire Rod* cases, Commerce then rescinded initiations of CVD investigations on imports of potash from the Soviet Union and the German Democratic Republic. At that time, all four countries (Czechoslovakia; Poland; Soviet Union; German Democratic Republic) were considered non-market economies because each was characterized by central government control over prices and the allocation of resources.

Commerce's NME classification was founded on an economic analysis that concluded that "markets" did not exist in countries that relied on government central planning to allocate resources and prices. Commerce said in the *Wire Rod* cases:

We believe a subsidy (or bounty or grant) is definitionally any action that distorts or subverts the market process and results in a misallocation of resources, encouraging inefficient production and lessening world wealth.

In NMEs resources are not allocated by a market. With varying degrees of control, allocation is achieved by central planning. Without a market, it is obviously meaningless to look for a misallocation of resources caused by subsidies. There is no market process to distort or subvert. Resources may appear to be misallocated in an NME when compared to the standard of a market economy, but the resource misallocation results from central planning, not subsidies.

It is this fundamental distinction -- that in an NME system the government does not interfere in the market process, but supplants it -- that has led us to conclude that subsidies have no meaning outside the context of a market economy.¹¹³

In countries with pervasive control of prices and resources, Commerce said it could not disaggregate government actions so as to identify the exceptional action that is a subsidy. In sum, Commerce believed that, in an NME country where “markets” did not exist, there would be no way to quantify subsidies.

On appeal, Commerce's determination was reversed by the U.S. Court of International Trade (CIT).¹¹⁴ Subsequently, however, the U.S. Court of Appeals for the Federal Circuit (CAFC) reversed the CIT's decision and affirmed Commerce's determination.¹¹⁵ The CAFC affirmed Commerce's determination because it could not say that Commerce's decision was “unreasonable, not in accordance with law, or an abuse of discretion” in view of the discretion accorded administrative agencies.¹¹⁶

Thus, Commerce's policy is based on the view that while a subsidy is a government action that distorts markets, there is no “market” in an NME, so it is not possible for subsidies to distort that which does not exist.

¹¹³ *Carbon Steel Wire Rod from Czechoslovakia*, 49 Fed. Reg. 19370, 19371 (May 7, 1984) (final negative CVD determination) (emphasis added); *Carbon Steel Wire Rod from Poland*, 49 Fed. Reg. 19374, 19375 (May 7, 1984) (final negative CVD determination) (emphasis added).

¹¹⁴ *Continental Steel Corp. v. United States*, 614 F. Supp. 548 (CIT 1985).

¹¹⁵ *Georgetown Steel Corp. v. United States*, 801 F.2d 1308 (Fed. Cir. 1986).

¹¹⁶ *Georgetown Steel Corp.*, 801 F.2d at 1318, citing *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

3. Possible Ways to Address Chinese Subsidy Practices

In the context of countervailing duty law, the U.S. can address Chinese subsidies if (1) the statute is amended to expressly direct Commerce to apply CVD law to NME countries, or (2) Commerce changes its present policy (which it has discretion to do). Outside the context of CVD law, the U.S. can address Chinese subsidies in the WTO pursuant to the Agreement on Subsidies and Countervailing Measures. Indeed, the U.S. Commerce Department position is bizarre at the present time in light of the heavy emphasis the U.S. placed on eliminating subsidies as part of China's accession process to the WTO. If subsidies in modern day China don't distort markets, why did the U.S. insist time and time again that such subsidies had to be eliminated, reduced, identified and/or reported?

a. Statutory amendment

Congress could amend the countervailing duty law to expressly provide that CVD law applies to non-market economy countries. In the 108th Congress, bills were introduced in both the House and Senate to make such a change. The House bill (H.R. 3716) and the Senate bill (S. 2212) both would have amended the law as follows: "Section 701(a)(1) of the Tariff Act of 1930 (19 U.S.C. 1671(a)(1)) is amended by inserting '(including a nonmarket economy country)' after 'country' each place it appears."

b. Change in policy by Commerce

The present U.S. policy that CVD law does not apply to NME countries was established by Commerce in 1984 and Commerce has the discretion to change that policy so as to apply CVD law to NME countries such as China. There are a number of factors that would support such a change.

First, in 1984, the term “subsidy” was not defined. GATT Article XVI, paragraph 1, referred to “any subsidy” as including “any form of income or price support, which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into” a country. The 1979 Subsidy Code used the terms “subsidy” and “subsidize” without elaboration. This definitional gap was filled in 1994 by the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement). Article 1 (“Definition of a Subsidy”) of the SCM Agreement provides that a subsidy shall be deemed to exist if:

- (a) (1) there is a financial contribution by a government or public body,¹¹⁷
or
- (a) (2) there is any form of income or price support in the sense of Article XVI of GATT 1994;
- (b) a benefit is thereby conferred.¹¹⁸

Article 2 of the SCM Agreement requires that, to be actionable, a subsidy must be given to a specific enterprise or industry or group of enterprises or industries.

Significantly, the SCM Agreement, unlike Commerce's 1984 working definition and GATT Article XVI, defines a subsidy based on what it is, instead of whether it distorts a market. This approach is practical because if a subsidy can be identified by its characteristics, it is not necessary to examine the market effects of a subsidy in order to determine whether, in fact, a subsidy exists. Compared to the SCM Agreement’s definition of a subsidy, the Commerce

¹¹⁷ This includes any direct transfer of funds; fiscal incentives such as tax credits; provision of goods (other than general infrastructure) or purchase of goods; payments to a funding mechanism or direction of a private body to carry out what would normally be government functions. SCM Agreement, art. 1.1(a)(1)(i)-(iv).

¹¹⁸ SCM Agreement, art. 1.1.

policy's focus on economic effects to determine whether a subsidy exists would appear to be outdated.

Second, with respect to China, the accession agreements acknowledged that subsidies exist in China, as they identify Chinese domestic and export subsidies and provide alternate methods of subsidy measurement. Neither the U.S. nor any other Member expressed a belief that that subsidies do not or could not exist in the present Chinese economy.

In fact, the U.S. successfully negotiated to impose disciplines on Chinese subsidies. In the Protocol of Accession, China agreed to eliminate all export subsidies.¹¹⁹ China also agreed that WTO Member Authorities could use non-Chinese benchmarks for subsidy quantification if Chinese benchmarks were not available or could not be adjusted.¹²⁰ In addition, Annex 5A of the Protocol listed 24 existing domestic subsidy programs maintained by China (which some Members considered to be incomplete).¹²¹ And, in Annex 5B to the Protocol, China listed three export subsidies that it agreed to phase out (although some members considered this list to be incomplete as well).¹²²

Third, the question of quantifying subsidies in NME countries absent benchmarks can be practically addressed. A common benchmark in CVD investigations in measuring preferential loans or identifying the discount rate for grants is the market rate of interest. To the extent the

¹¹⁹ *Protocol of Accession of the Peoples Republic of China*, WT/L/432 (23 November 2001), art. 10.3.

¹²⁰ *Protocol of Accession of the Peoples Republic of China*, WT/L/432 (23 November 2001), art. 15.

¹²¹ *Report of the Working Party on the Accession of China*, WT/MIN(01)/3 (10 November 2001), at para. 173. In particular, they felt that some subsidies, such as "policy" loans by State owned banks, forgiveness of debt, and the selective use of "below-market" interest rates should have been notified. There was also reference to unnotified tax subsidies, and subsidies provided by sub-national governments.

International Monetary Fund publishes interest rates for various non-market economy countries, that measure could be used. For China, for example, the IMF's *International Financial Statistics* publishes three rates: the Bank Rate, Deposit Rate, and Lending Rate. Moreover, specifically with respect to China, the Protocol of Accession, Item 15(b) provides that WTO Members may use alternative valuation approaches for Chinese subsidies, including external benchmarks.¹²³

Finally, given that Commerce's policy is not required by statute, should Commerce determine to change its policy so as to apply CVD law to NME countries, the change is likely be upheld by Commerce's reviewing courts as long as Commerce supports the change with reasoned analysis.

c. Action at the WTO

Notwithstanding the current U.S. policy not to apply CVD law to NME countries, the U.S. could address Chinese subsidies at the WTO through the consultation and dispute settlement procedures set out in the SCM Agreement. Notably, in the third Transitional Review Mechanism, the U.S. requested that China provide detailed information regarding a number of programs and practices that appeared to constitute subsidies. In one request, the U.S. asked why China had not yet submitted any subsidy notifications required under Article 25 of the SCM Agreement, and also asked for information regarding the status of certain programs that appeared to involve subsidies:

- Semiconductors – whether China grants VAT rebates on semiconductor exports;

¹²² Id. at para. 166.

¹²³ *Protocol of Accession of the Peoples Republic of China*, WT/L/432 (23 November 2001), art. 15.

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-
- Copper – whether China grants VAT rebates on imports of copper scrap or on exports of copper-based, semi-fabricated or finished products;
 - Subsidies to State-Owned Enterprises Running at a Loss – whether China has eliminated these subsidies as promised in the accession agreement;
 - Non-Performing Loans – China’s injection of US\$ 45 billion into the Bank of China and the China Construction Bank; China’s debt forgiveness as part of the Northeast Revitalization Programme;
 - Price Controls – whether certain price control programs provide subsidies.¹²⁴

In another submission,¹²⁵ the U.S. identified a number of programs and practices that appeared to constitute prohibited subsidies under Article 3 of the SCM Agreement (subsidies contingent upon export performance; subsidies contingent upon the use of domestic over imported goods), as well as other programs that appeared to constitute subsidies under Article 1 (financial benefit) and Article 2 (specific) of the SCM Agreement. They were:

- **Subsidies Contingent Upon Export Performance**
 - Honourable Enterprises – preferential benefits
 - Export-Contingent Tax Reduction for FIEs in Special Zones
 - Income Tax Refund for Foreign Investors Investing in Export-Oriented Businesses
 - Special Steel for Processing Exports Policy
 - Export-Contingent Income Tax Reduction for FIEs or Tax Allowance for FIEs
 - Export Subsidies for High-Technology Products
 - Customs Duty and VAT Refund on Imported Capital Equipment Used for Production of Products for Exports
 - Government Assistance to Increase Fabric Exports
 - Tax Incentives for Dehydrated Garlic Exports
 - Guangdong Grants Provided for Export Performance
 - Low Interest Loans for Processors of Agricultural Products in Henan Province
- **Subsidies Contingent Upon the Use of Domestic Over Imported Goods**
 - VAT Rebate on Purchases of Domestic Equipment by FIEs
 - Enterprise Income Tax Reduction for Purchase of Domestically Made Machinery and Equipment

¹²⁴ *Questions from the United States to China Concerning Subsidies and Price Controls*, G/SCM/Q2/CHN/8 (6 October 2004).

¹²⁵ *Request from the United States to China Pursuant to Article 25.8 of the Agreement on Subsidies and Countervailing Measures*, G/SCM/Q2/CHN/9 (6 October 2004).

- **Other Programmes**

- Assistance Provided to Forest Products:
 - Financing for development of fast-growth-high-yield plantations
 - Financing for technology renovations of state-owned paper mills
 - Financing for wood processing projects
 - Local government development policies for the pulp, paper, and wood industries
- Assumption of Interest on Loans for Technology Upgrades
- Assistance for Capacity Expansion in the Soda Ash Industry
- Assistance Provided to the Textile Industry
- Chendu Assistance to the Semiconductor
- Reduction in VAT for Sino-Russian Border Trade
- Subsidies Listed in Annex 5A of China's Protocol of Accession

E. Intellectual Property Rights

1. Problems of Infringement and Enforcement

One of the most serious issues that face U.S. companies vis-à-vis China is the problem of intellectual property piracy and counterfeiting. As the Department of Commerce noted in its report *Manufacturing in America*, the importance of IPR enforcement to U.S. manufacturers cannot be overstated:

For U.S. manufacturers, protection of intellectual property is not an abstract concept. America's competitive edge ensues directly from innovation and rising productivity. Intellectual property protection is the best means for ensuring that American manufacturers enjoy the benefits of their investments in research and development and of their efforts to raise productivity. It is also the means best calculated to ensure that they can enjoy the investment they make in customer service and creating a brand name that distinguishes them from other manufacturers.¹²⁶

¹²⁶ U.S. Dept. of Commerce, *Manufacturing in America: A Comprehensive Strategy to Address the Challenges to U.S. Manufacturers* (January 2004) at 54.

The two principal problems with protecting intellectual property in China are continued rampant piracy and China's failure to enforce intellectual property rights. The rate of piracy and counterfeiting in China is enormous, estimated to be about 90 percent over the last 15 years for certain types of products. USTR's 2004 WTO compliance report notes that "current estimates of U.S. losses due to the piracy of copyrighted materials alone range between \$2.5 billion and \$3.8 billion annually."¹²⁷

As noted in testimony by the President of the International Intellectual Property Alliance (an IP trade association):

Copyright piracy dominates the local market almost completely. Piracy rates have consistently been over 90 percent in China for the last 15 years, and that is despite massive raiding and seizures ... throughout China and particularly in the Southern part, where piracy has been the worst.

* * *

[T]he bottom line is that with piracy rates over 90 percent, China is not in compliance with its TRIPS obligations under Articles 41 and 61 of the WTO agreement, TRIPS agreement. Put simply, the Chinese enforcement system has failed to significantly lower piracy levels in any significant way over the last few years.

* * *

We estimate losses to U.S. companies through copyright piracy in China to be at least \$1.8 billion annually, and if you add that up over the last 15 or 20 years, it's massive losses to the U.S. economy.¹²⁸

¹²⁷ USTR, 2004 Report to Congress on China's WTO Compliance December 11, 2004) at 63.

¹²⁸ Testimony of Eric Smith, President, International Intellectual Property Alliance, printed in *China and the WTO: Compliance and Monitoring*, Hearing Before the U.S.-China Economic and Security Review Commission, 108th Cong., 2d Sess., February 5, 2004, at 134.

Since acceding to the WTO, China has taken some steps to decrease piracy and better enforce intellectual property rights, but unacceptably high levels of piracy and counterfeiting have continued. While China has promulgated intellectual property laws (copyright; patent; trademark) that generally comply with its WTO obligations, there has been a chronic problem in enforcement. For example, the U.S. Commercial Service has noted:

While industries report improved cooperation with administrative enforcement agencies in regard to raids, the administrative penalties for IPR violations, often no more than confiscation of the counterfeit products or nominal fines, are generally insufficient to deter counterfeiters. Very few cases are referred to criminal prosecution because the threshold for initiating criminal cases for IPR infringements remain very high. China's criminal sanctions against IPR violations are seldom used, in part because of restrictions on types of admissible evidence and unclear mandates for law enforcement authorities with little experience in prosecuting IPR violations.¹²⁹

U.S. industry representatives generally acknowledge that China's legal framework of intellectual property laws are adequate but that enforcement is fundamentally deficient. For example:

China has no equal either as a source of counterfeit and pirated goods to the world or as a market in which fakes are produced and sold locally. Despite significant improvements in China's IP legal regime over the last few years, ... the enforcement system continues to be fraught with weaknesses and inefficiencies that facilitate massive counterfeiting and piracy.¹³⁰

¹²⁹ U.S. Commercial Service, *China Country Commercial Guide FY 2004 (July update): A Guide to Doing Business in China & Information on Current Economic Conditions*; http://www.usembassy-china.org.cn/fcs/doc/complete_and_final.html.

¹³⁰ International AntiCounterfeiting Coalition (IACC), Comments submitted to Trade Policy Staff Committee, September 15, 2004 at 3.

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The shortfall in China's intellectual property protection lies not in its legal framework but more in the area of intellectual property rights enforcement.¹³¹

2. U.S. Efforts to Address IPR Problems

USTR has stated that “addressing weak IPR protection and enforcement in China is one of the Administration's top priorities.”¹³² The U.S. made IPR one of its highest priorities for the April 2004 meeting of the U.S.-China Joint Commission on Commerce and Trade (JCCT). At the JCCT meeting, the U.S. secured a commitment from China's Vice Premier Wu Yi that China would undertake a series of actions to significantly reduce IPR infringements throughout the country.

As an outcome of the JCCT meeting, the U.S. and China agreed to set up a working group on IPR issues, and China agreed to step up its efforts at IPR enforcement, particularly by promising to reduce IPR infringement levels, increase criminal penalties, apply criminal sanctions, conduct nation-wide IPR enforcement actions, increase customs enforcement actions, and launch an education campaign in China.

In particular, China agreed to the following:

¹³¹ Information Technology Association of America (ITAA), Comments submitted to Trade Policy Staff Committee, September 15, 2004 at section II.

¹³² USTR, 2004 Special 301 Report, Section 306 – China (May 3, 2004); http://www.ustr.gov/Document_Library/Reports_Publications/2004/2004_Special_301/2004_Special_301_Report_Section_306.html

Intellectual Property

China presented an action plan designed to address the piracy and counterfeiting of American ideas and innovations. Under this plan, China has committed to:

- Significantly reduce IPR infringement levels.
- Increase penalties for IPR violations by taking the following actions by the end of 2004:
 - Subject a greater range of IPR violations to criminal investigation and criminal penalties.
 - Apply criminal sanctions to the import, export, storage and distribution of pirated and counterfeit products.
 - Apply criminal sanctions to on-line piracy.
- Crack down on violators by:
 - Conducting nation-wide enforcement actions against piracy and counterfeiting – stopping the production, sale and trade of infringing products, and punishing violators.
 - Increasing customs enforcement action against the import and export of infringing products and making it easier for rights-holders to secure effective enforcement at the border.
- Improve protection of electronic data by:
 - Ratifying and implementing the World Intellectual Property Organization (WIPO) Internet Treaties as soon as possible.
 - Extending an existing ban on the use of pirated software in central government and provincial agencies to include local governments.
- Launch a national campaign to educate its citizens about the importance of IPR protection (campaign started on April 6). The campaign will include press events, seminars and outreach through television and print media.
- Establish an intellectual property rights working group under the JCCT. Under this working group, U.S. and Chinese trade, judicial and law enforcement authorities will consult and cooperate on the full range of issues described in China's IPR action plan.¹³³

¹³³ *The U.S.-China JCCT: Outcomes*; <http://www.mac.doc.gov/china/JCCT%20outcomes%20-%20Commerce.pdf>.

In addition, at the JCCT meeting, China pledged that it “would undertake a series of near-term actions with the objective of significantly reducing IPR infringement levels.” In particular, China agreed to:

Promulgate a judicial interpretation before the end of the year from the Supreme People's Court and the Supreme People's Procuratorate that:

- appropriately lowers thresholds for applying criminal sanctions for acts of IPR infringement; and
- stipulates guidelines for applying criminal sanctions for the import, export, storage, and transport of counterfeit and pirated products and for online piracy.

The new judicial interpretation is an attempt to remedy China's failure to make effective use of its criminal enforcement regime to address IPR issues.¹³⁴

China did not issue the judicial interpretation until December 21, 2004 and did not provide the U.S. with any drafts of the document before issuance. Early press reports indicate that the new judicial interpretation “falls short of U.S. government demands in at least three areas.”¹³⁵

{T}he interpretation in many cases only slightly lowers the thresholds that IPR violators need to exceed before criminal penalties can be applied

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Secondly, the interpretation maintains China's previous system of subjecting corporations and individuals to different thresholds

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¹³⁴ USTR, 2004 Special 301 Report, Section 306 – China (May 3, 2004); http://www.ustr.gov/Document_Library/Reports_Publications/2004/2004_Special_301/2004_Special_301_Report_Section_306.html

¹³⁵ *China's IPR Enforcement Decision Falls Well Short of U.S. Demands*, Inside US-China Trade, January 5, 2005.

In addition, sources noted that while the interpretation talks about the possibility of fines, it does not spell out what these fines will be.

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In light of these shortfalls, industry sources said the interpretation means China will essentially maintain the same IPR enforcement regime that has led to increasing complaints from the U.S., and in some cases will only slightly modify the thresholds triggering criminal sanctions.¹³⁶

Regarding follow-up to the JCCT meeting, USTR reports that the U.S. and China have had several bilateral meetings where the U.S. “has pressed China to move forward aggressively in pursuit of significantly reduced IPR infringement levels.”¹³⁷ In addition, “Vice Premier Wu pledged that China would move forward with the legislative and judicial measures needed to improve China’s IPR protection regime.”¹³⁸ Despite these optimistic statements, however, in September 2004, in comments submitted to the U.S. Trade Representative concerning China’s WTO compliance, numerous U.S. industry groups said that “China has so far done little to improve intellectual property rights protections,” despite the JCCT promises to do so.¹³⁹

As a follow-up to the JCCT’s IPR agreements, in September 2004, the U.S. Trade Representative announced that, in early 2005, it would be conducting an out-of-cycle Special 301 review of China to evaluate China’s implementation of the commitments announced at the

¹³⁶ *China’s IPR Enforcement Decision Falls Well Short of U.S. Demands*, Inside US-China Trade, January 5, 2005.

¹³⁷ USTR, *2004 Report to Congress on China’s WTO Compliance*, December 11, 2004, at 60.

¹³⁸ USTR, *2004 Report to Congress on China’s WTO Compliance*, December 11, 2004, at 60.

¹³⁹ *Industry Groups Say Little Has Changed in China on IPR Since JCCT*, Inside US-China Trade, September 22, 2004, at 3.

JCCT meeting on April 7, 2004 and whether China's actions are achieving results.¹⁴⁰ USTR indicated that it would publish a Federal Register notice in the coming months regarding the review and that it would be seeking from U.S. industry information about the prevalence of IPR infringement in China and examples of specific cases of IPR infringement.¹⁴¹

In addition, on October 4, 2004, the U.S. Trade Representative announced, in conjunction with the Departments of Commerce, Justice and Homeland Security, a new coordinated government-wide initiative, the Strategy Targeting Organized Piracy (STOP), to block the importation of counterfeit and pirated goods.¹⁴² The STOP initiative is targeted at worldwide counterfeiting, but China is clearly one of the major targets of the program.

3. Potential Ways to Reduce Infringement and Improve Enforcement of IPR

The problem of rampant IPR infringement in China coupled with poor and inadequate IPR enforcement is clearly a primary target that needs improvement. USTR and private sector groups have recommended a number of actions that China could take to reduce infringement and improve enforcement. Representative among these are the following:

- China should “revise its IPR legal framework to provide for substantially higher administrative fines, and the administrative authorities then need to impose and publicize

¹⁴⁰ See *Letter to Industry from Amb. Josette S. Shiner Regarding 2005 Out-of-Cycle Review on China*; http://www.ustr.gov/Trade_Sectors/Intellectual_Property/2005_China_Out_of_Cycle_Review/Letter_to_Industry_from_Amb._Josette_S._Shiner_Regarding_2005_Out-of-Cycle_Review_on_China.html.

¹⁴¹ See *Letter to Industry from Amb. Josette S. Shiner Regarding 2005 Out-of-Cycle Review on China*; http://www.ustr.gov/Trade_Sectors/Intellectual_Property/2005_China_Out_of_Cycle_Review/Letter_to_Industry_from_Amb._Josette_S._Shiner_Regarding_2005_Out-of-Cycle_Review_on_China.html.

¹⁴² See USTR Press Release, *U.S. Announces Major New Initiative to Fight Global Trade in Fakes*, October 4, 2004; http://www.ustr.gov/Document_Library/Press_Releases/2004/October/U.S._Announces_Major_New_Initiative_to_Fight_Global_Trade_in_Fakes.html.

them so they will have a deterrent effect, including facilitating referrals for criminal prosecution.” (USTR at 65)¹⁴³

- China should “revise its laws, regulations and other measures, including judicial interpretations, and investigate, prosecute, convict and sentence a much higher percentage of IPR infringers, particularly those engaged in commercial-scale counterfeiting or piracy and repeat offenders. China also needs to increase the criminal penalties available.” (USTR at 66)
- China should eliminate or substantially lower criminal liability thresholds for IPR violations. (USTR at 66; U.S. Chamber at 8)¹⁴⁴
- China should seize and destroy infringing products and, where appropriate, the equipment used in producing or packaging counterfeit goods. (U.S. Chamber at 9)
- China should clarify the standards for obtaining preliminary injunctions in civil disputes involving IPR. (U.S. Chamber at 9)
- China should circulate for comment draft judicial interpretations on IPR violation criminal thresholds. (U.S. Chamber at 9)
- China should increase resources for police investigations into counterfeiting and piracy. (U.S. Chamber at 9)
- China should accede to the 1996 WIPO Internet-related treaties. (USTR at 62; U.S. Chamber at 9)
- The U.S. should continue to work with China’s central and local government officials to improve China’s IPR enforcement, through regular bilateral discussions and technical assistance programs for central and local government officials on TRIPS Agreement rules, IPR enforcement and rule of law issues. (USTR at 64)
- The U.S. should intensify efforts to block counterfeit and pirated goods at the U.S. border. (USTR at 64)

¹⁴³ “USTR” refers to the USTR’s 2004 Report to Congress on China’s WTO Compliance (December 11, 2004).

¹⁴⁴ “U.S. Chamber” refers to the U.S. Chamber of Commerce’s report *China’s WTO Implementation: A Three-Year Assessment* (September 2004).

**F. Areas of China’s WTO Non-Compliance That Should Be Considered
For Possible WTO Challenges**

Three years have passed since China acceded to the WTO. In that time, “while China’s efforts to fulfill its WTO commitments are impressive, they are far from complete and have not always been satisfactory, and China at times has demonstrated difficulty in adhering to WTO rules.”¹⁴⁵ As a new member of the WTO, other Members, understandably, have allowed China a grace period to adjust and conform its trade policies and practices to WTO rules before asserting dispute settlement challenges. So far, only one WTO dispute settlement case has been filed with respect to China. That case, filed by the U.S. in March 2004 concerning China’s discriminatory VAT policies that favored domestic over imported semiconductors, was settled at the consultation stage.

After three years, however, the U.S. should give serious consideration to filing dispute settlement cases at the WTO on a number of outstanding issues where China is not in compliance with its commitments. Used prudently, WTO dispute settlement cases are a means to induce and encourage China to come into full compliance with its commitments to the U.S. and other WTO Members. As USTR has stated:

The Administration is ... committed to working with China to resolve problems in our trade relationship before they become broader bilateral irritants. When this process is not successful, however, the Administration will not hesitate to employ the full range of dispute settlement and other tools available through China’s WTO accession agreement.¹⁴⁶

¹⁴⁵ USTR, *2004 Report to Congress on China’s WTO Compliance*, December 11, 2004, at 3.

¹⁴⁶ USTR, *2004 Report to Congress on China’s WTO Compliance*, December 11, 2004, at 8 (emphasis added).

The following areas of China’s non-compliance should be considered as potential topics for WTO dispute settlement cases. They are presented in the order in which they appear in USTR 2004 compliance report.

Category	Issue	Problem
Trading Rights and Distribution Service	Sales Away from a Fixed Location	<ul style="list-style-type: none"> • China committed to end market access and national treatment restrictions for sales away from a fixed location (direct selling) by December 11, 2004. During 2004, MOFCOM drafted three regulations to implement the direct selling commitment, but China did not make these draft regulations available for public comment. • Problems: <ul style="list-style-type: none"> ▪ National treatment: the draft regulation permits direct selling of domestically-produced goods, but restricts selling of imported goods to a fixed location. ▪ Other provisions have requirements that appear to make direct selling commercially unviable. <p><i>See USTR 2004 Report at 20-21</i></p>
Import Regulation	Customs Valuation	<ul style="list-style-type: none"> • Upon accession, China assumed the obligations of the WTO Agreement on Customs Valuation and agreed to implement these without a transition period. In January 2002, China issued customs valuation regulations. In addition, by December 11, 2003, China had committed to value digital products (<i>e.g.</i>, floppy disk, cd-rom) based on the value of the underlying carrier medium, rather than the imputed value of the content. • Problems: <ul style="list-style-type: none"> ▪ China has not uniformly implemented its regulations with the result that U.S. exporters are still encountering valuation problems at Chinese ports. These problems include: (1) valuation based on reference pricing instead of transaction value; (2) addition of royalties and license fees to the dutiable value of imported software; (3) non-uniform valuation by ports of particular digital products; and (4) valuation of high-value electronic media to be used to produce multiple copies of products (<i>e.g.</i>, DVDs) based on the estimated value of the future copies instead of the value of the carrier medium itself. <p><i>See USTR 2004 Report at 22-24</i></p>
Export Regulation	Export Quotas on Fluorspar	<ul style="list-style-type: none"> • China agreed to maintain export restrictions in accordance with WTO rules, which generally prohibit (with exceptions) export restrictions (other than duties, taxes or other charges) (GATT Article XI). • Problem: <ul style="list-style-type: none"> ▪ China has continued to impose export restrictions on fluorspar. China imposes quotas and license fees on fluorspar exports, but does not restrict domestic users of

Category	Issue	Problem
		<p>fluorspar. See USTR 2004 Report at 34</p>
Internal Policies Affecting Trade	Nondiscrimination	<ul style="list-style-type: none"> • Problems: <ul style="list-style-type: none"> ▪ U.S. pharmaceutical manufacturers have experienced national treatment problems regarding price controls on medicines and drug reimbursement. ▪ From accession, China has continued to discriminate in applying SPS measures. ▪ With respect to fertilizer, China exempts all phosphate fertilizers except DAP (a fertilizer the U.S. exports to China) from a 13% VAT. So far, China has not changed this policy. <p>See USTR 2004 Report at 35-37</p>
Internal Policies Affecting Trade	Consumption Taxes	<ul style="list-style-type: none"> • Problem: <ul style="list-style-type: none"> ▪ The effective consumption tax rate on imported products (e.g., spirits/alcoholic beverages, tobacco, cosmetics and skin/hair care preparations, jewelry, fireworks, rubber, motorcycles and automobiles) is substantially higher than the rate applied to domestic products because China uses different tax bases to compute consumption taxes for domestic and imported products. <p>See USTR 2004 Report at 38</p>
Internal Policies Affecting Trade	Standards Testing	<ul style="list-style-type: none"> • Problem: <ul style="list-style-type: none"> ▪ Despite China’s changes to its standards testing regime, in some sectors, foreign products are tested in specially designated laboratories that are separate from those laboratories used to test domestic products. This disparate testing can lead to uneven treatment. <p>See USTR 2004 Report at 41</p>
Internal Policies Affecting Trade	Conformity Assessment Procedures	<ul style="list-style-type: none"> • China has established one safety mark (“China Compulsory Certification” or “CCC” mark), issued to both Chinese and foreign products. • Problem: <ul style="list-style-type: none"> ▪ Despite national treatment commitments, to date, China has accredited 68 Chinese enterprises to test for and certify the CCC mark, but has not accredited any foreign-invested conformity assessment bodies. <p>See USTR 2004 Report at 44-45</p>
Investment	Auto Industrial Policy	<ul style="list-style-type: none"> • Although China had committed, by accession, to revise its Industrial Policy for the Automotive Sector to make it WTO-consistent, China missed the deadline. China circulated a draft revised automobile industrial policy in 2003 and issued the final version in May 2004. • Problem: <ul style="list-style-type: none"> ▪ The new auto industrial policy contains discriminatory provisions that discourage the importation of auto parts and encourage the use of domestic technology. <p>See USTR 2004 Report at 48-49</p>
Agriculture	Sanitary and Phytosanitary	<ul style="list-style-type: none"> • Through the SPS Agreement, China committed that SPS measures would address legitimate scientific-based concerns, not discriminate

Category	Issue	Problem
		<p>arbitrarily, and not be disguised restrictions on trade.</p> <ul style="list-style-type: none"> • Problems: <ul style="list-style-type: none"> ▪ Regarding raw poultry and meat, China applies certain non-science-based standards (e.g., zero tolerance for pathogens) to imports that are not applied to domestic raw poultry and meat. This violates national treatment and has slowed imports from the U.S. ▪ Regarding food additives, China imposes overly restrictive standards that block imports of many U.S. processed food products. The banned food additives are widely used in other countries and are approved by the World Health Organization (WHO). <p><i>See USTR 2004 Report at 56</i></p>
Services	Financial Services – Insurance	<ul style="list-style-type: none"> • Problem: <ul style="list-style-type: none"> ▪ China has been issuing concurrent branch approvals (more than one at a time) for Chinese insurers, but only approving branches of foreign firms consecutively (one at a time). <p><i>See USTR 2004 Report at 72</i></p>
Services	Express Delivery Services	<ul style="list-style-type: none"> • Problems: <ul style="list-style-type: none"> ▪ In July-November 2003, China circulated draft amendments to the postal services law, which (1) gave China Post a monopoly on letters under 500 grams (a horizontal commitment violation as it restricted existing scope of activities), and (2) failed to establish an independent regulator. At the April 2004 JCCT, China indicated that the weight restriction would not resurface as a problem. However, the July 2004 draft amendment still contained a weight restriction (reduced to 350 grams). <p><i>See USTR 2004 Report at 76-78</i></p>

Please note that we have not listed intellectual property rights as an area that the U.S. should consider as ripe for a near-term WTO complaint. This is because we think that the working group on IPR established between the U.S. and China as a result of the JCCT meeting and the internal program initiated by China to reduce IPR infringement and improve IPR enforcement should both be given sufficient time to put their programs into full effect toward achieving their targets. The area of IPR enforcement is also an area where the U.S. should work closely with other WTO Members (e.g., EC, Japan, and others) to provide China with stepped up training and technical assistance and to coordinate increased pressure on China to make the legal

modifications necessary to improve IPR enforcement. Of course, if this course ultimately fails to achieve real progress, the U.S. should then consider WTO dispute settlement.

G. Cooperation and Competition Between the U.S. and Other Members Regarding China Issues

1. Areas Where the U.S. Can Work Jointly With Other WTO Members to Encourage China's Compliance With its WTO Obligations

There are a host of areas concerning China's WTO compliance where the interests of the U.S. coincide with the interests of other WTO Members. In its efforts to monitor and encourage China's compliance with WTO commitments, the U.S. often finds itself allied with the European Communities and Japan, among others. To an extent, on a case-by-case basis, the U.S. and other Members have consulted in order to coordinate their strategies toward China. This has occurred, for example, in the context of the Transitional Review Mechanism process where the U.S., the EC and Japan have been the most active participants. As illustrated by the following table, the USTR's 2004 WTO compliance report identifies a multitude of areas where the U.S. was joined by other Members in pushing for greater compliance by China in the context of the TRM process.

Areas	Other Members Supporting U.S.	USTR 2004 Report
Wholesaling and Commission Agents' Services	EC; Japan	18
Retailing Services	EC; Japan	20
Import Licensing	EC; Japan	25
Antidumping – transparency and fair procedures	EC; Japan	29
Export quota on coke	EC; Japan	34
Export quota on fluorspar	Japan	34
VAT on semiconductors	EC; Japan; Mexico	37
Subsidies Notification	EC	39
Conformity Assessment Procedures	EC; Japan	45
Investment – technology transfer, export	EC; Japan	48

Areas	Other Members Supporting U.S.	USTR 2004 Report
performance, and local content requirements		
Auto Industrial Policy	EC; Japan	48
IPR Enforcement	Japan	64
Banking Services	Australia; Canada; EC; Japan	70
Insurance Services	Canada; EC; Japan; Switzerland	71
Motor Vehicle Financing Services	Australia; Canada; EC; Japan	73
Legal Services	EC	74
Telecom Services	EC; Japan	76
Express Delivery Services	EC; Japan	76

2. Areas Where the U.S. is Likely to Face Competition With Other WTO Members With Respect to Favorable Trade Terms With China

Notwithstanding the cooperation that the U.S. enjoys with some other WTO Members in dealing with issues related to China’s compliance with WTO obligations and commitments, it is also that case that the U.S. faces competition with other WTO Members (and prospective members) as they attempt to achieve favorable trade deals with China. A review of recent press articles illustrates some of the areas where the U.S. is likely to face competition – energy, agriculture, raw materials, oil, aviation, etc. – and some of the WTO Members with whom the U.S. will compete – Canada, Australia, Brazil, Venezuela, and the EU. For example, see the following excerpts:

There’s no escaping the buzz around China in the business world. And understandably so: The country has 1.3 billion potential consumers, is home to a vast army of cheap labour, and is also in dire need of natural resources—the likes of which Canada has in abundance—to fuel its economic growth and consumer demand. Many critics and economists have sounded the alarm that the opportunities in China have inevitable and serious downsides. But speaking at the Canada-China business council meeting in Toronto, the Prime Minister said he believes that “all we should see [in China] is opportunity,” he said, encouraging Canadian

businesses large and small to continue “developing and implementing strategies for China.”

Martin will undoubtedly be pressing for more deals with China for Canada’s natural resources, such as oil and gas, and other raw materials such as minerals. As Chinese demand for natural resources has been expanding in recent years, the country has become Canada’s second-largest trading partner, next only to the United States. China has been involved in talks to purchase Canada’s largest mining company Noranda, and state-owned companies have also reportedly been eyeing Alberta’s Husky Energy.

Canada's PM to Balance Human Rights, Trade on China Trip, The Epoch Times, Jan 13, 2005; <http://english.epochtimes.com/news/5-1-13/25668.html>.

Brazil has agreed to recognize China as a market economy, and China has agreed to support Brazil in its bid to join a new revised Security Council in the United Nations. These were just part of the deals signed by Chinese president Hu Jintao on his visit to Brasilia.

Hu's visit to Brazil was in reciprocation for Brazilian president Lula da Silva visit to China in May. While the Chinese side was mainly focused on getting China recognized as a market economy, the Brazilians were most interested in getting investment commitments to upgrade Brazil's transport infrastructure.

China is keenly interested in Brazil as a source for foodstuffs and raw materials. Since only 15% of the land in China is arable, and the country is undergoing rapid urbanization, the need is particularly urgent. Brazil, along with the US, is already a major supplier of soybeans to China. Baosteel, China's largest steelmaker, already has an iron-ore facility in Brazil.

On this trip, Brazil was able to secure a deal for China to purchase about US\$650 million of Brazilian beef annually. China has also said that it is interested in investing US\$5-7 billion annually to upgrade inland road and port infrastructure. These upgrades are needed if Brazil is able to sell the amount of foodstuffs and minerals it hopes to sell to China.

Brazil, China Do Mega-Deals, China Business Strategy, November 15, 2004; <http://www.china-ready.com/news/Nov2004/BrazilChinaDoMegaDeals111504.htm>.

AWB Ltd., Australia's monopoly wheat exporter, won a contract worth about US\$267 million to supply China National Cereals, Oils and Foodstuffs Corp., its biggest order from China in at least eight years.

The 1.5 million-ton contract of milling-grade wheat announced Monday adds to an order 11 months ago from China's central grain-buying agency for one million tons, Melbourne-based AWB said in a statement to the Australian Stock Exchange.

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China's government said Monday wheat imports jumped more than 18-fold in the first 10 months of this year to six million metric tons compared with a year earlier. China chose Australian wheat over supplies from North America and Europe because of Australia's "quality and freight advantage," McBride said.

China, Australia sign big new wheat deal, People's Daily Online, November 23, 2004; http://english.people.com.cn/200411/23/eng20041123_164862.html.

China and Australia stepped forward to forge a lucrative liquefied natural gas (LNG) deal involving millions of tons of the substance with the opening of representative office in Beijing on Monday.

The establishment of the China Representative LNG Office under Australia's massive Gorgon gas project is an important step toward one of the biggest LNG agreements in the industry's history, as foreshadowed in the October 2003 agreement between Gorgon Venture and CNOOC (China National Offshore Oil Corporation).

LNG Deal to Boost Trade Links Between China, Australia, China Daily, April 28, 2004; <http://www.china.org.cn/english/BAT/94225.htm>.

Venezuelan president Hugo Chavez has offered China wide-ranging access to the country's oil reserves.

The offer, made as part of a trade deal between the two countries, will allow China to operate oil fields in Venezuela and invest in new refineries.

Venezuela has also offered to supply 120,000 barrels of fuel oil a month to China.

Venezuela - the world's fifth largest oil exporter - sells about 60% of its output to the United States.

Mr Chavez's administration, which has a strained relationship with the US, is trying to diversify sales to reduce its dependence on its largest export market.

***Venezuela and China sign oil deal, BBC News, December 24, 2004;
<http://news.bbc.co.uk/1/hi/business/4123465.stm>.***

Brazil was closer to achieving its goal of feeding millions of Chinese with soya that may be grown on cleared Amazonian rainforest yesterday, after five days of talks on trade and diplomacy between the two nations.

Luiz Inacio Lula da Silva, the president of Brazil, led a delegation of eight cabinet ministers, six state governors and 450 business leaders to China in a push to foster closer ties in Asia's fastest growing economy.

The range and dimension of the commercial deals demonstrated a degree of economic synergy rarely seen between two developing countries.

Brazil's vast land and mineral resources, and a perennially weak currency, mean that it is emerging as a key supplier of the raw materials China needs to feed its growing urban population and to keep its factories exporting goods.

The enormous expansion in soya cultivation for export is the most visible sign so far of Brazil's success in locking into Chinese markets.

China's plan to move 300 million rural people into the cities by 2020 poses food supply problems, and Brazil intends to fill the gap.

Lula seals deal to feed China's booming cities, Guardian Unlimited, May 28, 2004; <http://www.guardian.co.uk/brazil/story/0,12462,1226498,00.html>.

Canada and China are negotiating a broad agreement on energy co-operation in oil, gas and nuclear power that could be signed as early as next week when Prime Minister Paul Martin tours the Asian economic superpower.

Among other things, the deal seeks to encourage "mutually beneficial commercial partnerships" in sectors such as the oil sands, sources say.

The Canada-China Framework on Energy Co-operation would forge closer ties between Ottawa and Beijing on natural resources at a time when both countries are eager for something the other has to offer.

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China is growing rapidly and is on the hunt for new natural resources, while Canada, eager to stem a long-term decline in its share of global direct investment, is anxious to attract foreign cash to develop its petroleum and mineral assets. (Ottawa also wants to sell nuclear reactors to electricity-hungry China.)

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Sources say the deal could also encourage collaboration on uranium, which Canada sells and China needs to power its growing number of nuclear reactors. It may also cover research on oil sands technology, which Canadian firms use to extract petroleum from tarry deposits in northern Alberta.

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The Martin government's focus on China is part of its campaign to expand trade beyond the United States amid concerns that a string of recent free-trade deals signed by Washington is diluting Canada's special access to the U.S. market. China is Canada's second-largest trading partner with two-way merchandise trade of \$23.3-billion in 2003, up 16 per cent from 2002.

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Separately, Canada and China are negotiating a foreign investor promotion and protection agreement, a deal that would take trade relations to a new level because it would safeguard the rights of investors in each of the countries, giving them the same legal standing as domestic businesses.

***Canada-China energy deal in works, The Globe and Mail, January 15, 2005;
<http://aolcanada.workopolis.com/servlet/Content/qprinter/20050115/RTRADE15>.***

A move by the European Union to lift an arms embargo on China looks certain to pave the way for a new order for Airbus's A380 superjumbo.

The embargo was imposed in the wake of the Tiananmen Square massacre and Chinese officials were reported last year to be refusing to sign a deal for five of the 555-seater, double decker jets because of the EU's reluctance to lift the ban.

Airbus sees China as a crucially important market if it is to maintain its sales lead over American rival Boeing.

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Foreign Secretary Jack Straw's revelation yesterday that the arms embargo will probably be lifted within the next six months is certain to clear the way for the European aircraft maker to try again to clinch the Chinese superjumbo deal.

EU move on China could mean major Airbus order, Liverpool Daily Post, January 13, 2005; http://icliverpool.icnetwork.co.uk/business/news/tm_objectid=15071000&method=full&siteid=50061&headline=eu-move-on-china-could-mean-major-airbus-order-name_page.html

III. Transitional Review Mechanism

A. Review of the Third Transitional Review Mechanism (TRM)

Three years into China's membership, the 16 WTO subsidiary bodies and the General Council conducted the third annual transitional review of China's implementation of its WTO commitments as required under Article 18 of China's Protocol on Accession. The third TRM which began at the Committee on Market Access on September 23, 2004, and concluded at the General Council on December 13, 2004, followed the established normal procedures of the previous two TRM reviews. In advance of the review, Members submitted written questions and

China submitted the information as required under Annex 1A of Article 18 to relevant committees. During each committee review, which was carried out at a regular committee meeting, China addressed concerns of other Members with a general introduction from one representative and then a second representative made oral responses to individual questions. The committee reports generated thereby basically comprise the minutes of the meeting without recommendations on China's compliance efforts.

1. Member Participation

In the second TRM, there was a pronounced decline in the submission of questions to China from Members compared to the first TRM (44 submissions from 7 members versus 74 submissions from 13 members). At the third review, Member participation registered a similar record as the second review. Six Members submitted a total of 44 documents posing questions to China with respect to its WTO compliance efforts during the third year of its WTO membership, as shown in the table below.

Summary Table of Submissions of Questions to China by WTO Members in the Third TRM

Committees / Councils	Concerned Members						Committee Subtotal	
	AUS	CAN	EEC	JPN	TPKM	USA		
Agriculture					1	1		2
Antidumping Practices			1	1	1	1		4
Balance of Payments Restrictions								0
Customs Valuation								0
Financial Services	1	1	1	1	1	1		6
Import licensing			1	1		1		3
Market Access			1	1		1		3
Rules of Origins								0
Safeguards				1	1			2
Sanitary and Phytosanitary Measures			1		1	1		3
Subsidies and Countervailing Measures			1	1	1	1		4
Technical Barriers to Trade			1	1		1		3
Trade-Related Investment Measures			1		1	2		4
Council for Trade in Goods			1	1		1		3
Council for Trade in Services			1	1	1	1		4
Council for TRIPS			1	1		1		3
Subtotal by Country	1	1	11	10	8	13	Total	44

Notes:

AUS = Australia; CAN = Canada; EEC = The European Communities; JPN = Japan;
TPKM = The Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu;
USA = The United States of America

The TRM was originally designed as a tool to help the Chinese focus on areas of concerns to WTO members. China initially had a very negative reaction to the TRM process since it was not required of other acceding countries. China's actions appear to have lowered expectations of other WTO members in the TRM process. At the same time, China has in fact provided more information and has brought more officials from Beijing to address questions during Committee meetings at which TRM issues are addressed. For many countries, the main focus of the process is working through problems their exporters are having with China's

policies and actions. Countries have found reasonably responsive Chinese ministries in many instances, leading some WTO members to limit their involvement in the TRM process and simply pursue resolution bilaterally. For example, at the Committee on Sanitary and Phytosanitary Measures, Australia did not submit written questions to China in the context of the TRM nor raise concerns orally at the committee review, but rather resorted to the bilateral avenue as indicated in the following statement made by its representative during the review at the Committee on SPS Measures.

Australia was continuing to pursue a number of bilateral SPS issues with China, some of a long-standing nature. The Australian delegation held a constructive meeting with the Chinese delegation during the course of the week, and had clarified a number of market access issues with the Chinese delegation at that time.¹⁴⁷

Nonetheless, a number of WTO members remain involved in the TRM process. Not surprisingly, the major trading members (US, EC, Japan) are the most active with other major trading nations (Canada, Australia, Taiwan) also raising at least some issues within the multilateral context. It should also be noted that no written questions or comments were received at the Committee on Balance-of-Payment Restrictions, Committee on Rules of Origin and Committee on Customs Valuation in the context of TRM. The first two committees also reported no discussion on China's compliance efforts. This is the first time in the TRM process that no submission was received and no discussion was held by a subsidiary body.

¹⁴⁷ *Report to the Council for Trade in Goods on China's Transitional Review*, Committee on Sanitary and Phytosanitary Measures, G/SPS/34 (2 November 2004) at para. 8.

2. Interaction Between China and Other Members on Procedural Issues

At the third TRM, whether China should provide responses in written form was not a contentious issue. Given the limited likelihood of procedural changes, few Members expressed the hope or made the request for written responses. In many committees, China's efforts in providing oral responses and explanations were largely appreciated. Nevertheless, some responses were considered insufficient which gave rise to occasional friction over the procedural issues between China and concerned Members such as the U.S.

At the Committee on Subsidies and Countervailing Measures, China was confronted with a host of questions and concerns from Members. After the initial response, China did not provide further responses to follow-up questions from Members. The representative of China stated that the follow-up concerns would be transmitted to the relevant departments in Beijing, and recognizing the limited time allocated for the TRM, China was willing to discuss SCM issues either before or after this review.¹⁴⁸ The U.S. found it a disturbing development that China did not provide responses to the substantive questions forwarded by the Members. The U.S. representative expressed the willingness to work with China bilaterally over time, but asked China to realize that the issues raised were not going to go away.¹⁴⁹ The EC also expressed disappointment that the review process was cut short and commented that the Committee was

¹⁴⁸ *Chairman's Report to the Council for Trade in Goods on Transitional Review of China*, Committee on Subsidies and Countervailing Measures, G/SCM/115 (22 November 2004), at para. 58.

¹⁴⁹ *Id.* at para 60.

left hanging with respect to a large number of the questions asked without any knowledge when the answers would be provided.¹⁵⁰

At the Committee on Import Licensing, a question arose as to whether Members can raise the same questions at different committees. China commented about the avoidance of unnecessary repetitive work under the TRM and different committees, noting that a number of questions that were received under the Import Licensing Committee had already been raised under the Market Access Committee and had been replied to clearly by China. China argued that the relevance between the implementation issues and the mandate of each committee was clearly defined, and Members could not raise the same questions repetitively in different Committees.¹⁵¹ Members such as the EC stated that they did raise questions in another context but they still had issues pending.¹⁵² In response, China insisted that it had already provided answers to some questions in detail in other contexts and suggested the EC consult the information and responses already provided under other contexts.¹⁵³

On a related development, at the Council for Trade in Goods (CTG), China went further to raise a procedural question on whether the CTG has the mandate to review those issues which should be covered by its subsidiary bodies. This move was in response to the statement from the U.S. and the EC that at the review by CTG they wanted to seek clarifications about matters that

¹⁵⁰ *Id.* at para. 61.

¹⁵¹ *Report to the Council for Trade in Goods on China's Transitional Review*, Committee on Import Licensing, G/LIC/13 (22 November 2004), at para. 3.9.

¹⁵² *Id.* at para. 3.14.

¹⁵³ *Id.* at para. 3.21.

had not been fully answered in some of the CTG subsidiary bodies.¹⁵⁴ Specifically, the U.S. noted in its submission of questions that “many of these questions relate to matters that were not fully addressed by China during the transitional review held before the committees that report to the Council for Trade in Goods.”¹⁵⁵ The EC pointed out in its submission that “the assessment of this year’s TRM exercise in the subsidiary bodies under the CTG is rather disappointing” and “China provided replies of a very general nature that lacked specificity...”¹⁵⁶ China challenged the U.S. for a definition of “fully addressing matters” and the EC for the legal basis for their comment on China’s replies. In response, the U.S. interpreted the term “fully addressed” as a polite way of saying that the questions listed in the U.S. submission had not been answered. As regards to the mandate of the CTG, the U.S. stated that the jurisdiction of the CTG was the jurisdiction of the subsidiary bodies and it was entirely proper for Members to address the matters that had been raised in those subsidiaries.¹⁵⁷ The EC and Japan also voiced the same understanding as the U.S. on the mandate of the CTG. No agreement was achieved between China and other Members over this issue, and finally the Chairman made the suggestion of consulting with the Secretariat’s Legal Affairs Division after the review.¹⁵⁸

¹⁵⁴ *Report of the Council for Trade in Goods on China’s Transitional Review*, Council for Trade in Goods, G/L/722 (10 December 2004), at para. 3.2.

¹⁵⁵ *Transitional Review Mechanism Pursuant to Paragraph 18 of the Protocol on the Accession of the People’s Republic of China: Question from the United States to China*, Council for Trade in Goods, G/C/W/499 (11 November 2004) at 1.

¹⁵⁶ *Transitional Review Mechanism Pursuant to Paragraph 18 of the Protocol on the Accession of the People’s Republic of China: Communication from the European Communities*, Council for Trade in Goods, G/C/W/502 (23 November 2004) at 1.

¹⁵⁷ *Report of the Council for Trade in Goods on China’s Transitional Review*, Council for Trade in Goods, G/L/722 (10 December 2004), at para. 3.10.

¹⁵⁸ *Id.* at para. 3.17.

3. U.S. Concerns and China's Responses

Many concerns highlighted at the third TRM are of a long-term nature, such as IPR enforcement, capitalization requirements in service sectors, TRQ allocations, subsidy notification, etc. The following represents a summary of selected issues raised by the U.S. and China's corresponding responses. Areas of concern reviewed include: agricultural TRQs, auto policy, subsidies, export restrictions on coke, services, and intellectual property rights (IPR). Many of these concerns were also shared by other Members.

a. Agricultural TRQs

At the Committee on Agriculture, the U.S. noted the following issues respecting China's administration of its agricultural tariff rate quotas (TRQs), pressing China to continue to improve its TRQ regime.

- At the November 2003 meeting of the Committee on Agriculture and again during bilateral discussions with the U.S. in April 2004, China agreed to provide certain information on quota holders and amounts allocated or reallocated upon written request if quota holders have expressed their consent to the Chinese government for release of the information. After submitting a written request to China regarding all TRQ commodities, the U.S. received an initial list of quota holders for wheat and cotton, but no information on the amounts allocated or reallocated, nor any information with regard to other TRQ commodities.¹⁵⁹
- Can China verify that cotton imported into bonded warehouses, bonded areas and export processing zones does not count towards China's total cotton TRQ allocation? Due to the limited transparency in China's operation of its TRQ system, the U.S. has had difficulty in verifying that.¹⁶⁰

¹⁵⁹ *China's Transitional Review Mechanism: Questions to China from the United States, Committee on Agriculture, G/AG/W/64 (31 August 2004), at para. 2.*

¹⁶⁰ *Id.* at para. 4.

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- The U.S. is still concerned that China's revised TRQ regulations provide for the application of out-of-quota tariff rates if a TRQ product imported under a processing trade channel is sold in China rather than processed and re-exported. Can China confirm that although it never requires that quota holders bring product in as processing trade as a condition of any TRQ import certificates, quota holders have the option of choosing the processing trade channel as opposed to the general trade channel and China counts the product as in-quota imports in either case?¹⁶¹

In response, China provided explanations as follows:

- *On information on quota holders:* China is not yet in a position to provide a list of enterprises because the information is considered to be confidential business information. The enterprises concerned expressed the view that release of this information would affect their competitiveness in the market.¹⁶²
- *On cotton:* Cotton imported into bonded warehouses and bonded areas does not count towards its global cotton tariff quota allocation, as provided for in the annual Announcement for Allocation of TRQs for agricultural products.¹⁶³
- *On the matter of processing trade:* Under general trade, there is no preferential treatment of bonded imports, although imports within quota could be sold in the domestic market at the in-quota tariff rate. Processing trade is subject to preferential treatment of bonded imports with the prohibition of sale in the domestic market, in which case they are subject to out-of-quota tariffs and other penalties. To do otherwise would be unfair for the imports conducted under general trade.¹⁶⁴

b. Auto Policy

At the Committee on Market Access and the Committee on TRIMS, the U.S. posed questions to China regarding the new Development Policy of the Automobile Industry published on June 1, 2004.

¹⁶¹ *Id.* at para. 5.

¹⁶² *Report to the Council for Trade in Goods on China's Transitional Review*, Committee on Agriculture, G/AG/19 (3 November 2004), at para. 46.

¹⁶³ *Id.* at para. 48.

¹⁶⁴ *Id.* at para. 49.

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- What restrictions apply to the distribution of autos in China and whether an enterprise may distribute, through the same network, (1) autos produced by different joint ventures, (2) imported and domestically produced autos and (3) different brands?¹⁶⁵
 - How does China define completely knocked-down kits for motor vehicles and semi-knocked down kits for motor vehicles and what are the tariff rates that are applicable to them?¹⁶⁶
 - In Article 47 of the new policy, a new auto production plant requires a minimum investment of RMB 2 billion, of which owned capital should not be less than RMB 800 million. The new plant should also include an R&D facility, investment in which should not be less than RMB 500 million. Article 47 also requires the establishment of an R&D facility in connection with new auto engine manufacturing. Does this Article apply to foreign-invested enterprises? If so, how does it comply with China's commitments of not conditioning the right of investment on the conduct of research and development in China?¹⁶⁷
 - In Annex II of the new policy, technology transfer agreements of the foreign party are among the documents required to be filed to seek approvals for new production plants. How can China justify this requirement in light of its commitments of not conditioning the right of investment on the transfer of technology?¹⁶⁸

China provided the following responses at the Committee on TRIMS {part of China's responses are not available as regards to the first two questions as the minutes of the review at the Committee on Market Access have not been issued}:

- *On the requirement of R&D facility:* The reason for the requirement is to equip the enterprises with basic technical ability in order to ensure that the newly-established enterprises be able to conduct technical reconstruction and research and development on their own products, and that they could meet the increasing technical and legal requirements on safety, environmental protection and energy saving, as well as

¹⁶⁵ *China's Transitional Review Mechanism – Communications from the United States*, Committee on Market Access, G/MA/W/58 (31 August 2004), at para. 3.

¹⁶⁶ *Id.*

¹⁶⁷ *Transitional Review Mechanism Pursuant to Paragraph 18 of the Protocol on the Accession on the People's Republic of China – Additional Questions from the United States to China Concerning TRIMS*, Committee on TRIMS, G/TRIMS/W/37 (23 September 2004).

¹⁶⁸ *Id.*

customer demand in China. There is no specific and mandatory requirement on product R&D performance.¹⁶⁹

- *On the requirement of technology transfer:* The reason why China requires “foreign technology transfer and contract on technical cooperation” is to prevent illegal assembling, to protect intellectual property and to ease up the procedures for product testing and accreditation, but not to force foreign parties to transfer their technologies.¹⁷⁰

c. Subsidies

At the Committee on Subsidies and Countervailing Measures, the U.S. noted quite a few concerns concerning subsidies:

- Three years after the accession, China has still not submitted a notification of any subsidy under Article 25 of the SCM Agreement. At the first TRM, China stated that it would submit the required notification when the information was accurate and complete. At the second TRM, China stated that it was vigorously pushing forward work on its notification, but was unable to provide a specific time frame for completion. Why has China been unable to meet this obligation?¹⁷¹
- Has China eliminated subsidies to SOEs running at a loss? At the first TRM, China said these subsidies were eliminated in 2001. However, 2003 Chinese press reports said the government is currently working to eliminate these subsidies by 2005. China did not provide response in the second TRM.¹⁷²
- In December 2003, the central government injected US\$45 billion into the Bank of China and the China Construction Bank from its foreign exchange reserves. How do the bailouts address the underlying causes of the non-performing loan problem and the massive subsidization inherent in it? How do the 2003 bailouts differ from earlier

¹⁶⁹ *Minutes of the Meeting Held on 26 October 2004*, Committee on Trade-Related Investment Measures, G/TRIMS/M/19 (5 November 2004), at para. 21.

¹⁷⁰ *Id.*

¹⁷¹ *Transitional Review Mechanism Pursuant to Section 18 of the Protocol on the Accession of the People's Republic of China: Questions from the United States to China Concerning Subsidies and Price Controls*, Committee on Subsidies and Countervailing Measures, G/SCM/Q2/CHN/8 (6 October 2004), at para. 1.

¹⁷² *Id.* at para. 6.

bailouts? What are the plans for ensuring that all state-owned banks are run on a commercial basis and are responsible for their own profits and losses?¹⁷³

China's responses to the foregoing statements are as follows:

- *On the subsidy notification:* First, China has implemented the commitment of eliminating all export subsidies and subsidies for import substitution, therefore could not undertake any obligation of further notification in these two areas. Second, China made all notifications on subsidy measures maintained and subsidies to be phased out (Annexes 5A and 5B to the Protocol of Accession), which reflected the situation with respect to Chinese subsidy measures accurately and completely. These two are still current and effective, and they fulfill the notification requirements under the SCM Agreement. Third, since the accession, China has been actively collecting subsidy information. However, there is more than one authority responsible for the administration of subsidies in China, and that information collecting and sorting is a complex and time consuming exercise.¹⁷⁴
- *On subsidies to SOEs:* The Chinese government undertakes no obligation to verify information published on non-official websites, and it does not accept that such information can be a basis for making accusations against China's policies.¹⁷⁵
- *On the recent bank bailouts:* The latest reorganization and injection of capital into the Bank of China and the China Construction Bank are one of the steps needed in the overall reform of the banking sector in China. Compared with previous reform measures, the latest capital injection measures were designed and implemented with commercial considerations in mind. The State, through the Central Weijing Corporation, injected USD 45 billion into the two banks to increase their capital funds, with future dividends expected as a return on this investment. The action is an investment in nature, not a subsidy, and is aimed at fully commercializing the operations of the two banks. There is no major difference between this reform by China and reforms by other WTO members. Any such reform involves a write-off of non-performing loans.¹⁷⁶

¹⁷³ *Id.* at para. 7.

¹⁷⁴ *Chairman's Report to the Council for Trade in Goods on Transitional Review of China*, Committee on Subsidies and Countervailing Measures, G/SCM/115 (22 November 2004), at paras. 21-23.

¹⁷⁵ *Id.* at para. 29.

¹⁷⁶ *Id.* at paras. 31-32.

In response to China's comments on the subsidy notification, the U.S. voiced disagreement with China over its view that a notification that was supplied in the course of accession satisfied an ongoing obligation of all WTO Members. The U.S. also expressed disappointment that, despite China's apparent efforts in collecting subsidy information, there have been no concrete results in the past three years of China's WTO membership.

In addition to the above concerns, China also tried to explain the VAT rebate granted for imports of copper scrap¹⁷⁷ upon request from the U.S. and other Members and provide responses to a series of U.S. questions on pricing mechanism¹⁷⁸ during the review at the SCM Committee.

d. Export Restrictions on Coke

China's export restriction on coke was a high-profile issue at the third TRM. In 2004, China imposed an export quota of 8.3 million MT, down from the 2003 level of 14.3 million MT. In the first six months of 2004, China's export quota combined with the illegal selling of export quotas caused the export price for Chinese coke to soar.¹⁷⁹ At the Committee on Market Access and the Council for Trade in Goods, the U.S. raised the following specific questions:

- WTO rules establish a general prohibition against export restrictions, with only limited exceptions. How does China's export restriction on coke satisfy the GATT Article XX exception which allows measures that are made effective in conjunction with restrictions on domestic production or consumption? The U.S. notes that in 2003, China's policies resulted in China reserving approximately 163 million MT for the domestic market, while only allowing less than 15 million MT to be exported.¹⁸⁰

¹⁷⁷ *Id.* at para. 24-26.

¹⁷⁸ *Id.* at paras. 33-38.

¹⁷⁹ *China's Transitional Review Mechanism: Communication from the United States*, Committee on Market Access, G/MA/W/58 (31 August 2004), at para. 1.

¹⁸⁰ *Id.*

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- What is the current status of the China-EU bilateral agreement on coke?¹⁸¹
 - Does China have any plans to impose any new or additional domestic restrictions?¹⁸²
 - Does China have any timetable for eliminating the export quota on coke?¹⁸³

At the Council for Trade in Goods, China made the following comments {part of China's responses are not available as the minutes of the review meeting at the Committee on Market Access have not been released}:

Coke was an exhaustible resource, while the coke industry was highly pollutive and energy-consuming. Therefore, in order to protect the environment and achieve sustainable development, China had taken a series of measures to reduce the output of coke. Meanwhile pursuant to GATT Article XX(g), as well as the relevant domestic laws and regulations, coke export was under a global quota administration in China. However, it might take some time to see the results of their efforts in terms of restricting coke production of domestic industry. In the year 2004 the demand for coke in international markets had risen tremendously, which had drawn great attention from the Chinese Government. ... On 23 July 2004, MOFCOM had issued urgent notice on an administrating order of coke export which required local government and relevant enterprises to strictly comply with the export administration restriction to actively improve their operations and to thoroughly eliminate sales of export licences for coke. The above measures had been proved effective. At present China's exportation of coke was stable and prices had declined rapidly. The export quota for coke in the year 2005 would be 14 million tonnes. ... China hoped that WTO Members would realise the sacrifices China had made as well as the pressure and the dilemma China was facing in terms of environmental protection and natural resource preservation. As a WTO Member China

¹⁸¹ *Id.*

¹⁸² *Transitional Review under Section 18 of the Protocol on the Accession of the People's Republic of China: Questions from the United States to China*, Council for Trade in Goods, G/C/W/49 (11 November 2004), at para. 1.

¹⁸³ *Id.*

would continue to abide by WTO rules in the future and take measures on the basis of non-discrimination, publicity and transparency to maintain the stable supply of coke in the international markets.¹⁸⁴

In response, the U.S. cautioned China on the possible remaining effect and hoped that China could finally eliminate the export restriction:

In 2004 this became a significant problem, as the prices for coke, a key steel-related import, more than tripled from the 2003 level, and this was due largely to the shrinking export quota in 2004 as well as the selling of export licences. The US had discussed these issues with China as they arose, and had been pleased with China's short-term response. China had expanded the 2004 quota and cracked down on the selling of export licences, and as a result the price of coke had gone down substantially and more quantities were available. He cautioned, however, that these were just short-term fixes. The US appreciated the measures taken but would also like to see China eliminate export quotas, in particular the export quota system for coke and other raw materials.¹⁸⁵

e. Services

U.S. concerns at the third TRM with respect to the services sector focused on financial services, distribution services, express delivery services, and telecommunications services.

Financial Services:

- The *Regulations on the Administration of Insurance Companies and the Implementing Rules for the Regulation on the Administration of Foreign-Invested Insurance Companies* issued on May 13, 2004 encourage foreign non-life insurers to convert existing branch operations to subsidiaries. Can existing branches of non-life insurers continue to operate under the existing conditions? Will China allow non-life insurers

¹⁸⁴ *Report of the Council for Trade in Goods on China's Transitional Review*, Council for Trade in Goods, G/L/722 (10 December 2004), at para. 3.23.

¹⁸⁵ *Id.* at para. 3.40(i).

already established in China to open branches and sub-branches even if they do not first establish as a subsidiary?¹⁸⁶

- The new insurance regulations and implementing rules do not specify the number of branches foreign insurers may apply for at one time, whether branch approvals will be granted consecutively (one at a time) or concurrently (more than one at a time). Can China justify the differential treatment in which foreign insurers have only received consecutive approval to open single branch while Chinese insurers are able to receive concurrent approvals to open multiple branches?¹⁸⁷
- The new insurance regulations and implementing rules require RMB 200 million for the initial establishment of insurance companies, whether as a subsidiary of a branch, and RMB 20 million for each additional branch. What is the rationale for requiring RMB 20 million for each additional branch, particularly in light of the fact that any additional branches would still be backed by the full asset base of the parent foreign insurer?¹⁸⁸
- What is the rationale for the extremely high qualifying threshold (e.g., total assets of RMB 5 billion) for insurers to be able to invest their foreign exchange funds in overseas funds or equities in the *Provisional Measures on the Administration of the Overseas Utilization of Insurance Foreign Exchange Funds* issued on August 9, 2004?¹⁸⁹
- Pursuant to the *Regulations on the Administration of Foreign-Invested Financial Institutions* and the *Detailed Implementing Rules for the Regulations on the Administration of Foreign-Invested Financial Institutions*, China imposes minimum capital requirements for foreign banks, on a branch-by-branch basis, that remain extremely high by international standards. At last year's TRM, the U.S. and other Members asked China whether it was reviewing high capital requirements to determine whether they are necessary and not overly burdensome for foreign banks. What is the current status of CBRC's review of these capital requirements?¹⁹⁰

¹⁸⁶ *Communication from the United States: Transitional Review Mechanism in Connection with Paragraph 18 of the Protocol on the Accession of China*, Committee on Trade in Financial Services, S/FIN/W/40 (8 November 2004), at para. 1.

¹⁸⁷ *Id.* at para. 2.

¹⁸⁸ *Id.* at para. 4.

¹⁸⁹ *Id.* at para. 5.

¹⁹⁰ *Id.* at para. 9.

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- What is the rationale for the high capital requirement of RMB 300 million in the rules issued by the China Securities Regulatory Commission addressing joint venture asset management companies for foreign firms to qualify as a joint venture partner?¹⁹¹

China provided the following answers with regards to the above concerns:

- *On branching:* The Implementation Rules allow branches of foreign funded property insurance companies to be changed into wholly foreign-owned property insurance companies. They can remain as branches or change their status according to this regulation.¹⁹²
- *On licensing:* The number of licenses that the CIRC can grant to foreign insurers at one time is based on the licensing procedures in the relevant laws and regulations, as well as the prudential principle. The available amount of sub-branches for one application is not statutorily stipulated in the Chinese law, and therefore it is appropriate in his view to set a compulsory number of licences for the CIRC to issue to a particular foreign insurer at one time. National treatment does not mean strict equivalence in the number of licences for sub-branches issued at one time. What is important for national treatment is that the approval procedure and the requirement for sub-branches are equal for both domestic and foreign applicants.¹⁹³
- *On the overseas investment by insurance companies:* The qualifying threshold is applied to both foreign and domestic insurers based on prudential consideration.¹⁹⁴
- *On the horizontal issue of minimum capital requirement:* China's minimum capital requirements are based on prudential considerations and set up according to the level of development of China's financial sector and the regulatory capacity of the financial authority. The determination of minimum capital requirements is a legitimate right of Members when regulating. Depending on the improvement of the risk management system of foreign banks and the development of China's regulatory framework, China's financial regulatory authorities would relax the minimum capital requirements for foreign banks and insurance companies accordingly. Since December 2003, the amount of operating capital requirements for branches of foreign-funded banks has been reduced and the categories have been simplified. Based on foreign-funded banks'

¹⁹¹ *Id.* at para. 10.

¹⁹² *Transitional Review under Section 18 of the Protocol on the Accession of the People's Republic of China: Report to the Council for Trade in Services, Committee on Trade in Financial Services, S/FIN/13 (26 November 2004), at para. 58.*

¹⁹³ *Id.* at para. 58.

¹⁹⁴ *Id.* at para. 60.

business development and risk control capacity, China will continue to adjust the operational capital requirement in the future.¹⁹⁵

Distribution Services:

- To implement the important commitment of opening up the distribution services sector, China first issued the *Regulations on the Administration of Foreign Investment in the Commercial Sector* on April 16, 2004. However, China has not yet issued necessary implementing rules clarifying application procedures, including when approvals may be obtained from provincial authorities versus the Ministry of Commerce and permitted scope of activities.¹⁹⁶

In response, China drew Members' attention to a Notice issued by China's Ministry of Commerce regarding the procedure for the implementation of the *Regulations on the Administration of Foreign Investment in the Commercial Sector*.¹⁹⁷

Express Delivery Services

- What is the rationale for the creation of a China Post monopoly on the delivery of letters weighing less than 350 grams according to the new draft of the Postal Services Law circulated in July 2004?¹⁹⁸
- What are China's plans for separating China Post's regulatory and operational functions?¹⁹⁹

In response, China stated that the draft was for the purpose of seeking comments in the law-revising process, not the final draft and some of its provisions were still under consideration

¹⁹⁵ *Id.* at para. 54.

¹⁹⁶ *Communication from the United States: Transitional Review Mechanism Pursuant to Paragraph 18 of the Protocol on the Accession of China*, Council for Trade in Services, S/C/W/243 (9 November 2004), at para. 1.

¹⁹⁷ Report of the Meeting Held on 26 November 2004, Council for Trade in Services, S/C/M/75 (3 December 2004), at para. 29.

¹⁹⁸ *Communication from the United States: Transitional Review Mechanism Pursuant to Paragraph 18 of the Protocol on the Accession of China*, Council for Trade in Services, S/C/W/243 (9 November 2004), at para. 5.

¹⁹⁹ *Id.*

and review. China also reiterated that the revised Postal Law will not violate relevant WTO agreements and China's horizontal commitments.²⁰⁰

Telecommunications Services

- Article 5 of the *Regulation on the Administration of Foreign-Invested Telecommunications Enterprises* establishes RMB 2 billion capital requirement for foreign-invested telecom enterprises to engage in national or cross-provincial basic services. This high capital requirement limits the ability of foreign firms to access China's telecommunications market.²⁰¹
- The Ministry of Information Industry (MII) in its April 2003 Catalogue of Telecommunications Services reclassified several telecommunications services from the value-added category to the basic category, contrary to widely accepted international practice. Also, the Catalogue omits "code and protocol conversion" from the list of value-added services, which is identified in China's Services Schedule as a value-added service. These steps limit market access in value-added services.²⁰²
- China has not yet established an independent regulator, as MII is not structurally and financially separate from all telecommunications operators and providers.²⁰³

In response to the above concerns, China only provided an explanation on the omission of "code and protocol conversion" from the list of value-added services in MII's Catalogue.

- *On the code and protocol conversion:* The approach to classification of telecommunication services is based on each Member's development level, economic situation and administrative measures. The code and protocol conversion is applied when technical criteria or standards in telecommunications are not unified. Its purpose is to ensure the interconnection between networks or services using different codes and

²⁰⁰ Report of the Meeting Held on 26 November 2004, Council for Trade in Services, S/C/M/75 (3 December 2004), at para. 28.

²⁰¹ *Communication from the United States: Transitional Review Mechanism Pursuant to Paragraph 18 of the Protocol on the Accession of China*, Council for Trade in Services, S/C/W/243 (9 November 2004), at para. 11.

²⁰² *Id.* at paras. 10-11.

²⁰³ *Id.* at para. 12.

protocols. As technical criteria have been gradually unified at the international level, there is no demand for this service in China.²⁰⁴

f. Intellectual Property Rights (IPR)

As in the previous two TRM reviews, a wide array of issues were identified at the Council for TRIPS during the third review, covering patents, trademarks, copyright, and IPR enforcement regime. Major U.S. concerns included:

- When will China circulate a draft for public comment of the judicial interpretation on criminal thresholds which is currently in an advanced stage of drafting? What efforts are under way for revising national or local guidelines for referral of cases to criminal prosecution or criminal investigation, and for reorganization of entities involved in criminal IPR investigation or prosecution?²⁰⁵
- China is by far the largest exporter of infringing goods that are seized at the borders of the U.S. by U.S. Customs authorities. What new steps, if any, are being taken to stop the exportation of counterfeit and pirated goods from China?²⁰⁶
- How many well-known trademarks have the Chinese Trademark Office and the Trademark Review and Adjudication Board recognized under the rules issued by the State Administration of Industry and Commerce in 2003, including the number of foreign well-known marks recognized under these rules?²⁰⁷
- What efforts are under way to consolidate content review of copyrighted works through "one stop" review, and/or to expedite the overall process, particularly in industries that are quite sensitive to the high incidence of piracy in China's market?²⁰⁸
- What steps have been taken to resolve the uncertainty of relevant administrative agencies in the judgment as to whether end-user piracy is against the "public interest" for purposes of administrative enforcement of China's Copyright Law?²⁰⁹

²⁰⁴ Report of the Meeting Held on 26 November 2004, Council for Trade in Services, S/C/M/75 (3 December 2004), at para. 27.

²⁰⁵ *Transitional Review Mechanism of China: Communication from the United States, Council for Trade-Related Aspects of Intellectual Property Rights*, IP/C/W/432 (16 November 2004), at paras. 46-47.

²⁰⁶ *Id.* at para. 48.

²⁰⁷ *Id.* at para. 16.

²⁰⁸ *Id.* at para. 19.

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- What tools are available to non-Chinese companies to fight pre-emptive patent filings by Chinese companies for designs they did not create?²¹⁰

China provided the following answers:

- *On the judicial interpretation of criminal threshold:* The Judicial Interpretation and Application of the Laws dealing with Criminal Offences of IPR will be promulgated soon. In drafting the Interpretation, the Supreme Court and the Supreme Procuratorate solicited the comments and questions from various agencies and enterprises, chambers and associations of the U.S., EU and Japan. After the comments and questions are summarized, the Interpretation will carry out clearer and more definite standards for verdicts and lower the threshold for criminal acquisition. When the Interpretation takes effect, the provisions of the relevant judicial documents that are inconsistent with the Interpretation will automatically be nullified.²¹¹
- *On Customs enforcement:* Measures taken by the General Administration of Customs to protect IPR include establishing more laws and regulations on IPR protection, training more enforcers of GCA, strengthening cooperation with right holders, participating more in cooperation and communication with foreign counterparts, and employing more advanced technology to find more pirated products. All these measures have proven effective to prohibit exportation and importation of pirated goods.²¹²
- *On the determination of well-known trademarks:* Since the implementation of provisions on determination and the protection of well-known marks on June 1, 2003, the Trademark Office and the Trademark Review and Adjudication Board have totally determined the status of 153 well-known marks, among which 24 are from abroad, 12 from the U.S., 12 from other Members.²¹³
- *On pre-emptive patent filings:* Pursuant to Article 23 and 45 of the Patent Law, any entities or individuals, including foreign nationals, could request a patent right to be declared invalid on the grounds that the patent for design is identical or similar to any design before the date of filing. In addition, pursuant to rule 79 and rule 86 of the implementing regulations of the Chinese Patent Law, where there is a dispute over the

²⁰⁹ *Id.* at para. 21.

²¹⁰ *Id.* at para. 9.

²¹¹ *Transitional Review under Section 18 of the Protocol on the Accession of the People's Republic of China, Council for Trade-Related Aspects of Intellectual Property Rights, IP/C/34 (9 December 2004), at para. 15.*

²¹² *Id.* at para. 72.

²¹³ *Id.* at para. 40.

ownership of patent rights, the parties concerned can request administrative authority for patent affairs to mediate or institute legal proceedings with a People's Court.²¹⁴

In addition, as requested by the U.S., China provided recent statistics on IPR enforcement actions.²¹⁵

The following two tables present: (1) a list of the document references for the third TRM committee and council reports and the minutes of the TRM meetings, and (2) a list of the committees and councils in which the U.S. made submissions during the third TRM and the areas of concern identified by the U.S.

Committee/Council Reports and Meeting Minutes in the Context of the Third TRM

Committee/Council	Document Symbol of Committee/Council Reports	Document Symbol of Committee/Council Minutes
Committee on Agriculture	G/AG/19	G/AG/R/40
Committee on Anti-Dumping Practices	G/ADP/13	G/ADP/M/27
Committee on Balance-of-Payments Restrictions	WTO/BOP/R/75	not available
Committee on Financial Services	S/FIN/13	S/FIN/M/47
Committee on Import Licensing	G/LIC/13	G/LIC/M/20
Committee on Market Access	G/MA/155	G/MA/M/38
Committee on Rules of Origin	G/RO/58	not available
Committee on Safeguards	G/SG/73	G/SG/M/26
Committee on Sanitary and Phytosanitary Measures	G/SPS/34	G/SPS/R/35
Committee on Subsidies and Countervailing Measures	G/SCM/115	G/SCM/M/52
Committee on Technical Barriers to Trade	G/TBT/W/249	G/TBT/M/34
Committee on Trade-Related Investment Measures	not available	G/TRIMS/M/19
Committee on Customs Valuation	G/VAL/57	G/VAL/M/38
Council for Trade in Goods	G/L/722	G/C/M/78
Council for Trade in Services	S/C/23	S/C/M/75
Council for Trade-Related Aspects of Intellectual Property Rights	IP/C/34	IP/C/M/46

²¹⁴ *Id.* at para. 23.

²¹⁵ *Id.* at paras. 51-55.

Summary of Submissions by the US in the Context of the Third TRM

Committee/Council & Document Symbol	Areas of Concern
Committee on Agriculture G/AG/W/64; G/AG/W/64/Add.1	Administration of agricultural TRQs; AQSIQ licensing for inspection of imports
Committee on Anti-Dumping Practices G/ADP/W/441	Notifications and related matters; transparency; judicial review; enquiry point
Committee on Import Licensing G/LIC/Q/CHN/12	AQSIQ licensing for inspection of imports; entities responsible for authorization or approval of imports; buying, selling and transferring of import licenses
Committee on Market Access G/MA/W/58	Export restrictions; new automobile industrial policy; TRQs on fertilizers
Committee on Sanitary and Phytosanitary Measures G/SPS/W/153	Transparency and oversight of regulatory bodies; absence of sound scientific evidence; assessment of risk and appropriate level of phytosanitary protection; control, inspection and approval procedures;
Committee on Subsidies and Countervailing Measures G/SCM/Q2/CHN/8	Notification; semiconductors; copper; subsidies to SOEs running at a loss; non-performing loans; price controls
Committee on Technical Barriers to Trade G/TBT/W/245	Notifications; changes in China's standardization and regulatory system; international standards; conformity assessment procedures; scrap recycling regulations; distilled spirits; chemicals; radio frequency identification; cosmetics
Committee on Trade-Related Investment Measures G/TRIMS/W/35; G/TRIMS/W/37	Sectoral Guidelines Catalogue for Foreign Investment; new auto industry policy
Council for Trade in Goods G/C/W/499	Export restrictions; TRQs on fertilizers; VAT applied to diammonium phosphate; SPS measures; control, inspection and approval procedures; border control; transparency; government procurement
Committee on Financial Services S/FIN/W/40	Insurance; financial holding companies; banking; securities; pensions
Council for Trade in Services S/C/W/243	Distribution services; express delivery services; transport services; telecommunications services; construction services
Council for Trade-Related Aspects of Intellectual Property Rights IP/C/W/432	Legislation and judicial interpretations; patents; trademarks and enterprise name protection; copyright; general enforcement issues; administrative enforcement; civil enforcement; criminal enforcement; customs/border enforcement

B. Assessment of the Effectiveness of the TRM Process

When the Transitional Review Mechanism was established under Article 18 of China's accession protocol, it was hoped and expected that the review process would be an important and effective tool to monitor China's progress in meeting its WTO obligations and commitments as well as act as a stimulus to China's trade regime transformation. Unfortunately, after the completion of three TRMs, these expectations have not been met.

The U.S., the EU, Japan and other countries initially believed that the Article 18 obligation, like normal WTO practice in all of the Committees for other reporting obligations, would be a robust enquiring exercise. That is, it was expected that WTO members would be able to forward initial and follow-up questions to China in advance of TRM meetings, and that China would similarly respond prior to the TRM meeting.

In the first TRM, other members (including the U.S.) tried to establish a schedule early in China's membership to ensure the process would be meaningful and would permit a thorough evaluation. However, China's initial attitude to the TRM process was hostile in tenor, refusing to permit the Article 18 process to go beyond the literal language of the protocol. Since Article 18 did not establish a timeline, China would not agree to early meetings and, in fact, blocked agendas being issued or meetings being held where the topic of the Article 18 TRM was included.

China asserted that, as Article 18 did not refer to written answers, it was not required to provide them. China thus frustrated other Members' expectation of a spirited and transparent exchange of information. And, because the WTO works on consensus, China did not agree to

have the reports from the various standing committees or the councils go beyond merely a review of the topics identified. As a result, none of the reviewing bodies made any conclusions or recommendations regarding China's compliance.

As a result of China's behavior in TRM-1 (2002), the expectations of WTO members for succeeding TRMs were effectively lowered, as can be seen by viewing the various committee reports and notes from TRM-2 (2003) and the most recent TRM-3 (2004). Thus, the TRM process has not proved to be the effective monitoring and compliance enforcement tool that was envisioned in the protocol.

These conclusions are reflected in a report by the Government Accountability Office, which observes:

{T}he initial TRM did not result in the thorough and detailed review of China's compliance that U.S. officials had envisioned. 15 Chinese officials told us that while they will abide by their TRM commitments, they view the TRM as a discriminatory mechanism that was imposed on China during their WTO membership negotiations. With this as the prevailing sentiment from China, the 2002 review was marked by contention between China and some of the other WTO members regarding the form, timing, and specific procedures for the TRM. The United States and some other members were disappointed that China refused to provide written answers to members' written questions in advance of TRM meetings. Additionally, some members were disappointed that the review did not result in any conclusions or recommendations regarding China's implementation.

* * *

However, as in 2002, China did not respond in writing to member questions during the 2003 review, nor did the TRM result in a WTO report with conclusions or recommendations. U.S., WTO, and other foreign officials told us that they expected future TRM

reviews to operate similar to the 2003 review, with no substantive changes in procedures or outputs.²¹⁶

As noted by a recent article, the most recent review, TRM-3, followed the pattern established in the first two reviews, leaving interested members frustrated by the process:

As in past years, China's studied vagueness in response to detailed questions frustrated participants in this year's TRM. China continued to respond in an unclear, often defensive manner, refusing in some cases to answer questions that it claimed were irrelevant to the committee topic (such as questions related to the Foreign Trade law). . . . Members explicitly stated that China's participation in the TRM was "rather disappointing," noting that China frequently did not provide written answers and that oral answers to detailed questions were too vague. Members highlighted China's lack of transparency in virtually every committee session.²¹⁷

Based on background discussions with various close observers of the TRM process, a number of observations can be made about the operation of the TRM:

- The trend in Year 2 of lowered expectations continued in Year 3. TRM-3 was largely a mirror of the TRM-2. That is, China would provide written statements at the end of the process but not at the beginning.
- China appeared less confrontational in Year 3 and more forthcoming than in previous TRMs.
- WTO members appear to have accommodated themselves to the TRM's reduced scope. In other words, they now tend to view the TRM as simply one of a number of avenues for obtaining information on China's compliance performance.

²¹⁶ U.S. Government Accountability Office, *U.S.-CHINA TRADE: Opportunities to Improve U.S. Government Efforts to Ensure China's Compliance with World Trade Organization Commitments*, GAO-05-53 (October 2004) at 17-18; <http://www.gao.gov/new.items/d0553.pdf>.

²¹⁷ Julie Walton, *WTO: Year Four; Progress in the past year signals China is on its way to becoming a normal business environment*, *The China Business Review* (January-February 2005) at 34.

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- The TRM has become essentially a transparency and accountability exercise, but not a forum to clearly identify problems and obtain an action program. Nonetheless, the experience of a number of members has been that there has been reasonable success in resolving problems with China's compliance through bilateral consultations.
 - China takes the modified TRM process more seriously, and appears more prepared at the Committee meetings and in at least many cases provides responsive information. Still, some members would like more information.
 - The TRM process is not as important a tool for monitoring and enforcement of China's commitments as was hoped but it does provide a regularity of focus on the China compliance question.
 - Members seem to have accepted that although they may receive factual information from China, the TRM is not likely to put pressure on China to change practices.
 - China seems to respond bilaterally reasonably well. Where problems persist, a WTO complaint is viewed as the necessary avenue to pursue to obtain compliance.

Notwithstanding the diminished effectiveness and disappointing results of the TRM process, the U.S. and other Members still view it as a useful forum for airing problems directly to China. The GAO report presents the reasons that the U.S. believes that TRM has continuing utility:

U.S. officials acknowledged the continuing limitations of the TRM in 2003, but cited three major benefits of the review: (1) the TRM increased China's transparency on trade issues, (2) the TRM resulted in a useful exchange of information and fostered better coordination among key Chinese ministries, and most importantly, (3) the TRM provided the United States with a formal multilateral forum for raising compliance problems.

First, U.S. officials stated that the TRM was an effective way to urge China to disclose information about its implementation in a formal, public multilateral forum. Officials said it was important to demonstrate to China that the United States and other concerned members would be actively seeking information about China's implementation on an annual basis.

Second, several U.S., WTO Secretariat, and other member government officials said that China sent more experts from the relevant ministries to attend the TRM in 2003, and many officials

stated that this had resulted in a more effective exchange of information during the reviews. Further, U.S. and foreign officials, including China's ambassador to the WTO, indicated that the TRM process was effective in helping China's main trade ministry, the Ministry of Commerce, gain cooperation and coordination from other Chinese ministries that might not have understood the problems or might have been reluctant to cooperate otherwise.

Third, U.S. officials said that the TRM provided the United States with an opportunity to highlight specific areas of concern about China's implementation and obtain an official, public position from China on key issues. U.S. officials further noted that, although the TRM was never intended to supplant the dispute settlement process, the TRM could help lay the groundwork for any potential areas where the United States would initiate a WTO dispute settlement case with China.²¹⁸

Thus, while it must be acknowledged that the TRM process has not been the important and useful multilateral forum for monitoring China's WTO compliance that was hoped, still it is useful as a forum for clarifying China's implementation efforts, as an information exchange, and as a means to convey Members' expectations about the fulfillment of China commitments.²¹⁹

²¹⁸ U.S. Government Accountability Office, *U.S.-CHINA TRADE: Opportunities to Improve U.S. Government Efforts to Ensure China's Compliance with World Trade Organization Commitments*, GAO-05-53 (October 2004) at 19-20; <http://www.gao.gov/new.items/d05553.pdf>.

²¹⁹ See, e.g., *Report of the Meeting Held on 23 November 2004*, Committee on Trade in Financial Services, S/FIN/M/47 (26 November 2004), at para. 37.