CHINA

TRADE SUMMARY

The U.S. trade deficit with China was $124.0 billion in 2003, a 20.3 percent increase over the $103.1 billion deficit in 2002. U.S. goods exports to China increased by 28.4 percent to $28.4 billion in 2003, compared to $22.1 billion in 2002, as China is currently the fastest growing export market for U.S. goods. Indeed, over the last three years, U.S. exports to China increased by 76 percent, while U.S. exports to the rest of the world decreased by 9 percent. U.S. imports from China increased by 21.7 percent to $152.4 billion in 2003, compared to $125.2 billion in 2002. The pace of growth in U.S. exports to China has outstripped the growth in U.S. imports from China over the last three years 76 percent to 52 percent.

U.S. exports of private commercial services (i.e., excluding military and government) to China were $6.1 billion in 2002 (latest data available), and U.S. imports were $4.1 billion. Sales of services in China by majority U.S.-owned affiliates were $2.6 billion in 2001 (latest data available), while sales of services in the United States by majority China-owned firms were $144 million.

The stock of U.S. foreign direct investment (FDI) in China in 2002 was $10.3 billion, down from $11.4 billion in 2001. U.S. FDI in China is concentrated in the manufacturing and mining sectors.

Three areas continued to generate significant problems – agriculture, intellectual property rights (IPR) and services. The area of agriculture proved to be especially contentious between the United States and China. While concerns over market access for U.S. agricultural products are not unique to China, particularly serious problems were encountered on many fronts during the first two years of China’s WTO membership, particularly with regard to China’s regulation of agricultural goods made with biotechnology, the administration of China’s tariff-rate quota system for bulk agricultural commodities, and the application of sanitary and phytosanitary (SPS) measures and inspection requirements. In the IPR area, China has made significant improvements to its framework of laws and regulations, but the lack of effective IPR enforcement remains a major challenge. In addition, concerns arose in many services sectors, largely due to transparency problems, delays in the issuance of legislative measures, and China’s use of prudential and entry threshold requirements that exceeded international norms. Transparency concerns cut across sectors, and although China has made notable improvements in this area, China’s decision-making and regulatory processes largely continue to be opaque. While some ministries and agencies took steps to improve opportunities for public comment on draft laws and regulations, and to provide appropriate WTO enquiry points, China’s overall effort was plagued by uncertainty and a lack of uniformity. Recognizing that adjustments must be made to address fundamental issues of transparency more systemically, China’s leadership has instructed government think tanks to draft concrete reform proposals on a wide array of legal and policy issues to improve the transparency and efficiency of China’s market structure.

As the slowdown in China’s WTO implementation efforts became evident in 2003, senior Administration officials stepped up efforts to engage senior Chinese leaders. U.S. Trade Representative Zoellick made two separate visits to China for talks on WTO implementation matters with Premier Wen and with Vice Premier Wu Yi. He also raised U.S. concerns throughout the year with his MOFCOM counterpart. The Secretaries of Commerce and Treasury made their own trips to China, again carrying the message that China’s WTO implementation was a matter of the highest priority. Sub-cabinet officials from various U.S. economic and trade agencies also met with their Chinese counterparts in China, Washington and Geneva to work through areas of concern, including WTO implementation issues, on numerous other occasions.

The Administration also utilized the newly established sub-cabinet dialogue on WTO compliance and other trade matters, which brings together U.S. economic and trade agencies and various Chinese ministries and agencies with a role in China’s WTO implementation. Meetings were convened twice in

2003, once in February, led by then Deputy United States Trade Representative Huntsman, and later in November, led by Deputy United States Trade Representative Shiner. These meetings have proven to be effective in communicating specific trade concerns and in serving as an early warning mechanism for emerging trade disputes.

The new Chinese leadership continues to adhere to the policy of pegging China's currency (the RMB) to the U.S. dollar, as it has done for the past 10 years. The new leadership has publicly committed itself to the goal of moving toward a flexible exchange rate and has taken some measures to prepare for such a system such as relaxing some capital controls, but has not announced a timetable for implementing a more liberalized, market-oriented currency regime. Throughout 2003, the Administration urged China, both bilaterally and in multilateral fora, to move toward a flexible, market-based exchange rate regime and to reduce controls on capital flows. Treasury Secretary Snow traveled to China for discussions with senior Chinese officials on a range of financial issues, including exchange rate policy. In addition, at the September 2003 G7 meeting in Dubai, the ministers and central bank governors endorsed flexibility in exchange rates for large economies. Serious engagement with China on this issue will continue in 2004. For example, a new Technical Cooperation Program involving the Treasury Department and the central bank of China was implemented in early 2004. This program is intended to help create the market mechanisms needed for China to make the transition to a flexible exchange rate regime.

Overall, while China has a more open and competitive economy than 25 years ago, and China's WTO accession has led to the removal of additional trade barriers, there are still substantial barriers to trade that have yet to be dismantled, In addition, some agencies have renewed efforts to erect new technical barriers to trade. In many sectors, import barriers, opaque and inconsistently applied legal provisions, and limitations on foreign direct investment often combine to make it difficult for foreign firms to operate in China. The central government continues to implement industrial policies and protect noncompetitive or emerging sectors of the economy from foreign competition. Provincial and lower-level governments have strongly resisted certain reforms that would eliminate sheltered markets for local enterprises or reduce jobs and revenues in their jurisdictions, although they have also supported market access for other foreign investors that do not pose a threat to local vested interests.

If China is to complete the implementation of its WTO commitments and institutionalize market-oriented reforms, it will have to resist the temptation to retain mechanisms that allow government officials to intervene in the Chinese economy in a manner that is inconsistent with market principles. Despite its remarkable transformation over the past quarter century, China continues to suffer from its command economy legacy. As a result, Chinese economic policy-making operates in a way that prevents U.S. businesses from achieving their full potential in the China market

IMPORT POLICIES

China has traditionally restricted imports through high tariffs and taxes, quotas and other non-tariff measures, and restrictions on trading rights. As part of its first year in the WTO, China significantly reduced tariff rates on many products and the number of goods subject to import quotas, expanded trading rights for Chinese enterprises, and increased the transparency of its licensing procedures. However, during China's second year of WTO membership, while China continued to reduce tariff rates on schedule and made other implementation progress, bureaucratic inertia and a desire to protect sensitive industries contributed to a significant loss of the momentum created in the first year of China's WTO membership.

Trading Rights and other Restrictions

Trading Rights

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China restricts the types and numbers of entities with the right to trade. Only those domestic and foreign firms with trading rights may import goods into or export goods out of China. Restrictions on the type and number of firms with trading rights contribute to systemic inefficiencies in the trading system and create substantial incentives to engage in smuggling and other corrupt practices.

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

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

Through the first two years of its WTO membership, it appears that China has fully implemented the required liberalization of trading rights for Chinese enterprises. However, it appears China has fallen behind in phasing in trading rights for foreign-invested enterprises. By now, China should have made full trading rights available to all joint ventures with minority or majority foreign ownership. Instead, China has continued to limit the availability of trading rights by imposing conditions on the eligibility of these enterprises, including requirements related to minimum registered capital, import levels, export levels and prior experience.

In January 2004, China circulated a draft of a new Foreign Trade Law for comment. This new law is intended to institute an automatic trading rights system and bring China into full compliance with its WTO commitments on trading rights for all Chinese-foreign joint ventures, wholly foreign-owned enterprises and foreign individuals. The United States subsequently raised two concerns with this draft, and China indicated that it would make the changes sought by the United States. In connection with the run-up to the April 2004 meetings of the Joint Commission on Commerce and Trade (JCCT), to be hosted by Commerce Secretary Evans and U.S. Trade Representative Zoellick, the United States has sought assurances from China that it will issue any necessary implementing regulations swiftly after it finalizes the new law, so that China will be in a position to comply fully with its trading rights commitments by the December 11, 2004 deadline.

Under the terms of China's WTO accession, the import of some goods such as grains, cotton, vegetable oils, petroleum, sugar, fertilizers, news publications and related products can still be reserved primarily for state trading enterprises. However, for grains, cotton, vegetable oils and fertilizers, China committed to making a portion of the tariff-rate quotas (ranging from 10 percent to 90 percent) available for import through non-state traders. In some cases, the percentage available to non-state traders increases each year.

Import Substitution Policies

Throughout the 1990s, China gradually reduced formal import substitution policies. In its WTO accession agreement, China committed that it would not condition import or investment approvals on whether there are competing domestic suppliers or impose other performance requirements. In anticipation of this commitment, China enacted legal changes in 2000 and 2001 to eliminate local content requirements for foreign investments. Under the prevailing rules, however, investors are still “encouraged” to follow some of the formerly mandated practices. Instances in which the Chinese Government has reportedly pursued import substitution policies include:

Fertilizer. Since 2001, China has offered value-added tax (VAT) exemptions and rebates for the types of fertilizers that are primarily produced domestically, but not for like or directly competitive imported fertilizers of American producers. U.S. industry representatives believe China is trying to encourage consumption of domestically produced fertilizer.

Semiconductors. China’s 10th Five-Year Plan calls for an increase in Chinese semiconductor output from $2 billion in 2000 to $24 billion in 2010. In pursuit of this policy, China has attempted to encourage the development of China's domestic integrated circuit (IC) industry through, among other things, discriminatory VAT policies. In particular, through a series of measures, China has provided for the rebate of a substantial portion of the 17 percent VAT paid by domestic manufacturers on their locally produced ICs. China, meanwhile, charges the full 17 percent VAT on imported ICs, unless they were designed in China. The United States raised this issue with China in several high-level bilateral meetings beginning in early 2003. Although China initially appeared willing to reconsider its differential tax treatment of ICs, by the end of 2003 China appeared to have hardened its conviction that it was acting consistently with its WTO obligations. In March 2004, the United States requested formal consultations with China, the first step under the WTO’s dispute resolution procedure. If the consultations do not lead to a resolution within 60 days, the United States can then request that a WTO panel rule on whether China’s differential tax treatment is consistent with its WTO obligations.

Automobile Investment Guidelines. China’s automobile industrial policy offered significant advantages for foreign-invested factories using high-levels of local content. In 2001, in anticipation of China’s new obligations as a WTO member, SETC issued Bulletin No.13, which provided that the preferential policy for automobile localization rates would be cancelled upon China’s WTO accession. However, U.S. auto manufacturers report that some local government officials continued in 2002 to require local content and cite the old auto policy’s standards. China also committed to issue a revised automotive industrial policy within two years of its WTO accession, or by December 11, 2003. In an effort to comply with that commitment, the NDRC announced in April 2003 that it was drafting a new development policy for the automotive industry. Although the NDRC called for comments by interested parties, it released the draft policy only to domestic firms. Foreign automakers later obtained copies from their joint venture partners, but the U.S. Government’s request for a copy was refused. Reportedly, the April 2003 draft of the policy

did not contain specific local content requirements, but did contain a target that domestically designed automobiles would account for 50 percent of the market by 2010. It also includes provisions that discourage the importation of auto parts, seek to restrict imports of complete knocked-down auto kits, and set targets encouraging the use of domestic technology. China is also reportedly considering a requirement that separate distribution channels be used for domestic and imported autos. At WTO meetings in late 2003 and during the run-up to the April 2004 JCCT meetings, the United States expressed concern about the direction of the draft policy and urged China to issue the draft policy for public comment.

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

Tariffs and other Import Charges

Tariff Reductions

Under the terms of its WTO accession, China committed to substantial reductions in its tariff rates. In 2002, China's first full year of WTO membership, the overall average tariff rate fell from over 15 percent to 12 percent. Further tariff cuts are scheduled, with most of them taking place within five years of China's WTO accession.

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

China's WTO accession commitments are having a dramatic effect on tariffs for many products of interest to the United States. Tariffs for some passenger cars were over 100 percent prior to accession, and will be reduced to 25 percent by 2005. China will also reduce its tariffs on auto parts to 9.5 percent by 2005. China's elimination of tariffs on the products covered by the Information Technology Agreement (ITA) – semiconductors and semiconductor manufacturing equipment, computers and computer parts, software, telecommunications equipment and computer-based analytical instruments – began upon accession and is to be completed by 2005. U.S. exports of ITA goods to China continued to expand in 2003, totaling $4.4 billion by the end of the year.

In 2003, the United States, with the support of other WTO members, resolved one notable problem involving China's treatment of fifteen ITA product categories, covering certain semiconductor and telecommunications equipment inputs. When China implemented its 2002 ITA tariff changes, it conditioned the availability of reduced or zero tariffs for these products on the importer's completion of an end-use certificate, to be approved by the Ministry of Information Industry (MII), guaranteeing that the products being imported would be used as inputs into the production of finished information technology

(IT) products in China. This requirement was not authorized by China's WTO accession commitments, and the WTO Committee of Participants in the Expansion of Trade in Information Technology Products (ITA Committee) had rejected this type of condition whenever a WTO member sought to pursue it. The United States pursued this issue bilaterally with the Chinese and blocked China's membership in the ITA Committee until this issue could be resolved. When China made its 2003 tariff changes, it addressed this issue by transferring the certification requirement from MII to the Customs Administration and thereby creating, in essence, a notification process. China was voted into the ITA Committee in April 2003.

A number of other U.S. industrial products benefiting from reduced Chinese tariffs showed strong export growth in 2003. For example, U.S. exports of iron and steel to China increased by 123 percent in 2003 and reached $1.1 billion. U.S. medical and optical equipment exports increased by 28 percent in 2003, rising to $1.6 billion.

In another important sector, tariffs for U.S. priority agricultural products fell from an average of 31 percent to 14 percent on January 1, 2004. China has also reduced its tariffs on frozen beef cuts to 12 percent, frozen potato products and grapes to 13 percent, beef and pork offal, cheese and citrus to 12 percent, frozen poultry parts, apples, pears, almonds and pistachios to 10 percent, paper to 5.4 percent, and wood to 4.2 percent.

However, China plans to maintain high duties on some products that compete with sensitive domestic industries. For example, the tariff on large motorcycles will only fall from 60 percent to 45 percent. Likewise, most video, digital video, and audio recorders and players still face duties of around 30 percent. Raisins face duties of 35 percent.

Tariff Classification

Tariff classification remained a problem in 2003. Customs officers have wide discretion in classifying a particular import. Chemical importers report that they have to "negotiate" tariff classification with customs officers at each port. While foreign businesses might at times have benefited from their ability to negotiate tariff classification into tariff categories with lower import duty rates, lack of uniformity makes it difficult to anticipate border charges.

Customs Valuation

Importers have often reported inappropriate valuation methods by customs officials, resulting in higher-than-necessary customs charges. In early 2002, China released new valuation regulations in order to bring its valuation practices into conformity with the WTO Customs Valuation Agreement.

Despite the issuance of the new valuation regulations, importers report that many Customs officials continue to use minimum and reference price lists rather than the actual transaction price for valuation purposes. While at times this can result in lower import charges – especially for certain luxury imports – it tends to increase fees for many products, ranging from apples to big-ticket machinery and electronic imports. In addition, many Customs officials still automatically apply royalty and software fees to the dutiable value, even though China's new regulations correctly direct them to add those fees only if they have been paid to the exporter as a condition of the particular sale in question.

In 2003, another concern became more immediate. According to reports from U.S. exporters, China was continuing to value digital products based on the imputed value of the content, which includes, for example, the data recorded on a floppy disk or CD-ROM. China committed to discontinue that valuation method by December 11, 2003 and instead implement the WTO Decision on Valuation of Carrier Media Bearing Software for Data Processing Equipment. That decision makes clear that duties are to be assessed on the basis of the value of the underlying carrier medium, meaning, for example, the floppy disk or CD-ROM itself. Following high-level bilateral engagement, China began charging duties on the value of the underlying carrier medium in late 2003.

Rules of Origin

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

Border Trade

Firms along China's borders can receive an exemption from, or reduction in, tariff and licensing requirements based on a regulation issued in 1996. This policy was intended to allow small-scale traders to operate in border communities. The regulation expired in 2000, but in the absence of a new policy governing border trade, customs officials are still applying the 1996 regulation. Larger operators appear to be taking advantage of this system to import bulk shipments across China's land borders into its interior at preferential rates. For some time, China was reluctant to stop such shipments in its economically depressed northern and western areas. The government, however, recently eliminated preferential tariff rates for boric acid and a number of other import items of concern to the United States, although several other products continue to benefit from preferential treatment. China continues to use border trade policies to provide preferential treatment for Russian timber imports, to the detriment of U.S. timber exporters.

Taxation

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

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

Application of China's single most important revenue source – the VAT, which ranges between 13 percent and 17 percent, depending on the product – is uneven. Importers from a wide range of sectors report that, because taxes on imported goods are reliably collected at the border, they are sometimes subject to application of a VAT that their domestic competitors often fail to pay. As discussed above in the section on import substitution policies, China has substantially reduced the VAT rate for semiconductors manufactured in China through a rebate program, while the full VAT must be paid on imported semiconductors. China has also announced the selective exemption of certain fertilizer products from the VAT, to the disadvantage of imports from the United States. Other tax exemption programs, designed to reduce the tax burden on farmers, put U.S. farm imports at a competitive disadvantage. China also retains an active VAT rebate program for exports, although rebate payments are often delayed. In 2003, China announced the reduction of VAT rebates for exports by three percentage points partly in response to foreign complaints about an under-valued RMB. Although State Administration of Taxation officials plan eventually to eliminate rebates as a way to increase tax revenues, the authorities have continued this practice to date in order to spur domestic economic growth.

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

Antidumping, Countervailing Duty and Safeguard Measures

CHINA

China continued to aggressively apply its antidumping law in 2003, initiating six new investigations and completing eleven. Of the newly initiated investigations, five involved U.S. exports. Chemical products are the most frequent targets of Chinese antidumping investigations. China's implementation of its antidumping regime has raised concerns in key areas such as transparency, due process and judicial review. The United States is seeking to clarify and address these concerns both bilaterally and multilaterally. To date, China has not initiated a countervailing duty investigation. At the end of 2003, China removed safeguard measures put in place in 2002 against certain steel products, although the effect of those measures had been reduced by several rounds of exclusions during 2003.

A government restructuring carried out early in 2003 merged the agencies formerly responsible for conducting China's antidumping investigations into MOFCOM. Investigations continue to be conducted under regulations and rules issued by the predecessor organizations, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) and SETC. These regulations and rules were primarily good-faith efforts to implement the relevant WTO commitments and improve pre-WTO measures, including procedures for public hearings, but they remain vaguely worded. In addition, as MOFCOM has conducted investigations under the new regulations and rules, several concerns have developed in key areas such as transparency and due process. Meanwhile, the Chinese People's Supreme Court in Beijing has promulgated rules providing for judicial review of trade remedy determinations, but no case has yet reached the courts.

Non-Tariff Barriers

China's WTO accession agreement obligated China to address many of the non-tariff barriers it had historically used to restrict trade. For example, China is obligated to phase out its import quota system, apply international norms to its testing and standards administration, remove local content requirements, and make its licensing and registration regimes transparent. At the national level, China made progress following its WTO accession in reforming its testing system, revising regulations requiring local content, and improving overall regulatory transparency, including in the licensing area. Despite this progress,

however, as China's trade liberalization efforts moved forward, some non-tariff barriers remained in place and even increased in 2003.

Two years after China's WTO accession, many U.S. industries complain that they face increasing non-tariff barriers to trade. These barriers include regulations that set high thresholds for entry into service sectors such as banking and insurance, selective and unwarranted inspection requirements for agricultural imports, unreasonable rules on biotechnology products, and the use of questionable sanitary and phytosanitary measures to control import volumes.

Many U.S. industries have also complained about China's manipulation of technical standards. In fact, several national officials have stated openly in the state-run media that China should manipulate technical standards to limit imports. At the sub-national level, importers have expressed concern that local officials do not understand China's WTO commitments and are not prepared to relinquish control over the local economy. These problems are compounded by the fact that coordination between the State Administration for Quality Supervision and Inspection and Quarantine (AQSIQ) and its new affiliated bodies, the China National Certification and Accreditation Administration (CNCA) and the Standardization Administration of China (SAC), is lacking, as is coordination between these bodies and China Customs and other local implementers of standards and import regulations.

Import Quotas

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

In the past, China often did not announce quota amounts or the process for allocating quotas. The government set quotas through negotiations between central and local government officials at the end of each year. Under the terms of its WTO accession agreement, China must make quotas available at agreed levels that increase 15 percent each year. China is required to allocate quotas to importers based on detailed rules outlined in China's accession agreement. For some products, such as autos, China's implementation of the required quota system has been characterized by unwarranted delay, lack of transparency and inappropriate allocations in both 2002 and 2003.

Monopoly importers have also been able to establish *de facto* quotas that maximize their monopoly rents. For example, the sole official government theatrical film importer informally limits the number of foreign motion pictures for theatrical release it allowed each year. In 2001, this number was ten. In its WTO accession agreement, China committed to allow 20 foreign films to be distributed annually in China on a revenue-sharing basis.

Tariff-Rate Quotas

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

As part of its WTO accession commitments, China was to establish large and increasing TRQs for imports of wheat, corn, rice, cotton, wool, sugar, vegetable oils, and fertilizer, with most in-quota duties ranging from 1 percent to 9 percent. Each year, a portion of each TRQ is to be reserved for importation through non-state trading entities. China's accession agreement sets forth specific rules for administration of the TRQs, including increased transparency and reallocation of unused quota to end-users that have an interest in importing.

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

China's performance improved in certain respects during 2002, and 2003 TRQs were issued close to the prescribed times. However, the U.S. Government remained concerned, particularly because 2002 trade data showed extremely low fill-rates for the TRQ commodities of most interest to U.S. industry. The quota fill-rates for wheat, corn and cotton were 7 percent, 0.1 percent and 22 percent, respectively.

While the United States' efforts in 2003 focused on ensuring that necessary systemic changes were made by the National Development and Reform Commission (NDRC), exports of some bulk agricultural commodities from the United States increased dramatically primarily due to market conditions. In particular, U.S. cotton exports totaled $737 million during 2003, representing a 423 percent increase over 2002.

Nevertheless, in 2003, the most serious problems – lack of transparency, sub-divisions of the TRQ, small allocation sizes and burdensome licensing – persisted. In June 2003, following high-level meetings between the United States and China, China agreed to take steps to address most of these concerns. China followed through in part in October 2003, when it issued new regulations for shipments beginning January 1, 2004. Key changes made by these regulations include the elimination of separate allocations for general trade and processing trade, the elimination of certain unnecessary licensing requirements, and the creation of a new mechanism for identifying allocation recipients.

Import Licenses

In the early 1990s, China began to reduce substantially the number of products subject to import licensing requirements. With its WTO accession, China committed to the fair and non-discriminatory application of licensing procedures.

Among other things, China committed upon its WTO accession to limit the information that a trader must provide in order to receive a license, to ensure that licenses are not unnecessarily burdensome, and to increase transparency and predictability in the licensing process. MOFTEC issued new regulations and implementing rules to facilitate licensing procedures shortly after China's accession. However, license applicants reported that they have had to provide sensitive business details unnecessary for simple import monitoring.

In some sectors, importers also reported that MOFTEC was using a "one-license-per-shipment" system rather than providing licenses to firms for multiple shipments. This system acted as an impediment to trade. MOFTEC began to allow more than one shipment per license in late 2002 following U.S. interventions, although the measure authorizing the "one-license-per-shipment" system apparently remains in place.

China's inspection and quarantine agency, AQSIQ, has also imposed inspection-related requirements that had the effect of restricting imports of some U.S. agricultural goods. In particular, two AQSIQ measures issued in 2002 require importers to obtain an import inspection permit or a quarantine permit for many agricultural goods before they can enter China, such as livestock, poultry, grains, oilseeds, planting seeds, horticultural products, and hides and skins. U.S. exporters have been concerned that AQSIQ is using the procedures provided for by these measures to control the pace and quantity of some imports, which would be contrary to China's market access and import licensing commitments. They have also been concerned about the burdensome nature of these procedures and reported selective enforcement by AQSIQ. Following multiple U.S. interventions, some progress appeared to have been achieved in early 2003, as China discontinued arbitrary limits on imported poultry and pork shipments. However, many concerns of U.S. exporters have not yet been addressed.

Export Licenses and Fees

Over the last several years, China has progressively reduced the number of products requiring some type of export license. In 2003, China continued this trend, as it freed up two more categories of products from this requirement. However, 52 categories of products (equaling 338 items at the 8-digit tariff level) are still subject to various types of export licenses. Products still requiring export licenses include some grains, cotton, livestock, raw materials and metals, lethal chemicals, and food products. For some products, such as fluorspar and coke, export licenses require exporters to pay fees beyond the administrative costs of administering an export license system and are accompanied by export quotas. In addition, China still occasionally imposes new export licensing requirements on strategically sensitive commodities.

China also requires export licenses on products that are the subject of antidumping duties in a foreign market. However, the central government has delegated responsibility for issuing these licenses to quasi-governmental industry associations formed to take the place of the ministries that governed production during the earlier central planning era. Foreign investors report that the industry associations are using the power to issue export licenses to force companies to participate in association-supported activities. For example, the steel producers' industry association will not issue an export license to any company that does not contribute to its antidumping defense funds.

STANDARDS, TESTING, LABELING AND CERTIFICATION

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

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

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

China's designated standards notification authority, the Ministry of Commerce, has been notifying proposed standards, technical regulations and conformity assessment procedures to WTO members, as required by the WTO Agreement on Technical Barriers to Trade (TBT Agreement). Almost all of these notified TBT measures have emanated from AQSIQ, however, and have not included measures that should be notified from other agencies. In late 2003, in part to address this problem, China reportedly formed a new inter-agency committee, with representatives from approximately 20 ministries and agencies and chaired by AQSIQ, to achieve better coordination on TBT (and SPS) matters.

In 2003, as in 2002, the comment periods established by China for notified TBT measures in some cases were unacceptably brief. In other cases, insufficient time was provided for Chinese regulatory authorities to consider interested parties' comments before a regulation was adopted. In addition, China failed to notify many measures emanating from AQSIQ and other agencies that should have been notified according to the terms of the TBT Agreement.

Meanwhile, in 2003, after China's formerly separate bureaucracies for imported and domestic goods settled into unified entities, Chinese standards agencies developed a closer working relationship with the U.S. Government and private sector, including joint technical programs and ongoing consultations on issues related to standardization and conformity assessment. To increase U.S.-China cooperation on standards issues, the United States obtained AQSIQ's support in principle for the establishment of a new U.S. private sector standards office in China. This new office will focus on strengthening ties with Chinese government regulatory authorities, Chinese industry associations and Chinese standards developers and on ensuring that close communication exists between U.S. and Chinese standards developers. The United States has also increased its technical assistance to China in the standards area, with programs addressing pharmaceuticals, medical devices, building materials, fertilizer and information and communications technology.

China banned imports of U.S. beef in December 2003 with the detection of one positive case of Bovine Spongiform Encephalopathy (BSE) in the State of Washington. As of the publication of this report, the U.S. government is taking aggressive action and is working intensively to re-open the market as quickly as possible. In addition, the United States is working in the International Organization for Epizootics to revise international standards on BSE to reflect current scientific knowledge.

Wireless LAN Encryption Standards

In May 2003, China issued two mandatory standards for encryption over Wireless Local Area Networks (WLANs), applicable to domestic and imported equipment containing WLAN (also known as Wi-Fi) technologies. These standards, which are scheduled to become fully effective in June 2004, incorporate the WLAN Authentication and Privacy Infrastructure (WAPI) encryption technique for secure communications. This component of the standards differs significantly from the internationally recognized standards that U.S. companies have adopted for global production. China is enforcing its use by providing the necessary algorithms only to a limited number of Chinese companies. Accordingly, U.S.

and other foreign manufacturers would have to work with and through these companies, some of which are their competitors, and provide them with technical product specifications, if their products are to continue to enter China's market.

China's WLAN encryption policy is a matter of grave concern to the U.S. Government and U.S. companies. If this policy goes into effect, China would be the only country in the world mandating a specific encryption standard for general consumer use. The United States is particularly concerned that the new standards would require foreign suppliers to enter into joint ventures with Chinese companies and transfer technology to them. This type of compelled investment and technology transfer would appear to be inconsistent with China's WTO commitments. It also raises other serious WTO concerns, including the use of standards that are more trade-restrictive than necessary to fulfill a legitimate objective. As a technical matter, these new standards also should have been notified to the WTO.

The Administration has repeatedly pressed China on this issue since the issuance of the new standards, including during the run-up to the April 2004 JCCT meetings. Most recently, in early March 2004, the Administration demonstrated the seriousness of its concern in a joint letter from Commerce Secretary Evans, Secretary of State Powell and U.S. Trade Representative Zoellick to Vice Premiers Wu Yi and Zeng Peiyan.

Quality and Safety Certification

In December 2001, CNCA promulgated a new compulsory product certification system. Under this system, there is one quality and safety mark, called the "China Compulsory Certification" (or CCC) mark, for both Chinese and foreign products. Under the old system, domestic products were only required to obtain the Great Wall mark, while imported products in some cases needed both the Great Wall mark and the CCIB mark. The new CCC mark system took full effect on August 1, 2003, following a transition period that lasted for fifteen months, and is required for over 100 product categories.

Despite these positive changes, U.S. companies in some sectors have complained that certification remains a difficult, time-consuming and costly process. The process involves on-site inspection of manufacturing facilities outside of China, the cost of which is borne by producers. Some U.S. companies report that China is applying the CCC mark requirements inconsistently. Some shipments of imported products that do not require a CCC mark have been denied entry by Customs. In other cases, companies that apply for the CCC mark have found their shipments of product samples, required for testing during the CCC mark application process, blocked by Customs, despite regulations permitting the import of such product samples.

In special circumstances, like the import of replacement parts or the import of parts for assembly in China and re-export, companies can seek an exemption from CCC mark requirements. However, smaller and medium-sized U.S. companies without a presence in China find it burdensome to apply for these exemptions, because China requires the applications to be done in person in the Beijing offices of CNCA.

In addition, under the CCC mark system, China will not accept foreign manufacturers' self-certification of conformance to Chinese standards. Products must be tested in designated laboratories in China. Chinese officials must also inspect and certify manufacturing facilities before products can be certified for import into China, with annual follow-up inspections. These inspections are time-consuming and costly for producers. In 2003, China took measures to reduce the costs of the follow-up inspections by permitting certain U.S. private-sector testing companies to conduct the follow-up inspections on behalf of CNCA.

Redundant Testing

U.S. companies have expressed concern about continued requirements for redundant testing, particularly for cosmetics, pharmaceuticals, medical equipment, cellular telephones and other telecommunications products and consumer electronic products. For example, telecommunications equipment faces CNCA quality and safety tests, but then MII conducts functionality tests that overlap the CNCA tests.

Sanitary and Phytosanitary Measures

China's phytosanitary and veterinary import standards sometimes are based on dubious scientific principles and have not always been consistently applied. To advance its bid to join the WTO, China addressed certain longstanding barriers to U.S. agricultural imports. China agreed to lift bans on imports of U.S. grain, citrus, and meat and poultry with the signing of the U.S.-China Agricultural Cooperation Agreement (ACA) in April 1999. In particular, China agreed to recognize the U.S. certification system for meat, promising to accept U.S. beef, pork, and poultry meat from all USDA-certified plants. China also lifted its ban on imports of citrus from the United States, allowing imports of citrus from most counties in Arizona, California, Florida, and Texas. In addition, China lifted its ban on imports of wheat and other grains from the U.S. Pacific Northwest and promised to allow the import of U.S. wheat that meets specified tolerances for TCK fungus. China's implementation of the ACA has produced mixed results, however. This situation continued in 2003.

China has imposed a "zero tolerance" standard for certain pathogens in imported uncooked meat and poultry. While it is possible to reduce contamination through cooking, the complete elimination of pathogens in uncooked meat and poultry is not reasonably achievable, nor scientifically justifiable. It has resulted in the de-listing of four U.S. processing plants, and it has so far proven impossible to get these plants re-listed, as AQSIQ is requiring U.S. health authorities to identify and correct problems in these plants when U.S. authorities believe none exist. With regard to citrus, China continues to hold up the approval of imports from four counties in Florida. Additionally, while Chinese quarantine officials did approve Pacific Northwest wheat imports, traders reported that quarantine officials required special treatment of some wheat imported from the Pacific Northwest, effectively discouraging imports.

Phytosanitary barriers also continued to block imports of several other U.S. products in 2003, including stone fruit, several varieties of apples, pears, fresh potatoes and processed food products containing certain food additives.

A separate problem arose in November 2002, when AQSIQ issued a decree imposing new requirements for certification of imported seafood products, which was scheduled to go into effect in December 2002. The certification requirements appeared to exceed what is necessary to protect consumer health and discriminated against imported seafood products. Prompt U.S. intervention secured a delay in the implementation of these new requirements until June 2003, and the United States used that time to work with the Chinese authorities to eliminate some of the more burdensome certification requirements. However, U.S. industry remains concerned about the certification requirements as implemented, and the United States has continued to pursue technical discussions with the Chinese authorities in an effort to resolve those concerns. Meanwhile, AQSIQ issued a similar decree requiring the certification of live aquatics, which went into effect in November 2003. The United States is pursuing technical discussions with the Chinese authorities on this decree as well.

In August 2003, AQSIQ announced plans to suspend soybean imports from four companies trading U.S. soybeans, along with companies from Argentina and Brazil. According to AQSIQ, this action was based on detections of Phytophthora sojae in shipments of soybeans beginning in the Spring of 2003. However, there was no apparent legitimate purpose for AQSIQ's months-long delay in making the announcement, and it is unusual for an inspection and quarantine agency to announce plans for a suspension but not set a specific date upon which the suspension would take place. These circumstances suggested that AQSIQ's intent was to disrupt the importation of U.S. soybeans, and not to address a legitimate phytosanitary concern. Indeed, the presence of Phytophthora sojae in soybeans is ubiquitous in many parts of the world, including China. In September 2003, following high-level U.S. interventions, China agreed to technical level meetings of U.S. and Chinese agricultural experts, and in the interim it committed not to impose the suspensions.

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

China's Biotechnology Regulations

In January 2002, the Ministry of Agriculture (MOA) issued new rules implementing a June 2001 regulation on agricultural biotechnology safety, testing and labeling. The product most affected was soybeans. However, the implementing rules did not provide adequate time for completion of required safety assessments before their effective date of March 20, 2002.

In response to U.S. interventions, China issued "interim" regulations which have allowed trade to continue while authorities carry out safety assessments of transgenic products. These interim rules have been extended twice and will expire in April 2004. In December 2003 talks, MOA officials promised that permanent approval of Round-up Ready soybeans would be complete at least 60 days before expiration of the interim regulations, which should prevent any trade disruption. China followed through on this promise and approved Round-up Ready soybeans, along with two cotton varieties and two corn varieties, in February 2004. However, because of delays in conducting required tests, MOA could not promise when approvals would be completed for six other corn varieties planted in the United States.

Substantial U.S. concerns with China's biotechnology regulation and implementing rules remain, particularly with regard to risk assessment (including the administration of field trials), labeling and inter-ministerial coordination of biotechnology policy. China is a signatory to the Convention on Biodiversity, but has yet to ratify the Biosafety Protocol.

Labeling

The U.S. processed food industry has registered its concerns with a number of standards and labeling requirements on its exports to China. The meat industry in particular is concerned that new meat labeling regulations promulgated in late 2002 have several requirements that go beyond those of any other country. They assert that these requirements are unnecessary and costly.

Agricultural importers and importers of processed foods are also concerned about new measures requiring labels for products containing transgenic material, such as soybeans and corn. The June 2001 biotechnology regulations issued by MOA require labeling of bulk commodities, but implementation has been limited and sporadic. Future implementation of these measures remains uncertain.

The distilled spirits industry is concerned that China will require its products to comply with all existing food labeling regulations. The industry believes that some of these requirements are inappropriate since the industry does not consider distilled spirits to be a food.

CHINA

EXPORT SUBSIDIES

China officially abolished subsidies in the form of direct budgetary outlays for exports of industrial goods on January 1, 1991. China agreed to eliminate all forms of export subsidies on industrial (and agricultural) goods upon its accession to the WTO in December 2001.

It is difficult to identify and quantify possible export subsidies in China because of the lack of transparency in China's subsidy regime. Chinese subsidies are often the result of internal administrative measures and not publicized. They can also take a variety of forms, including mechanisms such as credit allocations or low-interest loans. U.S. industry has alleged that subsidization is a key reason that Chinese exports are undercutting prices in the United States and gaining market share. Of particular concern are China's subsidization practices in the textiles industry as well as in the steel, petrochemical, machinery and copper and other non-ferrous metals industries. U.S. subsidy experts are currently seeking more information about several Chinese programs and policies that may confer export subsidies. Their efforts have been frustrated in part because China has failed to make any of its required subsidy notifications since becoming a member of the WTO.

U.S. agriculture exporters have expressed concern that China continues to use export subsidies for corn. In both 2002 and 2003 China's corn exports exceeded 12 million metric tons, compared to 6 million tons in 2001. It appears that corn, including corn from Chinese government stocks, is being exported at prices 20 percent to 30 percent below domestic Chinese prices. As a result, U.S. corn exporters have lost market share in Asia, while China is exporting record amounts of corn. China claims that it stopped using subsidies in March 2002, and instead supports exports with various WTO-consistent measures, such as transportation subsidies and VAT rebates. Because export procedures are not transparent, it is difficult to determine what effect these measures have on export prices. However, the VAT rebate appears to account for only a small proportion of the difference between export prices and domestic prices.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

While China has made significant progress in its efforts to make its framework of laws, regulations and implementing rules WTO-consistent have been largely satisfactory, serious problems remain with China's enforcement of IPRs. Throughout 2003, the need for improvements in China's enforcement efforts was a major focus of the Administration's engagement with China. In meetings with the U.S. Government and U.S. industry, China's leaders have acknowledged the importance of improving IPR enforcement and have stated that China can improve its enforcement record. China's leaders appear to recognize that deficiencies in the protection and enforcement of IPR are impeding knowledge-based, value-added trade and investment. The appointment of Vice Premier Wu Yi to head a new Leading Group on IPR issues in the October 2003 signals that China recognizes the need for more focused and sustained efforts to tackle the IPR enforcement problems.

Legal Framework

In anticipation of its accession to the WTO, China began modifying the full range of IPR laws, regulations and implementing rules, including those relating to patents, trademarks and copyrights, in an effort to become compliant with the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement). By the end of 2001, China had completed amendments to its patent law, trademark law and copyright law, along with regulations for the patent law. In 2002, after it had acceded to the WTO, China issued regulations for the trademark law and the copyright law. China also issued various sets of implementing rules covering specific subject areas, such as integrated circuits, computer software and pharmaceuticals. In 2003, China issued several other new measures. In the patent area, the State Council issued the Amendments to the Patent Law Implementing Measures. In the trademark area, the State Administration of Industry and Commerce issued the Rules on the Determination and Protection of Well-Known Trademarks, the Measures on the Implementation of the Madrid Agreement on Trademark International Registration and the Measures on the Registration and Administration of Collective Trademarks and Certification Marks. In the copyright area, the National Copyright Administration of China issued the Measures on the Implementation of Administrative Penalties in Copyright Cases. These regulations and implementing rules have generally been well-received by U.S. companies as steps toward full compliance with China's TRIPS Agreement obligations. Overall, while China could make improvements to its legal framework, the legal changes made by China are major improvements.

By the end of 2003, with copyright infringement on the Internet becoming a growing phenomenon in China because of loopholes in existing regulations and implementing rules, China still had not acceded to the 1996 World Intellectual Property Organization (WIPO) Internet-related treaties. These treaties entered into force in 2002 and have been ratified by many developed and developing countries. The United States considers the WIPO treaties to reflect international norms for providing copyright protection over the Internet. While China's existing regulations and implementing rules do address certain copyright issues related to the Internet, and China is reportedly in the process of drafting further Internet-related implementing rules, China needs to accede to the WIPO treaties and harmonize its regulations and implementing rules with them to meet international norms. China's accession to the WIPO treaties is an important priority for the United States and many other countries because China has the second largest number of Internet users of any country in the world.

Enforcement

Although the central government worked effectively to modify the full range of China's IPR laws and regulations in an effort to bring them into line with China's WTO commitments, IPR enforcement continues to be seriously inadequate. In 2003, IPR infringement in China continued to affect products, brands and technologies from a wide range of industries, including films, music, publishing, software, pharmaceuticals, chemicals, information technology, consumer goods, electrical equipment, automotive parts and industrial products, among many others. According to a July 2003 report by the State Council's Development Research Center, the market value of counterfeit goods in China is between $19 billion and $24 billion, which translates into enormous losses for IPR rights holders. Various U.S. copyright holders report that inadequate enforcement has resulted in piracy levels in China that have remained at 90 percent or above in 2003 for all copyright sectors, and that estimated U.S. losses due to the piracy of copyrighted materials continues to exceed $1.8 billion annually.

China's IPR laws and regulations provide for three different mechanisms for IPR enforcement – enforcement by administrative authorities, criminal prosecutions and civil actions for monetary damages. However, China's IPR enforcement efforts are hampered by lack of coordination among Chinese government ministries and agencies, local protectionism and corruption, high thresholds for initiating investigations and prosecuting cases, lack of training and inadequate administrative penalties. China needs to take immediate steps to improve each of these enforcement methods, particularly by improving access to and application of criminal enforcement measures. The United States has repeatedly urged China to take immediate and substantial steps to put it on the path toward effective enforcement mechanisms, and it has also sought to foster improvements through a variety of technical assistance programs.

Administrative Enforcement. China continues to take a large number of administrative enforcement actions against IPR violators. However, these actions do not appear to deter further infringements of IPRs.

Although the central government continues to promote periodic anti-counterfeiting and anti-piracy campaigns, and these campaigns result in high numbers of seizures of infringing materials, counterfeiting and piracy remain rampant. Administrative cases usually result in extremely low fines. Fine amounts are kept artificially low because many administrative authorities do not calculate fines on the basis of the value of the genuine articles, but rather establish value based on the price charged for the counterfeit or pirated goods. In addition, evidence showing that a person was warehousing infringing goods is not sufficient to prove an intent to sell those goods. As a result, the administrative authorities often do not include those goods in the value of the infringing goods when determining the fine amounts. The problem is compounded because the administrative authorities rarely forward cases for criminal investigation, even for commercial-scale counterfeiting or piracy. As a result, the infringers consider the seizures and fines simply to be a cost of doing business, and they often are able to resume their operations.

It is crucial for the administrative authorities to begin to refer cases to the Supreme People's Procuratorate for criminal prosecution. At the same time, China needs to revise its IPR legal framework to provide for substantially higher administrative fines. In addition, for these fines to have a deterrent effect, the administrative authorities need to provide greater transparency throughout the enforcement process, issue written decisions and publicize the results.

Criminal Enforcement. Effective criminal enforcement offers the deterrence needed for China to begin to handle the rampant IPR infringement hurting both foreign and domestic enterprises. Application of criminal procedures and remedies in cases of willful trademark counterfeiting and piracy on a commercial scale is required by the TRIPS Agreement.

At present, criminal enforcement has virtually no deterrent effect on infringers. China's authorities have pursued criminal prosecutions in a small number of cases, and a lack of transparency makes it difficult to determine if the cases resulted in convictions and, if so, what penalties were imposed. If this situation is to change, China needs to revise its laws and regulations to make it easier to prosecute criminal cases and then to prosecute a much higher percentage of IPR infringers, particularly those engaged in commercial-scale counterfeiting or piracy and repeat offenders.

One critical legal change involves criminal liability thresholds. At present, these thresholds are very high and seldom met. For example, under a Supreme People's Court interpretation, in order to bring a criminal action against an alleged copyright infringer, there must be evidentiary proof of sales totaling RMB 200,000 ($24,100) for enterprises and RMB 50,000 ($6,030) for individuals. This proof-of-sale requirement has proved unworkable, as it does not apply to counterfeit or pirated goods discovered in a warehouse but not yet sold, and infringers generally do not issue receipts or keep detailed records of the sales that they have made. The proof-of-sale requirement is also misguided, as the amount of counterfeit or pirated goods sold should only be relevant to the severity of the penalty imposed, not to the decisions to investigate, prosecute or convict. In its WTO accession agreement, China committed that its administrative authorities would work with the Supreme People's Court in an attempt to address these concerns, but this work has not yet been completed.

A significant related concern in the criminal enforcement area involves the scope of China's laws and regulations. China needs to broaden its laws and regulations so that they do not apply only when a sale can be proved. China's laws and regulations would be much more effective if they also applied to the willful manufacture, storage, distribution and use of counterfeit and pirated goods. Similarly, China's failure to consider the export of counterfeit or pirated goods on a commercial scale as related to a criminal act remains a problem.

China also needs to increase the criminal penalties provided for in its laws and regulations. In particular, the prison terms prescribed are too short to deter infringers engaged in commercial-scale counterfeiting or piracy.

U.S. companies complain that, in most regions of China, the police are either not interested in pursuing counterfeiting and piracy cases or simply lack the resources and training required to investigate these types of cases effectively. In addition, in some circumstances, it is not clear under China's laws and regulations whether a particular activity warrants administrative, civil or criminal enforcement. Moreover, even when IPR violations are referred for criminal enforcement, the actual prosecution of IPR crimes frequently requires coordination among a relatively large number of agencies at the national and local levels. Coordination remains problematic, however, with different agencies apparently unwilling or unable to work together.

Civil Enforcement. In part because of the ineffectiveness of the administrative and criminal enforcement mechanisms in China, there has been an increase in the number of civil actions brought for monetary damages or injunctive relief. Most of these actions have been brought by Chinese right holders, but recently an increasing number of foreign right holders are also pursuing civil actions. This increased use of civil actions has coincided with an increasing sophistication on behalf of China's IPR courts, as China continues to make efforts to upgrade its judicial system. However, U.S. companies complain that there is still a lack of consistent and fair enforcement of China's IPR laws and regulations in the courts. They have found that most judges lack necessary technical training and that court rules regarding evidence, expert witnesses, protection of confidential information are vague or ineffective. In addition, in the patent area, where enforcement through civil litigation is of particular importance, a single case can still take four to seven years to complete, rendering the new damages provisions adopted to comply with the TRIPS Agreement less meaningful.

SERVICES BARRIERS

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

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

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

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

Insurance Services

China's insurance market is growing steadily, but not as quickly as its potential. Some experts believe potential revenues for foreign and domestic insurers could reach $15 billion per year after a full opening of the market. Since 1992, China has allowed foreign firms limited access to its insurance market. Prior to 2001, 16 foreign insurers reportedly received licenses to operate either in Shanghai or in Guangdong Province. The pace of opening increased rapidly in 2001 when the China Insurance Regulatory Commission (CIRC) committed to accept an additional 16 license applications from foreign firms.

In its WTO accession agreement, China committed to a gradual opening of both its life and non-life insurance sectors. Foreign life insurers are limited to a 50 percent equity stake in a joint venture, while non-life firms are limited to a 51 percent stake. After two years, non-life firms can be wholly foreign-owned. Geographic restrictions will also be removed over the next three years.

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

China's insurance company capital requirements are extremely high and many foreign firms complain they act as a barrier to market access and in some cases to finding a suitable joint venture partner. A national license which includes a main office and three branch offices requires a capital infusion of RMB 500 million ($60 million), while a regional license which includes a main office and two branch offices requires a capital infusion of RMB 200 million ($24 million). Once a firm has a national license, an additional RMB 50 million ($6 million) capitalization will be required for additional branches. CIRC has recently issued draft regulations that would reduce capital requirements for national licenses to RMB 200 million and reductions for branch offices to RMB 20 million ($2.4 million), but these regulations have yet to be finalized.

With regard to transparency, the regulations continue to permit considerable bureaucratic discretion and create uncertainty for foreign insurers seeking to operate in China's market. This lack of transparency has manifested itself particularly in the licensing process. Foreign firms complain that the insurance licensing requirements are overly complex and cumbersome. The regulations are also unclear as to whether multiple branch and sub-branch expansion applications may be submitted simultaneously or can only be submitted at intervals. CIRC has also insisted that non-life insurers that are already in the market as a branch and that wish to branch or sub-branch cannot do so unless they first establish as a subsidiary, a costly – and unnecessary – proposition.

Currently, approximately 50 insurance companies operate in China's market. Approximately 30 of them are foreign firms (operating joint ventures with Chinese partners), and 20 of them are Chinese firms. By the end of 2003, the operations of foreign insurers in China had grown significantly. While foreign insurers had only about 2 to 3 percent of the national market (when measured in terms of premiums paid), they reportedly had captured 12 percent and 17 percent market shares in Shanghai and Guangzhou, respectively. In addition, U.S. industry reports that its market share in Beijing has been growing rapidly.

Banking and Securities Services

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

China continues to have strict limitations, in particular, on foreign banks' participation in local currency operations. Restrictions on the rights of foreign banks to raise RMB in the interbank market, being planned by the People's Bank of China (PBOC), China's central bank, will inhibit the ability of foreign banks to build RMB loan portfolios necessary for profitable operations in China. In addition, although China reduced capital requirements for foreign bank branches in December 2003, they still remain excessively high, increasing local capital costs for foreign banks.

In December 2001, the Chinese government issued revised regulations permitting the establishment of foreign bank branches anywhere in China so long as the bank meets certain criteria, including having gross assets of $20 billion. Although foreign currency business with any customer, foreign or domestic, is also freely permitted under the new regulations, the Bank of China, one of China's four major state-owned commercial banks, continues to enjoy a monopoly on forward foreign exchange contracts. Foreign bank branches must also place 30 percent of their operating capital in interest bearing assets designated by the PBOC. Foreign bank branch current assets (cash, local bank demand deposits, and

PBOC deposits) must continue to be greater than 25 percent of customer deposits. In addition, the ratio of customer deposits in foreign currency to domestic foreign currency loans may not exceed 70 percent, an increase from the 40 percent-level mandated previously. China calculates prudential ratios and limits based on the local capital of foreign bank branches rather than on the global capital base of the bank.

As part of its WTO accession agreement, China agreed to allow foreign banks to conduct local currency business with Chinese companies two years after WTO entry, and with Chinese individuals three years later. The Chinese government also committed to opening four new cities every year where foreign banks could engage in local currency operations. Regulations released in December 2001 place the authority for determining the geographic and operational scope for foreign financial institutions to participate in local currency business with the PBOC. As of December 2003, four new cities were opened – Jinan, Fuzhou, Chengdu and Chongqing – bringing the total number to 13. Qualified foreign banks will also be allowed to conduct local currency business with Chinese enterprises for the first time in these areas. In December 2003, the Chinese Government also increased the stake a single foreign investor can take in a Chinese bank from 15 to 20 percent, with a total 24.9 percent allowed for all foreign investors. All non-prudential market access and national treatment restrictions on foreign banks are to be lifted within five years of China's accession to the WTO.

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

Motor Vehicle Financing Services

China's WTO accession agreement required China to allow non-bank financial institutions to provide motor vehicle financing immediately upon accession and without any limits on market access. However, heading into 2003, China's second year of WTO membership, China still had not issued regulations allowing the entry of foreign non-bank auto financial services companies. Following repeated U.S. engagement with China, both bilaterally and at WTO meetings, China issued motor vehicle financing regulations in October 2003. The necessary implementing regulations came out in November 2003, opening up this sector to foreign financial institutions.

Several foreign firms, including at least one U.S. company, have since applied for licenses. Although the regulations as finally issued reduced capital requirements from the levels set in earlier drafts, capital requirements still remain relatively high. In addition, access to local currency still presents problems for foreign firms.

Wholesale Distribution Services

In its WTO accession agreement, China committed to eliminate national treatment and market access restrictions on foreign enterprises seeking to provide wholesaling and commission agents' services and related services, such as repair and maintenance services, through a local presence within three years of China's accession (or by December 11, 2004), subject to limited product exceptions. In the meantime,

China agreed to progressively liberalize its treatment of these services pursuant to a set schedule. The phase-in of these services was supposed to start with minority foreign-owned joint ventures by December 11, 2002, followed by majority foreign-owned joint ventures by December 11, 2003.

For the most part, China's implementation efforts have been problematic. In particular, China has fallen behind in its implementation of the required progressive liberalization, as foreign businesses continue to be plagued by a variety of restrictions relating to trade volumes, registered capital and prior experience. It is also not clear whether these businesses will be allowed simply to amend their business licenses to receive authorization to provide these distribution services, or whether the establishment of new enterprises will be required. In addition, there has been no indication whether foreign businesses will be required to license separate units of their China operations to conduct distribution activities, or whether they will be allowed to integrate these activities under a single entity.

MOFCOM and other relevant government agencies are apparently working to revise the existing regulatory framework to satisfy China commitment to full liberalization by December 11, 2004. However, the relevant authorities have maintained drafts of all new regulations in strict confidence, making it difficult to predict how China will actually implement this commitment. The Administration has been using the run-up to the April 2004 JCCT meetings to press China to issue new WTO-compliant regulations in draft form for public comment well in advance of the December 11, 2004 deadline.

Retailing Services

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

China's WTO commitments are designed to further expand the ability of foreign retailers to enter the market through a much wider range of modalities. Smaller retail operations, some large retail operations, gas stations and even car dealerships will be allowed to be wholly foreign-owned within three to five years of China's December 11, 2001 WTO accession. In addition, franchising, sales away from a fixed location (both wholesale and retail), and related subordinate activities will be permitted without restrictions within three years of accession. Certain types of large retail operations, however, may still face ownership limitations.

China was required to begin phasing in most of these commitments for joint ventures with minority foreign ownership upon its accession and for majority foreign-owned joint ventures two years later, subject to geographic restrictions, quantitative restrictions and exceptions for a handful of listed goods. To date, although China has authorized retailing services to be supplied through joint ventures, it greatly restricts the supply of these services. For example, onerous threshold requirements (relating to minimum wholesale volume, minimum imports and exports, minimum assets, minimum registered capital and prior experience) significantly reduce the number of enterprises that can qualify for the right to supply retailing services. These requirements are burdensome and trade-restrictive. In addition, China subjects joint ventures to cities' commercial development plans. China is also currently drafting regulations governing certain activities of foreign retailers that appear to raise national treatment concerns.

Direct selling remains a prohibited sector in China. In 1998, China banned all direct selling activities because some foreign and domestic firms used direct selling techniques to operate pyramid schemes and other less-than-legitimate operations. Direct selling firms were allowed to convert to more traditional fixed location retailers, but were only permitted to sell products manufactured in China. China indicated that it would allow full resumption of direct selling activities by December 2004, consistent with the commitment that it made in its WTO accession agreement. China is currently drafting regulations to implement this commitment.

As in the case of wholesale distribution, the Administration has been using the run-up to the April 2004 JCCT meetings to press China to issue new WTO-compliant retailing regulations in draft form for public comment well in advance of the December 11, 2004 deadline.

Express Delivery Services

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

In July 2003, however, China circulated draft amendments to its postal services law that generated two immediate concerns among U.S. companies. First, the draft amendments purported to give China Post a monopoly over the delivery of letters under 500 grams, which would have constituted a new restriction on the scope of activities of existing foreign-invested express delivery companies, contrary to China's horizontal "acquired rights" commitment. Second, the draft amendments did not address the need for an independent regulator. In September, October and November 2003, China circulated new sets of draft amendments. While each set of draft amendments included a different definition of the China Post monopoly, the most recent draft amendments again provided China Post with a monopoly on letters weighing less than 500 grams. They also included other problematic provisions. For example, they appeared to create a new licensing process to replace the existing entrustment process, and they seemed to require express couriers to pay a percentage of their revenue from express shipments into a universal service fund.

To date, no final amendments have been issued. Working closely with U.S. industry, the U.S. Government has continued to urge China during the run-up to the April 2004 JCCT meetings not to issue amendments that would be inconsistent with its WTO obligations.

Transportation and Logistics Services

The transportation and logistics sector has in the past faced severe regulatory restrictions, high costs, dominance by government-invested agents, and limitations on permitted activities. The multiple government bodies responsible for this sector include: the Ministry of Communications, the Ministry of Railways, MOFCOM, NDRC and the Civil Aviation Administration of China. Overlapping jurisdictions, multiple sets of approval requirements, and opaque regulations hinder market access. Domestic firms have used government connections and investments to monopolize the sector. Foreign shipping firms have found it impossible to open subsidiaries in inland ports.

Nevertheless, China's WTO commitments support a broad opening of the transportation and logistics sector to foreign service providers, as do China's own reform policies. After periods of time ranging from three to six years after WTO accession, foreign firms are supposed to be able to invest freely in warehousing, road freight transport, rail freight transport and freight forwarding companies.

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

China's international maritime transportation regulations became effective January 1, 2002. Implementing rules issued in June 2002 raised various concerns, particularly with their imposition of a requirement that non-vessel-operating common carriers make a cash deposit of RMB 800,000 (about $100,000) in Chinese banks without clear rules on access to and use of this money. In December 2003, however, the United States and China signed a bilateral maritime agreement that allowed the use of surety bonds and also settled a range of maritime issues between our two countries.

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

Regulation of International Data Flows and Restrictions on Data Processing

Chinese authorities routinely filter Internet traffic entering China, focusing primarily on the content they deem objectionable on political, social or religious grounds. In 2002, China lifted filters on most major western news sites. However, according to a Harvard University study, China has blocked 19,032 sites on multiple occasions. In addition to blocking sites related to Taiwan, the Falun Gong spiritual movement, Tibetan and Uighur support groups, and human rights organizations focusing specifically on China, university alumni homepages such as that for MIT, various Church and other religious-themed sites, and search engines such as Alta Vista, have been blocked repeatedly. Foreign news websites were also blocked for several weeks during the 16th National Congress of the Communist Party of China in March 2003. Few, if any, websites related to strictly economic and business matters are blocked. Changes to Internet filtering can occur without warning or public explanation. For example, the popular Internet search engine Google was blocked completely in China for a few weeks starting in late August 2002. When Google became available again in September, its “cached pages” feature remained blocked; that feature had previously allowed users in China to access “snapshots” of some webpages that were otherwise blocked in China.

Internet content restrictions are governed by a number of measures, not all of which are public. The most important of these measures was issued in September 2000 and cover Internet content providers, electronic commerce sites and application service providers. In March 2002, the Internet Society of China, a nominally private group affiliated with MII, established a “Public Pledge on Self-Discipline for the China Internet Industry.” Signatories commit to “refrain from producing, posting or disseminating pernicious information that may jeopardize state security and disrupt social stability, contravene laws and regulations and spread superstition and obscenity.” At least one Chinese subsidiary of a U.S. Internet firm has signed the pledge.

China generally prohibits foreign-developed encryption and decryption technologies. In the past, this prohibition has not applied to software and hardware for which encryption is only an incidental feature. However, recent standards on encryption for WLAN dramatically changed this precedent in December 2003 (see “Wireless LAN Encryption Standards” section above).

Telecommunications

In its WTO accession agreement, China made important commitments in the area of telecommunications services. It agreed to permit foreign suppliers to provide a broad range of services through joint ventures with Chinese companies, including domestic and international wired services, mobile voice and data services, value-added services, such as electronic mail, voice mail and on-line information and database retrieval, and paging services. The foreign stake permitted in the joint ventures is to increase over time, reaching a maximum of 49 percent for most types of services. In addition, all geographical restrictions are to be eliminated within two to six years after China’s WTO accession, depending on the particular services sector.

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

Since making these commitments, China has separated post and telecommunications services. It has also developed a number of telecommunications regulations.

In May 2002, the government split China Telecom, the country's largest telecommunications company, into northern and southern parts. Two of China's seven national basic telecommunications companies, China Netcom and Jitong, merged with China Telecom's subsidiaries in 10 northern provinces to form China Network Communications; subsidiaries in the other 21 provinces and municipalities in southern and northwestern China retained the China Telecom name. Other national companies – China Unicom, China Mobile, China Satellite, and Railcom – will continue to operate separately.

China's new Regulations on Foreign-Invested Telecommunications Enterprises went into effect January 1, 2002. They define registered-capital requirements, equity caps, requirements for Chinese and foreign partners, and licensing procedures. The regulations stipulate that foreign-invested telecommunications enterprises can undertake either basic or value-added telecommunications services. Foreign ownership may not exceed 49 percent in the case of basic telecommunications services (excluding wireless paging) and 50 percent in the case of value-added services (including wireless paging, which is otherwise categorized as a basic service). The entire process of forming a Sino-foreign joint venture for basic services pursuant to the new regulations is expected to be lengthy, lasting on average 9 to 12 months.

Draft revisions of China's telecommunications law are still under consideration, and when approved, will represent China's first comprehensive set of regulations in this sector. China's existing telecommunications regulations were issued by the State Council in September 2000 and allow for interconnection, cost-based pricing, universal service, and stipulate licensing authority and procedures. However, these regulations are generally vague and lacking in specific and necessary details. For instance, they do not stipulate any transparent methodology for determining cost-based interconnection rates.

China has not yet established an independent regulator in the telecommunications sector. The current regulator, MII, is not structured as an independent entity as it still bears the responsibility to help develop China's IT and telecom manufacturing industries. An additional anecdotal example comes from a November 28, 2003 article in the China South Morning Star newspaper summarizing comments made by the MII's Deputy Director of Telecommunications Administration at a meeting of foreign investors and analysts. The Deputy Director reiterated MII's support for the mainland's homegrown 3G technology, TD-SCDMA, and was quoted as saying, "MII might 'suggest' to operators which 3G technology should be adopted."

China has also used regulatory authority to disadvantage foreign firms. For example, MII arbitrarily raised settlement rates for international calls terminating in China, which had the effect of artificially boosting the revenues of Chinese telecommunications operators at the expense of foreign firms. At times, MII also changed applicable rules without notice and without transparency. For example, on February 21, 2003, MII announced its problematic notice reclassifying certain basic and value-added telecommunications services and indicated that it would become effective April 1, 2003. No public comment period was provided for.

Little progress has been made in opening the market for value-added services, such as Internet service and content providers. MII announced moves toward convergence in voice, video and data services in 2000, but China considers information content sensitive, so foreign companies face significant barriers in the Internet services sector. Although more foreign companies are registering ".com.cn" websites in China, these sites are still often blocked, which hinders companies' abilities to maintain a stable Internet presence. The requirement that Internet Service Providers (ISPs) must provide user login information and transaction records to authorities upon request, without clear guidelines as to the circumstances and situations that warrant such actions, raises concerns about consumer privacy and prevention of data misuse.

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

Audiovisual Services (Including Film Imports)

China's new Regulations on the Administration of Audio-Visual Products and Regulations on the Management of Film went into effect on February 1, 2002. They are designed to bring more order and transparency to the film and audio-visual industries, with an eye to moving toward greater commercial efficiency in accordance with domestic reform efforts and WTO commitments. Despite these positive moves, the desire to protect the monopoly rents earned by the state-owned movie and print media importers and distributors, and China's concerns about politically sensitive materials, result in continued restrictions in audiovisual services.

Distribution of sound recordings, videos, movies, books and magazines remains highly restricted. In addition news services remain wary that the government will impose new restrictions on their activities. Inconsistent and subjective application of censorship regulations further impedes market growth for foreign and domestic providers alike.

China began importing foreign films on a revenue-sharing basis in 1994. The Chinese Government continues to limit the number of foreign films allowed to enter China. China allowed in only ten foreign films annually through much of the 1990s, but more recently allowed in twenty foreign films annually on a revenue-sharing basis under its WTO commitments. However, U.S. industry sources report that China treats its WTO commitment as a ceiling, rather than a floor, which artificially increases demand for pirated products.

Although China is also obligated to open theaters and film distribution to foreign investment, currently there are only two authorized distributors of foreign films, the state-owned China Film Distribution Company and Huaxia. Furthermore, lengthy censorship reviews by Chinese authorities delay the arrival of legitimately imported foreign films on Chinese movie screens. When the films do make it to the screen, they are subject to blackout viewing periods during national holidays. China's large black market for foreign films continues to grow because these market access restrictions not only create a demand for pirated DVDs in the absence of legitimately licensed films, but also diminish the incentive for foreign investment in movie theaters. Right holders who comply with Chinese law must forego marketing legitimate products, leaving the demand for movies to be satisfied almost entirely by pirates. This situation somewhat negates the apparent benefits of China's recent raising of the percentage of foreign investment allowed for movie theaters to 75 percent, thus allowing for majority ownership by foreign investors.

Tourism and Travel Services

Immediately following China's WTO accession, China issued new travel agency administration regulations to allow large foreign travel and tourism service providers to operate full-service joint venture travel agencies to promote foreign inbound tourism in the four major foreign tourist destinations in China:

Beijing, Shanghai, Guangzhou and Xian. Within six years after accession, wholly foreign-owned firms catering to foreign inbound tourists will be permitted, and all geographic restrictions will be removed.

For now, the agencies must have an annual worldwide turnover in excess of $40 million, and local registered capital of almost $500,000.

China issued Provisional Measures for the Establishment of Foreign Controlled and Wholly Foreign-funded Travel Agencies, effective July 2003. In November 2003, Germany's Touristic Union International (TUI) signed a letter of intent with the China Tourism Agency to form the first joint venture travel agency controlled by a foreign interest since China's accession to the WTO. Japan Airlines has also established the first wholly foreign-funded travel agency. These and other foreign firms, however, continue to be restricted from marketing to Chinese outbound tourists.

Holders of Chinese official passports, over 85,000 of whom applied for U.S. visas in FY2002, are required to use China's state-owned airlines or their code-share partners. Most of these individuals, state-owned enterprise employees, would not be considered government employees in most countries. This represents a significant loss of business for U.S. airlines.

The total number of visa applications by Chinese wishing to travel to the United States in 2003 was approximately 86% of the total from the preceding year. The SARS outbreak in China and the fall-off in travel during and immediately after the war in Iraq account for most of this decrease.

Education and Training Services

China faces a shortage of qualified teachers and clearly needs educators in inland regions. However, the Ministry of Education (MOE) continues to restrict participation by foreign educators and trainers. China permits only non-profit educational activities and only activities that do not compete with the MOE-supervised nine years of compulsory education, thereby inhibiting much-needed foreign investment in the education sector. In April 2000, MOE banned foreign companies and organizations from offering educational services via satellite networks. Foreign universities may set up non-profit operations, but must have a Chinese university host and partner to ensure that programs bar subversive content and localize imported information. China's training market is unregulated, which discourages potential investors from entering the market.

Legal Services

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

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

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

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

As more foreign businesses enter Chinese markets, the demand for U.S. law firms will likely grow as well. A number of U.S. law firms have recently established new offices in Beijing.

Engineering, Architectural and Contracting Services

U.S. engineers, architects and contractors have enjoyed a relatively cooperative and open relationship with the Chinese government. These professionals have operated in the Chinese market through joint venture arrangements and have been less affected by regulatory problems than other service sectors. Nevertheless, they also face restrictions. Under an older regulation, it has been difficult for foreign architecture and engineering firms to obtain licenses to perform architecture and engineering services except on a project-by-project basis. Foreign firms also face severe partnering and bidding restrictions. Foreign firms cannot hire Chinese nationals to practice architecture and engineering services as licensed professionals. Currently, Chinese architecture and engineering firms must approve and stamp all drawings prior to construction. There have been instances where U.S. architectural firms have had to pay Chinese domestic taxes on designs prepared in the United States for Chinese projects. China also sets extremely low design fees, rather than letting the market set prices. In addition, China does not have adequate lien laws to protect the rights of engineers, architects, contractors and material suppliers from non-payment.

Construction Services

In September 2002, the Ministry of Construction and MOFTEC jointly issued Decrees 113 and 114, which opened up construction and related construction design services to joint ventures with majority foreign ownership and, two years ahead of schedule, wholly foreign-owned enterprises. At the same time, however, these decrees created concerns for U.S. and other foreign firms by imposing new and more restrictive conditions than existed prior to China's WTO accession, when they were permitted to work in China on a project-by-project basis pursuant to Ministry of Construction rules. In particular, these decrees for the first time required foreign firms to obtain qualification certificates, effective October 1, 2003. In addition, these decrees for the first time required foreign-invested firms supplying construction services to incorporate in China, and they impose high minimum registered capital requirements and foreign personnel residency requirements that are difficult for many foreign firms to satisfy. In consultation with U.S. industry, the United States, in a high-level intervention, pressed its concerns about

Decrees 113 and 114 and sought a delay before the decrees' problematic requirements would become effective. In September 2003, the Ministry of Construction agreed to extend the implementation date from October 1, 2003 until April 1, 2004 so the concerns of foreign firms could be analyzed further.

Accounting and Management Consultancy Services

Prior to China's accession to the WTO, foreign accounting firms could not choose their own Chinese joint venture partners freely or enter into contractual agreements that could fully integrate these joint ventures. In its WTO accession agreement, China agreed to allow foreign accounting firms to partner with any Chinese entity of their choice. China also agreed to abandon the prohibition on foreign accounting firms' representative offices engaging in profit-making activities. Foreign accounting firms can also engage in taxation and management consulting services, without having to satisfy the more restrictive requirements on form of establishment applicable to new entities seeking to provide those services separately.

Meanwhile, the Chinese Institute of Certified Public Accountants, a government body under MOF, has made significant progress in modernizing accounting in China. In 2002, MOF released four newly revised auditing statements covering inter-bank confirmation, capital verification, accounting estimates and the audit of commercial bank financial statements. Furthermore, MOF has been active in standardizing accounting procedures across a wide range of topics including investments, inventories, cash flow statements, and fixed assets. The Chinese Securities Regulatory Commission required listed companies to appoint a certified international CPA firm to conduct audits on prospectuses and annual reports in accordance with international standards. While specific numbers are not available, most observers agree that the demand for internationally qualified accountants will grow rapidly in coming years. Despite these positive changes, pervasive problems remain. Differing accounting regulations limit the comparability of data, and the accounting practices followed by many domestic firms do not meet international conventions.

Advertising Services

The State Administration of Industry and Commerce (SAIC) enforces China's 1995 Advertising Law. Among other things, the law bans messages "hindering the public or violating social customs." The law is subject to interpretation by the SAIC, which must approve all advertising campaigns. One additional difficulty for foreign advertising firms, as well as foreign manufacturers, is that China has strict regulations prohibiting comparative advertising as well as any advertising with claims about the relative superiority of one brand over another. Marketing strategies that are successful in some other countries are therefore illegal in China.

Foreign firms have been restricted to representative offices or minority ownership of joint-venture operations. As part of its WTO accession commitments, however, China agreed to allow majority foreign ownership of joint venture advertising companies by December 11, 2003 and wholly foreign-owned subsidiaries by December 11, 2005.

Movement of Professionals

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

INVESTMENT BARRIERS

Foreign investors show great interest in China despite significant obstacles. China received $53.5 billion in FDI in 2003, remaining the top recipient in Asia. General barriers to investment include opaque and inconsistently enforced laws and regulations and a lack of a rules-based legal infrastructure. Nevertheless, China's leadership has reaffirmed its commitment to "further open" China to investment and to continue movement toward a rules-based economy.

Investment Requirements

In addition to taking on the obligations of the WTO Agreement on Trade-Related Investment Measures, China committed in its WTO accession agreement to eliminate export performance, local content and foreign exchange balancing requirements from its laws and regulations and not to enforce any contracts imposing those requirements. China also agreed that it would no longer condition investment (or import) approvals on those requirements or on requirements such as technology transfer and offsets.

In anticipation of these commitments, China revised its laws and regulations on foreign-invested enterprises to eliminate WTO-inconsistent requirements relating to export performance, local content and foreign exchange balancing as well as technology transfer. China also revised "Buy China" policies that regulated procurement of raw materials and fuels, and removed requirements that joint ventures and wholly foreign-owned enterprises submit production/operation plans to Chinese authorities. However, some measures continue to "encourage" technology transfer, without formally requiring it. U.S. companies are concerned that this "encouragement" will in practice amount to a "requirement" in many cases, particularly in light of the high degree of discretion provided to Chinese government officials when reviewing investment applications. In addition, according to U.S. companies, some Chinese government officials in 2003 still considered factors such as export performance and local content when deciding whether to approve an investment or to recommend approval of a loan from a Chinese policy bank, which is often essential to the success of an investment project.

Investment Guidelines

Foreign investment inflows continue to be controlled and channeled toward areas that support national development objectives. China has adjusted its investment guidelines a number of times over the last five years. The revisions have confused potential investors and added to the perception that the investment guidelines do not provide a stable basis for business planning. Uncertainty as to which industries are being promoted as investment targets, and how long such designations will be valid, undermines confidence in the investment climate. A new catalogue took effect April 1, 2002, listing sectors in which foreign investment would be encouraged, restricted or prohibited, replacing the December 1997 list. Unlisted sectors are considered to be permitted.

Among other things, the new catalogue aims to implement elements of sectoral openings that China committed to in its WTO accession agreement, including for banking, insurance, petroleum extraction, value-added telecommunications, and distribution. According to an accompanying regulation, projects in "encouraged" sectors benefit from duty-free import of capital equipment and VAT rebates on inputs.

The Chinese government emphasizes guiding new foreign investment towards “encouraged” industries and areas that support national development objectives. Regulations relating to the encouraged sectors were designed to direct FDI to areas in which China could benefit from foreign assistance or technology, such as in the construction and operation of infrastructure facilities. The government announced a series of measures in August 1999 that began to decentralize investment approval decision-making authority and to create new incentives for investments in key sectors and geographic regions. These guidelines allowed authorities at the provincial level of government to approve “encouraged” foreign-invested projects and raised the investment value at which central government approval is required.

Over the past five years, China has introduced new incentives for investments in high-technology industries, such as a regulation issued in November 1999 that provided foreign-invested enterprises a tax deduction for contributions to non-affiliated research and development or educational institutions. In December 2001, China announced comprehensive new incentives for investment in the less-developed central and western parts of the country.

Meanwhile, the Chinese government restricts foreign investment in sectoral projects not in line with “the needs of China’s national economic development.” In these sectors, foreign firms must form a joint venture with a Chinese company and restrict their equity ownership to a minority share in order to invest in the Chinese market.

The Chinese government also prohibits investment in certain sectors. China bans investment in the news media, broadcast and television sectors, citing national security interests. An official of the State Administration for Radio, Television and Film stated in February 2004 that China was going to allow foreign-invested joint ventures to produce films and television programming, although authorizing regulations have not yet been issued. The production of arms and the mining and processing of certain minerals remain prohibited sectors. U.S. investors have expressed particular concerns about China’s prohibition of investment in genetically modified seed development and production. Ongoing work and planned projects are at risk.

Other Investment Issues

Venture Capital. A new regulation that took effect March 1, 2003, replaced earlier provisional regulations permitting the establishment of foreign-invested venture capital firms, including wholly foreign-owned enterprises, aimed at funding high-technology and new technology startups in industries open to foreign investment. The new regulation lowers capital requirements, allows these firms to manage funds directly invested from overseas, and offers the option of establishing venture capital firms under an organizational form similar to the limited partnerships used in other countries. An April 2001 regulation barred securities firms (including foreign-invested firms) from the private equity business. Chinese laws concerning foreign private equity firms set limits on corporate structure, share issuance and transfers, and investment exit options. Investment exit problems, especially the difficulty of listing on China’s stock exchanges, coupled with the bureaucratic approvals required to list overseas, have limited interest in establishing China-based venture capital and private equity investment. As a result, most foreign venture capital and private equity investments in China are actually housed in offshore investment entities, which, as with other offshore FDI, can be transferred without Chinese Government approval.

Holding Companies. There has been some relaxation of the restrictions on the business scope and operations of holding companies, although minimum capital requirements normally make them suitable only for corporations with several sizeable investments to manage. A new regulation that took effect in April 2003 made it possible for holding companies to manage human resources across their affiliated companies and provide certain market research and other services to their affiliates. However, some restrictions on services provided by holding companies and on their financial operations and their ability to balance foreign exchange internally will remain even after full implementation of China's WTO commitments. Profit and loss consolidation within holding companies also remains prohibited.

Access to Capital Markets. Foreign-invested enterprises in China remain largely unable to access domestic and international stock markets, to sell corporate bonds, to accept venture capital investment, to sell equity, or to engage in normal merger, acquisition and divestment activity. Foreign exchange transactions on the capital account can be concluded only with case-by-case official review, and approvals are subject to very tight regulatory control. These barriers to capital market access are not removed by China's WTO accession agreement. China has begun to experiment with liberalization, such as the opening of domestic stock markets to listings by foreign-invested firms. Through the Qualified Foreign Institutional Investor (QFII) program, foreign securities firms can gain limited access to the RMB-denominated A share market by applying for QFII status with the Chinese Government. As of December 2003, 10 foreign firms had been granted QFII status.

GOVERNMENT PROCUREMENT

In accordance with the terms of its WTO accession agreement, China agreed to conduct its government procurement in a transparent manner and to provide all foreign suppliers with equal opportunity to participate in procurements opened to foreign suppliers. China also committed to become an observer to the WTO Agreement on Government Procurement (GPA), which it did in May 2002. In addition, China committed that it would table an offer and initiate negotiations for membership in the GPA "as soon as possible." According to Chinese officials, however, China has no immediate plans to begin discussions.

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

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

China has drafted and will soon make public a series of domestic software procurement regulations that will require government agencies to purchase domestically produced software. These new regulations are based on concerns of national information security, but are also aimed at supporting the domestic software industry. In addition to the overall lack of transparency regarding the drafting of the regulations, the U.S. Government and U.S. industry have expressed their concerns to the Chinese government about the likely decrease in market access.

In 1999, SETC issued regulations requiring state-owned enterprises to purchase all capital equipment from either domestic manufacturers or foreign-invested enterprises in China unless the equipment is not available domestically. In its WTO accession agreement, China subsequently agreed that purchases or sales by state-owned and state-invested enterprises of goods and services for commercial sale, production of goods or supply of services for commercial sale, or for non-governmental purposes would be subject to national treatment, market access and MFN requirements. It further agreed to ensure that state-owned and state-invested enterprises would make purchases and sales based solely on commercial considerations and, in addition, that foreign enterprises would be allowed to compete for sales to and purchases from these enterprises without discrimination. It also agreed that the government would not influence the commercial decisions of these enterprises, although in practice this has not consistently been the case.

ELECTRONIC COMMERCE

China has experienced dramatic growth in Internet usage. According to industry estimates, the number of people in China with access to the Internet was approximately 60 million by the end of 2003, compared with 620,000 in October 1997. China now has the second largest Internet population in the world, behind the United States. A fall in personal computer prices and the arrival of devices tailored for the Chinese market will further expand Internet access.

China has also experienced a dramatic increase in the number of electronic businesses established. An estimated 78 percent of all Chinese websites are now operated by “enterprises” and 5 percent by “businesses.” However, despite these developments, only 40 percent of Internet users in China have reported purchasing goods and services online. Moreover, only 11 percent of Chinese “enterprise” websites and 45 percent of Chinese “business” websites offer “e-commerce services.”

The Chinese government recognizes the potential of electronic commerce to promote exports and increase competitiveness and has made some progress toward establishing a viable commercial environment. However, some Chinese ministries with responsibility for electronic commerce have excessively regulated the Internet, thereby stifling the free flow of information and consumer privacy needed for electronic commerce to flourish. Content is still controlled and encryption regulated, as discussed more fully below (in the “Regulation of International Data Flows and Restrictions on Data Processing” section). In a positive sign, China plans to issue e-signature regulations in 2004 that will establish the legal efficacy of electronic signatures for official transactions.

A number of technical problems also inhibit the growth of electronic commerce in China. Rates charged by government-approved Internet service providers make Internet access expensive for most Chinese. Slow connection speeds are another barrier, although this is changing as broadband connections become more readily available. Other impediments to Chinese businesses and consumers conducting online transactions are: the paucity of credit payment systems; consumer reluctance to trust online merchants; the lack of a secure online payment system; and inefficient delivery systems. China has also yet to develop a legal framework conducive to the rapid growth of electronic commerce. Laws recognizing the validity of “e-contracting” tools and stressing the importance of online security have been proposed, but not yet issued. Despite these obstacles, however, over forty percent of Chinese Internet users surveyed in June 2003 said they had made an online purchase within the past year, and almost a third of them said they had paid online.

CHINA

ANTICOMPETITIVE PRACTICES

China continues to struggle with economic inefficiencies and investment disincentives created by local protectionism, pricing practices and preservation of industry-wide monopolies. Anticompetitive practices in China take several forms. In some cases, industrial conglomerates operating as monopolies, near monopolies, or authorized oligopolies (as in the telecommunications industry) have been authorized to fix prices, allocate contracts, and in other ways restrict competition among domestic and foreign suppliers. Regional protectionism by provincial or local authorities often blocks efficient distribution of goods and services inside China. These practices may restrict market access for certain imported products, raise production costs, and restrict market opportunities for foreign-invested enterprises in China.

There are several existing laws and regulations in China addressing competition matters. However, these measures are ineffective due to poor national coordination and inconsistent local and provincial enforcement. China is drafting a new anti-monopoly law that could be adopted as early as 2004 or 2005.

Regulations issued in November 2002 permit foreign purchase of traded and non-traded (designated state) shares of Chinese enterprises. In addition, China issued regulations that took effect in April 2003 which specify procedures for foreign acquisition of and merger with domestic enterprises. These regulations require pre-merger notification and allow for examination of antitrust considerations in some cases. By requiring approval of all owners of the domestic enterprise, the regulation implicitly prohibits hostile takeovers. The thresholds for notification are not straightforward, leaving open the possibility of abuse by officials or domestic competitors. Domestic competitors have the power under the regulations to call for public hearings on prospective mergers.

China also issued provisional regulations in November 2002, effective January 2003, on using foreign investment to reorganize state-owned enterprises. These reorganizations, however, require extensive approvals and full agreement of the domestic enterprise's labor union. These requirements are likely to limit the appeal of this type of investment.

OTHER BARRIERS

Transparency

Laws and regulations directly affecting international trade are increasingly becoming publicly available in China. Since 1992, China has published all trade laws and regulations in the "MOFCOM Gazette," available on a subscription basis, and MOFCOM maintains an updated list on its website. However, many measures that do not rise to the level of ministry-issued regulations or implementing rules continue to remain unavailable to the public. China's ministries routinely implemented policies based on internal "guidance" or "opinions" that are not available to foreign firms. Experimental or informal policies and draft regulations, in addition, are regarded as internal matters and public access is tightly controlled.

China, in its WTO accession agreement, committed to publishing all laws, regulations and other measures that relate to trade matters, including those that affect imports, and generally to allowing its WTO trading partners an opportunity to comment on them before implementation. China also agreed to provide a copy of new trade-related laws, regulations and other measures to the WTO Secretariat in Geneva, translated into one or more of the WTO's official languages (English, French and Spanish) no later than 90 days after implementation. China also agreed to create various contact points for its WTO trading partners and foreign businesses to inquire about these measures.

In 2003, China did a reasonable job of publishing national laws and regulations. Although several regulations carried effective dates before the dates of publication, the lag was usually only a couple of weeks. Various government-owned specialty newspapers routinely carried the texts of government regulations, implementing rules, circulars and announcements. Many government ministries also published digests or gazettes containing the texts of these measures, both in written form and on their websites. In addition, there has been a proliferation of online news and information services that routinely offer up-to-date news about and texts of new laws and regulations. Some services even provide legal-quality English translations by subscription.

China failed in 2003 to publish all measures related to trade, however. Chinese businesses continue to report unofficial guidance provided by Chinese regulators, which is usually unavailable to foreign entities. In some cases, Chinese officials provided unpublished documents to interested parties, but this dissemination was ad hoc and based more on personal connections than formal procedures.

MOFCOM's predecessor, MOFTEC, in late 2001, established an "Enquiry Center" to provide information on new trade and investment laws, regulations and other measures. In addition, MOFCOM and State Council Legislative Affairs Office officials have researched the United States' "Federal Register" and are planning to begin a journal to publish all national, provincial and local laws, regulations and other measures related to trade and investment.

The Chinese government has been considering a system to solicit input from interested parties before issuing trade and investment laws or regulations. In December 2001, the State Council issued regulations explicitly allowing comment periods and hearings. However, many of China's ministries and agencies continued to follow the practice prior to China's accession to the WTO. The ministry or agency drafting a new or revised law or regulation will normally consult with and submit drafts to other ministries and agencies, Chinese experts and affected Chinese companies. At times, it will also consult with select foreign companies, although it will not necessarily share drafts with them. As a result, only a small proportion of new or revised laws and regulations have been issued after a period for public comment, and even in these cases the amount of time provided for public comment has generally been too short. In April 2003, the NDRC posted on its website a call for comment on a draft Automobile Industry Development Policy, but the text of the policy was never posted online. Consequently, foreign companies and governments were not uniformly allowed an opportunity to review and comment on the draft policy. Government officials are still researching the wisdom of establishing a formal mechanism for soliciting input prior to finalization of all governmental measures.

Legal Framework

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

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

This lack of a clear and consistent framework of laws and regulations can be a barrier to the participation of foreign firms in the Chinese domestic market. A comprehensive legal framework, coupled with adequate prior notice of proposed changes to laws and regulations, and an opportunity to comment on those changes, would greatly enhance business conditions, promote commerce and reduce opportunities for corruption. The U.S. Government has provided technical assistance, at the central and local levels of government in China, in an effort to promote improvements in China's legislative and regulatory drafting process.

In its WTO accession agreement, China committed to establish tribunals for the review of all administrative actions relating to the implementation of trade-related laws, regulations, judicial decisions and administrative rulings. These tribunals must be impartial and independent of the government authorities entrusted with the administrative enforcement in question, and their review procedures must include the right of appeal. China also committed, at all levels of government, to apply, implement and administer all of its laws, regulations and other measures relating to trade in goods and services in a uniform and impartial manner throughout China, including in special economic areas. In connection with this commitment, China further committed to establish an internal review mechanism to investigate and address cases of non-uniform application of laws based on information provided by companies or individuals.

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

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

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

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

Labor issues. In recent years, China has expanded the scope of its national labor laws and regulations so they now cover most, though not all, key labor areas. Even with these changes, China does not adhere to certain internationally recognized labor standards, such as the right to freely associate or bargain collectively. There are also persistent concerns about the use of prison labor and child labor.

The Chinese government is slowly developing nationwide pension, unemployment insurance, medical insurance, and workplace injury insurance systems that will require substantial employer contributions. These systems are still rudimentary and characterized by serious funding shortfalls, in part due to widespread non-compliance among domestic firms. There is also inconsistent application and enforcement of labor regulations between Chinese-owned enterprises and foreign-invested enterprises.

The cost of labor – especially unskilled labor – is low in much of China. The existence of an enormous surplus rural labor force, many of whom seek work in urban areas, helps to keep unskilled wages low. Where competition for workers is intense and the supply limited, as in the case of technical, managerial and professional staff in China's coastal areas, wages can be higher. However, restrictions on labor mobility distort labor costs. China is gradually easing restrictions under a household registration system, which traditionally has made it difficult for rural Chinese to work or live in urban areas, in part due to the recognition that labor mobility is essential to the continued growth of the economy.

Corruption

Corruption is endemic in China. Chinese officials themselves admit that corruption is one of the most serious problems the country faces. China pursued more than 32,759 corruption cases in the first nine months of 2003. Of those, 905 were major cases of bribery or embezzlement each involving over one million RMB (over $120,000). Lower-level officials bore the brunt of the ongoing anti-corruption campaign, but over the past year the former Minister of Land and Resources, former Party Secretary of Guizhou Province, former Governor and Party Secretary of Hebei Province and former Vice Governor of Liaoning Province were among the high-level officials disciplined for corruption. Separately, a highly influential, politically connected Shanghai real estate developer was among those held on corruption charges. Many people expect China’s entry into the WTO, which has greatly reduced tariffs, to significantly reduce incentives for smuggling-related corruption. Most other official graft in China involves misappropriation of funds, abuse of power and embezzlement.

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

Land Issues

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

A new 2002 rural land law that took effect in 2003 gives peasants fixed contracts for periods of 30 to 50 years, and permits peasants to exchange or rent out their land-use rights while their use contract remains in force. There is no present prospect for changing from land-use rights to direct ownership of rural land. In addition, when farmland is converted from agricultural to industrial or residential use, compensation paid to individual peasants rarely reflects the actual value of the land.

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