# 2002 REPORT TO CONGRESS ON CHINA'S WTO COMPLIANCE

**United States Trade Representative**

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# FOREWORD

The People's Republic of China (China) joined the World Trade Organization (WTO) on December 11, 2001, after fifteen years of negotiations with the United States and other WTO members. In those negotiations, the Administration, as well as previous administrations, sought maximum gains for U.S. manufacturers, services suppliers and agricultural exporters and their workers. In addition to seeking these economic benefits through China's entry into WTO, the Administration has been guided by the principle that open markets and trade are powerful engines for fueling positive changes and reform in China, as they are elsewhere. China's entry into the WTO, a rules-based system that requires its members to operate with openness and transparency and stresses the central role of markets and private enterprise, is an important step in China's integration into the global community. The implementation of China's WTO commitments, which this report examines, should be considered within this broader context.

This report was prepared pursuant to section 421 of the U.S.-China Relations Act of 2000 (P.L. 106-286), 22 U.S.C. § 6951 (the Act), which requires the United States Trade Representative (USTR) to report annually to Congress on compliance by China with commitments made in connection with its accession to the WTO, including both multilateral commitments and any bilateral commitments made to the United States. The report also incorporates the findings of the Overseas Compliance Program, as required by section 413(b)(2) of the Act, 22 U.S.C. § 6943(b)(2).

In preparing this report, USTR drew on its experience in overseeing the U.S. Government's monitoring of China's WTO compliance efforts. USTR chairs the Trade Policy Staff Committee (TPSC) Subcommittee on China WTO Compliance, a newly created, inter-agency TPSC subcommittee whose mandate is devoted to China and the extent to which it is complying with its WTO commitments. This TPSC subcommittee is composed of experts from USTR, the Departments of Commerce, State, Agriculture and Treasury, among other agencies, and the U.S. Patent and Trademark Office. It works closely with State Department economic officers, Foreign Commercial Service officers and Market Access and Compliance officers from the Commerce Department, Foreign Agricultural Service officers and Customs attaches at the U.S. Embassy and Consulates General in China, who are active in gathering and analyzing information, maintaining regular contacts with U.S. industries operating in China and maintaining a regular dialogue with Chinese government officials at key ministries and agencies. During the past year, the subcommittee met on a monthly basis in order to evaluate and prioritize the monitoring activities being undertaken and to review the steps that China had taken to implement its commitments.

To aid in its preparation of this report, USTR also published a Federal Register notice on July 9, 2002, asking for written comments from the public and scheduling a public hearing for September 18, 2002, before the TPSC. A list of the written comments submitted by interested parties is set forth in Appendix 1, and the persons who testified before the TPSC are identified in Appendix 2.

Finally, this report is structured as an examination of the nine broad categories of WTO commitments undertaken by China, noting areas where progress has been achieved and underscoring shortcomings as appropriate. Throughout the report, USTR has attempted to provide as complete a picture of China's WTO compliance as possible, subject to certain constraints. For one thing, the sheer volume and complexity of the required changes to China's trade regime during the first year of China's WTO membership make comprehensive and accurate analysis sometimes difficult. For some commitments, moreover, USTR has not yet received or uncovered all information relevant to a complete assessment of China's WTO compliance. At the same time, other commitments are being phased in over a period of years and therefore have not yet fully come into force, including some critical ones, such as trading rights and distribution services, which will be crucial to full realization of the benefits of China's WTO accession by U.S. manufacturers, services suppliers and agricultural exporters and their workers.

December 11, 2002

## EXECUTIVE SUMMARY

For much of the past two decades, China had been gradually transitioning toward a market economy from what in the late 1970's was a strict command economy. In acceding to the WTO, China was required by the United States and other WTO members to agree to accelerate this process of market reform in order to comply with WTO requirements. Accordingly, China's WTO accession agreement embodies a set of extensive and far-reaching commitments on the part of China to change its trade regime, at all levels of government. Given the breadth and complexity of these commitments, assessing China's WTO compliance efforts is not a simple task.

Overall, during the first year of its WTO membership, China made significant progress in implementing its WTO commitments, although much is left to do. Progress was made both in making many of the required systemic changes and in implementing specific commitments. At the same time, serious concerns arose in some areas, where implementation had not yet occurred or was inadequate.

As expected, the principal focus of China's first year of WTO membership was on its framework of laws and regulations governing trade in goods and services, at both the central and local levels. China's trade ministry, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), reports that the central government has reviewed more than 2,500 trade-related laws and regulations for WTO consistency. By mid-2002, it had reportedly repealed 830 of these laws and regulations and amended 325 more. It had also reportedly drafted and adopted 118 new laws and regulations. Similar reviews are taking place at the local level, although the local governments are generally not as far along in their review process, in part because of the need to give effect to changes made by the central government. At the same time, some localities, particularly those in China's eastern provinces, are much further along in their review process than others.

Beginning early in 2002, China also devoted considerable resources to the restructuring of the various government ministries and agencies with a role in overseeing trade in goods and services. Some of these changes were mandated by China's accession agreement, while others were undertaken by China to facilitate its compliance with WTO rules.

Another significant focus for China during the past year involved education and training. China embarked on an extensive campaign to teach central and local government officials and state-owned enterprise managers about both the requirements and the benefits of WTO membership, with the goal of facilitating China's WTO compliance. The United States and other WTO members, along with many private sector groups, contributed substantial technical assistance and capacity building resources to this effort.

As a general matter, China took positive steps to implement many of its specific WTO commitments during the past year. It made required tariff reductions, notably for information technology products, chemicals, autos and auto parts, wood and paper products, and many agricultural goods, including beef, dairy products and citrus, among others. When discrepancies

between committed and implemented rates were reported, China usually made necessary adjustments. China also began the process of removing numerous non-tariff trade barriers that had affected a range of industries, from chemicals to scientific equipment, and it continued to improve its standards regime. For the most part, these steps were managed without serious incident, and market access for U.S. products in the affected sectors has generally improved. In addition, although not without problems, China took the necessary legal steps to allow for increased market access for foreign service suppliers in a variety of sectors, including financial services, telecommunications, audio-visual services, tourism and travel-related services, constructions and engineering services, educational services and environmental services.

While the efforts of China's leadership to implement China's WTO commitments should be recognized, the Administration also found a number of causes for serious concern during China's first year of WTO membership.

One area of cross-cutting concern involved transparency. In particular, China implemented its commitment to greater transparency in the adoption and operation of new laws and regulations unevenly at best. While some ministries and agencies did take steps to improve opportunities for public comment on draft laws and regulations, and to provide appropriate WTO enquiry points, the Administration found China's overall effort to be plagued by uncertainty and a lack of uniformity. The Administration is committed to seeking improvements in China's efforts in this area.

Apart from this systemic concern, three other areas generated significant problems and warrant continued U.S. scrutiny – agriculture, intellectual property rights 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. agriculture products are not unique to China, particularly serious problems were encountered on many fronts, including China's regulation of agricultural goods made with biotechnology, the administration of China's tariff-rate quota (TRQ) system for bulk agricultural commodities, the application of sanitary and phytosanitary measures and inspection requirements. The United States and China were able to make progress toward resolving some of these problems, particularly with regard to biotechnology. Other problems remain unresolved, however, with the most troublesome being China's inadequate implementation of its TRQ commitments.

In the area of intellectual property rights (IPR), China did make significant improvements to its framework of laws and regulations. However, the lack of effective IPR enforcement remained a major challenge. If significant improvements are to be achieved on this front, China will have to devote considerable resources and political will to this problem, and there will continue to be a need for sustained efforts from the United States and other WTO members.

Meanwhile, concerns arose in many services sectors due to transparency problems and China's use of prudential requirements that exceeded international norms. In addition, Chinese

regulators imposed particularly problematic restrictions in the insurance sector, where transparency issues, excessive capitalization requirements and restrictions on branching combined to present unique difficulties, and in the express delivery sector, where existing rights were placed in jeopardy. Nevertheless, progress was made in 2002 toward resolving the concerns associated with these two sectors.

China's compliance problems are occasionally generated by a lack of coordination among relevant ministries in the Chinese government. Another source of compliance problems has been a lack of effective or uniform application of China's WTO commitments at local and provincial levels. China is taking steps to address both of these concerns, through more effective inter-ministerial mechanisms at the national level, and through a more concerted effort to reinforce the importance of WTO-consistency with sub-national authorities. In other cases, however, compliance problems involve entrenched domestic Chinese interests that may be seeking to minimize their exposure to foreign competition, circumstances that, as one private sector representative submitted, require "particular vigilance by the U.S. government and the American private sector."

When confronted with compliance problems in 2002, the Administration used all available and appropriate means to obtain China's full compliance, including intervention at the highest levels of government. The Administration worked closely with the affected U.S. industries on compliance concerns, and utilized bilateral channels through multiple agencies, at all levels, to press these concerns. The Administration also initiated a regular dialogue on compliance issues between USTR and China's lead trade agency, MOFTEC, with the goal of bringing all involved Chinese ministries and agencies together when the resolution of particular problems warrants it. Where possible, the Administration also multilateralized its enforcement efforts, by working with like-minded WTO members on an ad hoc basis, whenever particular issues have had an adverse impact beyond the United States.

Despite the compliance problems that arose over the course of the past year, most private sector representatives remain enthusiastic about the actual and potential benefits for U.S. industry from China's WTO membership. As one witness at the September 18, 2002 hearing testified:

> [W]e all recognize that this is a process that will take time, and patience. The institutional, legal, and regulatory changes demanded of the Chinese are extraordinary, reaching in most corners of their economy, and complicated further by a highly decentralized administrative structure covering a vast, diverse country.

At the same time, the private sector wants to see China comply fully with its WTO commitments, as does the Administration. As one representative made clear, "we all believe that full implementation of the letter and spirit of [China's] WTO commitments is essential." The United States, working with fellow WTO members, will use all means at its disposal to ensure that China achieves full implementation.

# CHINA'S ACCESSION TO THE WTO

## Negotiations

In July of 1986, China applied for admission to the WTO's predecessor, the General Agreement on Tariffs and Trade (GATT). The GATT formed a Working Party in March of 1987, composed of all interested GATT contracting parties, to examine China's application and negotiate terms for China's accession. For the next eight years, negotiations were conducted under the auspices of the GATT Working Party. Following the formation of the WTO on January 1, 1995, a successor WTO Working Party, composed of all interested WTO members, took over the negotiations.

Like all WTO accession negotiations, the negotiations with China had three basic aspects. First, China provided information to the Working Party regarding its trade regime. China also updated this information periodically during the 15 years of negotiations to reflect changes in its trade regime. Second, each interested WTO member negotiated bilaterally with China regarding market access concessions and commitments in the goods and services areas, including, for example, the tariffs that would apply on industrial and agricultural goods and the commitments that China would make to open up its market to foreign services suppliers. The most trade liberalizing of the concessions and commitments obtained through these bilateral negotiations were consolidated into China's Goods and Services Schedules and apply to all WTO members. Third, overlapping in time with these bilateral negotiations, China engaged in multilateral negotiations with Working Party members on the rules that would govern trade with China. Throughout these multilateral negotiations, U.S. leadership in working with China was critical to removing obstacles to China's WTO accession and achieving a consensus on appropriate rules commitments. These commitments are set forth in China's Protocol of Accession and an accompanying Report of the Working Party.

WTO members formally approved an agreement on the terms of accession for China on November 10, 2001, at the WTO Ministerial Conference in Doha, Qatar. One day later, China signed the agreement and deposited its instrument of ratification with the Director-General of the WTO. China became the 143rd member of the WTO on December 11, 2001.

China's Protocol of Accession, accompanying Working Party Report and Goods and Services Schedules are available on the WTO's website (www.wto.org).

## Overview of China's Commitments

In order to accede to the WTO, China had to agree to take concrete steps to remove trade barriers and open its markets to foreign companies and their exports from the first day of accession in virtually every product sector and for a wide range of services. China further agreed to eliminate or significantly reduce restrictions on the rights of foreign companies to import and export goods and to distribute goods within China. Supporting these steps, China also agreed to

undertake important changes to its legal framework, designed to add transparency and predictability to business dealings.

Like all acceding WTO members, China also had to agree to assume the obligations of more than 20 existing multilateral WTO agreements, covering all areas of trade. Areas of principal concern to the United States and China's other trading partners, as evidenced by the accession negotiations, included the core principles of the WTO, i.e., most-favored nation treatment, national treatment, transparency and the availability of independent review of administrative decisions. Other key concerns could be found in the areas of agriculture, sanitary and phytosanitary measures, technical barriers to trade, trade-related investment measures, customs valuation, rules of origin, import licensing, antidumping, subsidies and countervailing measures, trade-related aspects of intellectual property rights and services. For some of its obligations in these areas, China was allowed minimal transition periods, where it was considered necessary.

Even though the terms of China's accession agreement are directed at the opening of China's market to WTO members, China's accession agreement also includes several safeguard mechanisms designed to prevent injury that U.S. or other WTO members' industries and workers might experience based on import surges or unfair trade practices. These include a unique, China-specific safeguard provision allowing a WTO member to restrain increasing Chinese imports that disrupt its market (available for 12 years), a special textiles safeguard (available for 7 years) and the continued ability to utilize a special non-market economy methodology for measuring dumping in anti-dumping cases against Chinese companies (available for 15 years). The Administration is committed to maintaining the effectiveness of these mechanisms for the benefit of affected U.S. businesses, workers and farmers.

With China's consent, the WTO also created a special multilateral mechanism for reviewing China's compliance on an annual basis. Known as the Transitional Review Mechanism, this mechanism operates annually for 8 years after China's accession, with a final review by year 10.

# STATUS OF CHINA'S COMPLIANCE EFFORTS

## Import Regulation

### *Tariffs*

Through its bilateral negotiations with interested WTO members, China agreed to greatly increased market access for U.S. and other foreign companies by reducing tariff rates. The agreed reductions are set forth as tariff "bindings" in China's Goods Schedule, meaning that while China cannot exceed the bound tariff rates, it can decide to lower them, as many members do when trying to attract particular imports.

In line with its WTO commitments, China implemented the required tariff changes for 2002 on January 1 of this year. The United States reviewed these tariffs and for the most part found only minor discrepancies (such as the use of a sliding tariff scale for newsprint), although it has not yet been able to review approximately 800 of China's 7,000 tariffs because China did not provide the WTO with the required electronic concordance showing 2002 HS nomenclature changes.

The tariff changes made by China greatly increase market access. Tariffs on industrial goods of greatest importance to U.S. industry are in the process of being reduced from a base average of 25 percent (in 1997) to 7 percent. These reductions generally are phased in over a period of five years, but in almost all instances the greatest reductions took place upon accession. Similarly dramatic reductions also benefitted U.S. agricultural exporters (see the Agriculture section below).

One of the more significant highlights among industrial tariffs was China's agreement to participate in the Information Technology Agreement (ITA), which requires the elimination of tariffs on computers, semiconductors and other information technology products. China agreed to complete its elimination of these tariffs by January 1, 2005. One notable problem did arise this year from China's treatment of 15 ITA tariff lines, covering certain semiconductor and telecommunications equipment inputs. China conditioned the reduced or zero tariffs for these tariff lines 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. The use of this condition is not authorized by the Goods Schedule negotiated as part of China's accession to the WTO, and the WTO Committee of Participants in the Expansion of Trade in Information Technology Products (ITA Committee) has rejected this type of condition whenever a WTO member has sought to pursue it. The United States addressed this issue bilaterally with China's trade ministry, MOFTEC, as well as with MII, the Ministry of Finance and the General Administration of Customs, so far without success. At the WTO, meanwhile, the United States has blocked China's membership in the ITA Committee until this issue is resolved. Despite this problem, the IT sector still estimates that U.S. companies saved more than $500 million in reduced tariff payments on high-tech exports to China in 2002.

China also began implementing the required tariff reductions on more than two-thirds of the 1,100-plus products covered by the WTO's Chemical Tariff Harmonization Agreement. In their written comments, U.S. exporters of chemical products reported "significant improvements in their ability to market their products in China following [its] accession."

Tariffs on autos and auto parts began a dramatic decline in 2002. Tariffs on autos are being reduced from 80-100 percent to 25 percent (by July 1, 2006), and tariffs on auto parts are being reduced from a base average of 23 percent to 9.5 percent (by July 1, 2006).

Meanwhile, tariffs in the wood and paper sectors are being reduced from a 1997 average of 11 percent on wood and 15 percent on paper to 4.2 percent and 5.4 percent, respectively. U.S. industry reports that the value of U.S. exports of paper increased by 30 percent in the first six months of 2002, when compared to the same period in 2001, while U.S. exports of paperboard and wood pulp were up 32 percent in value and 39 percent in value, respectively. U.S. exports of wood products surged by more than 65 percent in value.

***Customs and Trade Administration***

Like other acceding WTO members, China agreed to take on the obligations of the WTO agreements that address the means by which customs and other trade administration officials check imports and decide on and apply relevant trade regulations. These agreements cover the areas of customs valuation, rules of origin and import licensing.

Valuation

The WTO Agreement on the Implementation of GATT Article VII (also known as the Agreement on Customs Valuation) is designed to ensure that determinations of the customs value for the application of duty rates to imported goods are conducted in a neutral and uniform manner, precluding the use of arbitrary or fictitious customs values. Adherence to the Agreement on Customs Valuation is an important issue for U.S. exporters, particularly to ensure that market access opportunities provided through tariff reductions are not negated by unwarranted and unreasonable "uplifts" in the customs value of goods to which tariffs are applied. China agreed to implement its obligations under the Agreement on Customs Valuation upon accession, without any transition period. In addition, China's accession agreement reinforces China's obligation not to use minimum or reference prices as a means for determining customs value, and it calls on China to implement the World Customs Organization Decisions on Valuation of Carrier Media Bearing Software for Data Processing Equipment and Treatment of Interest Charges in Customs Value of Imported Goods within two years after accession.

On January 1, 2002, shortly after acceding to the WTO, China's General Customs Administration issued the *Measures for Examining and Determining Customs Valuation of Imported Goods.* These regulations addressed the inconsistencies that had existed between China's customs valuation methodologies and the Agreement on Customs Valuation. However, China

has not uniformly implemented these regulations. U.S. companies have reported that they are still encountering valuation problems at many ports. For example, even though China's new regulations provide that imported goods normally should be valued on the basis of their transaction price, i.e., the price the importer actually paid, many Chinese customs officials are still improperly using "reference pricing." The usual result is a higher dutiable value. In addition, many Chinese customs officials are not yet applying China's new regulatory provisions on royalties and software fees paid to the exporter. Following their pre-WTO accession practice, these officials are still automatically adding royalty and software fees to the dutiable value, even though they are now supposed to add those fees only if they are a condition of the particular sale in question.

The United States and other WTO members, including the European Communities (EC), presented their concerns about these continuing customs valuation problems being encountered by foreign companies during the transitional review conducted by the WTO Committee on Customs Valuation in November 2002. China indicated that it was working to establish more uniformity in its adherence to WTO customs valuation rules. The United States will continue to monitor developments in this area in 2003. In addition, the United States is planning to provide technical assistance to China in 2003 on WTO compliance in the customs area. The United States will focus on the Customs Valuation Agreement and will also present methods for modernizing customs processes.

Rules of Origin

Upon its accession, China also became subject to the WTO Agreement on Rules of Origin, which sets forth rules designed to increase transparency, predictability and consistency in both the preparation and application of rules of origin, which are necessary for import and export purposes, such as determining the applicability of import quotas, determining entitlement to preferential or duty-free treatment and imposing antidumping or countervailing duties or safeguard measures, and for the purpose of checking marking requirements. The Agreement on Rules of Origin also provides for a work program leading to the multilateral harmonization of rules of origin. This work program is ongoing, and China specifically agreed to adopt the internationally harmonized rules of origin once they were completed. China also confirmed that it would apply rules of origin equally for all purposes and that it would not use rules of origin as an instrument to pursue trade objectives either directly or indirectly.

In March 2001, the State Administration of Quality Supervision and Inspection and Quarantine (AQSIQ) issued regulations and implementing rules intended to bring the rules of origin used by China to check marking requirements into compliance with the Agreement on Rules of Origin. The General Administration of Customs (Customs Administration) is in the process of drafting the more important regulations that will bring China's rules of origin into conformity with WTO rules for import and export purposes.

Import Licensing

The Agreement on Import Licensing Procedures (Import Licensing Agreement) establishes rules for WTO members, like China, that use import licensing systems to regulate their trade. Its aim is to ensure that the procedures used by members in operating their import licensing systems do not, in themselves, form barriers to trade. The objective of the Import Licensing Agreement is to increase transparency and predictability and to create disciplines to protect the importer against unreasonable requirements or delays associated with the licensing regime. The Import Licensing Agreement covers both "automatic" licensing systems, which are intended only to monitor imports, not regulate them, and "non-automatic" licensing systems, which are normally used to administer tariff-rate quotas or import restrictions such as quotas or to administer safety or other requirements, e.g., for hazardous goods, armaments or antiquities. While the Import Licensing Agreement's provisions do not directly address the WTO consistency of the underlying measures that licensing systems regulate, they do establish the baseline of what constitutes a fair and non-discriminatory application of import licensing procedures. In addition, China specifically committed not to condition the issuance of import licenses on performance requirements of any kind, such as local content, export performance, offsets, technology transfer or research and development, or on whether competing domestic suppliers exist.

Shortly after China acceded to the WTO, MOFTEC issued regulations designed to bring China's automatic import licensing regime into compliance with the Import Licensing Agreement and its concept of "automaticity." It later supplemented these regulations with implementing rules. Some U.S. companies have complained that obtaining automatic licenses is unnecessarily burdensome because MOFTEC is using a "one-license-per-shipment" system rather than providing licenses to firms for multiple shipments. These companies have also noted that MOFTEC appears to be asking for more information than is required to monitor imports, and they have expressed concern because the measures allow the Chinese authorities to ask for unspecified "other necessary documents."

MOFTEC also issued regulations intended to bring China's non-automatic licensing regime into compliance with the disciplines of the Import Licensing Agreement on January 1, 2002. These regulations are in some respects vague, and there is also some concern that the licensing procedures created by the regulations may have unnecessary trade-distortive effects, such as the limitation that a particular license can only be used for the port of entry designated on that license.

The United States carefully reviewed the regulations on automatic and non-automatic licensing and discussed its concerns with MOFTEC early in the year. Together with other WTO members, the United States also presented detailed comments about these regulations in connection with the Import Licensing Committee's transitional review of China's WTO compliance efforts, held in September 2002. Since these interventions, MOFTEC has begun to allow more than one shipment per license under its automatic license regime. In 2003, the

United States will continue to press its other concerns and urge China to revise the regulations to add clarity and to make them less burdensome and trade-distortive.

***Non-tariff Measures***

In its accession agreement, China agreed that it would eliminate numerous trade-distortive non-tariff measures (NTMs), which included quotas, licenses and tendering requirements covering hundreds of products. Most of these NTMs, including, for example, the NTMs covering chemicals, agricultural equipment, medical and scientific equipment and civil aircraft, had to be eliminated by the time that China acceded to the WTO. China was allowed to phase out other NTMs, listed in an annex to the accession agreement, over a transition period ending on January 1, 2005. With regard to the quotas that were listed in the annex, which covered industrial goods such as autos and auto parts, crude oil, refined oil, and tires, China made a further commitment. China agreed to detailed procedures for allocating these quotas during the phase-out period in accordance with detailed rules set out in the goods schedule accompanying its accession agreement. In a side letter, China also committed to make its quota system operational in time for applications to be accepted and quota allocations to take place by December 31, 2001.

From the outset, China's quota system was beset with problems. The State Council did not issue necessary regulations until mid-December 2001. Not only were these regulations late, but they also appeared to be inconsistent with China's WTO commitments in certain respects. Further delay ensued as the administering authorities charged with implementing this system – MOFTEC for some products and the State Economic and Trade Commission (SETC) for other products – struggled with implementation. More problems arose when MOFTEC and SETC finally began allocating quotas. In the case of autos, for example, while MOFTEC issued necessary implementing rules shortly after the issuance of the State Council's regulations, it did not open up the quota application process until February, and it did not begin to allocate quotas until late April. Because of a lack of transparency, it was difficult to assess whether the quotas were allocated in accordance with the agreed rules. It became apparent, however, that MOFTEC was creating false fill rates by filling the quota for autos with auto parts (other than the key auto parts allowed by China's accession agreement). By mid-year, MOFTEC had also not yet fully allocated the auto quotas, although part of this delay was due to MOFTEC's crackdown on the illegal secondary market for auto import licenses.

At various times throughout 2002, the United States met bilaterally with Chinese officials and raised its concerns with the regulations, the slow pace of implementation, the lack of transparency and inappropriate allocations. The United States also raised these issues, in coordination with other concerned WTO members, including the EC and Japan, during regular meetings of the WTO Committee on Market Access and at the transitional review held in late September 2002.

While it is possible that some of the problems that arose during 2002, such as the missed deadlines, may have been attributable to first-time difficulties in implementing a new system,

other problems seemed to reflect protectionist policies, particularly, for example, MOFTEC's filling of the quota for autos with auto parts. With the 2003 quota year approaching, the United States will continue to monitor developments very closely and will quickly follow up with Chinese officials if it appears that a timely, transparent and appropriate allocation of quotas in 2003 is being threatened.

***Tariff-rate Quotas on Industrial Products***

China agreed to implement a system of TRQs designed to provide significant market access for three industrial products, including fertilizer, a major U.S. export. Under this type of TRQ system, a set quantity of imports is allowed at a low tariff rate, while imports above that level are subject to a higher tariff rate. In addition, for a period of years, the quantity of imports allowed at the low tariff rate increases annually by an agreed amount.

China's accession agreement specifies detailed rules, requiring China to operate its fertilizer TRQ system in a transparent manner and dictating precisely how and when China must accept quota applications, allocate quotas and reallocate unused quotas. In a side letter, China also agreed to issue necessary regulations in draft form by mid-October and in final form by the date of its accession and that its TRQ system would be operational in time for applications to be accepted and quota allocations to take place by December 31, 2001.

Problems with China's fertilizer TRQ allocation system appeared early on. SETC was late in issuing both draft and final regulations, and these regulations did not appear to be fully consistent with China's WTO commitments. The TRQ application process was similarly delayed, as it did not even begin until one month after the January 1 deadline for allocating TRQs. After SETC finally began accepting quota applications, further unexplained delay ensued. SETC finally began to allocate the first quotas in late April, nearly four months late, which meant that fertilizer imports were largely kept out of the Chinese market until after the Northern spring planting season, a boon to China's fertilizer producers. With the quota allocations, however, a new set of problems arose. The most immediate problem was a lack of transparency, which made it difficult to assess whether the quota allocations followed the rules set out in China's goods schedule, although SETC did provide a list of the allocations made. U.S. companies also complained of administrative guidance discouraging some TRQ holders from freely utilizing their quotas.

Throughout 2002, the United States repeatedly engaged China, at all levels of government, in order to improve this situation. Reflecting the growing concerns of the United States and U.S. industry and a lack of progress, the United States requested formal consultations with China under the headnotes in China's goods schedule. These consultations took place in September in Geneva. During the consultations, China was forthcoming in its responses and provided the United States with a better understanding of the challenges facing it, but the United States and China were unable to agree on concrete steps to remedy the situation.

As the 2002 TRQ year was drawing to a close, it appeared that some of the problems with SETC's fertilizer TRQ allocations may have been attributable to first-time difficulties in implementing a new system. For example, timeliness did not appear to be a problem as SETC prepared for the reallocation of TRQs in October, although in the end no reallocation took place because no TRQ holders returned unused quota amounts. But, other problems encountered in 2002 did not go away, and the United States and U.S. industry remained concerned as the 2003 TRQ year was approaching. SETC is still operating under imperfect TRQ regulations, transparency has not improved, and administrative guidance may affect how allocated 2003 TRQs are used. The United States will continue to monitor developments closely in 2003 and work to ensure that China fully complies with its commitments. The United States has also offered to provide technical assistance to China with regard to the implementation of its fertilizer TRQ allocation system.

***Other Import Regulation***

Antidumping

In its accession agreement, China committed that, by the time of its accession, it would revise its regulations and procedures for antidumping (AD) proceedings to make them consistent with the WTO Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (the AD Agreement), which sets forth detailed rules prescribing the manner and basis on which a WTO member may take action to offset the injurious dumping of products imported from another WTO member. China also separately agreed to provide for judicial review of determinations made in its AD investigations and reviews.

Just before China's accession, the State Council issued new AD regulations, which became effective on January 1, 2002. These regulations replaced the regulations that had governed China's AD regime since it began bringing such cases in 1997. In the ensuing months, MOFTEC, which is charged with making determinations of dumping under the new regulations, issued several sets of provisional procedural rules covering initiation of investigations, questionnaires, sampling, verifications, information disclosure, access to non-confidential information, price undertakings, hearings, interim reviews, refunds and new shipper reviews. SETC, which is charged with making the determination of injury, has not yet issued any implementing rules covering the procedures applicable to its own proceedings. The State Council's Tariff Policy Commission makes the final decision on imposing, revoking or retaining AD duties, based on recommendations provided by MOFTEC, although its authority vis-à-vis MOFTEC and SETC is not clearly defined in the new regulations.

In August 2002, the Supreme People's Court issued *Rules on Certain Issues Related to Hearings of International Trade Administrative Cases*, which provide some guidance concerning judicial review of administrative agency decisions affecting international trade, including those in the AD and countervailing duty (CVD) areas. In early December 2002, the Supreme People's Court issued judicial interpretations specifically governing appeals of AD and CVD determinations, which

become effective January 1, 2003. The Supreme People's Court has also issued guidelines laying some groundwork for independent judicial review.

On the whole, China has made an impressive effort to conform its AD regulations to the provisions and requirements of the AD Agreement, which is in noticeable contrast to its pre-accession regulations. The provisions of China's new regulations generally track those of the AD Agreement, but certain omissions and ambiguities remain, and some provisions do not find a counterpart in the AD Agreement and may be inconsistent with it. The United States and other WTO members sought to explore and clarify these issues during the transitional review conducted by the WTO's AD Committee in October 2002. The key issues addressed included: the factors that China will examine in conducting an injury analysis; the definition of "interested" and "related" parties in China's AD practice; methods for calculation of export price and normal value; the use of facts available in AD determinations; and how China intends to identify and address evasion of AD measures. The United States will continue to seek needed clarifications before the AD Committee and through bilateral contacts, including technical assistance training and information exchanges.

There is insufficient data upon which to base an assessment of whether China has applied its new AD regulations and procedural rules in conformity with WTO AD rules. Although China became increasingly active in the AD area in 2002(by initiating nine new AD investigations, compared to a total of twelve during the period from 1997, when China first established its AD regime, to 2001), none of its post-WTO accession investigations has reached the final determination stage. U.S. AD experts, however, have some concerns regarding China's respect for transparency, due process and procedural safeguards based on their evaluation of the regulations and procedural rules that have been promulgated to date and on how the Chinese authorities have handled the pending AD investigations.

According to U.S. AD experts, there are troubling signs of some potential shortcomings with regard to transparency. Based on their discussions with U.S. respondents in the pending AD investigations and on testimony at the hearing before the TPSC Subcommittee on China WTO Compliance, U.S. AD experts are concerned about insufficient openness in the practices of China's administering authorities, in terms of both decision-making processes and making sufficient information available for parties to understand the facts and mount effective arguments. While MOFTEC has made noteworthy efforts to make non-confidential information submitted during AD proceedings available to interested parties and to the public, U.S. AD experts believe that MOFTEC should do more in this regard. The SETC, meanwhile, has not yet established a means to make available to the public, or even to interested parties, non-confidential summaries of materials submitted to it. Moreover, at both agencies, there appears to be little or no disclosure of their respective analyses and decision-making processes. It may be that improvements will become more apparent – or will be instituted – as the Chinese authorities progress in the investigations now under way.

With regard to judicial review of AD determinations, the new rules adopted by the Supreme People's Court are generally encouraging. There does, however, remain some ambiguity regarding the judicial entities to which appeals of AD determinations may be made and the rules under which those appeals will be conducted, in part because there have been no appeals of AD determinations since China's WTO accession. (See the section below on Legal Framework, under the heading of Judicial Review, for a further discussion of the new Supreme People's Court rules.)

Countervailing Duties

China committed that, by the time of its accession, it would revise its regulations and procedures for conducting CVD investigations and reviews to make them consistent with the Agreement on Subsidies and Countervailing Measures (Subsidies Agreement), which sets forth detailed rules prescribing the manner and basis on which a WTO member may take action to offset the injurious subsidization of products imported from another WTO member. Although China did not separately commit to provide judicial review of determinations made in its CVD investigations and reviews, Subsidies Agreement rules require it.

Shortly before China's accession, the State Council issued new CVD regulations, which came into force on January 1, 2002. Later, MOFTEC, which has responsibility for determinations of subsidization under China's CVD regime, issued provisional procedural rules on initiation of investigations, questionnaires, verifications and hearings. The SETC, which determines injury in China's CVD proceedings, has not yet issued any implementing rules covering the procedures applicable to the proceedings before it. The Supreme People's Court, meanwhile, has issued new rules regarding judicial review, as discussed above under the heading of Antidumping.

As in the AD area, China has made a good faith effort to conform its CVD regulations and procedural rules to the provisions and requirements of the WTO rules. The provisions of China's regulations and procedural rules generally track those found in the Subsidies Agreement, although there are certain areas where key provisions are omitted or are worded in an ambiguous manner, and some provisions do not find a counterpart in the Subsidies Agreement and may be inconsistent with it. During the transitional review conducted in the WTO's Subsidies Committee in November 2002, the United States and other WTO members sought to clarify the following key issues: the roles and functions of the various administering authorities in a CVD proceeding; the definition of "subsidy" and "specificity" under China's CVD regulations; how China will determine injury; and China's provisions for ensuring respect for the confidentiality of submissions while providing transparency. The United States will continue to seek needed clarifications through the Subsidies Committee.

China has never initiated a CVD investigation, either pre- or post-WTO accession. Consequently, it is not yet possible to assess whether China applies its new regulations and procedural rules in conformity with WTO CVD rules.

Safeguards

China committed that, by the time of its accession, it would revise its regulations and procedures for conducting safeguard investigations to make them consistent with the WTO Agreement on Safeguards (Safeguards Agreement). That agreement imposes disciplines on WTO members' use of safeguard measures, such as the imposition of temporary quotas, to prevent or remedy serious injury from products imported from other WTO members.

Shortly before China's WTO accession, the State Council issued the *Regulations on Safeguards*, which became effective on January 1, 2002. Under these regulations, MOFTEC is responsible for determining whether the volume of imports has increased and (together with the SETC) whether there is a causal link between any such increased imports and injury to the domestic industry. MOFTEC has issued two sets of provisional procedural rules, one covering initiations and the other hearings. SETC, the agency charged with determining injury to the domestic industry, has not yet issued any general implementing rules covering procedures applicable to the proceedings before it.

As with the AD and CVD areas, it appears that China has made good faith efforts to implement its commitment to establish a WTO-consistent safeguard regime, as the provisions of China's new regulations and procedural rules generally track those of the Safeguards Agreement. However, certain omissions and ambiguity remain, and some provisions do not find a counterpart in the Safeguards Agreement and may be inconsistent with it. In the transitional review before the WTO Committee on Safeguards in October 2002, the United States and other WTO members sought clarification of these issues, which included: the treatment of confidential information; whether increased tariffs and quotas are the only types of safeguards relief permitted by Chinese law, and the responsibility of China's different administering authorities with regard to the application of these different remedies; application of the injury factors outlined in China's regulations and their consistency and completeness vis-à-vis Safeguards Agreement analytical requirements; and the terms and conditions governing the extension of a safeguard measure. The United States will continue to seek needed clarifications before the Safeguards Committee.

On May 20, 2002, MOFTEC initiated China's only safeguard investigation to date. The investigation addressed imports of certain steel products from several countries, including the United States. U.S. companies, however, export little of the subject merchandise to China, and none of them chose to participate in the investigation. China proceeded to impose provisional measures in the form of tariff-rate quotas on nine categories of products the day after initiation, and it rendered a final determination approximately six months later, on November 19, 2002. Even though this investigation has had little impact on U.S. companies, China's conduct of this investigation may have implications for future safeguard actions that could affect the interests of U.S. companies. The United States is therefore studying China's handling of this investigation and will be following further developments with an eye toward taking rapid action if U.S. interests are more directly impacted.

**Export Regulation**

China agreed in its WTO accession agreement that it would only maintain restrictions on exports (other than duties, taxes or other charges) where justified under WTO rules. Article XI of the General Agreement on Tariffs and Trade 1994 (GATT 1994) generally prohibits WTO members from maintaining export restrictions, although certain limited exceptions are allowed.

China also agreed to eliminate all taxes and charges on exports unless they were included in Annex 6 to the Protocol of Accession or are applied in conformity with Article VIII of GATT 1994. Article VIII of GATT 1994 only permits fees and charges limited to the approximate cost of services rendered and makes clear that they shall not represent an indirect protection to domestic products or a taxation of exports for fiscal purposes.

After its accession to the WTO, China has continued to impose restrictions and fees on exports of a few raw materials and intermediate products not included in Annex 6. In an attempt to justify these restrictions and fees, MOFTEC has invoked an exception in Article XX of GATT 1994 that permits a WTO member to impose restrictive export measures relating to the conservation of exhaustible natural resources, provided that such measures are made effective in conjunction with restrictions on domestic production or consumption. Fluorspar is one example of a raw material that is still subject to this type of export regulation. China imposes quotas and license fees on fluorspar exports, apparently with the design to support China's domestic users of fluorspar, which face no comparable restrictions. The United States raised its concerns about continuing export regulation of raw materials and intermediate products bilaterally with China. The United States also worked with other WTO members with an interest in this issue, including Japan, and it raised this issue during the Council for Trade in Goods' transitional review of China's compliance efforts, held in late November 2002. U.S. efforts to resolve this issue will continue in 2003.

**Trading Rights**

Prior to its accession, China restricted the number of companies with trading rights, i.e., the right to import and export goods, and it made extensive use of state trading enterprises. It also restricted the products that a particular company could import or export.

In its accession agreement, China agreed to phase in full trading rights for wholly Chinese-invested enterprises and foreign-invested enterprises and individuals over a three-year period, with only a relatively small number of goods continuing to be limited to state trading, predominantly with regard to the right to export. Upon accession, wholly Chinese-invested enterprises were to have full trading rights, subject to certain minimum registered capital requirements, to be gradually decreased during the three-year transition period. Joint ventures with minority foreign ownership are to be granted full trading rights within one year after accession, and joint ventures with majority foreign ownership must be granted full trading rights within two years after accession. All enterprises in China and all foreign enterprises and

individuals must be granted full trading rights within three years after accession. China also made similar commitments to phase out restrictions on distribution services, as discussed below in the Services section.

In July 2001, several months before China's accession to the WTO, MOFTEC began to loosen trading restrictions for its domestic, non-state trading enterprises with the issuance of its *Circular Concerning the Rules of the Administration of Trading Rights*. The objective of the rules in this circular is to shift MOFTEC out of trade management and towards simple registration of prospective domestic traders. These rules extend trading rights not only to private manufacturing firms, but also to private trading companies. In order to improve transparency, the rules set time limits for the approval process, meaning that applications can no longer be indefinitely held up by regulatory authorities. The rules also reduce the minimum registered capital requirement for wholly Chinese-invested enterprises to obtain trading rights. Beginning in 2002, the minimum registered capital for wholly Chinese-invested trading enterprises is RMB 5 million ($603,000), except in the Central and Western Regions, where the requirement is RMB 3 million ($362,000), and the minimum registered capital for wholly Chinese-invested manufacturing enterprises is RMB 3 million. These capital requirements are scheduled to fall to RMB 3 million for coastal traders in 2003, and by 2005 there will be no minimum capital requirement for any domestic traders or manufacturers. Since the issuance of the circular, the Chinese authorities have been regularly issuing trading rights under these new rules.

Also in July 2001, MOFTEC issued its *Circular Concerning the Extension of Trading Rights for Foreign-Funded Enterprises*, which granted trading rights to some foreign-invested firms ahead of schedule. This circular allows foreign-invested manufacturing firms located in China with over $10 million in annual exports to trade in most products, and it allows research and development centers to import products for test marketing. Earlier in 2001, China had also loosened trading restrictions on foreign manufacturing facilities with a presence in China, although companies without an office in China were still required to use a Chinese agent. Because these new provisions for the most part only benefit large companies, some small and medium-sized companies are concerned that they will have a more difficult time entering the market once full trading rights are granted, in accordance with China's accession agreement.

In line with China's WTO commitments, MOFTEC is currently drafting regulations that will extend trading rights to all domestic and foreign enterprises within two more years. Under these regulations, it is expected that trading licenses will be issued automatically on the basis of routine applications and without reference to equity ownership, registered capital, scope of business, prior experience or other threshold requirements. The United States will continue to monitor developments in this area closely, particularly regarding the timeliness of the scheduled phase-in of trading rights for joint ventures with minority foreign ownership.

## Internal Policies Affecting Trade

### *Non-Discrimination*

China agreed to assume the obligations of GATT 1994, the WTO agreement that lays down the core principles that constrain and guide WTO members' policies relating to trade in goods. The two most fundamental of these core principles are the Most-Favored Nation (MFN), or non-discrimination, rule – referred to in the United States as "normal trade relations" – and the rule of national treatment.

The MFN rule (set forth in GATT Article I) attempts to put the goods of all of an importing WTO member's trading partners on equal terms with one another by requiring the same treatment to be applied to goods of any origin. It generally provides that if a WTO member grants another country's goods a benefit or advantage, it must immediately and unconditionally grant the same treatment to imported goods from all WTO members. This rule applies to internal taxes and charges, among other internal measures. It also applies to customs duties and charges of any kind connected with importing and exporting.

The national treatment rule (set forth in GATT Article III) complements the MFN rule. It attempts to put the goods of an importing WTO member's trading partners on equal terms with the importing member's goods by requiring, among other things, that a WTO member accord no less favorable treatment to imported goods than it does for like domestic goods. Generally, once imported goods have passed across the national border and import duties have been paid, the importing WTO member may not subject those goods to internal taxes or charges in excess of those applied to domestic goods. Similarly, with regard to measures affecting the internal sale, purchase, transportation, distribution or use of goods, the importing WTO member may not treat imported goods less favorably than domestic goods.

In its accession agreement, China agreed to repeal or revise all laws, regulations and other measures that were inconsistent with the MFN, or non-discrimination, rule upon accession. China also confirmed that it would observe this rule with regard to all WTO members, including separate customs territories, such as Hong Kong, Macau and Taiwan. In addition, China undertook to observe this rule when providing preferential arrangements to foreign-invested enterprises within special economic areas.

With regard to the national treatment rule, China similarly agreed to repeal or revise all inconsistent laws, regulations and other measures. China also specifically acknowledged that its national treatment obligation extended to the price and availability of goods or services supplied by government authorities or state-owned enterprises as well as to the provision of inputs and services necessary for the production, marketing or sale of finished products. Among other things, this latter commitment precludes dual pricing, i.e., the practice of charging foreign or foreign-invested enterprises more for inputs and related services than Chinese enterprises. China also agreed to ensure national treatment in respect of certain specified goods and services, which

had traditionally received discriminatory treatment in China, such as boilers and pressure vessels (upon accession), pharmaceuticals, chemicals and spirits (one year after accession) and after sales service (upon accession).

China reviewed its pre-WTO accession laws and regulations and revised many of those which conflicted with the WTO principles of MFN and national treatment. Most of these revisions were made to secure national treatment, including with regard to boilers and pressure vessels, after sales service, the pricing of pharmaceutical products, and registration requirements for foreign chemical products, among other areas.

Nevertheless, MFN and national treatment are still not observed in all areas. For example, China continues to generate MFN and other concerns through the manner in which it provides preferential import duty and value-added tax (VAT) treatment to certain Russian products under the auspices of border trade. Several U.S. industries also reported that China continued to apply the VAT in a manner that unfairly discriminates between imported and domestic goods, both through official measures and on an *ad hoc* basis, as discussed below in the Taxation section. In addition, it appeared that China applied sanitary and phytosanitary measures in a discriminatory manner in 2002, as discussed below in the Agriculture section. The United States has addressed these issues with China, both bilaterally and in WTO meetings, and it will continue to pursue them in 2003.

***Taxation***

China committed to ensure that its laws and regulations relating to taxes and charges levied on imports and exports would be in full conformity with WTO rules upon accession, including, in particular, the MFN and national treatment provisions of Articles I and III of GATT 1994.

Several U.S. industries have complained about the unfair operation of China's VAT system. Often, Chinese producers are able to avoid payment of the VAT on their products, either as a result of poor collection procedures, special deals or even fraud, while the full VAT still must be paid on competing imports. In discussions with Chinese officials on this issue, the United States has complained about the discriminatory treatment accorded to foreign products. The United States has also emphasized the value to China of a properly functioning VAT system as a revenue source, and it has begun to explore possible technical assistance that might help to alleviate this problem.

In some sectors, China issued formal tax measures that have had the effect of disadvantaging U.S. exports and therefore give rise to national treatment concerns. For example, in July 2001, the Ministry of Finance and the State Administration of Taxation issued a circular exempting all phosphate fertilizers except diammonium phosphate (DAP) from China's VAT. DAP, a product produced in the United States, competes with similar phosphate fertilizers produced in China, such as monoammonium phosphate (MAP). The circular also allowed a partial VAT rebate for domestic producers of urea, a nitrogen fertilizer, through the end of 2002. The United States

began to raise these issues with China soon after it acceded to the WTO, and it also raised them at the WTO in regular meetings of the Committee on Market Access throughout the year and during the transitional review held in late September 2002. So far, however, China has refused to make any changes. In 2003, the United States will continue to seek elimination of the differential tax treatment contained in the circular.

National treatment concerns also surround China's consumption tax regulations, which first went into effect in 1993 and applies to a range of consumer products, including spirits and alcoholic beverages, tobacco, cosmetics and skin and hair care preparations, jewelry, fireworks, rubber, motorcycles and automobiles. Under these regulations, China uses different tax bases to compute consumption taxes for domestic and imported products, with the result that the consumption taxes for imported products are substantially higher than those for domestic products. The United States raised this issue with China after its accession, both bilaterally and during the transitional review conducted by the WTO Committee on Market Access. However, China has so far not revised these regulations. The United States will continue to work for the revision of these regulations in 2003.

***Subsidies***

Upon its accession to the WTO, China agreed to assume the obligations of the WTO Subsidies Agreement, which addresses not only the use of CVD measures by individual WTO members (see the section above on Import Regulation, under the heading of Countervailing Duties), but also a government's use of subsidies and the application of remedies through enforcement proceedings at the WTO. As part of its accession agreement, China committed that it would eliminate, by the time of its accession, all subsidy programs prohibited under Article 3 of the Subsidies Agreement, i.e., subsidies contingent on export performance (export subsidies) and subsidies contingent on the use of domestic over imported goods (import substitution subsidies). This commitment expressly extended throughout China's customs territory, including in special economic zones and other special economic areas.

China also agreed to various special rules which apply when other WTO members seek to enforce the disciplines of the Subsidies Agreement against Chinese subsidies (either in individual WTO members' CVD proceedings or in WTO enforcement proceedings). Under these rules, WTO members can identify and measure Chinese subsidies using alternative methods in order to account for the special characteristics of China's economy. For example, when determining whether preferential government benefits have been provided to a Chinese enterprise via, e.g., a loan, WTO members can use foreign or other market-based criteria rather than Chinese benchmarks to ascertain the preferentiality of that loan and its terms. Special rules also govern the actionability of subsidies provided to state-owned enterprises.

China has not yet fulfilled one key requirement of the Subsidies Agreement, which is to notify certain information about its subsidy programs (on an annual basis). Although China submitted a subsidies notification in an annex to its accession agreement, that notification only contained

information through 1998 or 1999, and China acknowledged that it was far from comprehensive. While many WTO members (including the United States) have faced difficulties in keeping up with their annual notification obligations, timely and informative notifications are vital to satisfying the rights of other WTO members to know and understand the range and operation of a member's subsidy programs and to be assured that the member is not maintaining any prohibited subsidies. In this connection, the United States and other WTO members have urged China to submit a full and updated notification as soon as possible. They have also urged China to take advantage of notification training opportunities made possible through the WTO Secretariat and the efforts of other WTO members, and the United States has offered to share technical advice and the benefit of its own experience.

U.S. subsidies experts are currently seeking more information about several Chinese programs and policies that may confer prohibited export subsidies or import substitution subsidies. The programs in question benefit various high technology products in the electronics, bio-medicine, and new materials sectors, among others, as well as the integrated circuit industry. The experts are also examining subsidies provided by China in special economic areas to determine whether any of them may be contingent upon export performance or the use of domestic over imported goods. The United States raised these concerns and sought more information from China during the transitional review before the WTO's Subsidies Committee in November 2002, and it will continue to investigate these subsidy practices in 2003.

### *Price Controls*

In its accession agreement, China agreed that it would not use price controls to restrict the level of imports of goods or services. In addition, in an annex to the agreement, China listed the limited number of products and services remaining subject to price control or government guidance pricing, and it provided detailed information on the procedures used for establishing prices. China agreed that it would try to reduce the number of products and services on this list and that it would not add any products or services to the list, except in extraordinary circumstances. During the transitional review before the Subsidies Committee, the United States sought, but did not obtain, detailed information from China on its use of price controls in 2002. The United States will continue to seek this information from China in 2003.

### *Standards, Technical Regulations and Conformity Assessment*

With its accession, China also assumed obligations under the Agreement on Technical Barriers to Trade (TBT Agreement), which establishes rules and procedures regarding the development, adoption and application of voluntary product standards, mandatory technical regulations, and the procedures (such as testing or certification) used to determine whether a particular product meets such standards or regulations. Its aim is to prevent the use of technical requirements as unnecessary barriers to trade. The TBT Agreement applies to a broad range of industrial and agricultural products. It establishes rules that help to distinguish legitimate standards and technical regulations from protectionist measures. Among other things, standards, technical

regulations and conformity assessment procedures are to be developed and applied transparently and on a non-discriminatory basis and should be based on relevant international standards and guidelines, when appropriate.

In its accession agreement, China also 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 addition, China agreed to ensure that all of its conformity assessment bodies are authorized to handle both imported and domestic goods within one year of accession. China also consented to accept the Code of Good Practice (set forth in an annex to the TBT Agreement) within four months after accession, which it has done, and to speed up its process of reviewing existing technical regulations, standards and conformity assessment procedures and harmonizing them with international norms.

In anticipation of its WTO accession, China made significant progress in the areas of standards and technical regulations. China addressed problems that foreign companies had encountered in locating relevant regulations and how they would be implemented, and it took steps to overcome poor coordination among the numerous regulators in China. This progress continued after China's accession to the WTO.

China began to take steps in 2001 to address problems associated with its multiplicity of conformity assessment bodies, whose task it is to determine if standards and technical regulations are being observed. AQSIQ was established as a new ministry-level agency in April 2001. It is the result of a merger of the State Administration for Quality and Technical Supervision and the State Administration for Entry-Exit Inspection and Quarantine. Chinese officials explained that this merger was designed to eliminate discriminatory treatment of imports and requirements for multiple testing simply because a product was imported rather than domestically produced. China also formed the quasi-independent National Certification and Accreditation Administration, which is attached to AQSIQ and is charged with the task of unifying the country's conformity assessment regime. Despite these changes, however, foreign companies do not yet have any choice regarding which laboratories they can use to test their products. Foreign products are sent to laboratories specially designated for testing them.

China also announced its creation o f the State Administration of China for Standardization (SACS) under AQSIQ in October 2001. SACS is charged with unifying China's administration of product standards and aligning its standards and technical regulations with international practices and China's commitments under the TBT Agreement. SACS is the Chinese member of the International Organization for Standardization and the International Electro-technical Commission.

AQSIQ, meanwhile, established a TBT inquiry point after China acceded to the WTO. U.S. companies report that this inquiry point has been helpful as they try to navigate China's system of standards and technical regulations. In addition, China's designated notification authority, MOFTEC, began to notify proposed technical regulations and conformity assessment procedures to WTO members in 2002, as required by the TBT Agreement. In some cases, the comment periods established by China were unacceptably brief. In other cases, insufficient time was provided for Chinese regulatory authorities to consider interested parties' comments before a regulation was adopted, although China recently demonstrated its awareness of this concern when it agreed to postpone adoption of a proposed fertilizer standard in order provide more time for its regulatory authorities to consider comments from U.S. industry.

In January 2002, AQSIQ issued regulations to facilitate its adoption of international standards. AQSIQ has announced that approximately 44 percent of China's nearly 20,000 national standards are based on international standards. Its goal is to have 70 percent of China's national standards based on international standards within 5 years. However, in a number of sectors, including, for example, autos, telecommunications equipment, electrical products, heating and air conditioning equipment, whiskey and fertilizer, concern has grown over the past year as China has pursued the development of unique requirements, despite the existence of well-established international standards. If China follows through and adopts arbitrarily unique requirements, it will be creating significant barriers to entry into its markets, as the cost of complying will be high for foreign companies. At the same time, China will also be placing its own companies at a disadvantage in its export markets, where international standards prevail.

AQSIQ also issued regulations establishing a new Compulsory Product Certification System. Under this system, there is to be one quality mark, called the "China Compulsory Certification" or "CCC" mark, issued to both Chinese and foreign products. This new mark became effective May 1, 2002, although the regulations allow companies a one-year grace period. Under the old system, domestic products were only required to obtain the "Great Wall" mark, while imported products needed both the "Great Wall" mark and the "CCIB" mark. Despite the changes made by these regulations, U.S. companies in some sectors complained in 2002 about continued duplication in certification requirements, particularly for cosmetics, pharmaceuticals, medical equipment, cellular telephones and other telecommunications products and consumer electronic products.

The United States raised these and other issues in the areas of standards, technical regulations and conformity assessment with China bilaterally. The United States also voiced its concerns during meetings of the WTO's TBT Committee, including the transitional review held in October 2002, where it received support from the EC, Japan and others. In addition, the United States conducted technical assistance programs for China on product standards development for the medical device, pharmaceutical and information and communication technology industries. These programs focused on the requirements of the TBT Agreement and national treatment issues. The United States will continue to engage the relevant Chinese authorities in the areas of standards, technical regulations and conformity assessment in 2003.

***Other Internal Policies***

State-Owned and State-Invested Enterprises

While many provisions in China's WTO accession agreement indirectly discipline the activities of state-owned and state-invested enterprises China also agreed to some direct disciplines. In particular, it agreed that laws, regulations and other measures relating to the purchase and commercial sale and production of goods or supply of services for commercial sale by state-owned and state-invested enterprises or for use in non-governmental purposes would be subject to WTO rules. China also affirmatively agreed that state-owned and state-invested enterprises would have to make purchases and sales based solely on commercial considerations, such as price, quality, marketability and availability, and that the government would not influence the commercial decisions of state-owned and state-invested enterprises. Since China's accession to the WTO, U.S. officials have not discovered evidence of WTO compliance problems in this area, although a lack of available information makes it a difficult area to assess.

State Trading Enterprises

In its WTO accession agreement, China also agreed to disciplines on the importing and exporting that was still taking place through state trading enterprises. China committed to provide full information on the pricing mechanisms of state trading enterprises and to ensure that their import purchasing procedures are transparent and fully in compliance with WTO rules. China also agreed that state trading enterprises would limit the mark-up on goods that they import in order to avoid trade distortions. The United States and other WTO members requested detailed information from China on the pricing and purchasing practices of state trading enterprises, principally through the transitional review before the WTO's Council for Trade in Goods in late November 2002. However, China has so far only provided general information, which does not allow a meaningful assessment of China's compliance efforts.

Government Procurement

The WTO Agreement on Government Procurement (GPA) is a plurilateral agreement, and membership is therefore limited to the 28 WTO members (including the United States) that so far have affirmatively decided to join it. The GPA applies to central and local government procurement of goods and services, and it requires GPA members to provide MFN and national treatment to the goods, services and suppliers of other GPA members and to adhere to detailed procedures designed to ensure fairness and predictability in the procurement process.

At present, China is not a GPA member. It committed to become an observer to the GPA upon its WTO accession, and in February 2002 it became an observer. It also committed to initiate negotiations for membership in the GPA "as soon as possible," but it has not yet done so.

In the interim, China did agree that all of its central and local government entities would conduct their procurements with transparency, as reflected in its accession agreement. China also agreed that, if a procurement were opened to foreign suppliers, it would provide MFN treatment by allowing all foreign suppliers an equal opportunity to participate in the bidding process. In June 2002, China adopted its *Government Procurement Law*, which becomes effective on January 1, 2003. This law attempts to follow the spirit of the GPA and also incorporates provisions from the United Nations Model Law on Procurement of Goods.

In 2003, the United States will continue to urge China to initiate negotiations for GPA membership. It will also monitor the treatment accorded to U.S. suppliers under the *Government Procurement Law*.

**Investment**

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

Beginning before its accession to the WTO, 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. However, the revised laws and regulations 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 officials when reviewing investment applications. In addition, some Chinese officials have acknowledged that they continue to consider factors such as export performance and local content when deciding whether to approve an investment or to recommend approval of a loan from a Chinese policy bank, which is often essential to the success of an investment project. The United States and other WTO members, including the EC, Japan and Taiwan, raised these concerns during the transitional review conducted by the Committee on Trade-Related Investment Measures in October 2002. The United States will continue to follow this situation closely in 2003.

In a separate commitment, China agreed to revise its Industrial Policy for the Automotive Sector upon accession to make it compatible with WTO rules and principles. However, China has not yet revised this policy, and U.S. industry reports that some local officials continue to enforce the incompatible provisions of the policy. The Administration is fully engaged with China and relevant U.S. companies and organizations on this issue and is committed to achieving China's full implementation of this commitment.

Finally, in March 2002, the State Council issued a revised *Sectoral Guidelines Catalogue for Foreign Investment*. This catalogue brought China into compliance with its accession agreement commitments to open up certain sectors to foreign investment, including travel agencies, human resources companies, cinemas, railway cargo and publications distribution (see the Services section below), while it also opened up a number of other sectors not covered by China's accession agreement. One notable exception to this progress was the area of biotechnology seed development and production, which China changed to the "prohibited" category.

## Agriculture

Overall, China's compliance efforts in the agriculture sector produced mixed results in 2002. While China made agreed tariff reductions, and some U.S. agricultural products experienced dramatic increases in sales to China, including beef, almonds and citrus, among others, particularly serious problems were encountered on many other fronts. For the United States, the key problems involved China's new biotechnology regulations, the administration of TRQs on bulk agricultural commodities, the application of sanitary and phytosanitary measures and inspection requirements, resulting in impeded market access for many U.S. agricultural products, particularly soybeans, wheat, corn, cotton, vegetable oils, poultry and pork. Some of these problems can be attributed to unfamiliarity with the relevant WTO agreements or the requirements of specific commitments made by China. Others, however, appear to have been driven by protectionist pressures within China. For the most part, little progress was made in resolving U.S. concerns, and U.S. exports of the affected products were well below industry expectations. Nevertheless, by the end of 2002, the United States did successfully reach a solution with China on the most troublesome problem facing the U.S. agriculture sector in 2002 – the timing of the requirement for obtaining permanent safety certificates under China's biotechnology regulations.

### *China's Commitments*

Upon its accession to the WTO, China assumed the obligations of the WTO Agreement on Agriculture, which contains commitments in three main policy areas for agricultural products: market access, domestic support and export subsidies. In some instances, China also made further concessions, as specified in its accession agreement.

In the area of market access, WTO members committed to the establishment of a tariff-only regime, tariff reduction and the binding of all tariffs. As a result of its accession negotiations,

China agreed to significant reductions in tariffs rates on a wide range of agricultural products. China also agreed to eliminate quotas and implement a system of TRQs designed to provide significant market access for certain bulk commodities upon accession. This TRQ system is very similar to the one governing fertilizers (discussed above in the Import Regulation section). China's goods schedule sets forth detailed rules intended to limit the discretion of the agriculture TRQ administrator, the State Development and Planning Commission (SDPC), and to require SDPC to operate with transparency and according to precise procedures for accepting quota applications, allocating quotas and reallocating unused quotas.

In the area of domestic support, the basic thrust is to encourage a shift in policy to the use of measures that distort production and trade as little as possible. Essentially, WTO members committed to reduce over time the types of domestic subsidies and other support measures that distort production and trade, while WTO members remained free to maintain or even increase support measures that have little or no distorting effect, such as agricultural research or training by the government. China committed to a cap for trade- and production-distorting domestic subsidies that is lower than the cap permitted developing countries and that includes the same elements that developed countries use in determining whether the cap has been reached.

In the area of export subsidies, WTO members committed to ban the use of these subsidies unless they fall within one of four categories of exceptions, the principal one of which allows export subsidies subject to certain reduction commitments. However, like many other WTO members, China agreed to eliminate all export subsidies upon its accession to the WTO.

Another important area is covered by the WTO Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement), under which China also became obligated. The SPS Agreement establishes rules and procedures regarding the formulation and application of sanitary and phytosanitary measures, i.e., measures taken to protect against risks associated with plant or animal borne pests and diseases, additives, contaminants, toxins and disease-causing organisms in foods, beverages or feedstuffs. The rules and procedures in the SPS Agreement require that sanitary and phytosanitary measures address legitimate human, animal and plant health concerns, do not arbitrarily or unjustifiably discriminate between WTO members' agricultural and food products, and are not disguised restrictions on international trade. The SPS Agreement requires that the measures in question be based on scientific principles and developed through risk assessment procedures, while at the same time it preserves each member's right to choose the level of protection it considers appropriate with regard to sanitary and phytosanitary risks.

Other WTO agreements also place significant obligations on China in the area of agriculture. Three of the most important ones are GATT 1994, the Import Licensing Agreement and the TBT Agreement, which are discussed above (in the sections on Import Regulation and Internal Policies Affecting Trade).

China also made several additional commitments that should help to rectify other problematic agricultural policies, either upon accession or after limited transition periods. For example, China

agreed to eliminate import monopolies maintained by state trading enterprises on agricultural goods such as wheat, rice and corn and to permit non-state trading enterprises to import specified shares of these goods.

***China's Compliance Efforts***

Tariffs

China implemented the required tariff changes on agricultural goods for 2002 on January 1, 2002, just as it did for industrial goods. The United States' review of these changes showed only a few minor discrepancies. For example, China continued its past practice of using specific, i.e., per kg, tariffs rather than ad valorem tariffs on chicken meat, although it remains unclear whether the per kg tariffs actually result in tariffs above the bound rates.

The 2002 tariff changes made by China included significant reductions in tariffs rates on agricultural goods of greatest importance to U.S. farmers and ranchers. Those tariff rates are scheduled to drop from a 1997 average of 31 percent to 14 percent in almost all cases within 5 years, although the most dramatic reductions took place in 2002.

For example, tariffs on many beef products have begun to fall significantly. By January 1, 2004, the tariffs on beef cuts are scheduled to be reduced from 45 percent to 12 percent, and the tariffs on beef carcasses will drop from 45 percent to 20-25 percent. Tariffs on dairy products are also being reduced substantially (by January 1, 2004). Butter tariffs fall from 50 percent to 10 percent, tariffs on milk and cream products fall from 25 percent to 10-15 percent, and tariffs on some cheeses falling from 50 percent to 12 percent. Tariffs on many other agricultural products will be showing similar declines, as China is scheduled to reduce tariffs on frozen potato products and grapes to 13 percent, on citrus products to 12 percent, and on apples, pears, almonds and pistachios to 10 percent.

In part due to these 2002 tariff reductions, some U.S. exports to China increased markedly. For example, exports of beef and beef variety meats increased by 37 percent in tonnage and by 28 percent in value during the first six months of 2002, when compared to the same period in 2001. U.S. citrus exports also rose dramatically in 2002, while U.S. almond growers anticipate that their exports will have increased by approximately $50 million annually within one to three years of China's WTO accession.

However, not all of China's tariff cuts resulted in improved market access in 2002. As discussed below, because of problems that arose with some non-tariff barriers, market access for many U.S. agricultural products was still impeded.

China's Biotechnology Regulations

One of the most contentious agriculture issues that arose during China's first year of WTO membership involved new rules implementing June 2001 regulations relating to biotechnology safety, testing and labeling. The implementing rules, issued by China's Ministry of Agriculture (MOA) shortly before China's WTO Accession, did not provide adequate time for completion of mandated field trials and the issuance of permanent safety certificates for biotechnology products. As the March 2002 effective date for these implementing rules approached, trade in biotechnology products began to be disrupted. The U.S. products most affected were soybeans, which had seen exports to China grow to more than $1 billion in 2001, while corn and other commodities, such as consumer products made from biotech commodities, remained at risk. Following concerted, high-level pressure from the United States, China agreed to a temporary solution in March 2002, which provided for a nine-month delay, effected through the issuance of temporary safety certificates, good though December 20, 2002.

By September 2002, it became apparent that high-level engagement would again be needed to head-off a major disruption of trade as the expiration date for the temporary safety certificates began to approach. During the run-up to the October Summit between Presidents Bush and Jiang, the United States and China were able to agree on an extension to the previous interim agreement, allowing for another nine-month delay (until September 2003) before permanent safety certificates would be required. It is anticipated that this extension will be sufficient, but the United States will continue to watch this area closely in 2003 and will continue to press on multiple fronts in an effort to ensure that further trade disruptions are avoided.

As the end of 2002 draws near, it appears that the extension achieved in September 2002 will help to add the market certainty that U.S. exporters of biotechnology products, and particularly soybeans, have sought. In marketing year 2001/2002, U.S. exports of soybeans fell from 5.7 million tons to 4.3 million tons, in large part because exports were effectively blocked in early 2002 due to the uncertainty surrounding MOA's implementing rules. With the start of the 2002/2003 marketing year in September 2002, exports picked up dramatically. For September and October 2002, exports totaled nearly 2.3 million tons, as compared to 1.5 million tons for the same period in the 2001/2002 marketing year, setting a record for the first two months of a marketing year.

Meanwhile, other U.S. concerns with China's biotechnology regulations and implementing rules remain, particularly with regard to risk assessment, labeling and field trials. The United States provided written comments on these issues to MOA in early 2002, and MOA has agreed to the creation of a special working group of U.S. and Chinese government agricultural specialists to discuss these issues.

Tariff-rate Quotas on Bulk Agricultural Commodities

Of particular concern in 2002 was the manner in which China implemented its first year commitments relating to TRQs on bulk agricultural commodities, which included several commodities of particular importance to U.S. farmers, such as wheat, corn, cotton and vegetable oils. SDPC was late to issue both draft and final regulations, and when they were issued, they were flawed. The regulations did not provide for the required transparency, imposed burdensome licensing procedures, and appeared to contravene agreed rules in China's accession agreement by allowing TRQ allocations to be reserved for the processing and re-export trade. SDPC was then late beginning the application process, and its subsequent allocation of TRQs did not even begin until late April, approximately four months late. Moreover, all of the available information indicated that SDPC had decided to allocate TRQs in a manner that would protect domestic farm interests and maintain the monopoly enjoyed by state trading enterprises. SDPC operated with only limited transparency, refusing to provide specific details on the amounts and the recipients of the allocations. At the same time, SDPC reserved a significant portion of the TRQs for the processing and re-export trade, despite China's market access and national treatment commitments. This practice kept down the market share held by imports in China's domestic market and, at the same time, created more competition for WTO members' processed goods in other export markets. In the case of cotton, more than 60 percent of the TRQs apparently were reserved for Chinese companies that process cotton for re-export. In addition, SDPC allocated a portion of the TRQs for some commodities in smaller than commercially viable quantities, thereby undermining China's market access commitments.

Throughout the first several months of 2002, the United States repeatedly engaged China, at all levels of government, in an attempt to improve SDPC's performance. The United States also raised its concerns at the WTO during meetings of the Committee on Agriculture and urged other WTO members to voice their concerns as well. When these efforts had generated no progress by July, the United States requested formal consultations with China under the headnotes contained in China's WTO goods schedule. These consultations took place in September in Geneva. The United States presented its full range of concerns to China, and it confirmed China's policy of reserving a portion of the TRQs for the use of the export processing and re-export trade in China.

Since then, some progress has been achieved. SDPC was able to complete the required re-allocation of 2002 TRQs in a timely manner, and it issued 2003 TRQs on time. The United States and U.S. industry remain concerned, however. As the United States pointed out during the transitional review before the Committee on Agriculture in late September 2002, SDPC is still operating under imperfect regulations, transparency has not been improved, and it appears that allocations will again be inappropriately reserved for the processing and re-export trade. The United States will continue to monitor developments in this area very closely in 2003 and will take actions necessary to obtain China's full compliance.

Sanitary and Phytosanitary Issues

U.S. exports were subjected to several SPS measures in 2002 that raised WTO concerns. For example, with regard to raw poultry and meat, China began to apply a standard that was not based on science, which had the effect of slowing imports from the United States. In particular, China declared zero tolerance for pathogens in imported raw poultry and meat. While it is possible to reduce contamination through cooking, the complete elimination of pathogens in raw poultry and meat is not reasonably achievable, short of irradiation. As a result, it is extremely doubtful that any country could produce raw poultry and meat meeting a zero-tolerance standard. Indeed, one troubling aspect of this problem was that China apparently did not apply this same standard to domestic raw poultry and meat. In addition, while the 1999 U.S.-China Agricultural Cooperation Agreement established an agreed level of TCK fungus tolerance in U.S. wheat, China has reportedly been requiring special treatment of wheat imported from the Pacific Northwest.

The United States repeatedly engaged China on these and other SPS issues during the past year, both bilaterally and during meetings of the WTO Committee on Sanitary and Phytosanitary Measures, including the transitional review held in November 2002. To date, however, little progress has been achieved. The United States will be holding further discussions with China in the coming months, and it will continue to press for resolution of these issues as 2003 progresses.

Inspection-Related Requirements

In the last half of 2002, China's inspection and quarantine agency, AQSIQ, began to impose inspection-related requirements that had the effect of restricting imports of some U.S. agricultural goods. AQSIQ requires importers to obtain quarantine inspection certificates before agricultural goods can enter China's market, and traders have reported that AQSIQ has imposed quantitative restrictions and time limits in connection with them. For example, in mid-2002, AQSIQ appeared to be limiting inspections of imported poultry and pork to no more than two shipments per month per importer, with each shipment not to exceed 200 metric tons.

The United States sought to achieve elimination of these restrictions in bilateral meetings with China, and it also raised its concerns during the transitional reviews conducted by the Committee on Agriculture in September 2002 and by the SPS Committee in November 2002. The United States will continue to seek a solution to this situation in 2003.

Export Subsidies

U.S. industry has expressed concern that China continues to use export subsidies for corn and perhaps cotton, despite its WTO commitment to eliminate all export subsidies upon its accession to the WTO. It appears that significant quantities of corn are being exported from China, including corn from Chinese government stocks, at prices below domestic prices in China. As a

result, U.S. corn exporters have lost market share for corn in Asian markets, while China is exporting record amounts of corn.

The United States raised questions about possible export subsidies with China, both bilaterally and during meetings before the Committee on Agriculture, including the transitional review held in September 2002. To date, however, it has been difficult to develop the necessary evidence to confirm the existence of the suspected export subsidies, in part because China has refused to provide information on its pricing structure. The United States will make every effort to ensure that any use of export subsidies is eliminated.

**Intellectual Property Rights**

With its acceptance of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement), China took on the obligations to adhere to internationally accepted norms to protect and enforce the intellectual property rights held by U.S. and other foreign companies and individuals in China. Specifically, the TRIPS Agreement sets minimum standards of protection for copyrights and neighboring rights, trademarks, geographical indications, industrial designs, patents, integrated-circuit layout designs and undisclosed information. Minimum standards are also established by the TRIPS Agreement for the enforcement of intellectual property rights in administrative and civil actions and, at least in regard to copyright piracy and trademark counterfeiting, in criminal actions and actions at the border. The TRIPS Agreement requires as well that, with very limited exceptions, WTO members provide national and most-favored-nation treatment to the nationals of other WTO members with regards to the protection and enforcement of intellectual property rights.

At the time of its accession to the WTO, China was in the process of modifying the full range of IPR laws, regulations and implementing rules, including those relating to patents, trademarks and copyrights. China had completed amendments to its patent law, trademark law and copyright law, along with regulations for the patent law. Within several months after its accession, China issued regulations for the trademark law and the copyright law. China also issued various sets of implementing rules, and it issued regulations and implementing rules covering specific subject areas, such as integrated circuits, computer software and pharmaceuticals.

U.S. experts have carefully reviewed China's new IPR laws, regulations and implementing rules. In September 2002, together with other WTO members, the United States undertook a comprehensive review of them as part of the transitional review of China before the WTO's Council for Trade-related Aspects of Intellectual Property Rights (TRIPS Council) and identified various areas where China could make improvements. Overall, the United States and U.S. industry view the legal changes made by China as major improvements that generally move China generally in line with international norms in most key areas.

At the same time, significant concerns remain, particularly in IPR enforcement. The TRIPS Agreement requires China to implement effective enforcement procedures and to provide

remedies that have a deterrent effect. Although China has revised its IPR laws and regulations to strengthen administrative enforcement, civil remedies and criminal penalties, IPR violations are still rampant. IPR enforcement is hampered by lack of coordination among Chinese government ministries and agencies, local protectionism and corruption, high thresholds for criminal prosecution, lack of training and weak punishments.

As explained by one trade association, "[e]ffective enforcement against [IPR] infringement in China is universally recognized as the chief concern of [IPR] rights-holders, as piracy rates in China in all areas, including copyright, trademark and patents, continues to be excessively high." U.S. copyright holders report, for example, that inadequate enforcement "has resulted in piracy levels in China for most copyright sectors at around or in excess of 90 [percent]," and "[l]osses due to piracy are estimated to be a staggering $1.9 billion" annually.

The United States recognizes that addressing IPR enforcement problems in China is a critically important task. The United States worked with central and local government officials in China in 2002 in a determined and sustained effort to improve China's IPR enforcement. A variety of U.S. agencies engaged in regular bilateral discussions with their Chinese counterparts and conducted numerous technical assistance programs for central and local government officials on TRIPS Agreement rules, IPR enforcement and rule of law issues. The United States' effort also benefitted from cooperation with Japan and other WTO members to seek improvements in China's IPR enforcement, both on the ground in China and at meetings of the TRIPS Council. The United States will continue this vital work in 2003.

***Legal Framework***

Patents

China's new patent law went into effect on July 1, 2001, and implementing regulations became effective not long thereafter. They generally comply with China's TRIPS Agreement obligations.

The new law and regulations strengthen patent protection, simplify patent examination and issuance procedures, and adjust the prior law and regulations to make them conform more closely to TRIPS Agreement provisions. For example, there is now a prohibition on advertising or marketing of infringing products, and judicial review of patent revocations is now available. The new law and regulations also make improvements in administrative and civil enforcement. Administrative authorities may now confiscate income from patent-infringing products and fine violators. On the civil enforcement side, there is a new provision allowing a patent holder (or trademark or copyright holder) in a civil proceeding to request immediate suspension of potentially infringing acts before requesting a formal legal determination. In addition, much larger damages can be awarded than in the past, when judges had no legal basis for levying stiff awards against violators. Judges in civil proceedings can now issue awards in the amount of the actual damages suffered by the injured party. If damages are difficult to calculate in a particular

case, damages can still be awarded in an amount equal to a reasonable multiple of the licensing fee involved.

U.S. companies have recently complained about a new regulation that appears to establish a broad right to require compulsory licensing of patents on all technologies introduced into China. The TRIPS Agreement limits compulsory licensing of semiconductor technology, and it further provides that compulsory licenses for this technology may only be granted for public, non-commercial use or to remedy anti-competitive behavior. This regulation may therefore be too broad.

Trademarks

China's new trademark law went into effect on December 1, 2001, and new implementing regulations took effect on September 15, 2002. The changes made by the new law and regulations were intended primarily to bring China into compliance with the minimum requirements of the TRIPS Agreement, which they largely did. Some problems do remain, however.

The United States, with the support of other WTO members, including the EC and Japan, raised concerns about whether foreign trademark owners are receiving national treatment with regard to well-known marks, which benefit from additional protections during the trademark prosecution process as well as enhanced civil and criminal enforcement, such as lower thresholds for criminal prosecution. China has recognized nearly 200 marks as well-known, none of which is a foreign mark. In response to the interventions by the United States and others, China committed to review the relevant provisions in its trademark regulations and to ensure that national treatment is provided.

The other area that raised national treatment concerns involves the registration of trademarks. Chinese enterprises can file for registration on their own, but foreign-invested enterprises must use a state-mandated agent. Following bilateral meetings between U.S. and Chinese officials and multilateral meetings at the WTO, including the transitional review before the TRIPS Council in September 2002, China amended its regulations to permit foreign-invested enterprises to file for trademarks without an agent.

Besides bringing China largely into compliance with the TRIPS Agreement, the new trademark law and regulations also substantially improve the legal framework for enforcement. These improvements can be found in each of the three areas of enforcement, i.e., enforcement by administrative authorities, civil judicial proceedings brought by rights holders and criminal prosecutions.

In the area of administrative enforcement, the authorities are now authorized to confiscate and destroy counterfeit products and the equipment used to manufacture them. They can also impose fines equal to three times the value of the counterfeit products and, in cases where it is

impossible to determine this value, discretionary fines of up to RMB 100,000 ($12,500). Under the old regulations, fines were limited to 50 percent of the value of the counterfeit products.

With regard to civil judicial proceedings, the plaintiff trademark holder now can seek a preliminary injunction and can obtain an award equal to the amount of its actual damages. If the plaintiff's damage or the infringer's profits cannot be determined, the plaintiff can obtain statutory damages of up to RMB 500,000 ($60,420).

Improvements in criminal enforcement have been attempted through the State Council's issuance of regulations designed to achieve the timely transfer of counterfeiting cases from administrative enforcement authorities to the police. Under these regulations, the administrative authorities are required to transfer cases to the police for criminal investigation based on the suspicion that a crime has been committed; the old regulations called for proof of a crime, not just suspicion, in order to transfer a case. Private parties are also authorized to file complaints with the criminal prosecutors if they believe that the administrative authorities have failed to transfer a case that meets the new threshold test. In addition, the Supreme People's Court and the Supreme People's Procuratorate issued judicial interpretations and prosecution guidelines aimed at clarifying the standards for criminal liability and enforcement.

Nevertheless, some problems remain in the area of enforcement. For example, a defendant may not be administratively fined and criminally fined for the same offense.

Copyrights

China's new copyright law took effect on October 27, 2001, and implementing regulations became effective on September 15, 2002. Together, the new law and regulations are designed to bring China into compliance with minimum TRIPS Agreement requirements, which they generally do.

At the same time, the new law and regulations also strengthen available enforcement measures. Now, in the area of administrative enforcement, the authorities are authorized to order a person to cease infringing activities and to confiscate and destroy pirated products and the equipment used to produce them. They can also impose fines equal to three times the value of the counterfeit products and, in cases where it is impossible to determine this value, discretionary fines of up to RMB 100,000 ($12,500). In civil copyright infringement proceedings, the plaintiff copyright holder now can seek a preliminary injunction and can obtain an award equal to the amount of its actual damages. If damages are difficult to calculate in a particular case, they can be set as high as RMB 500,000 ($60,420). Judges can also order confiscation of illegal gains, pirated copies and property used to conduct the infringement activities. The new law and regulations also place the burden of proof on the alleged infringer to prove that it has a legitimate license, and they allow for reference to China's contract law as a basis for fulfillment of the parties' licensing obligations. Meanwhile, in the area of criminal enforcement, as in the case of trademarks, there is a new regulation intended to achieve the timely transfer of piracy cases from

administrative enforcement authorities to the police, and new judicial interpretations and prosecution guidelines attempt to clarify the standards for criminal liability and enforcement.

The new law and regulations for the first time address copyrights issues related to the Internet. U.S. companies, however, would still like to see China accede to the World Intellectual Property Organization (WIPO) internet treaties and harmonize its laws and regulations fully with WIPO internet treaty requirements. Some observers view China's offer to host the annual WIPO Conference in April 2003 as a step in the right direction.

A new regulation on copyright protection for computer software products delineates the protected interests for computer software development, circulation and application. According to the regulation, an individual software developer may keep his or her copyright for life, and it will continue in the individual's name for 50 years after death.

***Enforcement of IPR Laws and Regulations***

The central government displayed strong leadership in modifying the full range of China's IPR laws and regulations in order to bring them into line with China's WTO commitments. Although some further improvements to these laws and regulations could be made in the area of IPR enforcement, the more critical issue is that the central government's leadership has not translated into effective IPR enforcement at the local level, as IPR infringement remains a serious problem throughout China. The reasons for this situation range from protectionism by local government officials and corruption to structural obstacles and lack of training.

Criminal enforcement, in particular, remains a major problem. 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, criminal prosecutions for the import or export of infringing products have never been undertaken. Moreover, even when IPR violations are referred for criminal prosecution, the actual prosecution of IPR crimes frequently requires coordination among a relatively large number of agencies at the national and local levels. Coordination nevertheless remains problematic, with different agencies often unwilling or unable to work together. In addition, ambiguity in China's IPR laws and regulations impedes criminal enforcement, as it is not always clear whether a particular activity warrants administrative, civil or criminal enforcement.

Effective enforcement is also impeded by limitations on enforcement powers, particularly in the area of administrative enforcement. For example, when administrative authorities decide on fines, the fine amounts are kept artificially low because the administrative authorities do not treat the infringing goods as having the value of the genuine articles. Furthermore, evidence showing that a person was caught warehousing infringing goods is not sufficient to prove an intent to sell them, and as a result administrative authorities will not even include those goods in the value of the infringing goods when determining the fine amounts.

China is making efforts to upgrade its judicial system, but these efforts are still in progress. 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 expert witnesses are vague, among other issues. In addition, in the patent area, where enforcement through civil litigation is of particular importance, a single case still takes four to seven years to complete, rendering the new damages provisions adopted to comply with China's TRIPS Agreement obligations less meaningful.

Meanwhile, the central government did initiate a new anti-counterfeiting and anti-piracy campaign in 2002. As in prior years, this campaign resulted in high numbers of seizures. For example, according to Chinese government reports, the 2002 campaign initially focused on clearing the market of illegal publications and pirated computer and video discs. By the end of May, it was reported that more than 400,000 government agents had been sent out to conduct investigations, and 16 million copies of illegal publications and 39 million pirated discs were reportedly seized. Nevertheless, these centrally mandated enforcement campaigns do not appear to have significantly impacted most sectors, either due to the sporadic nature of these campaigns or the lack of deterrent criminal penalties, particularly for commercial-scale piracy of foreign copyrights.

**Services**

The commitments that China made in the services area begin with the General Agreement on Trade in Services (GATS). The GATS provides a legal framework for addressing market access and national treatment limitations affecting trade and investment in services. It includes specific commitments by WTO members to restrict their use of those limitations and provides a forum for further negotiations to open services markets around the world. These commitments are contained in national services schedules, similar to the national schedules for tariffs.

In its services schedule, 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 are ones that 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.

Finally, 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.

***Distribution***

Prior to its WTO accession, China generally did not permit foreign companies to distribute products in China, i.e., to provide wholesaling, retailing, franchising or commission agent services or to provide related services, such as repair and maintenance services. In its accession agreement, China agreed to phase out these prohibitions over three years, subject to limited exceptions.

Upon accession, all foreign-invested enterprises are to have the right to distribute and provide related services for goods that they make in China. Then, within one year after accession, the first significant step in the extension of distribution rights to foreign enterprises is scheduled to take place. At that time, minority foreign-invested enterprises will have the right to distribute goods, whether made in China or imported, and provide related services, with some exceptions. Within two years after accession, majority foreign-invested enterprises will have these rights. Within three years, foreign-invested enterprises and wholly foreign-owned enterprises will have the right to distribute and provide related services for almost all types of goods, whether made in China or imported.

The United States is monitoring developments in this area carefully, with the focus now on ensuring that China implements its commitment to extend distribution rights to minority foreign-invested enterprises by December 11, 2002. Currently, the United States is concerned that China has not yet issued any regulations implementing this commitment, either in draft or final form. Implementing regulations are necessary to provide more certainty to foreign enterprises planning distribution systems, and until they are issued, foreign enterprises may be reluctant to go forward with their plans.

***Financial Services***

<u>Banking</u>

Prior to its accession to the WTO, China had allowed foreign banks to conduct foreign currency business in selected cities. Although China had also permitted foreign banks, on an experimental

basis, to conduct local currency business, the experiment was limited to foreign customers in two cities.

In its accession agreement, China committed to a five-year phase-in for banking services by foreign banks. Specifically, China agreed that, immediately upon its accession, it would allow U.S. and other foreign banks to conduct foreign currency business with Chinese enterprises and individuals throughout China. The ability of U.S. and other foreign banks to conduct domestic currency business with Chinese enterprises and individuals is scheduled to be phased in. Within two years after accession, foreign banks will be able to conduct domestic currency business with Chinese enterprises, subject to certain geographic restrictions. Within five years after accession, foreign banks will be able to conduct domestic currency business with Chinese individuals, and all geographic restrictions will be lifted. Foreign banks will also be permitted to provide financial leasing services at the same time that Chinese banks are permitted to do so.

Shortly after China's accession to the WTO, the People's Bank of China (PBOC) issued regulations governing foreign-funded financial institutions, along with implementing rules, which became effective February 1, 2002. The PBOC has also issued several other related measures. Although these measures have kept pace with the commitments that China made, the PBOC has so far decided to exercise extreme caution as it opens up the banking sector. In particular, it has imposed working capital requirements and other prudential rules that far exceed international norms, both for the foreign financial institutions' headquarters and branches, thereby making it more difficult for foreign financial institutions to establish and expand their market presence in China. In addition, the PBOC has been slow to act on foreign banks' applications for approval to conduct foreign currency business, although several foreign banks have received the necessary approval and begun their operations.

In bilateral meetings, the United States has urged the PBOC to reconsider its prudential requirements and to bring them in line with international norms. Together with other WTO members, the United States also raised these same concerns during the transitional review conducted by the WTO Committee on Trade in Financial Services in October 2002. The United States will continue to engage China on this issue in 2003.

Insurance

Prior to its accession, China allowed selected foreign insurers to operate in China on a limited basis and in only two cities. Three U.S. insurers had licenses to operate, and several more were either waiting for approval of their licenses or were qualified to operate but had not yet been invited to apply for a license by China's insurance regulator, the China Insurance Regulatory Commission (CIRC).

In its accession agreement, China agreed to phase out existing geographic restrictions on all types of insurance operations during the first three years after accession. It also agreed to expand the ownership rights of foreign companies. Upon accession, foreign life insurers were permitted to

hold 50 percent equity share in a joint venture. Foreign property, casualty and other non-life insurers were permitted to establish as a branch or as a joint venture with 51 percent foreign equity share upon accession, and they will be able to establish as a wholly foreign-owned subsidiary two years after accession. In addition, foreign insurers handling large scale commercial risks, marine, aviation and transport insurance and reinsurance were permitted 50 percent foreign equity share in a joint venture upon accession; they will be able to own 51 percent three years after accession and establish as a wholly foreign-owned subsidiary five years after accession. China further agreed that all foreign insurers will be permitted to expand the scope of their activities to include group, health and pension lines of insurance within five years after accession.

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.

The regulations establish high and redundant capitalization requirements. While China has a justified interest in maintaining appropriate prudential requirements, its capitalization requirements are significantly more exacting than those of other populous countries with no less an interest in preserving a healthy insurance market. It is expected that the effect of these requirements will be to limit the ability of foreign insurers to make necessary joint venture arrangements, and thus to limit the viability of foreign participation in the Chinese insurance market.

With regard to transparency, the regulations continue to permit considerable bureaucratic discretion and offer limited certainty to foreign insurers seeking to operate in China's market. To date, this lack of transparency has manifested itself particularly in the licensing process. Even though China had agreed to award new licenses to qualified foreign insurers based solely on prudential criteria, with no need for an invitation to apply and no quantitative limits on the number of licenses or restrictions such as an economic-needs test, CIRC has been slow to act on pending applications.

With regard to branching, China scheduled a commitment to allow non-life firms to establish as a branch in China upon accession and to permit internal branching in accordance with the lifting of China's geographic restrictions. China further agreed that foreign insurers already established in China that were seeking authorization to establish branches or sub-branches would not have to satisfy the requirements applicable to foreign insurers seeking a license to enter China's market. Notwithstanding these clear commitments, the regulations are vague on foreign insurers' branching rights, and CIRC has 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.

In close consultation with U.S. insurers, the United States raised these issues in bilateral meetings with CIRC shortly after the regulations were issued. The United States also held further bilateral

meetings with CIRC, MOFTEC and the State Council throughout the year to emphasize the seriousness of its concerns, and it raised them again during the Committee on Trade in Financial Services' transitional review of China in mid-October 2002, where it received support from Canada, the EC, Japan and Switzerland. The United States continued to raise its concerns bilaterally during the run-up to the October 25 Summit between Presidents Bush and Jiang, and CIRC began to show some flexibility. It agreed to establish a working group, composed of U.S. regulators and insurers, to discuss insurance issues, with a particular focus on appropriate capitalization requirements and other prudential standards. The first meeting of the working group is scheduled for December 2002.

One other development of note took place earlier in 2002. CIRC lifted certain geographic restrictions applicable to foreign life insurers ahead of schedule. It approved life insurance operations in Beijing, Suzhou and Tianjin, two years before China had committed to do so in its services schedule. Other foreign life insurers now are guaranteed the same access to those cities.

Motor Vehicle Financing

In its WTO accession agreement, China agreed to open up the motor vehicle financing sector to foreign non-bank financial institutions for the first time, and it did so without any limitations on market access or national treatment. These commitments became effective immediately upon China's accession to the WTO.

Despite these commitments, China has not yet opened up this sector to foreign companies, and therefore China's commercial banks remain the only financial institutions able to offer auto loans. It is anticipated that China will open up this sector once the Chinese regulator, the PBOC, has been able to finalize necessary regulations.

In June and again in September 2002, the PBOC released draft regulations for comment. As drafted, these regulations represent an important step in leveling the playing field for foreign and Chinese entities, but they also raise serious concerns about their consistency with China's commitments. The key WTO issues involve excessive capitalization requirements, excessive net asset requirements and an unnecessarily long approval process. Working closely with U.S. industry, the United States filed written comments with the PBOC on the June draft of the regulations and again on the September draft, which had reflected some improvements. In addition, the United States emphasized the seriousness of its concerns in bilateral meetings with the PBOC and as part of the Council for Trade in Services' transitional review in October 2002. The United States also urged China to issue final regulations quickly, so that this sector could be opened to foreign companies. The United States will continue to monitor developments closely through the end of 2002 and in 2003.

***Professional Services***

China made specific commitments to provide increased market access for several professional services sectors. Of these sectors, the one that has received the most attention, and the most controversy, is legal services.

Prior to its WTO accession, China had imposed various restrictions in the area of legal services. It maintained a prohibition against 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.

China's accession agreement provides that, upon China's accession to the WTO, foreign law firms may provide legal services through one profit-making representative office, which must be located in one of several designated cities in China. The foreign representative offices will be able 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. All quantitative and geographic restrictions will be phased out within one year of China's accession to the WTO, which means that foreign law firms should be able to open more than one office anywhere in China beginning on December 11, 2002.

In December 2001, the State Council issued the *Regulations on the Administration of Foreign Law Firm Representative Offices*. In July 2002, the Ministry of Justice issued implementing rules. While these new measures removed some market access barriers, they also generated concern among foreign law firms doing business in China. In many areas, these measures are ambiguous. For example, it appears that these measures have created an economic needs test for foreign law firms that want to establish offices in China, contrary to China's GATS commitments. These measures also seem to take an overly restrictive view of the types of legal services that foreign law firms may provide. In addition, the procedures for establishing a new office or an additional office are unnecessarily long and call into question China's commitment to eliminate all quantitative limitations on new offices by December 11, 2002.

In consultation with U.S. law firms, the United States carefully reviewed the new measures and expressed its concerns in written comments and in bilateral meetings with China's Ministry of Justice and MOFTEC earlier this year. Together with the EC and Japan, the United States also presented its detailed concerns and questions to China in connection with the transitional review of China's compliance efforts before the Council for Trade in Services, held in October 2002. The United States will continue to work with China in 2003 in an attempt to resolve its concerns.

***Telecommunications***

In its accession agreement, China agreed to important commitments in the area of telecommunications services. It committed 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, China also accepted key principles from the WTO Agreement on Basic Telecommunications Services. As a result, China became obligated to separate the regulatory and operating functions of MII (which has been both the telecommunications regulatory agency in China and the operator of China Telecom) upon its accession. China also became 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 China Telecom.

In December 2001, the State Council issued regulations on the administration of foreign-invested telecommunications enterprises. These regulations implement China's commitments by providing for the establishment of foreign-invested joint ventures, and they set forth relatively clear procedures and requirements for the joint ventures when applying for approval to commence operations, although, as in several other services sectors, they also establish capital requirements (in basic and value-added telecommunications services) that pose a barrier to entry for many potential foreign suppliers. Nevertheless, since the issuance of these regulations, several foreign-invested joint ventures have applied for and received approvals to begin operations.

China has not yet made any progress toward establishing an independent regulator in the telecommunications sector. The current regulator, MII, is not structurally or financially separate from all telecommunications operators and providers. The United States and the EC raised this issue during the transitional review of China's compliance efforts before the Council for Trade in Services in October 2002. The United States will continue to pursue this matter in 2003.

China has also used regulatory authority to disadvantage foreign firms during 2002. 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. The United States has voiced its concerns bilaterally with China and will continue to address these matters in 2003.

***Express Delivery Services***

The specific commitments that China made in the area of express delivery services for the most part were forward-looking and did not require China to take implementation action during the first year of its WTO accession. Basically, China agreed to increase the stake allowed by foreign express delivery companies in joint ventures over a period of years, with wholly foreign-owned subsidiaries allowed within four years of accession.

Nevertheless, shortly after acceding, China issued two problematic measures. These measures required Chinese and foreign-invested international express delivery companies, including those which were already licensed by MOFTEC to provide international express delivery services, except for the delivery of private letters, to apply for and obtain so-called "entrustment" authority from China's postal authorities, China Post, their direct competitor, if they wanted to continue to provide express delivery services. The measures also placed new weight and rate restrictions on the letters that the companies could handle, assuming that they could obtain entrustment authority.

Working closely with U.S. express delivery companies and other affected WTO members, particularly the EC and Japan, the United States led an effort to convince China to revise these measures. In repeated contacts in Beijing at all levels of government, and through multilateral meetings at the WTO in Geneva, the United States argued that the measures placed new restrictions on the conditions of operation and the scope of activities of existing foreign-invested express delivery companies, contrary to China's horizontal "acquired rights" commitment (discussed at the beginning of the Services section). The United States also expressed concern that China Post would be serving both as the regulator and as one of the competitors in the express delivery industry, and it emphasized the crucial role played by experienced international express delivery companies in China's economy. At the same time, U.S. express delivery companies and their Chinese joint venture partners also expressed their dissatisfaction directly with the Chinese government.

In response to these government and private sector efforts, China delayed the implementation of these measures. On September 5, 2002, China issued a new measure, which eliminated the weight and rate restrictions and eased burdensome aspects of the entrustment application process. In bilateral meetings, China also provided assurances that the regulatory and operational functions of China Post would be split up and that MOFTEC would seek to ensure that China Post did not abuse its regulatory authority. Subsequently, on October 23, following continued U.S. pressure during the run-up to the Bush-Jiang Summit, China streamlined the entrustment application process even further and effectively eliminated China Post's ability to exercise its discretionary authority to reject entrustment applications from foreign-invested express delivery companies already licensed by MOFTEC. According to the measure, these companies need only present their MOFTEC licenses to the postal authorities to receive entrustment certificates, and the entrustment certificates would have the same scope and duration as the MOFTEC licenses.

The measure also provided that these companies do not have to apply for separate entrustment certificates for existing or new branches.

U.S. express delivery companies and their Chinese joint venture partners subsequently applied for and obtained the needed entrustment authority from China Post. They have been able to continue to operate in China, without disruption to their business.

### *Logistics*

On July 29, 2002, MOFTEC published a *Notice on Establishing Foreign-invested Logistics Companies in Trial Regions*. The scope of the activities covered by the term "logistics services" in this notice is unclear, but it appears that it encompasses some services sectors for which China made commitments in its services schedule. If that is the case, the notice may raise certain WTO-consistency issues. For example, the rules in the notice cap foreign participation in a foreign-invested logistics company at 50 percent. If "logistics services" as used in the notice includes freight forwarding and auxiliary services, there may be a conflict with China's accession agreement, where China committed to allow foreign majority ownership for freight forwarders and providers of auxiliary services within one year of accession, or by December 11, 2002. Another key concern with the notice is that it imposes high capital requirements, which will serve to exclude smaller companies from the market.

The United States raised these concerns with China as part of the transitional review before the WTO's Council for Trade in Services, which took place in October 2002, and received some clarifications from China. The United States will continue to pursue this matter in 2003.

### *Other Services*

In its accession agreement, China agreed to give foreign service suppliers increased access in several other sectors, including audio-visual services, tourism and travel-related services, construction and engineering services, educational services and environmental services. In each of these sectors, China committed to the phased elimination or reduction of various market access and national treatment limitations. To date, the United States has not discovered any significant problems with China's implementation of the commitments made in these sectors, and U.S. companies confirm that the relevant laws and regulations are generally in compliance with China's WTO commitments.

## Legal Framework

In order to address major concerns raised by WTO members during its lengthy WTO accession negotiations, China committed to broad legal reforms in the areas of transparency, uniform application of laws and judicial review. Each of these reforms, if implemented, will strengthen the rule of law in China's economy and help to address pre-WTO accession practices that made it difficult for U.S. and other foreign companies to do business in China.

***Transparency***

China made a number of transparency commitments in its accession agreement. One of the most important of these commitments concerned the procedures for adopting or revising laws and regulations, given that China's accession to the WTO became effective while China was still in the process of revising its trade-related laws and regulations to become WTO-consistent. China agreed to provide a reasonable period for public comment on these new or modified laws and regulations before implementing them, except in certain specific instances, enumerated in China's accession agreement. China also agreed to translate all of its trade-related laws and regulations into one or more of the WTO languages (English, French and Spanish) and to regularly publish them in official journals.

To date, China's ministries and agencies have a poor record of providing an opportunity for public comment before new or modified laws and regulations are implemented. Although the State Council issued new regulations in December 2001 addressing the procedures for the formulation of administrative regulations and rules and expressly allowing public comment, 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, mostly from the PBOC and the China Securities Regulatory Commission, 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.

Other State Council regulations issued in December 2001 require the publication of new or amended regulations thirty days before their implementation, and almost all new or revised laws and regulations have been available (in Chinese) soon after issuance and prior to their effective date, an improvement over pre-WTO accession practice. China has, however, lagged behind in its obligation to provide translations of these laws and regulations, in large part because of the extraordinary number of laws and regulations issued during the last year.

In bilateral meetings with the State Council and other Chinese ministries, the United States has emphasized the importance of China's adherence to the notice and comment commitment in China's accession agreement, both in terms of fairness to WTO members and the benefits that would accrue to China. The United States has also offered to provide technical assistance to facilitate Chinese ministries' understanding of the workings, and benefits, of an open and transparent rulemaking process. Together with other WTO members, the United States has also raised this issue during regular WTO meetings and as part of the transitional reviews being conducted this year before WTO councils and committees. The United States will continue to work to secure China's full compliance with this fundamental commitment in 2003.

To facilitate understanding of its trade-related laws and regulations, China also agreed to establish enquiry points, which respond to questions and information requests from any WTO member or foreign company or individual. Under the agreed terms, these enquiry points normally must provide responses to inquiries within 30 days. In compliance with this obligation, China established a WTO Enquiry and Notification Center, operated by MOFTEC's Department of WTO Affairs, in January 2002. Other ministries and agencies have also established formal or informal, subject-specific enquiry points. U.S. companies have generally found these various enquiry points to be responsive and helpful, and they have generally received timely replies. Because of the success of these enquiry points, some ministries and agencies are planning to create websites to provide answers to frequently asked questions as well as further guidance and information. MOFTEC was the first one to do so, with a special website that became operational in September 2002.

***Uniform Application of Laws***

In its accession agreement, China committed, at all levels of government, to apply, implement and administer 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 support of this commitment, China agreed 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.

In anticipation of these commitments, the State Council issued the *Regulations Concerning Prohibiting the Implementation of Regional Barriers in the Course of Market Economy Activities* on April 21, 2001. These regulations give the central government new powers to discipline local government officials who pursue or implement policies that are inconsistent with central government laws and regulations.

Since China's WTO accession, the central government has also launched an extensive campaign to inform and educate both central and local government officials and State-owned enterprise managers about WTO rules and their benefits. In addition, several provinces and municipalities have established their own WTO centers, designed to supplement the central government's efforts and to position themselves so that they will be able to take full advantage of the benefits of China's WTO membership.

China has also established an internal review mechanism to handle cases of non-uniform application of laws. This responsibility falls to MOFTEC's Department of WTO Affairs, but the actual workings of this mechanism are not yet clear.

During 2002, some problems with uniformity persisted. These problems are discussed above in the sections on Customs and Trade Administration, Taxation, Investment and Intellectual Property Rights.

***Judicial Review***

China agreed to establish tribunals for the review of all administrative actions relating to the implementation of laws, regulations, judicial decisions and administrative rulings on trade-related matters. 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.

Beginning before China's accession to the WTO, China had taken steps to improve the quality of its judges. For example, 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. However, existing judges, many of whom have had no legal training, were grandfathered.

Many U.S. companies continue to express serious concern about the independence of China's judiciary. In their experience and observation, Chinese judges are often influenced by political, government or business pressures, particularly outside of China's big cities.

In August 2002, the Supreme People's Court issued *Rules on Certain Issues Related to Hearings of International Trade Administrative Cases*. These rules designate 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. Because the rules only took effect on October 1, 2002, foreign companies so far have had little experience with their implementation. The United States will closely monitor how the designated courts handle international trade disputes in 2003.

# APPENDIX 1

## List of Written Comments
## Submitted in Response to Request for Public Comment
## by the Trade Policy Staff Committee

1. U.S.-China Business Council
2. American Chamber of Commerce-China
3. International Intellectual Property Alliance
4. UPS/FedEx
5. National Electrical Manufacturers Association
6. AFL/CIO
7. National Food Processors Association
8. International Anti-Counterfeiting Coalition, Inc.
9. American Iron and Steel Institute
10. American Sugar Alliance
11. Distilled Spirits Council of the United States, Inc.
12. Blue Diamond Growers
13. U.S. Wheat Producers
14. Central Soya Company
15. U.S. Grains Council
16. American Bar Association
17. U.S. Council of International Business
18. U.S. Motorcycle Manufacturers Association
19. National Association of Manufacturers
20. Stewart & Stewart
21. Advanced Medical Technology Association
22. U.S. Information Technology Office
23. American Forest and Paper Association
24. Global Alliance for Trade Efficiency
25. Grocery Manufacturers of America
26. Walmart
27. Automotive Trade Policy Council
28. AgBiotech Planning Committee
29. ISAC 10
30. American Insurance Association/American Council of Life Insurers
31. Wine Institute
32. National Cattlemen's Beef Association
33. American Soybean Association
34. U.S. Chamber of Commerce

# APPENDIX 2

## List of Witnesses
## Testifying at the Public Hearing
## before the Trade Policy Staff Committee

Washington, D.C.
September 18, 2002

1. Robert A. Kapp
   President
   US-China Business Council

2. Willard A. Workman
   Senior Vice President, International Affairs
   U.S. Chamber of Commerce

3. Eric H. Smith
   President
   International Intellectual Property Alliance

4. Robert Vastine
   President
   Coalition of Service Industries

5. Joseph M. Damond
   Associate Vice President for Japan and Asia-Pacific
   Pharmaceutical Research and Manufacturers Association

6. Timothy P. Stratford
   Vice Chairman & General Counsel
   General Motors China Operations
   (on behalf of American Chamber of Commerce-China)

7. Jim Gradoville
   Vice President & Regional Director
   Motorola China Electronics Ltd.
   (on behalf of the United States Information Technology Office)

8. Daryl Hatano
   Vice President, Public Policy
   Semiconductor Industry Association

9. Sue Presti
Executive Director
Air Courier Conference of America, International

10. Ford B. West
Senior Vice President
The Fertilizer Institute

11. Michael Eads
Executive Director
Global Alliance for Trade Efficiency

12. John Meakem
Manager, International Trade
National Electrical Manufacturers Association

13. Thomas Weishing Huang
Burns and Levinson LLP