PEOPLE'S REPUBLIC OF CHINA

In 1996, the U.S. trade deficit with China was over $39.5 billion, an increase of more than $5.7 billion from the U.S. trade deficit of $33.8 billion in 1995. U.S. merchandise exports to China were nearly $12.0 billion, an increase of $230 million (2.0 percent) from the level of U.S. exports to China in 1995. China was the United States' fifteenth largest export market in 1996. U.S. imports from China were nearly $51.5 billion in 1996, an increase of over $5.9 billion (13.0 percent) from the level of imports in 1995.

The U.S. Department of Commerce has estimated that for services trade in 1995, the U.S. exported $2.5 billion to China and imported $1.6 billion in services, resulting in a positive service trade balance with China of $937 million. A 1996 services trade balance is not yet available.

The stock of U.S. foreign direct investment (FDI) in China in 1995 was $2.0 billion, an increase of 20.6 percent from the level of new U.S. FDI in 1994. U.S. FDI in China is concentrated largely in the manufacturing and petroleum sectors.

Overview

Since 1992, the United States has made progress toward opening China's market to U.S. goods and services. Over the past five years, the United States has successfully negotiated landmark trade agreements with China that have resulted in increased market access for a range of goods and services through reduced tariff and non-tariff barriers. For example:

- *Market Access:* On October 10, 1992, the United States and China signed a Memorandum of Understanding (MOU) on market access that commits China to significant liberalization of key aspects of its import administration, including reduction of trade barriers and gradual opening of its market to U.S. exports. This MOU resolved a 301 investigation initiated by the U.S. Government that started on October 10, 1991. The investigation examined four broad areas: the absence of transparency; import licensing requirements; import quotas, restrictions, and controls; and standards and certification requirements.

- *Intellectual Property Rights (IPR) Protection:* In 1992, the United States and China signed an MOU that committed China to strengthen its IPR legal regime. On February 26, 1995, the United States and China signed an IPR Agreement designed to ensure both a crackdown on piracy and real market access for the intellectual property industry. In May 1996, when it became clear that China was not fully implementing this MOU, the Clinton Administration threatened to impose approximately $2 billion worth of sanctions on Chinese goods if China did not take action to stop piracy and improve market access. Subsequently, China closed 15 illegal CD factories and, in June 1996, the United States and China exchanged information in an IPR Accord that detailed the steps that China had taken and would take in the future to ensure effective implementation of the 1995 Agreement. Over the past nine months, China has taken significant steps to crack down on piracy including closing 9 more factories between May and June 1996, and 28 production facilities between September 1996 and March 1997 (see the section of this chapter entitled "Lack of Intellectual Property Protection").

- *Textiles:* In February 1997, the United States and China renewed their bilateral textile agreement. The new agreement enhances market access opportunities for U.S. exports of textiles and apparel, includes additional protection against circumvention, and effectively controls China's exports to the United States.

Clearly, these bilateral agreements demonstrate the significant progress that has been made in China. That said, however, there remains a great deal of work to be done before China's market is sufficiently open to U.S. exports. China's growing economic strength, coupled with its focus on boosting competitiveness in certain export-oriented industries, requires continued vigilance by the Administration to ensure China's policies and practices are consistent with existing bilateral agreements and are in line with international rules.

In this light, the Administration is committed to supporting China's accession to the World Trade Organization (WTO) -- but only on the basis of a commercially meaningful protocol package. Recognizing that China is undergoing complex economic reform, USTR has approached WTO accession negotiations flexibly and pragmatically, with the understanding that the outcome must secure solid commitments from China to provide market access and follow WTO rules.

IMPORT POLICIES

China restricts imports through a variety of means, including high tariffs and other taxes, non-tariff measures, limitations on which enterprises can import, and other barriers, such as import substitution. For example:

- *Tariffs:* China has used prohibitively high tariffs, in combination with other import restrictions and foreign exchange controls, to protect its domestic industry and restrict imports -- contributing to inefficiencies in China's economy and posing a major barrier to U.S. commercial opportunities.

- *Non-Tariff Measures:* While China has generally met the requirements of the 1992 Market Access MOU to remove various non-tariff barriers, such as quotas and licensing requirements, China still maintains a large number of non-tariff administrative controls to implement its trade and industrial policies.

Tariffs and Taxes

China's tariffs have traditionally been so high as to be prohibitive to foreign exporters. In fact, in 1996, most-favored-nation (MFN) tariffs facing goods entering China ranged as high as 120 percent. In 1996, China lowered its average import tariff from 35.9 percent to 23 percent. Despite recent tariff reductions, however, U.S. industry continues to express concern that tariff rates for sectors in which China is seeking to build its international competitiveness, such as chemicals, remain extremely high.

In addition to high tariff rates, unpredictable application creates difficulties for companies trying to export to, or import into, the Chinese market. Tariffs may vary for the same product, depending on whether the product is eligible for an exemption from the published MFN tariff. High-technology items whose purchase is incorporated into state or sector plans, for instance, have been imported at tariff rates significantly lower than the published MFN rate. In addition, import tariffs have sometimes been reduced or even not applied, either through temporary tariff rates published by China's General Administration of Customs (Customs) or through informal means.

China has taken steps to reduce tariffs pursuant to its bilateral commitments and in an effort to support its WTO accession bid. While many of the tariff reductions are still under negotiation in the context of WTO discussions, in November 1996, China's President Jiang Zemin announced that China would reduce the simple average tariff rate from the current 23 percent to 15 percent by the year 2000, as well as make further reductions in the medium- and long-term.

In addition to import tariffs, imports may also be subject to value-added and other taxes. U.S. industry complains that the current value-added taxing system (VAT) amounts to an added surcharge of 17 percent on both imported goods and domestic products, which discourages consumers by raising prices. A product subject to the average 23 percent import tariff, for example, is in fact subject to a 40 percent tax when the VAT is added. Since some domestic and foreign firms are able to avoid the VAT through negotiation, U.S. firms who “play by the rules” are at a competitive disadvantage.

U.S. and other foreign businesses selling goods into China also complain about China's lack of uniformity in customs valuation practices. Different ports of entry may charge significantly different duty rates on the same products. Because there is flexibility at the local level in deciding whether to charge the official rate, actual customs duties, like many taxes, are often the result of negotiation between businesspeople and Chinese customs officers. Allegations of corruption often result.

In a move that could raise major project costs in China by 20 percent or more despite nominal tariff reductions underway, China is phasing out over a two-year period tariff exemptions for capital equipment imported by foreign investors in China. In early 1997, Chinese officials were still clarifying and finalizing the details and criteria under which firms, products, and projects will be eligible for tariff exemptions of up to another two years.

On December 31, 1996, Customs announced that foreign enterprises approved for establishment between October 1, 1995, and March 31, 1996, that reported to China’s Ministry of Foreign Trade and Economic Cooperation (MOFTEC) for reapproval and registered with the Customs Tariff Department, as well as reported to local customs offices, may continue to enjoy the preferential tax policy of duty-free imports of capital equipment until June 30, 1997, provided the total investment is over $30 million. Other enterprises valued under $30 million must apply to MOFTEC for an extension. Projects approved prior to October 1, 1995, must receive State Council approval for an extension of preferential tax treatment.

There appears, however, to be a difference in practice in the way MOFTEC and Customs apply extension criteria to foreign-invested enterprises (FIEs): MOFTEC interprets the notice more strictly than Customs. MOFTEC maintains it has submitted to Customs a finite list of FIEs out of the total number of FIEs approved between the October - March window which are eligible for the extension. Customs, however, has interpreted the notice more broadly to include all FIEs approved between October and March. To date, how many and which companies are approved for extensions is unknown.

Non-Tariff Measures (NTMs)

Non-tariff barriers are administered at national and subnational levels by the State Economic and Trade Commission (SETC), the State Planning Commission (SPC), and the Ministry of Foreign Trade and Economic Cooperation (MOFTEC). These non-tariff barriers include import licenses, import quotas, and other import controls. The levels of specific non-tariff barriers are the result of complex negotiations between the Central Government and Chinese ministries, state corporations, and trading companies.

Central Government agencies determine the levels of import quotas through data collection and negotiating sessions, usually late each year. These agencies -- including the SPC, SETC, and MOFTEC -- determine the projected demand for each product subject to import restrictions. Such restrictions generally include quantitative restrictions. Officials at central and local levels evaluate the need for particular products for individual projects or quantitative restrictions for the products. Once “demand” is determined, Central Government agencies allocate quotas that are eventually distributed nationwide to end-users and administered by local branches of the Central Government agencies concerned. China provides little transparency regarding the quantity or value of products to be imported under a quota, notwithstanding bilateral obligations and WTO requirements to provide such information.

MOFTEC uses import licenses to exercise an additional, nationwide system of control over some imports. Many products are subject both to quotas or restrictions and also to import licensing requirements. For these products, after permission has been granted by other designated agencies for its importation, MOFTEC must decide whether to issue a license. MOFTEC officials claim that import licenses are issued automatically once other agencies have approved an import.

While far too many NTMs still remain in place, progress is being made. For example, China abolished non-tariff barriers on schedule at the end of 1995 on 176 items specified under the 1992 Market Access MOU. Several items for which abolition of import restrictions were required under the Market Access MOU are no longer listed in China Customs publications as subject to non-tariff measures, but in contrast to the elimination of import restrictions at the end of 1995, the embassy and interested industries have been unable to obtain from Chinese agencies published notices announcing the removal of those import restrictions. Some of the few goods in this category include certain refrigerators and freezers, air conditions, and skips and hoists. The Market Access MOU specifies further eliminations of non-tariff import barriers that China has agreed to undertake prior to the end of 1997.

According to U.S. exporters and investors, new alternative measures and some aspects of China's new industrial policies may be undercutting the market access gains that had been anticipated as a result of changes obligated under the Market Access MOU. These measures include the new "automatic" registration requirement, electro-mechanical product import control measures, new regulations on the administration of medical equipment, proposed guidelines for the electronics sector, and camera import control measures, among Close to 400 products covered by the annex to the MOU are now subject to these “automatic registration” requirements. The implementation of this registration requirement appears to pose a new de facto licensing requirement.

Transparency

The 1992 bilateral Market Access MOU laid the foundation for China to improve significantly the transparency of its trade regime, including the publication of a central repository for all central government trade regulations and publications in the provinces of all trade and investment-related trade regulations. While the MOFTEC *Gazette* was established to carry official texts of all trade-related laws and regulations at the national level -- and has been a significant step toward transparency -- its coverage of trade-related regulations is still incomplete and not always timely. In addition, important steps toward making the import approval process transparent, especially for industrial goods such as machinery and electronics products, are offset by the opaque nature of customs and other government procedures.

Central Government agencies have published many -- though not all -- of their import administration laws and regulations, making China's trade regime more transparent. Analysis of published Chinese “catalogs” of goods subject to general import quota administration or special registration requirements has identified several dozen tariff-line items that appear to be subject to Chinese import quota or import license requirements in addition to those previously notified by China to the WTO Working Party in Geneva. The U.S. and Chinese negotiating teams are working to reconcile these data.

Trading Rights and Other Restrictions

China restricts the types and numbers of entities within China which have the legal right to engage in international trade. Only those firms with import trading rights may bring goods into China. In addition, some goods that are of great commercial value to both China and its trading partners, such as grains, cotton, vegetable oils, petroleum, and certain related-products are imported principally through state trading enterprises.

In some cases, specific bureaus or ministries impose informal market access barriers for imports that fall under their jurisdictions. For example, the State Pharmaceutical Administration is responsible for issuing quality certificates for pharmaceutical products. Some Chinese organizations require end-users to acquire purchase certificates before they can receive permission to import.

As a result, China's real demand for these types of imported products greatly exceeds the supply made available through the official system. For example, the U.S. spirits industry estimates that only five percent or less of imported distilled spirits enter the Chinese market through official channels. Thus, a large illegal “grey” market for spirits has grown up around the official system. Sales of such products have resulted in revenue losses for China, because of rampant smuggling and the associated corruption. Another side effect of the smuggling that suppressing demand engenders is counterfeiting and passing off of poor quality or even dangerous products as the much sought after but difficult to obtain legitimate imports.

China

Import Substitution

Import substitution has been a longstanding Chinese trade policy. Nonetheless, in the 1992 MOU, China confirmed that it had eliminated all import substitution regulations, guidance, and policies, and that it would not subject any products to import substitution measures in the future. This constitutes a commitment, for example, that a Chinese government agency would no longer deny permission to import a foreign product because a domestic alternative exists.

Despite this commitment, in 1994 China announced an automotive industrial policy that included import substitution requirements. This policy, designed to foster development of a modern automobile industry in China, explicitly calls for production of domestic automobiles and automobile parts as substitutes for imports, and establishes local content requirements, which would force the use of domestic products, whether comparable or not in quality or price. The United States is consulting with China in the context of its WTO accession negotiations on the elimination of these policies and ensuring that any future policies do not contain such provisions.

STANDARDS, TESTING, LABELING, AND CERTIFICATION

China maintains statutory inspection requirements (conformity assessment procedures) on more than 2,400 tariff line items, of which more than 860 are requirements on imported goods. Major problems include the lack of transparency, difficulty in determining the appropriate standard, use of different standards on imports from different countries and different standards from domestic goods, and adoption of unique standards that differ from international standards for no identifiable reason.

China passed the "Import and Export Commodity Inspection Law" establishing a separate regime for safety inspections of imported goods on February 2, 1989. The first catalog of 9 commodities covered by the law was announced on August 1, 1989, with compliance required as of May 1, 1990. A second catalog of commodities covered by the law was announced on August 1, 1995, and contained a list of 38 categories of equipment, the first 20 of which became subject to safety inspection and certification on October 1, 1996. The last 18 of these equipment categories will be subject to safety inspection and certification as of October 1, 1997. More commodities will be covered in future catalogs.

As noted, U.S. and other foreign traders often encounter difficulty in learning which Chinese standards apply to their goods. Officials of the State Administration for Commodity Inspection have said that, for some goods for which China has not yet developed its own standards, the standards of the country of origin will apply to that good. Therefore, a particular good from the United States may have to meet a different standard at the China's port of entry than does the same good from the European Union. This is a serious issue that goes to the heart of MFN treatment and is being taken up in the context of China's WTO accession negotiations.

For manufactured goods, China requires that a quality license be issued before the goods can be imported into China. With a few exceptions, China does not accept U.S. certification of product quality or manufacturing procedures. Obtaining quality licenses to export to China can be time-consuming and expensive. While the inspection and licensing requirements vary according to commodity, U.S. industry considers most to be burdensome and contrary the principles of the TBT Agreement.

The 1992 Market Access MOU requires that China apply the same standards and testing requirements to non-agricultural products, whether foreign or domestic. U.S. and other foreign suppliers have complained, however, that the safety and inspection procedures applied to foreign products are more rigorous than those applied to similar domestically produced products. Foreign suppliers have also had difficulty in learning exactly how and by whom inspections are conducted. For some types of product inspections, China does not use the same inspection agency for domestic and imported goods.

China's phytosanitary and veterinary import quarantine standards are often overly strict, unevenly applied, and not backed up by modern laboratory techniques. An example is China's use of past Mediterranean fruit fly occurrences in urban Los Angeles as a reason to ban the entry of citrus fruit from all parts of the United States. In another example, the Chinese Government continues to require foreign pesticide producers to submit to costly testing and registration procedures, but it does not apply these requirements to domestic producers. U.S. companies report that complying with these regulation costs more than $5 million per agricultural chemical.

China committed in the 1992 Market Access MOU to base its agricultural import standards on "sound science." Since 1992, China has made some progress on agricultural sanitary and phytosanitary issues, signing bilateral protocols for several agricultural items, including live horses (September 1994); apples from Washington, Oregon, and Idaho (April 1995); ostriches, bovine embryos, swine, and cattle (June 1995); and cherries (March 1996). However, China's sanitary and phytosanitary measures still prohibit imports of U.S. citrus, plums, grapes, tobacco, and Pacific Northwest wheat. In 1996, China's sanitary requirements for poultry and poultry meat became a major issue. Imports from the U.S. were abruptly stopped on several occasions for reasons inconsistent with international standards.

China's restrictions on imports of citrus and Pacific Northwest wheat are of particular concern to U.S. industries because they are not based on sound science. We have raised repeatedly raised these issues at the most senior levels throughout the year. Discussions aimed at resolving the other outstanding agricultural issues have also been ongoing. Technical experts from the United States and China met in Shanghai in January 1996 for phytosanitary discussions that covered California plums, grapes, cherries, apples, and tobacco. China, however, has been slow to address phytosanitary issues relating to citrus, particularly from California. In late 1995, China sent a technical team to inspect U.S. citrus growing regions, including California, Florida, Texas, and Arizona. In early 1997, the United States is still discussing with China the results of China's pest risk analysis from this technical inspection.

GOVERNMENT PROCUREMENT

China's government purchasing actions and decisions are subject to China's general laws, regulations and directives. Despite its commitment under the 1992 Market Access MOU to publish all laws and regulations affecting imports and exports, some regulations and a large number of directives have traditionally been unpublished, and there is no published, publicly available national procurement code in China. Only one tendering organization, the National Tendering Center for Machinery and Electrical Equipment, has published a tendering guide, which is brief and vague. If the Chinese Government maintains any laws, regulations, and policies on the conduct, evaluation, and award of government procurement procedures, they remain restricted for "internal use" and inaccessible to foreigners, including government officials and business representatives.

Based upon experiences of U.S. firms, government approval, at some level, is required for most government projects in China for which imports are required. Projects in certain fields require approvals from several different organizations and at different levels, depending on the value of the project or purchase. Projects of government-owned enterprises or projects requiring government funds valued at less than $10 million for inland provinces (or $30 million for coastal provinces and major jurisdictions including but not limited to Beijing, Shanghai, Tianjin, and Guangdong) must receive approval by their own departments or planning commissions at the provincial level. Projects over $30 million require approval by the ministries in charge of the industry concerned as well as State Planning Commission examination and approval. They also need final approval by the State Council.

Tendering procedures are typically non-transparent and inconsistent over time. Contracts below $100,000 are not usually tendered. For domestic procurement, Chinese enterprises increasingly compete to supply major projects. For international procurement not under World Bank guidelines, China may offer a project to a single bidder, a few, or as many bidders as it chooses. Bidders can be excluded for largely political reasons.

For projects using foreign loans provided by international organizations such as the World Bank, procurement complies with the standards set by the donor organization. Such procurement is overseen by either one of a handful of tendering companies that are subsidiaries of state-owned trading companies or the State Council's National Tendering Center. For procurement that is not required to meet World Bank standards, these procedures are optional and, to the best of our knowledge, seldom used. Influenced by the World Bank and other organizations, the SPC is understood to be examining the possibility of establishing regulations that would require competitive bidding for government procurement. Given widespread noncompetitive practices that provide latitude for corrupt exchanges, progress on such reforms is likely to be slow.

Procurement made with international financing requiring competitive bidding, regardless of the level of government, must be tendered. Other procurement need not be tendered but are encouraged to do so. Even if the bidding guidelines set up by the National Tendering Center must be followed for tenders that it conducts, the guidelines are vague enough to allow significant flexibility.

China's government procurement procedures allow for preferential treatment of domestic suppliers, products and services. Domestic procurement is often closed to foreign bidders. Even when open to foreign bidders, such suppliers may be discouraged from bidding by the uncertainty of obtaining foreign exchange.[1] Moreover, the Chinese Government routinely seeks to obtain offsets from foreign bidders in the form of

[1] China has moved toward an interbank market for foreign exchange and current account convertibility, but the extent to which the current changes will eliminate the need for approval to use foreign exchange remains unclear.

local content requirements, technology transfers, investment requirements, counter-trade or other concessions, not required of Chinese firms. In fact, bidding documents, including those for internationally-funded procurements, often express a "preference" for offsets.

Negotiation among a field of competitors narrowed by selection is frequently used to try to extract additional concessions from bidders. Such negotiations appear to focus as much on offsets as price, quality, and other technical and directly related economic factors. Chinese negotiators do not necessarily conduct negotiations on an equal basis with all bidders, but rather may focus their efforts on a principal bidder and try to use concessions from other bidders to extract further concessions from this bidder.

Since laws, regulations, or policies on government procurement remain largely unpublished, it is difficult to determine if practice conforms with World Bank standards. U.S. and other foreign businesses are of the opinion that most government procurement complies with China's unpublished laws, policies, and regulations. There may be some differences in uniformity on a regional basis with greater competition in the more developed, free-wheeling coastal areas. Tenders under World Bank guidelines appear to conform to those guidelines, but tendering is voluntary for projects or purchases not subject to such guidelines and is infrequently used in such cases.

Invitations may be extended to selected "qualified" bidders for tendered procurement, but it is not clear how these qualifications are determined or whether invitations are extended to all interested suppliers on the qualified suppliers list. Non-tendered procurements are not subject to any constraints. Procedures for adding suppliers to lists of qualified bidders are not clearly established, either in terms of periods for qualification or of criteria for domestic or foreign suppliers.

The non-transparency of the current procurement environment contributes to the perception that suppliers of U.S. products are, on occasion, not treated fairly. Tenders can be opened to a select list of bidders if the tendering organization determines that a limited number of "qualified" producers or suppliers exists (although it is not clear how such qualifications are determined). Non-tendered procurements often involve negotiations with a single supplier or a restricted number of suppliers. Procurement for some major purchases has apparently been awarded for political reasons, and single-source procurement -- including buying sprees timed to influence political decisions in other countries -- is not uncommon.

Finally, despite the promulgation of China’s first law on unfair competition in December 1993, the problem of official corruption remains widespread as the government continues to call for improved self-discipline and anti-corruption efforts at all levels. For procurements made using competitive procedures, there is little direct evidence that bribery or corrupt practices have influenced awards or resulted in failure to enforce competitive measures. However, competitive procedures are not followed for the bulk of procurements in China. Given the Chinese Government's own fervent campaign to attack widespread corrupt practices of officials, the likelihood of corruption or bribery affecting domestic procurements appears significant. To wit, U.S. suppliers have frequently raised this problem with U.S. officials, complaining that such practices in China put them at a competitive disadvantage. While this dilemma is less severe in sectors where the United States holds clear technological preeminence or cost advantages, it does undermine the long-term competitiveness of U.S. suppliers in the Chinese market.

China

The size and rate of growth of the Chinese economy, the proportion of the economy still falling under State control, and demand for the type of high technology goods and services that the United States provides all indicate that government procurement contracts would offer extremely significant commercial opportunities if current restrictions were removed. Sectors of highest demand include infrastructure development (especially energy, petrochemicals, transportation and environmental protection), telecommunications and value-added services, machinery, electrical equipment and precision instruments, and certain agricultural and forest products. Changes in China's government procurement practices might result in increased U.S. exports to China of over $500 million.

EXPORT SUBSIDIES

The Chinese Government claims that direct financial subsidies on all exports, including agricultural goods, ended on January 1, 1991. While this may be true for direct budgetary outlays, China continues to use a variety of measures to support and promote exports. For example, Chinese exporters benefit from preferential loan policies (e.g., access to funds on non-commercial terms), preferential tax policies (e.g., reduced income taxes), and preferential energy and raw material supply policies (e.g., access to freight services and input supplies on non-commercial terms). Certain export sectors also benefit from government-funded technological.

The government also generates exports by imposing foreign exchange earnings requirements on Chinese foreign trade corporations (FTCs) and export requirements on foreign invested enterprises. These foreign exchange earnings requirements tend to make FTCs over export, resulting in systematic financial losses. These losses are often covered by state commercial bank loans, and the chronic nature of these losses suggests that much of the lending is not on strictly commercial terms. State trading companies are also subject to constraints that make them export in volumes not consistent with their input costs or other commercial considerations.

China is attempting to bring a greater degree of uniformity in the type and amount of taxes and duties imposed on enterprises in China, domestic and foreign-funded alike. As a result, preferential tax and duty policies that benefit exporters in special economic zones and coastal cities are being revised. It remains to be seen, however, whether uniformity will, in fact, be achieved, particularly with respect to income and other direct taxes imposed on exporters.

LACK OF INTELLECTUAL PROPERTY PROTECTION

U.S. efforts to protect intellectual property rights (IPR) in China took a major step forward in 1996. In an effort to ensure effective enforcement by the Chinese of the 1995 U.S.-China IPR Agreement, in May 1996 the Clinton Administration threatened to impose increased tariffs on $2 billion of China's exports to the United States. In June 1996, China and the United States signed an IPR Accord which set out the steps that China had taken in recent months and further steps that it would take in the future. At that time China reported on its recent efforts to crack down on piracy which included shutting 15 illegal CD factories and over 500 laser disc cinemas nationwide. Imports of CD presses were also stopped unless central government authorities granted express approval for the import.

Since June, the Chinese have made significant progress in combating IPR violations. Specifically, Chinese officials have closed 9 factories and 28 illegal production facilities and confiscated millions of illegal and unauthorized LDs, CDs, VCDs and other publications. In addition, Chinese authorities launched 37,300 checks across the country on IPR related cases and collected US $491 million in revenue from IPR related fines, up 33 percent over 1995. To date, more than 3,000 judges have been specifically trained to hear IPR cases, and significant rewards have been paid for information leading to the arrest of pirates.

Significantly, China's customs authorities have notably increased IPR enforcement efforts at the border. Imports of CD presses through the ports of Shantou and Foshan have been stopped. In Guangdong province, over 6,000 smuggling cases involving goods worth approximately US $1.2 million were uncovered (up 18 percent over 1995). Cooperative efforts between Guangdong province and Hong Kong customs officials have paid off, resulting in 15 joint crackdown operations in 1996.

In addition, as a result of the 1995 IPR Agreement and the 1996 IPR Accord, intellectual property companies have gained ground in terms of market access. U.S. companies improved access to China's domestic audiovisual markets and China committed to permit, for the first time, the establishment of joint ventures to produce and reproduce product in China and to enter into contracts for distribution, sale, and performance of foreign works throughout China. In addition, U.S. motion picture companies have entered into revenue sharing arrangements with partners in China.

China and the United States have committed to frequent consultations and exchanges of data on IPR enforcement activities. U.S. government agencies and industry groups have provided specialized IPR training and assistance to Chinese government agency personnel pursuant to the agreements. Enforcement of IPR protection has become part of China's nationwide anti-crime campaign, thus ensuring Chinese police involvement in arresting IPR piracy.

The Administration commends China for taking these promising steps on effectively enforcing IPRs. USTR will continue to pursue improved enforcement, in particular in respect of end-user infringements such as institutional piracy. Industries estimate that continued improvements in China's enforcement of its IPR laws and regulations may result in an increase in U.S. exports of goods and services in excess of $500 million, and improved audiovisual market access may result in increased U.S. exports of between $50 million and $100 million.

SERVICES BARRIERS

While China has promised to liberalize its services markets upon accession to the WTO, today China's market for services remains severely restricted. For example, foreign service providers are only allowed to operate under selective "experimental" licenses and are restricted to specific geographic areas. As in other sectors, the absence of transparency and a sound legal and regulatory structure, and public ignorance of those laws and regulations that do exist, block market access for services companies.

In short, China denies U.S. and other foreign services companies national treatment. U.S. services companies continue to face significant administrative restrictions from which domestic firms are exempt. For example, U.S. financial institutions, law firms, and accounting firms, among others, must largely limit their activities to serving foreign firms or joint ventures. U.S. companies still are not permitted to offer after-sales services, except in collaboration with a Chinese partner. Although some U.S. companies, such as those involved in joint-ventures, are allowed to hire and fire based on demand and performance and pay wages according to market rates, the representative offices of U.S. service suppliers are still required to hire, recruit, or register all local staff through state labor services companies which collect large monthly fees for each employee hired. Access to distribution outlets remains severely restricted, and foreign firms are even barred from transferring products among various subsidiary production facilities.

In line with its effort to join the WTO, China has begun to allow foreign participation in several services industries on a trial basis. For example, the State Council has followed up on plans announced in January of 1996 to allow foreign banks in Shanghai's Pudong area to conduct *renminbi* transactions on a restricted trial basis. As of early 1997, 8 foreign banks had obtained permission to conduct local currency business in Pudong. U.S. and other foreign financial institutions, however, still need approval for new representative offices and branches, which is granted on a case-by-case basis. By the end of 1996, China approved a total of 150 bank branches and 530 representational offices. China has also licensed 73 U.S. law firms in 15 cities, but limited their practice to a single city and forbidden them to take Chinese clients, appear in Chinese courts or establish joint-venture law firms. In late 1996, the Ministry of Justice announced plans to further regulate the activities of foreign law firms. However, such restrictions were postponed indefinitely due to pressure from foreign firms and diplomats. Travel and other tourist-related services are limited to 11 areas in China, and retailing firms are subject to vague, restrictive guidelines, the implementation of which often varies considerably from locality to locality.

With regard to insurance services, China has passed an insurance law and is taking steps to reform and develop its domestic industry, but still blocks nearly all foreign companies from the market. While China has approved to date 144 representative offices opened by 84 different foreign insurance companies, including many large U.S. insurers, only one U.S., one Japanese, and one Canadian company have been granted licenses to operate in China. A fourth foreign insurance company has been granted a license to participate in a joint-venture with a Chinese partner. In addition, the licenses granted to the U.S. company restrict the company to a narrow range of operations in Shanghai and Guangzhou. Permission to compete directly with the state-run insurance company, the People's Insurance Company, or with other quasi-private Chinese companies such as Ping An or China Pacific, has not been granted. While U.S. companies suffer under such restrictions, new Chinese insurance conglomerates have been given free rein to set up operations and take market share.

In other areas, such as information and telecommunications services, U.S. companies continue to be closed out of the market. Current regulations governing providers of telecommunications services and value-added telecommunications services limit the management or ownership of these types of services to domestic companies.

Many foreign operators, including U.S. firms, are looking for ways to avoid these restrictions on operation, including forming joint venture with local companies. For example, some foreign companies have teamed with Chinese partners to provide information services via the internet. One non-U.S. foreign company, for example, is working with the People’s Daily to provide on-line translations of major computer and information industry publications. In another example, some foreign companies have entered into joint ventures with local companies to construct telecom networks. These ventures are Chinese legal entities, which can then contract with Unicom, China's second carrier. There is now some evidence that the MPT, China's first carrier, may be willing to participate in similar kinds of arrangements.

Information services also remains a difficult and sensitive area for U.S. companies to do business in China, in part because of Chinese concerns about pornographic and politically sensitive material entering China. In April 1996, for example, the State Council announced plans to enact severely restrictive regulations governing the activities for foreign news service providers. While it appears that such action has been set aside for the time being, foreign information services providers remain wary.

Since China's services sector remains underdeveloped and current foreign participation in the market is minimal, it is difficult to estimate how much such barriers to market access represent in lost U.S. exports of services. In some services sectors, such as insurance, even the most conservative estimates predict total premiums to reach $10-20 billion in the next several years. If China lifted barriers to market access in the sector, U.S. insurance providers could be expected to capture a portion of the Chinese market that would almost certainly exceed $500 million. In other services sectors, such as legal services, accountancy and consulting, while potential revenues are likely more modest, the lifting of barriers to market access would certainly result in significant a increase in U.S. exports of services.

INVESTMENT BARRIERS

Although official Chinese policy welcomes foreign investment as critical to the country's economic development plans, the Chinese Government continues to maintain barriers and controls on foreign investment, channeling it toward areas that support Chinese Government development policies. China encourages foreign investment in priority infrastructure sectors such as energy production, communications, and transportation, and restricts or prohibits it in sectors where China's planners have not determined that China has a specific need or where China wants to protect the local industry. In June 1995, Chinese authorities issued investment guidelines detailing sectors in which investment is encouraged, restricted or prohibited. The new guidelines were a positive step toward clarifying China's policies on foreign investment. However, a continued general lack of transparency in the foreign investment approval process and inconsistency in the implementation of regulations continue to hinder investors that meet the substantive requirements of the "guidelines."

According to the investment guidelines, the Chinese Government still prohibits foreign investment for projects with objectives not in line with national economic development under the state plan. In addition, there are many areas in which, although foreign investment is technically allowed, it is severely restricted. Restricted categories generally reflect: (1) the protection of domestic industries, such as the services sector, in which China fears that its domestic market and companies would be quickly dominated by foreign firms; (2) the aim of limiting luxuries or requiring large imports of components or raw materials; and (3) the avoidance of redundancy (i.e., excess capacity).

Examples of investment restrictions are abundant. For example, China bans investment in the management and operation of basic telecommunications, all aspects of value-added telecommunications as well as in the news media, broadcast and television sectors -- citing a "national security interest." In addition, China severely restricts investment in the rest of the services sector, including distribution, trade, construction, tourism and travel services, shipping, advertising, insurance, and education. Finally, China hinders foreign investment and distorts trade by insisting on fulfillment of contract-specific local content, foreign exchange balancing, and technology transfer requirements if companies are to import under anything other than prohibitive tariff rates. Furthermore, foreign enterprises are often limited in their scope. Generally, they are prohibited from directly importing and reselling goods without further processing.

The day-to-day problems faced by foreign ventures lie primarily in the uncertain investment climate created by policy vacillations and the uneven implementation of laws and regulations. The Chinese Government has taken steps to address investors' complaints regarding the inadequacies of protection for foreign investment, such as amending its joint venture law to prohibit the expropriation or nationalization of joint ventures without cause and compensation. While this action is a step in the right direction, the law continues to fall short of international standards sought by the United States. Other legislative actions taken by Beijing have promised greater autonomy and incentives for foreign-invested ventures, but these laws have been haphazardly enforced, if at all.

In addition, the designation of key state enterprises in many industries as the exclusive bases for the development of critical technologies limit the choice of joint venture partners. Designated partners are frequently unattractive for various business reasons such as lack of experience, inappropriate staffing levels, and outdated equipment.

Overall, foreign-invested enterprises have a significantly greater degree of managerial autonomy than do typical Chinese enterprises. On the other hand, Chinese enterprises enjoy certain advantages because they are fully integrated into the national economic system. Central government ministries and local governments frequently provide special advantages to state-owned firms. For example, many Chinese companies are able to obtain preferential treatment in local financing marketing, setting prices, and purchasing raw materials. Unlike many U.S. companies in China, Chinese companies have free access to the Chinese domestic market.

For many companies, the highly personalized nature of business in China and the limited number of suppliers and customers often make arbitration or other legal remedies impractical. Even when they have strong cases, foreign investors often decide against using arbitration or other legal means to resolve problems out of fear of permanently alienating critical business associates or government authorities. The lack of recourse to an impartial legal system that is not susceptible to Chinese Government pressure further undermines investor confidence.

In December 1992, the United States re-established the Joint Commission on Commerce and Trade (JCCT) as a ministerial-level forum for discussion of investor and business concerns, among other things. The JCCT met most recently in October 1996 with working group sessions on trade and investment in a number of sectors. These working groups have established and continue to coordinate a range of cooperative exchanges on trade and investment issues, providing a forum to discuss specific investor and business problems.

ANTICOMPETITIVE PRACTICES

Anticompetitive practices in China come in the form of industrial conglomerates created to improve the profitability of state-owned enterprises. In some cases, the government has provided subsidies and other public benefits to such conglomerates, as well as authorizing some to fix prices, allocate contracts and, in other ways, restrict competition among domestic suppliers. Such monopolistic or monopsonistic practices may restrict market access for imported products, raise production costs, and restrict market opportunities for foreign-invested enterprises in China.

OTHER BARRIERS

The explosive growth of the market for many products in China, while a very positive sign for China's economy as a whole, has led to the creation of a large “illegal” gray market in some sectors of great commercial interest to U.S. producers and exporters. While some U.S. products are traded in the gray market, most U.S. companies either cannot or choose not to accept the risks of entering this “unofficial” market. The existence of this parallel gray market resulting in part from controlled demand, thus deprives U.S. firms of sales that would otherwise occur on the legitimate market. Medical equipment is an example of this phenomenon. Similarly, restrictive import licensing requirements for low-end computers, only tardily lifted in mid-1995, appeared to allow third country competitors to make inroads in a market that is dominated elsewhere by U.S. manufacturers.

Smuggling of both legitimate and “fake” products constitutes a formidable disincentive to engage in legitimate importation of U.S. and other foreign products -- and harms U.S. exporters in several ways. Smuggling diverts income from U.S. joint ventures in China or their home operations. Reportedly many of the products smuggled into China are counterfeit or otherwise defective. In such cases, both the producer and importer of legitimate goods are harmed as well as consumers in China. Moreover, smuggling creates havoc for companies that try to provide after sales service and repairs. Smuggled goods do not carry warranties, are often damaged or handled poorly, and are not serviced by trained personnel.

Satellite Launch Services

On March 13, 1995, the United States and China signed an agreement renewing the Bilateral Agreement on International Trade in Commercial Space Launch Services. The agreement covers the period from 1995 to 2001 and continues quantitative and pricing disciplines established under the first U.S.-China space launch services agreement signed in 1989. The 1995 space launch agreement is covered under applicable U.S. trade laws and regulations.

The renewed agreement limits China to no more than 11 launches to geosynchronous earth orbit (GEO) over the seven-year period of the agreement. In addition, it allows four launches in 1995-96 to be counted against the quota of the first agreement since they had already been reviewed under that agreement. China conducted only four of its permitted nine launches in 1989-1994.

In light of the emergence of the remote-sensing and weather tracking market for launches to low-earth-orbit (LEO) since 1989 and commercial plans for the deployment of telecommunications satellite constellations into LEO beginning in 1997, the renewed Chinese agreement contains specific disciplines and guidelines regarding future Chinese launches to LEO. The agreement requires that Chinese participation in the LEO market segment be proportionate and non-disruptive. The U.S. may request consultations with China to establish the facts and agree on any necessary corrective action.

The 1995 agreement contains new language which more clearly describes the circumstances under which adjustments to the GEO quota may be made. For example, the GEO restrictions may be increased as a result of stronger than predicted growth for GEO launch services or the lack of availability of western launch services during a specified launch period. By providing this greater detail, the agreement should achieve its intended objective with respect to the U.S. space launch industry while balancing the needs of U.S. satellite manufacturers and users.

The renewed agreement contains two improvements to the GEO pricing discipline: (1) a detailed annex on the adjustments which might be appropriate to make when comparing Chinese and Western launch prices and average values associated with those adjustments, and (2) a safe harbor which provides that Chinese prices falling within 15 percent of Western prices will generally be assumed to be in compliance with the "par pricing" standard of the agreement, unless facts indicate otherwise. The former improvement will help prevent disputes with China on the nature and value of price adjustments, while the latter should aid in focusing attention on those transactions which could threaten the integrity of the "par pricing" discipline.

The LEO pricing disciplines consists of the same par pricing requirement as in GEO. The two sides have been working over the last year to reach a consensus on specific LEO pricing adjustments as have already been negotiated on GEO.

In July 1996, the United States and China held the first set of annual consultations that are called for under the agreement. Among the subjects covered at those consultations were developments in the overall supply and demand for international commercial space launch services and a review of competitions either won by, or involving, Chinese launch service providers since the new agreement was in place.

Taking into account the information supplied by China during the annual consultations with regard to the prices, terms, and conditions offered by China for international commercial space launch services, the United States subsequently concluded that Chinese pricing in two competitions did not appear to be justified under the pricing provisions of the 1995 agreement. As a result, the U.S. requested “special consultations” with China as provided for in Article IV (2) of the agreement to review its concerns. Those consultations were held on November 14-15, 1996, during which the United States reviewed its concerns in each of those consultations. In turn, China was given an opportunity to provide additional information regarding the prices, terms, and conditions of the competitions or other factors that would further clarify the apparent price differences. The United States is reviewing the results of those consultations.

Textiles

USTR engaged in several textile negotiations with China throughout 1996, culminating in a four year textile pact concluded February 3, 1997. The pact builds on the 1994 textile agreement -- which produced USTR sanctions against China on three different occasions, most recently in September 1996 -- improving it in two important areas, namely market access and enforcement against illegal transshipment. Under the market access aspects of the agreement, China has agreed to reduce tariffs and bind tariffs at applied rates, thereby increasing market access for U.S. exporters, and to ensure that non-tariff barriers do not impede the achievement of improved access. U.S. producers are confident that they can effectively export a number of products to China under these conditions.

While the pact provides some adjustment to China's quota levels and growth rates, the new package addresses on-going U.S. concerns about illegal transshipment practices. The new agreement reduces quota levels in fourteen apparel and fabric product categories where there were repeated violations of the 1994 agreement through transshipment or over shipment. It maintains strong enforcement measures, including the ability to "triple charge" quotas for repeated violations of the agreement, as well as a number of procedural measures to improve the bilateral consultation process, including arrangements to implement an "electronic visa" information system to more effectively track textile and apparel shipments. The parties have agreed to maintain the separate treatment of textiles quotas for Hong Kong, Macau, and China after July 1, 1997.

China