PEOPLE'S REPUBLIC OF CHINA

U.S. merchandise exports to China in 1997 were $12.8 billion, an increase of 6.9 percent from 1996. China was the United States' fourteenth largest export market in 1997. U.S. imports from China in 1997 were $62.6 billion in 1997, an increase of $11.1 billion (21.4 percent) from 1996. In 1997, the U.S. merchandise trade deficit with the People's Republic of China was $49.7 billion, an increase of $10.2 billion from 1996 and an approximate 50 percent increase since 1995, when the merchandise trade deficit with China stood at $33.8 billion.

The U.S. Department of Commerce has reported that for services trade in 1996, the United States exported $3.1 billion to China and imported $2.0 billion in services, resulting in a positive services trade balance with China of $1.1 billion.

The stock of U.S. foreign direct investment (FDI) in China in 1996 was $2.9 billion, an increase of 36 percent from the level of U.S. FDI in 1995. U.S. FDI in China has been concentrated largely in the manufacturing and petroleum sectors.

IMPORT POLICIES

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

China has used prohibitively high tariffs -- which in late 1997 still reached as high as 100 percent on some motor vehicles -- in combination with other import restrictions and foreign exchange controls to protect its domestic industry and restrict imports. These high nominal tariff rates -- to which China adds applicable value-added taxes and, on some goods, consumption taxes -- contribute to inefficiencies in China's economy and pose a major barrier to U.S. commercial opportunities.

While China has generally met the requirements of the 1992 Market Access MOU (Memorandum of Understanding) to remove various explicit 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

In prior years, China's tariffs have been so high as to preclude imports. In 1996, China lowered its average import tariff from 42.1 percent to 23 percent, and on October 1, 1997, further lowered the average import tariff to 17 percent. Despite these 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 and motor vehicles, remain extremely high. Many of China's tariff reductions in 1996 and 1997 have been on products on which China imports low volumes of goods. Indeed, China's overall increase in imports has been very modest when viewed in the context of recent reductions in China's average tariff rates.

According to China Customs trade data, China's total imports in 1996 increased 5.1 percent in 1996, while

imports from the United States increased 0.2 percent. Total imports in 1997 increased only 2.5 percent from 1996, while imports from the United States as measured by China Customs increased 0.6 percent.
In addition to high tariff rates, unpredictable application of those rates 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. Tariffs may also vary depending on the geographical point of entry. Also, local tariffs may be applied to imports even after the importer already paid the tariff at the port.

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. China implemented a new import tariff-exemption plan for some goods under revised investment guidelines on January 1, 1998, which is designed to increase imports of foreign-made capital equipment and other goods. The effectiveness of this new exemption plan, however, remains to be demonstrated in light of regional economic difficulties and domestic macroeconomic uncertainties.

China's General Administration of Customs (Customs) has also granted preferential tariff rates through special exemptions or more informal means. For example, in notices issued on July 10, 1997, China Customs granted 20 percent import duty rates to two Chinese automobile manufacturers for their imports of certain automobile parts. The notices cited domestic content exceeding 80 percent in sedans manufactured by the two automobile manufacturers as the basis for granting preferential import duties on parts imported by the two manufacturers. China's 1997 import tariff schedule showed automotive part duties ranging as high as 50 percent on parts from MFN trading partners.

U.S. and other foreign businesses selling goods into China also complain about the 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 business persons and Chinese Customs officers. Allegations of corruption often result.

China has taken steps to reduce tariffs pursuant to its bilateral commitments and in an effort to support its WTO accession bid. Many tariff reductions are still under negotiation in the context of WTO discussions with 36 trading partners. 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. The October 1, 1997, tariff adjustments noted above lowered China's simple average tariff level from 23 percent to 17 percent. U.S. negotiators are now working on the specific rates to be applied to the many items of export interest to U.S. companies.

In addition to tariffs, imports may also be subject to value-added and other taxes. U.S. industry has complained that the current value-added taxing system (VAT) amounts to an added surcharge on both imported goods and domestic products and discourages consumers by raising prices. China's value-added tax is usually 13 or 17 percent, and China levies that VAT after first imposing the import tariff and any applicable consumption tax and incorporating those amounts into the base on which the VAT is applied. Thus, a product subject to a 17 percent import tariff (the post-September 1997 average tariff level), a 17 percent VAT, and a consumption tax would be taxed ultimately at a rate in excess of 34 percent. 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.

In late 1997, China announced a reversal of course on its planned two-year phase-out of tariff exemption for capital equipment imported by foreign investors in China. China apparently had observed that a move to impose its nominal tariffs on foreign investors was raising project costs to commercially unacceptable levels. Contracted foreign investment (pledges of future business investments in China) has declined steeply since the planned two-year phase-out was announced in early 1996. The new tariff exemptions became available on January 1, 1998, but in early 1998 businesses were still facing some difficulties with respect to determining the availability and conditions for the tariff exemptions and procedures for applying for them.

On October 1, 1997, China introduced a sliding duty on newsprint for which the United States has been an important supplier to China. The sliding duty is sensitive to import prices, and as import prices drop, the duty payable increases to as high as 45 percent for newsprint from MFN trading partners. China's previous *ad valorem* duty rate on newsprint had been 15 percent in 1996. Even though Chinese newsprint consumers have often taken advantage of spot market volatility to import high-quality foreign-made newsprint at low prices, the October 1 imposition of a sliding duty raised the imported price of inexpensive foreign newsprint. In addition to this government action, in late 1997, Chinese newsprint producers filed China's first-ever antidumping petition. China's preliminary ruling on the newsprint case is expected in the first quarter of 1998.

Non-Tariff Measures

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). China's traditional 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 ministries, state-owned corporations, and trading companies.

Central government agencies determine the levels of import quotas through data collection and negotiating sessions, usually late each year. 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.

MOFTEC uses import licenses to exercise an additional, nationwide system of control over some imports. Many products are subject both to quotas and also to import licensing requirements. For these products, after permission has been granted by other designated agencies for 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. Import restrictions on 13 more goods were abolished on December 31, 1997, pursuant to the 1992 Market Access MOU.

China

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 "automatic" registration requirement, electromechanical product import control measures, regulations on the administration of medical equipment, and camera import control measures. About 400 products covered by the annex to the 1992 Market Access 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.

As a result of the 1992 bilateral Market Access MOU and China's bilateral and multilateral negotiations and notifications on accession to the World Trade Organization, China's trade regime has become significantly more transparent in recent years. Nonetheless, businesses sometimes encounter difficulties in learning which regulations or rules apply to their operations in China.

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. Some agencies require that only a certain group of companies alone be allowed to import. 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, U.S. 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. The same situation is also true for U.S. pork and citrus imports, which make their way into China from Hong Kong through unofficial channels. Sales of such products have resulted in revenue losses for China, because of rampant smuggling and the associated corruption.

In the context of its World Trade Organization accession negotiations, China has pledged to liberalize the availability of trading rights, i.e., the right to import, export and have access to China's distribution system, over a three year period. At the end of that transition period, all foreign and domestic enterprises will have trading rights. U.S. and third-country firms expect that the trading rights liberalization will enable them routinely to deal directly with customers and not be forced to go through intermediary companies that have the right to import goods into China. China's restrictive approach to licensing the scope of a business's operations (defining and limiting the types of goods a company can deal in and operations in which a company may engage in China) may prove to be a harbinger of restraint on the future expanded trading rights system.

Import Substitution Policies

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.

In 1996, the State Council began reexamining its policies and regulations on pharmaceutical pricing. A series of provisional regulations and implementing provisions have been issued that discriminate against imported products and embody an import substitution policy. Price formulas vary based on whether domestic substitutes exist and receipt of certain benefits (such as exceptions from limits on profits) is conditioned on whether a product replaces an import.

The United States is consulting with China bilaterally and 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 about 780 imported goods, and an even greater number of items are subject to statutory inspection requirements upon export from China. In addition to these conformity assessment inspections, China also imposes safety licensing requirements on certain products.

In the context of China's WTO accession negotiations, China has identified over one hundred tariff-line items that are subject to safety licensing requirements. Major problems with China's standards system include the lack of transparency, difficulty in determining the appropriate standards, 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 nine 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 became 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 WTO Agreement on Technical Barriers to Trade.

The 1992 Market Access MOU requires that China apply the same standards and testing requirements to non-agricultural products, whether foreign or domestic. The United States and other foreign suppliers have complained however, that these 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 certain areas 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); cherries from Washington (March 1996) and grapes from California (May 1997). However, China's sanitary and phytosanitary measures still prohibit imports of U.S. citrus, plums, and Pacific Northwest wheat.

In early 1997, China announced a one-year trial period for imports of meat for the retail market. Under this scheme, China allows meat imports into the general market from selected plants in three countries, Australia, Canada and the United States, during a trial period from June 1, 1997 to May 31, 1998. Only five U.S. plants were approved to export a total of 26,800 MT of beef, pork, turkey, and poultry. To date no meat has been imported through this trial project. With a tariff of 45 percent and a VAT of 13 percent, the informal importing channels through Hong Kong are preferred. Access for meat and poultry from other plants is limited to use in hotels, restaurants, and food processing facilities in China. In addition, pork imports face restrictive import licensing requirements: licenses are only issued by China Animal and Plant Quarantine (CAPQ) in Beijing. While industry estimates of up to $400 million worth of U.S. chicken parts made their way to China through Hong Kong in the past year, total U.S. beef, pork, and poultry direct exports in China amounted to just over $60 million.

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, China has not published any laws or regulations regarding its government procurement practices. Although one government entity, the National Tendering Center for Machinery and Electrical Equipment, published a tendering guide, procurement procedures remain unclear and are not transparent.

The State Planning Commission began drafting a national procurement law for China in 1997. At an APEC workshop on procurement, Chinese officials identified the State Planning Commission as the agency in charge of government procurement bidding procedures. The official also noted that when promulgated, the procurement law would be accompanied by ten regulations covering: procurement of goods; procurement of goods for construction; procurement of services; procurement for key construction works; military procurement; scientific research projects; charges for bidding agencies; qualifications for bidding agencies; disputes in procurement procedures; and the establishment and discipline of bid evaluation committees.

Like many countries with developing procurement markets, two types of procurement exist in China: 1) procurement funded by the World Bank or other international organizations and 2) procurement funded by the Chinese government. For projects using foreign loans provided by international organizations such as the World Bank, a condition of the loan requires that tendering procedures comply 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 Machinery and Electrical Equipment. The Chinese government seldom uses these same transparent and competitive bidding procedures in procurement it funds. In fact, most of these procurements allow for preferential treatment of domestic suppliers' goods and services. Even when procurements are open to foreign bidders, such suppliers may be discouraged from bidding by the uncertainty of obtaining foreign exchange. Moreover, the Chinese government routinely seeks to obtain offsets from foreign bidders in the form of 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 procurement, often express a "preference" for offsets.

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 procurement 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 procurement in China. Given the

Chinese government's own fervent campaign to attack widespread corrupt practices of officials, the likelihood of corruption or bribery affecting procurement appears significant. 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.

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 and non-transparent practices 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). State trading companies are also subject to constraints that make them export in volumes not consistent with their input costs or other commercial considerations.

The government also generates exports by imposing export requirements on Chinese foreign trade corporations (FTCs) and foreign-invested enterprises. These 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 strongly suggests that much of the lending is not on strictly commercial terms. State 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 be achieved, particularly with respect to income and other direct taxes imposed on exporters. In fact, the State Administration of Taxation recently announced its decision to increase the export rebate rate for textile products, as part of an overall package of preferential policies (including export quotas and financial subsidies) to shore up the debt-ridden textile industry.

China's recent corn exports (6.6 million metric tons in 1997) demonstrate clearly the continued willingness of parts of the Chinese government to subsidize exports. Most of China's 1997 corn exports were sold at prices $20 to $30 below domestic wholesale corn prices. Chinese officials argue that there is no subsidy involved since the corn was purchased domestically in 1995 and 1996 when domestic prices were much lower than they were when exported. The Chinese government incurred a loss of as much as $50 million in 1997 through exportation when compared to what the government might have realized by selling the corn in the domestic market.

In the context of negotiations on its accession to the WTO, China has agreed not to use export subsidies for agricultural products. Thus, reaching an understanding on what practices constitute subsidization is an important task.

LACK OF INTELLECTUAL PROPERTY PROTECTION

Based on the 1995 and 1996 Bilateral IPR Agreements and extensive follow-up work with Chinese officials, China now has a functioning system to protect intellectual property rights (IPR). Enforcement of intellectual property rights has become part of China's nationwide anti-crime campaign; the Chinese police and court system have become actively involved in combating IPR piracy. In 1996 and 1997, the Chinese closed 62 CD/CD-ROM lines, 52 lines from underground factories and 10 lines which had been improperly registered, discovered by central authorities and then shut. The result has been a significant reduction of pirated sound recording production in South China.

Regional cooperation on enforcement of IPR at the border has also increased. However, as China has closed down illegal production lines and prevented importation of additional lines, the number of production lines and manufacture of infringing product in Hong Kong and Macau have increased. We have urged customs authorities throughout the region to work together to stop the flow of infringing product and machinery across borders.

Training on IPR enforcement has been a key part of building the necessary infrastructure for continuing enforcement efforts. More than 3,000 judges in China have received training on IPR laws. U.S. government agencies and industry groups have provided specialized IPR training and technical assistance to Chinese government personnel pursuant to the 1995 Agreement.

Despite progress, serious enforcement concerns remain. Industry reports indicate that end user piracy of business software is widespread. End user piracy takes place when a business or agency purchases a limited number of licenses to use software, and then makes unauthorized copies for use by others in the organization. Although Chinese authorities have investigated cases involving the sale of computers preloaded with unauthorized software and the National Copyright Administration has issued a directive instructing government ministries to use legitimate software, serious problems remain and we have not seen effective action against unauthorized copying. USTR is continuing to work with Chinese government officials and industry representatives to develop an effective enforcement initiative in this area.

While China has closed pirate CD production lines, the government has recently sold some of the seized machinery to other factories. USTR is monitoring the situation to determine whether these production lines are dedicated to making legitimate product in China.

Trademark piracy appears to be on the increase. USTR has raised concerns in our frequent bilateral consultations on IPR issues regarding widespread complaints regarding infringement of well-known marks and trade dress. U.S. officials have raised particular concerns about Chinese companies counterfeiting the Underwriters’ Laboratory safety certification mark. U.S. customs seizures of imports from China bearing counterfeit UL marks have soared. Other trademark protection issues, such as access to all designated trademark agents in China, protection of unregistered well-known trademarks and revision and clarification of registration standards need to be resolved.

Some pharmaceutical firms have complained about delays and inconsistencies in China's implementation of "administrative" protection for pharmaceuticals. In addition to requests to modify the process for obtaining approval of administrative protection, U.S. officials have discussed with China cases in which one Chinese agency granted production and marketing approval to a Chinese firm days before another agency granted administrative protection to the holder of a U.S. patent on the product. USTR is continuing discussions on whether the company with administrative protection for its product can require the other firm to cease activities related to the protected product.

China has agreed, in the context of the multilateral negotiations on its accession to the World Trade Organization (WTO), to implement the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) upon accession without a transition period. China's IPR experts are now reviewing and drafting IPR laws in preparation for accession. We understand, for example, that revisions to the copyright law to implement the TRIPs Agreement and other international copyright treaties are under consideration. U.S. experts will be consulting with China on these and other steps China needs to take to implement the TRIPs Agreement as part of our comprehensive IPR monitoring program.

Although some progress has been made on market access for IPR products, including software, sound recordings and motion pictures, U.S. products and companies still face market access barriers. Although formal quotas have been eliminated on imports of motion pictures and imports of videos are increasing, the number of films imported for theatrical release on a revenue sharing basis is still limited. Since only one state-owned enterprise is authorized to import films for theatrical release, China has in effect a *defacto* quota on such imports. Also of concern are high tariffs on films, customs valuation of films, and distribution rights. In addition to bilateral efforts to address these problems, USTR will continue to press for market access in China's WTO accession negotiations.

In sum, we have seen continued progress in China with respect to copyright enforcement and legal developments. However, much remains to be done to ensure consistent effective results. USTR continues to raise particular problems relating to piracy and trademark counterfeiting. Progress on market access issues remains disappointing and significant improvements need to be made bilaterally and in the WTO accession negotiations.

SERVICES BARRIERS

While China has promised to liberalize upon accession to the WTO, China's market for services today remains essentially closed. Restrictive investment laws, lack of transparency in administrative procedures, and arbitrary application of regulations and laws limit U.S. service exports and investment in China. Service trade opportunities, particularly in the financial services, telecommunications, audiovisual, distribution, professional services and travel and tourism sectors, have been affected by a variety of limitations on foreign participation throughout China's economy.

In most sectors, foreign service providers are only allowed to operate under selective "experimental@ licenses with strict operational requirements, limits on the forms of establishment for entry, and restrictions on the geographic scope of activities. Once in the market, the lack of transparency and discretionary application of Chinese laws and regulations, along with the denial of national treatment, make doing business difficult for most foreign services companies.

Hiring issues are also complicated. Although some U.S. companies, such as those involved in joint-ventures, are allowed to hire and fire based on demand and performance and can 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. In some services sectors, particularly professional services, there are strict limits on the hiring of Chinese professionals.

In line with its effort to join the WTO, China has begun to allow greater foreign participation in a few services industries on a trial basis. For example, the State Council has followed up on plans announced in January 1996 to allow foreign banks in Shanghai's Pudong area to conduct local currency transactions on a restricted trial basis. To date, nine foreign banks have 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 discretionary, case-by-case basis. By the end of 1997, China approved a total of 142 bank branches, seven joint-venture banks, and five wholly foreign-owned banking firms in 19 cities. The scope of activities for these banks and branches is limited largely to business denominated in foreign currencies, essentially carving out the entire domestic market and leaving only international trade related business.

With respect to insurance services, China passed a new insurance law in 1993 and is taking steps to reform and develop its domestic industry. China still blocks nearly all foreign companies from the market. While China has approved to date 181 representative offices opened by 99 different foreign insurance companies, including many large U.S. insurers, only one U.S., one Japanese, and one Swiss company have been granted licenses to operate branches in China. A second U.S. company, as well as one company each from Germany, France and Canada, have been allowed to participate in joint venture insurance companies with a Chinese partner. All of the licenses granted to foreign companies restrict each company to a narrow range of operations in either Shanghai or 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, the new Chinese insurance conglomerates have been given free rein to set up operations and take market share.

In telecommunications services, U.S. companies continue to be closed out of the market. Current regulations governing providers of basic 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 get around these restrictions by forming joint ventures with local companies. For example, some foreign companies have entered into local joint ventures to construct telecom networks. These ventures are Chinese legal entities, which can then contract with Unicom, China’s second carrier, to provide telecommunications services. To date, however, the Ministry of Post and Telecommunications (MPT), China’s first carrier with the largest customer base and network, has been unwilling to participate in similar kinds of arrangements.

Information services also remain a difficult and sensitive area for U.S. firms to do business in China. In April 1996, for example, the State Council announced plans to apply severely restrictive regulations governing the activities of foreign financial information providers. U.S. diplomatic efforts in 1997, however, resulted in Chinese assurances that appear, for now, to have addressed the concerns of financial information providers and allowed their continued operations.

Audiovisual services is another sensitive area where foreign firms are almost completely closed out of the market, in part because of Chinese concerns about politically sensitive materials entering China. In April 1996, for example, the State Council announced plans to enact severely restrictive regulations governing the activities of foreign news service providers. While it appears that such action has been set aside for the time being, foreign information services providers remain wary. Other foreign audiovisual services providers, such as distributors of sound recordings, videos, movies, book, and magazines are almost completely shut out of the market. Foreign firms are denied the right of establishment. Inconsistent and subjective application of censorship regulations act as a further impediment to foreign participation in the market.

In the distribution services sector, U.S. companies are again significantly restricted in the scope of their activities. Business licenses often do not allow firms to provide the full range of services, including marketing, maintenance, after-sales services and customer support, except in collaboration with a Chinese partner. Foreign firms are not given the right to own and manage distribution networks, wholesaling outlets, or warehouses. Relatedly, foreign firms do not have access to transportation services on a reasonable and non-discriminatory basis and are required to use state-owned companies to distribute their goods, rather than being able to own or manage their own transport facilities.

In retailing, geographic and quantitative limits on the number of services suppliers prevent firms from competing effectively against local retailers. Restrictions on the ability of foreign firms to set product prices, quantity, import composition, and quality undercut any competitive advantages foreign firms might bring to the market. Foreign retailers are also only allowed to sell the products of their parent company and cannot engage in the sale of domestic goods. While direct sales companies have had broader geographic success, China has recently announced that it may take regulatory actions which could significantly undercut the economic viability of many direct sellers in China. The U.S. has urged China not to take any action against legitimate U.S. direct sellers, making the case that these firms provide China with significant investment income, employment opportunities and tax revenues.

In professional services, U.S. engineers and architects have enjoyed a relatively more cooperative and open relationship with the Chinese government. These professions have operated in the Chinese market through joint venture operations with relatively few regulatory problems. Foreign law firms and accounting firms, on the other hand, have been more tightly regulated.

China has permitted the establishment of foreign law firms in designated cities on a case-by-case basis only. As of February 1998, China has licensed 83 foreign law firms, of which almost 30 were U.S. firms, in 15 cities. China limits a firm’s practice to a single city and foreign attorneys are not permitted to employ Chinese lawyers or establish partnerships or form other types of associations with Chinese lawyers or law firms. Accounting services are almost as restricted. In accounting, China limits the scope of activities for representative offices to consultancy. In order to perform statutory audits and the full range of accountancy services, foreign firms are required to set up a 50 percent joint venture that has to gradually relinquish its control over 10 years down to 33 percent.

Finally, travel and other tourist-related services are also under tight regulation in China. Activities of foreign firms are limited to 11 areas in China. Current Chinese law prohibits non-Chinese companies from establishing full service travel agencies in China. China also imposes numerous restrictions on the guides and tourist agents that can be hired.

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 increases 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.

China has issued new foreign investment guidelines, effective January 1, 1998, and provided an revised list of sectors in which foreign investment is encouraged, restricted or prohibited. 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).

China has also reinstated tariff and VAT exemptions for imports of capital equipment by selected foreign-invested and domestic projects. These changes are in response to two years of declines in the number of new foreign investment projects and the value of such projects.

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, forcing foreign firms into joint venture arrangements in which they are often required to sell down to minority positions over a specified time frame. Finally, China hinders foreign investment and distorts trade by insisting on fulfillment of contract-specific local content and mandatory technology transfer requirements if companies are to import under anything other than prohibitive tariff rates.

China's move to current account convertibility appears, in practice, to have stopped the enforcement of foreign exchange balancing requirements in existing contracts. These requirements have not been formally rescinded, and thus, could be enforced at some later time.

Once in the market, foreign ventures face numerous problems because of the uncertain investment climate created by policy vacillations and the uneven implementation of laws and regulations. China 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.

While foreign-invested enterprises may have a significantly greater degree of managerial autonomy, Chinese enterprises enjoy certain advantages because they are fully integrated into the national economic system. 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 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 September 1997 and is scheduled to meet again later in 1998 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 rapid growth of the market for many products in China, while a 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, 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 are Chinese consumers. 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, four launches in 1995/96 were counted against the quota of the first agreement since they were reviewed at that time. To balance the needs of the U.S. space launch industry with those of U.S. satellite manufacturers and users, the GEO restrictions may be increased up to a potential of 20 launches as a result of stronger than predicted growth for GEO launch services or a lack of availability of Western launch services during a special launch period.

The 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.

In light of the emergence of the low earth orbit (LEO) satellite market, 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. In addition, the OEO pricing disciplines consist of the same par pricing requirements as in GEO. To further clarity these provisions, the two sides signed and annex on October 27, 1997 on specific LEO pricing adjustments, similar to those already negotiated for GEO. The annex will improve the effectiveness of the agreement by placing clear guidelines on the Chinese pricing of LEO launches and provide more information and greater certainty to industries interested in participating in this matter.

Taking into account the information supplied by China during 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 GEO competitions did not appear to be justified under the pricing provisions of the 1995 Agreement. As a result, the U.S. held "special consultations" with China in November 1996 as provided for in Article IV (2) of the agreement to review its concerns. China provided additional information regarding the prices, terms, and conditions of the competitions or other factors that would further clarify the apparent price differences.

After reviewing this additional information, the United States determined that one of these contracts was in violation of the pricing provisions of the agreement, while the other no longer raised concerns regarding compliance with the Agreement. As a result of these determinations, the U.S. informed the Chinese in April 1997 that the following enforcement actions would be taken:

1. The U.S. would refuse any request by China for a discretionary increase in the limitation on launches to GEO;

2. The U.S. will insist that the automatic increase in the limitation on launches to GEO of up to to 5 launches will only occur when actual launches to GEO average 20 or more as provided in the MOA; and

3. The U.S. will monitor more closely the prices, terms, and conditions offered by Chinese launch services providers during the bid stage of international commercial competitions.

The U.S. informed China that these actions could be modified depending upon subsequent experience with China under the agreement.

Textiles

USTR engaged in several textile negotiations with China throughout 1996, culminating in a four year extension of the bilateral textile agreement, which was concluded February 3, 1997. The pact builds on the enforcement gains in the 1994 Textile Agreement, which produced USTR sanctions against China for circumvention of the agreed quotas on three different occasions, most recently in September 1996. Also, for the first time, China agreed to open its market to textile and apparel exports from the United States. 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.

The Agreement provides some adjustment to China's quota levels and growth rates and it 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 also agreed to maintain the separate treatment of textiles quotas for Hong Kong, Macau, and China after July 1, 1997.