2003 REPORT TO CONGRESS ON CHINA'S WTO COMPLIANCE

United States Trade Representative

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FOREWORD

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

Like the inaugural 2002 report, this report is structured as an examination of the nine broad categories of WTO commitments undertaken by China. Throughout the report, USTR has attempted to provide as complete a picture of China's WTO compliance as possible, subject to the inherent constraints presented by the sheer volume and complexity of the required changes to China's trade regime and transparency obstacles. USTR notes areas where progress has been achieved and underscores shortcomings as appropriate, not only with regard to the commitments that became effective upon China's accession, but also the commitments scheduled to be phased in during this past year.

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

To aid in its preparation of this report, USTR also published a notice in the Federal Register on July 21, 2003, asking for written comments and testimony from the public and scheduling a public hearing before the TPSC, which took place on October 3, 2003. A list of the written submissions received from interested parties is set forth in Appendix 1, and the persons who testified before the TPSC are identified in Appendix 2.

EXECUTIVE SUMMARY

Much has changed in the U.S.-China economic and trade relationship since China began negotiations to join the predecessor to the WTO, the General Agreement on Tariffs and Trade (GATT), 17 years ago. In 1986, total U.S.-China trade was only $7.9 billion, and imports from China outpaced U.S. exports to China by $1.7 billion. In contrast, in 2003, total U.S.-China trade is projected to top $170 billion, with imports from China exceeding U.S. exports to China by more than $125 billion.

Two years after acceding to the WTO, China has become the United States' third largest trading partner and the sixth largest market for U.S. exports. Indeed, over the last three years, while U.S. exports to the rest of the world have decreased by 10 percent, U.S. exports to China have increased by 66 percent. China has become a major consumer of U.S. manufactured exports, such as electrical machinery and numerous types of components and equipment, among other goods. Growth in U.S. exports to China of agricultural products has also been robust, and the market share of U.S. service providers in China has been increasing rapidly in many sectors. One witness at the October 3, 2003, USTR-chaired public hearing on China's implementation of its WTO commitments, testifying on behalf of an association representing many U.S. businesses operating in China, emphasized this aspect of U.S.-China trade:

> Business is good. And, if you ask many American companies, if not most American companies, even the ones who are most exercised about apparent WTO lapses on the part of the Chinese whether 2003 is going to be better than 2002, most will say "yes." They [also] expect 2004 to be better than 2003.

The focus of this Report is on China's progress in implementing its WTO commitments. In that sense, U.S. business success in China is not necessarily a demonstration of WTO implementation progress, nor does it necessarily signal that expectations are being fully met. Rather, China's WTO implementation progress must be measured by the degree to which China has begun to institutionalize market mechanisms and to make its trade regime more predictable and transparent. By that score, the shortcomings in China's WTO implementation are noteworthy. Unlike last year, China's uneven and incomplete WTO compliance record can no longer be attributed to start-up problems.

China acceded to the WTO on December 11, 2001, after 15 years of negotiations with the United States and other WTO members. Under the terms of its accession, China committed to implement a set of sweeping reforms designed to implement the WTO's market access, national treatment and transparency standards, to protect intellectual property rights (IPR), to limit the use of trade-distorting domestic subsidies and to make other changes to bring its legal and regulatory system in line with those of other WTO members. For China's leadership, these commitments were primarily intended to consolidate and accelerate the market-oriented reforms responsible for lifting 300 million Chinese citizens out of poverty over the past 25 years. China also viewed joining the WTO as a means to ensure its continued access to export markets. In turn, other WTO members envisioned that faithful WTO implementation by China would reduce the ability of non-market forces, including government policies and officials, to intervene in the market to direct or restrain trade flows.

In its WTO accession agreement, China also agreed to two separate safeguard mechanisms designed to allow WTO members to cope with market disruptions caused by increasing economic integration with China. The first mechanism permits a China-specific safeguard and can be applied to any product being imported from China. The second mechanism applies specifically to textiles and apparel products. At the end of 2003, the Administration took action under the textile safeguard mechanism for three categories of products being imported from China.

Meanwhile, as China continued to pursue the implementation of its WTO commitments in 2003, China's second year of WTO membership, a number of positive developments occurred. China began to take steps to correct systemic problems in its administration of the tariff-rate quota (TRQ) system for bulk agricultural commodities, largely in response to high-level engagement by the Administration. It relaxed certain barriers to soybean trade that allowed U.S. exporters to achieve record sales. It reduced capitalization requirements in certain financial services sectors. It opened up the motor vehicle financing sector. It solved outstanding concerns that had prevented China's membership in the WTO's Committee of Participants in the Expansion of Trade in Information Technology Products.

Despite these gains, 2003 also proved to be a year in which China's WTO implementation efforts lost a significant amount of momentum. In a number of different sectors, including some key sectors of economic importance to the United States, China fell far short of implementing its WTO commitments, offsetting many of the gains made in other areas. Indeed, institutionalization of market mechanisms still remains incomplete, and intervention by Chinese government officials in the market is common. In many instances, China has sought to deflect attention from its inadequate implementation of required systemic changes by managing trade in such a way as to temporarily increase affected imports from vocal trading partners, such as the United States.

China's WTO implementation efforts, it should be noted, have taken place against a challenging political and social backdrop. In 2003, China underwent a major leadership change, passed through a harrowing national SARS epidemic, undertook a sizeable restructuring of the government's economic and trade functions, and confronted a host of dislocations inherent in its transition from a planned economy to a more market-oriented economy. These factors may have presented substantial challenges, but China still needs to fulfill its WTO commitments.

As highlighted in the 2002 Report, which covered China's first year of WTO membership, China's efforts were most problematic in the areas of agriculture, services, enforcement of intellectual property rights and transparency. Although we have seen progress in some of these areas in 2003 as a result of high-level engagement, they still remain areas of serious concern.

At the same time, other areas of concern have developed, such as China's questionable use of certain tax policies to favor domestic production. This year has also seen an increasing use of industrial policies to encourage domestic industries at the expense of imports from abroad or foreign businesses operating in China. This latter phenomenon is particularly apparent in the automotive sector, where a proposed industrial policy threatens to undercut many U.S. industry gains in China's market. In addition, there are a number of important commitments that will face implementation deadlines in 2004, with those involving trading rights and distribution services being the most critical. It will require vigilance by the United States and other WTO members to ensure China fulfills these commitments.

As the slowdown in China's WTO implementation efforts became evident in 2003, the Administration stepped up its efforts to engage senior Chinese leaders. Over the course of the past year, President Bush emphasized the importance of China's WTO obligations in meetings with his counterpart, Hu Jintao, and with China's Premier, Wen Jiabao. United States Trade Representative Zoellick made two separate visits to China for talks on WTO implementation matters with Premier Wen and with Vice Premier Wu Yi. He also raised U.S. concerns throughout the year with his Ministry of Commerce (MOFCOM) counterpart, including most recently at the October 2003 APEC meetings in Thailand. The Secretaries of Commerce and Treasury made their own trips to China, again carrying the message that China's WTO implementation was a matter of the highest priority. Sub-cabinet officials from various U.S. economic and trade agencies also met with their Chinese counterparts in China, Washington and Geneva to work through areas of concern, including WTO implementation issues, on numerous other occasions.

In 2003, the Administration also utilized the newly established sub-cabinet dialogue on WTO compliance and other trade matters (the Trade Dialogue), which brings together U.S. economic and trade agencies and various Chinese ministries and agencies with a role in China's WTO implementation. Trade Dialogue meetings were convened twice in 2003, once in February, led by then Deputy United States Trade Representative Huntsman, and later in November, led by Deputy United States Trade Representative Shiner. The Trade Dialogue meetings have proven to be effective in communicating specific trade concerns and in serving as an early warning mechanism for emerging trade disputes.

This year's report details China's WTO compliance efforts regarding the entire range of accession commitments made by China. A summary of the areas of the most concern to the United States follows.

Agriculture

China's potential as a market for U.S. agricultural exports was a key factor in U.S. support for China's WTO accession and the grant of permanent normal trade relations status to China. While China's attempts to restrict certain agricultural imports have been an ongoing theme of the first two years of China's WTO membership, high-level interventions by Administration officials have been able to contain much of the commercial impact of these barriers, particularly in 2003. Indeed, from January through September 2003, U.S. exports of soybeans climbed above $1.2 billion – a record – and cotton exports, at $337 million, were 478 percent greater than during the same period in 2002. Many other agricultural products also fared well, as U.S. exports to China totaled $2.9 billion from January through September 2003, representing a 102 percent increase over the same period in 2002.

Again, however, increased sales alone are not indicative of full WTO implementation. China committed to make systemic changes designed to create fairness, predictability and transparency in agricultural trade.

In 2003, China's actual and threatened use of unreasonable rules on biotechnology, most notably in the case of soybeans, and questionable sanitary and phytosanitary (SPS) measures have continued to frustrate efforts of U.S. agricultural traders to develop a consistent market for their exports to China. While many affected U.S. exports increased this year, in part because of high-level interventions by Administration officials, systemic problems with the biotechnology rules and China's SPS administration continue to cloud market access. These and other emerging concerns, such as China's apparent use of subsidies to promote certain agricultural exports, will require continued engagement by the Administration in order to prevent trade disruptions and ensure that China plays by the rules.

China's administration of TRQs for bulk agricultural commodities is another area that has caused serious concern. Since China's WTO accession, the setting of sub-quotas, use of Catch-22 import licensing procedures, allocation of TRQs in commercially unviable quantities and lack of transparency in TRQ allocation and management have combined to limit what should be an expanding market for U.S. exporters, particularly in the case of cotton. In June 2003, however, China agreed to address the United States' most pressing systemic concerns with China's TRQ system. Although the results of this settlement will not be clear until shipments begin to flow in early 2004, China has since taken steps to eliminate separate allocations for general trade and processing trade, eliminate certain unnecessary licensing requirements, and create a new mechanism for identifying allocation recipients. Due to these developments, the United States decided not to initiate WTO dispute resolution on this issue in 2003.

Intellectual Property Rights

In the year leading up to its WTO accession, China did make significant improvements to its framework of laws and regulations covering intellectual property rights. However, the lack of effective IPR enforcement in China is a major obstacle toward a meaningful system of IPR protection. IPR problems are pervasive, covering the widespread production, distribution and end-use of counterfeit and pirated products, brands and technologies. Violations include the rampant piracy of film, music, publishing and software products, infringement of pharmaceutical, chemical, information technology and other patents, and counterfeiting of consumer goods, electrical equipment, automotive parts and industrial products. IPR infringements not only have an economic toll, but also present a direct challenge to China's ability to regulate products that could have health and safety implications for China's population and international consumers. While a domestic Chinese business constituency is increasingly active in promoting IPR enforcement, piracy and counterfeiting remain pervasive. If significant improvements are to be achieved on this front, China will have to close legal and enforcement loopholes and devote considerable resources, political will and high-level attention to this problem.

The United States has had an ongoing dialogue with China on IPR matters for a number of years. In the Administration's view, keys to achieving effective IPR enforcement will be for China to lower thresholds for criminal prosecution, increase criminal penalties for IPR violators to deterrent levels, demonstrate a willingness to increase prosecution and punishment of IPR offenders, increase resources and devote more training for enforcement throughout China, and establish more effective communication procedures among relevant officials of China's courts and investigative units, the Supreme People's Procuratorate and China's lawmaking bodies.

In recent months, the Chinese leadership has signaled a new resolve to address IPR enforcement issues. In October 2003, Vice Premier Wu was appointed to head a Leading Group on IPR issues, which should help to reduce bureaucratic resistance and confusion on IPR enforcement among the numerous Chinese government entities with responsibilities in this area. In remarks following her appointment, she acknowledged China's IPR enforcement problem and explained that China was paying increasing attention to IPR enforcement, not just to implement its WTO commitments but also to attract more foreign investment as it opened up its market and to accelerate China's economic and social progress. She pledged that China would intensify its IPR enforcement efforts and penalize those who commit IPR infringement.

Services

Concerns continued to arise in many service sectors, principally due to transparency problems and China's use of capitalization and other requirements that exceed international norms. The United States and China have cooperated to resolve some of these concerns, but progress has been slow and uneven. Following bilateral discussions, China did begin to take steps to substantially reduce capitalization requirements in the insurance sector. In some cases, such as express delivery services, much progress was made toward resolving regulatory concerns in 2002, but problematic measures have re-surfaced in 2003 and remain under consideration. In other cases, such as China's implementation of its commitments on branching by insurance companies, the United States and China remain at odds despite a longstanding cooperative and otherwise productive dialogue with China's regulators.

Value-Added Tax Policies

China uses value-added tax (VAT) policies to encourage domestic production in a number of industrial and agricultural sectors. In the case of semiconductors, China's policy of providing VAT rebates to domestic semiconductor producers disadvantages U.S. exports and raises serious

WTO concerns. In the case of fertilizer, China exempts from the VAT fertilizer that is primarily produced domestically and that competes directly with the principal U.S. fertilizer export, another practice that raises serious WTO concerns. The Administration will continue to press China on these issues and will take further appropriate actions seeking elimination of China's differential tax treatment, including dispute resolution at the WTO, if necessary.

Transparency

An area of cross-cutting concern continues to be transparency. While some Chinese ministries and agencies have taken steps to improve opportunities for public comment on draft laws and regulations, and to provide appropriate WTO enquiry points, China's overall effort is plagued by uncertainty and a lack of uniformity. Some of China's ministries and agencies seek selective comment on proposed regulations and implementing rules from domestic Chinese interests, while excluding participation from foreign businesses active in the China market. The Administration is committed to seeking improvements in this area.

Trading Rights and Distribution Services

Ensuring the unrestricted rights of all Chinese and foreign businesses to engage in importing and exporting was a key WTO accession commitment obtained by the United States and other WTO members, as was China's commitment to fully liberalize the distribution services sector. To date, however, China has fallen behind in its implementation of these commitments, which are required to be phased in over the first three years of China's WTO membership. Foreign businesses, in particular, continue to be beset by a variety of restrictions, which are undercutting market access for the entire range of U.S. businesses active in the China market. With full liberalization in these important areas required by December 11, 2004, Administration officials are actively engaged with their Chinese counterparts in an effort to obtain China's full compliance.

Conclusion

As this year's Report reveals, while the U.S.-China economic and trade relationship is growing rapidly, there are a number of systemic concerns that remain, making further improvements in that relationship problematic. The Administration remains committed to resolving the United States' concerns through all available means. The Administration's preference is to resolve those concerns through bilateral consultations in a timely and effective manner. If bilateral efforts are not successful, however, the Administration is fully prepared to enforce U.S. rights through other means, including dispute resolution at the WTO.

BACKGROUND

China's WTO Accession Negotiations

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

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

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

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

Overview of China's WTO Commitments

In order to accede to the WTO, China had to agree to take concrete steps to remove trade barriers and open its markets to foreign companies and their exports from the first day of accession in virtually every product sector and for a wide range of services. Supporting these steps, China also agreed to undertake important changes to its legal framework, designed to add transparency and predictability to business dealings.

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

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

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

STATUS OF CHINA'S WTO COMPLIANCE EFFORTS

Trading Rights and Distribution Services

Trading Rights

Within the context of China's WTO commitments, the concept of "trading rights" includes two elements, i.e., the right to import goods (into China) and the right to export goods (from China). It does not include the right to sell goods within China, as that right is governed by separate commitments principally relating to "distribution services" set forth in China's Services Schedule (see the Distribution Services section below). In the business world, of course, trading rights and distribution services are fundamentally interrelated, and often an enterprise will need both of them to carry out its business plan.

China's commitments on trading rights and distribution services are critically important. They offer the potential to enormously expand the scope of business opportunities available to a wide range of U.S. and other foreign industries doing business, or seeking to do business, in China. When these commitments are fully phased in, existing restrictions on companies already invested in China should be removed, and U.S. companies and individuals should be fully able to import and sell goods in China or export goods from China.

In the trading rights area, until shortly before its WTO accession, China severely restricted the number and types of enterprises that could import or export, and it also restricted the products that a particular enterprise could import or export. For the most part, China confined trading rights to certain state-owned trading and manufacturing enterprises, which could import or export goods falling within their approved scopes of business. China also granted limited trading rights to foreign-invested enterprises, which could import inputs for their production purposes and export their finished products.

Members of the WTO working party on China's accession recognized that China's restrictions conflicted with Article XI of the GATT 1994. Working party members also recognized that these restrictions were inconsistent with GATT Article III's prohibition on discriminatory treatment of imported goods versus domestic goods.

In its accession agreement, China committed to substantial liberalization in the area of trading rights. Specifically, China committed to eliminate its system of examination and approval of trading rights and make full trading rights automatically available for all Chinese enterprises, Chinese-foreign joint ventures, wholly foreign-owned enterprises and foreign individuals, including sole proprietorships, within three years of its accession, or by December 11, 2004, which is the same deadline for China to eliminate most restrictions in the area of distribution services. As China confirmed, trading rights will be granted in a non-discriminatory and non-discretionary way, and any requirements for obtaining trading rights will be for customs and fiscal purposes only and will not constitute a barrier to trade.

Prior to the adoption of an automatic trading rights system, China committed that it would no longer condition eligibility for trading rights on export performance, trade balancing, foreign exchange balancing or prior experience requirements. This commitment took effect immediately upon China's accession (on December 11, 2001). China further committed to expand the availability of trading rights pursuant to an agreed schedule covering the first three years of its WTO membership. First, China committed that it would make trading rights available to Chinese enterprises immediately upon its accession, subject to certain minimum registered capital requirements, to be gradually decreased during the three-year transition period (ending December 11, 2004). The minimum registered capital was to be set at RMB 5 million ($603,000) on December 11, 2001, and then reduced to RMB 3 million ($362,000) one year later (December 11, 2002) and to RMB 1 million ($120,600) two years later (December 11, 2003) before being eliminated three years later (December 11, 2004). Second, China committed that it would make full trading rights available to joint ventures with minority foreign ownership beginning not later than one year after China's accession (or by December 11, 2002), except with regard to those goods still reserved for state trading under China's accession agreement. Third, China committed that it would make these same trading rights available to joint ventures with majority foreign ownership beginning no later than two years after China's accession (or by December 11, 2003).

To date, it appears that China has fully implemented its trading rights commitments insofar as they relate to Chinese enterprises. With the issuance of the *Circular Concerning the Rules on the Administration of Import and Export Rights* in July 2001, and the issuance of the *Notice on the Rectification of Import and Export Qualification Standards and Verification Procedures* in August 2003, China has kept pace with the required reductions in the minimum registered capital requirement for Chinese enterprises to obtain trading rights. Currently, the minimum registered capital for Chinese manufacturing enterprises is RMB 0.5 million ($60,300), and the minimum registered capital for Chinese trading enterprises is RMB 1 million, except in the central and western regions, where the requirement was RMB 0.5 million.

Meanwhile, it appears that China has fallen behind in implementing its trading rights commitments insofar as they relate to foreign-invested enterprises. China has not made full trading rights available to all joint ventures with minority foreign ownership (as was required by December 11, 2002), nor has China yet even issued provisions allowing for full trading rights to be available to all joint ventures with majority foreign ownership (as is required by December 11, 2003). Instead, China has continued to limit the availability of trading rights by imposing conditions on the eligibility of these enterprises, including requirements related to minimum registered capital, import levels, export levels and prior experience, as a review of China's measures in this area shows.

Since well before China's accession, pursuant to China's *Foreign Trade Law*, foreign-invested manufacturing enterprises have had the right to import inputs for production purposes and the right to export their finished goods, without the need for prior approval. In January 2001, China expanded the import rights of some foreign-invested manufacturing enterprises with the issuance of the *Supplementary Provisions (II) to the Provisional Regulations Governing the Establishment of Investment-type Companies by Foreign Business Investment*. In July 2001, shortly before its accession, China granted limited additional export rights to some foreign-invested manufacturing enterprises with the issuance of the *Circular Concerning the Extension of Import and Export Rights for Foreign-Funded Enterprises*. Both of these measures, however, conditioned trading rights eligibility on requirements related to minimum registered capital, import levels, export levels and/or prior experience, among others.

China's treatment of foreign-invested enterprises seeking to operate as trading companies is set forth in the January 2003 *Provisional Rules for the Establishment of Chinese-Foreign Equity Joint Venture Foreign Trade Companies*. The new rules permit the formation of foreign-invested trading enterprises (with minority foreign ownership immediately and majority foreign ownership after December 11, 2003), which may import and export all goods (except goods reserved for state trading), but only if certain stringent requirements are met. For example, the foreign investor must have had an average annual amount of trade with China of at least $30 million for the preceding three years (or $20 million if the foreign-invested trading enterprise registers in the central or western regions of China). Similar requirements apply to the Chinese investor. In addition, the foreign-invested trading enterprise must have minimum registered capital of RMB 50 million ($6.03 million) and personnel experienced in conducting international trade.

The United States raised its concerns with China's restrictive treatment of foreign-invested enterprises in bilateral meetings throughout 2003, beginning with the Trade Dialogue meeting held in Beijing in February and including a series of high-level meetings later in the year and a second Trade Dialogue meeting in November. The United States urged China to take immediate steps to bring its regulations into compliance with its trading rights commitments. The United States and several other WTO members also raised these same concerns during the transitional review held by the WTO's Market Access Committee in October 2003.

During these same meetings, the United States pressed China on the importance of issuing, in a timely manner, final laws and regulations creating an automatic trading rights system for all Chinese enterprises, Chinese-foreign joint ventures, wholly foreign-owned enterprises and foreign individuals, including sole proprietorships. These laws and regulations must be implemented by December 11, 2004, and MOFCOM reported that it is in the process of drafting relevant amendments to the *Foreign Trade Law*. The United States also urged China to adhere to its obligation to provide the opportunity for public comment on drafts of these laws and regulations, and China indicated that it would do so well in advance of the December 11, 2004 deadline.

In a positive development, in November 2003, China announced that it had authorized the granting of trading rights to certain U.S. auto companies, one year ahead of the schedule to which it had committed in its accession agreement. These companies will be able to import sizeable quantities of U.S.-produced motor vehicles into China and, as discussed below in the Distribution Services section, establish their own exclusive networks to sell and service those vehicles in China.

Distribution Services

Prior to its WTO accession, China generally did not permit foreign companies to distribute products in China, i.e., to provide wholesaling, commission agents', retailing or franchising services or to provide related services, such as repair and maintenance services. In its accession agreement, China committed to eliminate national treatment and market access restrictions on foreign enterprises providing these services through a local presence within three years of China's accession (or by December 11, 2004), subject to limited product exceptions. In the meantime, China agreed to progressively liberalize its treatment of wholesaling services, commission agents' services and direct retailing services, as described below.

For the most part, China's implementation efforts have been problematic. In particular, China has fallen behind in its implementation of the required progressive liberalization, as foreign businesses continue to be plagued by a variety of restrictions in the areas of wholesaling services, commission agents' services and direct retailing services.

Meanwhile, while China has not yet issued any measures providing for the full liberalization of distribution services required by December 11, 2004, China did recently announce (as discussed in the Trading Rights section above) that, beginning in 2004, it would permit certain U.S. auto companies to establish their own exclusive networks to sell and service U.S.-produced motor vehicles in China. Thus, these companies will benefit from the full liberalization of distribution services one year ahead of schedule.

<u>Wholesaling Services and Commission Agents' Services</u>

China committed that, immediately upon accession, it would permit Chinese -foreign joint ventures and wholly foreign-owned enterprises to distribute goods that they make in China, without any market access or national treatment limitations. Within one year after accession (or by December 11, 2002), China agreed to permit foreign service suppliers to supply wholesaling services and commission agents' services for almost all goods, whether made in China or imported, through joint ventures with minority foreign ownership. Excepted goods include salt, tobacco, chemical fertilizers, processed oil and crude oil as well as books, newspapers, magazines, pharmaceutical products, pesticides and mulching films. Within two years after accession (or by December 11, 2003), China agreed to permit foreign service suppliers to supply wholesaling services and commission agents' services through majority foreign-owned joint ventures, subject to the same exceptions. Within three years after accession (or by December 11, 2004), China agreed to permit foreign service suppliers to supply wholesaling services and commission agents' services through wholly foreign-owned enterprises. In addition, by this time, the exceptions for books, newspapers, magazines, pharmaceutical products, pesticides and mulching films are to be eliminated. The exceptions for chemical fertilizers, processed oil and crude oil (but not salt and tobacco) are to be eliminated within five years after accession (or by December 11, 2006).

China appears to have implemented its commitments regarding wholesaling services and commission agents' services provided by foreign-invested enterprises with respect to goods that they manufacture in China. Joint ventures have had the right to supply wholesaling (and retailing) services for the goods they manufacture in China since the issuance of the *Regulations for the Implementation of the Law on Chinese-Foreign Equity Joint Ventures* in December 1987. Similarly, wholly foreign-owned enterprises have this same right under the *Detailed Rules for the Implementation of the Law on Wholly Foreign-Owned Enterprises*, issued in April 2001.

However, China has fallen behind in implementing its commitments regarding wholesaling services and commission agents' services insofar as they relate to foreign-invested enterprises seeking to distribute goods made by other enterprises in China or imported goods. China was required to begin phasing in these commitments for joint ventures with minority foreign ownership on December 11, 2002. To date, however, China has only opened up wholesaling services and commission agents' services to joint ventures with minority foreign ownership that can satisfy a number of stringent qualification requirements and other restrictions.

One relevant measure, issued in June 1999, is the *Procedures for Pilot Projects for Commercial Enterprises with Foreign Investment*. Under this measure, China permits joint ventures with minority foreign ownership to apply for authority to engage in wholesaling services for domestic merchandise and merchandise imported for its own account in certain pilot areas (provincial capitals, certain municipalities and special economic zones), subject to certain product exceptions and stringent requirements. The foreign investor must have a minimum average annual merchandise wholesale volume of $2.5 billion during the preceding three years, along with minimum assets of $300 million during the preceding year. It must also be relatively strong economically, have advanced commercial experience and have an extensive international sales network. The Chinese investor must have minimum assets of RMB 50 million ($6.03 million) during the preceding year, or RMB 30 million ($3.62 million) if located in central or western China. In addition, if the Chinese investor is engaged in the wholesaling or retailing business, it must have minimum average annual sales volume of RMB 300 million ($36.2 million)during the preceding three years, or RMB 200 million ($24.1 million) if located in central or western China. If the Chinese investor is a trading enterprise, it must have minimum average annual volume of imports and exports for its own account of $50 million during the preceding three years, with exports accounting for at least $30 million. The Chinese investor must also be relatively strong economically and have relatively strong business capabilities, and it must submit a feasibility study. The joint venture, meanwhile, must have minimum registered capital of RMB 80 million ($9.64 million), or RMB 60 million ($7.23 million) in central or western China. The joint venture must also comply with the commercial development plans of the city in which it is located.

In January 2003, China issued the *Notice on Strengthening the Planning Work for Urban Commercial Networks*. That notice reiterates the June 1999 measure's requirement that wholesaling joint ventures comply with the commercial development plans of the cities in which they are located, and it provides that cities that have not yet formulated urban commercial network plans must complete their work by December 2004 and in the interim cannot submit wholesaling joint venture applications for approval.

One other measure, the January 2003 *Provisional Rules for the Establishment of Chinese-Foreign Equity Joint Venture Foreign Trade Companies* (discussed above in the Trading Rights section), extended the right to engage in wholesaling services to certain foreign-invested trading enterprises. Specifically, joint ventures that qualify for trading rights under this measure's stringent requirements regarding trade volumes, registered capital and prior experience may engage in wholesaling services for the goods that they import.

In 2003, the United States pressed its concerns with China's wholesale regulations at the Trade Dialogue meetings held in Beijing in February and November as well as in several other bilateral meetings during the course of the year. The United States urged China to take immediate steps to bring its regulations into compliance with its commitments. The United States raised these same concerns during the transitional review held by the WTO's Council for Trade in Services in December 2003, and it also urged China to allow ample time for public comment on draft regulations on the important wholesale commitments scheduled to be phased in on December 11, 2004.

Retailing Services

In addition to committing to permit Chinese-foreign joint ventures and wholly foreign-owned enterprises to distribute goods that they make in China without any market access or national treatment limitations, effective immediately upon China's WTO accession, China agreed to permit foreign service suppliers to supply retailing services for almost all goods, whether made in China or imported, through joint ventures with minority foreign ownership, subject to geographic restrictions (allowing China to limit market access to five Special Economic Zones and eight cities) and quantitative restrictions (allowing China to limit the number of joint ventures that can operate in six of the eight cities). Excepted goods include tobacco, chemical fertilizers and processed oil, pharmaceutical products, pesticides and mulching films, and books, newspapers and magazines. The exceptions for the retailing of books, newspapers and magazines were to have been removed within one year after accession (or by December 11, 2002). Within two years after accession (or by December 11, 2003), China agreed to permit foreign service suppliers to supply retailing services through majority foreign-owned joint ventures, subject to the product exceptions set forth above. China also reserved the right to continue to impose the geographic and quantitative restrictions set forth above, although the geographic restrictions are to be eased (with market access being extended to all provincial capitals and two other cities). Within three years after accession (or by December 11, 2004), China agreed to permit foreign service suppliers to supply retailing services through wholly foreign-owned enterprises. In addition, by this time, all geographic and quantitative restrictions are to be eliminated, and the exceptions for pharmaceutical products, pesticides, mulching films and processed oil are also to be eliminated. The exceptions for chemical fertilizers (but not tobacco) are to be eliminated within five years after accession (or by December 11, 2006).

As in the wholesale area, China appears to have implemented its commitment to permit foreign-invested enterprises to supply retailing services for their own goods manufactured in China, which became effective upon China's accession. Joint ventures have had the right to supply retailing services for the goods they manufacture in China since the issuance of the *Regulations for the Implementation of the Law on Chinese-Foreign Equity Joint Ventures* in December 1987. Similarly, wholly foreign-owned enterprises have this same right under the *Detailed Rules for the Implementation of the Law on Wholly Foreign-Owned Enterprises*, issued in April 2001.

However, China has not fully implemented its retailing services commitments insofar as they relate to joint ventures that do not manufacture their own goods in China. China was required to begin phasing in these commitments for joint ventures with minority foreign ownership upon its accession, subject to geographic restrictions, quantitative restrictions and exceptions for a handful of listed goods. To date, as discussed below, although China has authorized retailing services to be supplied through joint ventures with minority foreign ownership, it greatly restricts the supply of these services. For example, onerous threshold requirements (relating to minimum wholesale volume, minimum imports and exports, minimum assets, minimum registered capital and prior experience) significantly reduce the number of enterprises that can qualify for the right to supply retailing services. These requirements are burdensome and trade-restrictive. In addition, China subjects joint ventures to cities' commercial development plans.

The first relevant measure is the June 1999 *Procedures for Pilot Projects for Commercial Enterprises with Foreign Investment*, discussed above under Wholesaling Services and Commission Agents' Services. This measure permits joint ventures to apply for authority to engage in retailing services, including sales on an agency basis and sales on a commission basis, along with relevant ancillary services, in the same pilot areas, subject to certain product exceptions and stringent requirements. The extent of foreign ownership permitted in these joint ventures depends on the nature of the retailing operations, while the requirements for the foreign investor, the Chinese investor and the joint venture are very similar to those that apply in the wholesale context. The foreign investor must have a minimum average annual merchandise sales volume of $2 billion during the preceding three years, along with minimum assets of $200 million during the preceding year. It also must be relatively strong economically, have advanced commercial experience and have an extensive international sales network. The requirements for the Chinese investor are identical to the ones applicable in the wholesale area. The joint venture, meanwhile, must have minimum registered capital of RMB 50 million ($6.03 million), or RMB 30 million ($3.62 million) in central or western China. As in the wholesaling services context, the joint venture must also comply with the commercial development plans of the city in which it is located. Meanwhile, majority foreign ownership of up to 65 percent is permitted for joint ventures that establish not more than three branch stores or that operate convenience stores, specialty stores or exclusive stores as a chain. For joint ventures that operate more than three chain stores, the foreign investor is only entitled to minority ownership, except that foreign majority ownership may be permitted if the foreign investor has purchased large amounts of goods from China, the joint venture's business situation is relatively good, and the joint venture is able to use the foreign investor's international marketing network to expand the export of products from China. Finally, under this measure, a retail joint venture may not engage in the importing and exporting business, although it can import and export merchandise dealt in by itself.

The *Notice on Strengthening the Planning Work for Urban Commercial Networks*, discussed above under Wholesaling Services and Commission Agents' Services, applies to retail joint ventures just as it does to wholesale joint ventures. It reiterates the requirement in the June 1999 *Procedures for Pilot Projects for Commercial Enterprises with Foreign Investment* that retail joint ventures comply with the commercial development plans of the cities in which they are located, and it provides that cities that have not yet formulated urban commercial network plans must complete their work by December 2004 and in the interim cannot submit retail joint venture applications for approval.

The United States raised its concerns with China's retail regulations at the Trade Dialogue meetings held in Beijing in February and November 2003 as well as in several other bilateral meetings during the course of the year, urging China to take immediate steps to bring its regulations into compliance with its commitments. The United States raised these same concerns during the transitional review held by the Council for Trade in Services in December 2003 and also urged China to allow ample time for public comment on draft regulations implementing the important retail commitments scheduled to be phased in on December 11, 2004.

Import Regulation

Tariffs

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

China timely implemented the tariff reductions that it was required to make on January 1, 2003. These tariff changes further increased market access for U.S. exporters in a range of industries, as China continued the process of reducing tariffs on goods of greatest importance to U.S. industry from a base average of 25 percent (in 1997) to 7 percent over a period of five years, running from January 1, 2002, while it made similar reductions throughout the agricultural sector (see the Agriculture section below). The reductions made on January 1, 2003 involved a range of sectors, including agricultural equipment, construction equipment, paper and paper products, chemicals, steel, medical and scientific equipment, soda ash and cosmetics, and contributed to a significant increase in U.S. exports, which rose approximately 19 percent from January through September 2003, when compared to the same time period in 2002.

In one of its more significant tariff initiatives, China continued its participation in the Information Technology Agreement (ITA), which requires the elimination of tariffs on computers, semiconductors and other information technology products. China began reducing and eliminating these tariffs in 2002 and continued to do so in 2003, on schedule with its commitment to achieve the elimination of all ITA tariffs by January 1, 2005. U.S. exports of ITA goods from January through September 2003 continued at the pace of a year ago and were projected to exceed $4.1 billion by the end of the year.

This year, the United States, with the support of other WTO members, was able to resolve one notable problem involving China's treatment of 15 ITA product categories, covering certain semiconductor and telecommunications equipment inputs. When China implemented its 2002 ITA tariff changes, it conditioned the reduced or zero tariffs for these tariff lines on the importer's completion of an end-use certificate, to be approved by the Ministry of Information Industry (MII), guaranteeing that the products being imported would be used as inputs into the production of finished information technology (IT) products in China. The use of this condition was not authorized by the Goods Schedule negotiated as part of China's accession to the WTO, and the WTO Committee of Participants in the Expansion of Trade in Information Technology Products (ITA Committee) had rejected this type of condition whenever a WTO member sought to pursue it. Throughout 2002, the United States addressed this issue bilaterally with China's trade ministry (then known as the Ministry of Foreign Trade and Economic Cooperation, or MOFTEC, and re-named the Ministry of Commerce, or MOFCOM, following a government restructuring in mid-2003) as well as with MII, the Ministry of Finance and the General Administration of Customs (Customs Administration). In addition, at the WTO, the United States blocked China's membership in the ITA Committee until this issue could be resolved. When China made its 2003 tariff changes on January 1, 2003, it addressed this issue by transferring the certification requirement from MII to the Customs Administration. This change so far seems to have established a more workable system, and the United States has removed its block on China's ITA Committee membership. China joined the ITA Committee at the April 2003 meeting.

China also continued its timely implementation of another significant tariff initiative, which involves chemicals. China continued to make the required tariff reductions on more than two-thirds of the 1,100-plus products covered by the WTO's Chemical Tariff Harmonization Agreement in 2003, with significant results. U.S. chemical exports had increased nearly 102 percent from January through September 2003 and were projected to exceed $1 billion by the end of the year.

A number of other industrial products benefitting from reduced tariffs showed strong growth in 2003. For example, U.S. exports of iron and steel increased by 128 percent in the first nine months of 2003 and were projected to reach nearly $1.1 billion by the end of the year. U.S. medical and optical equipment exports, meanwhile, increased by 32 percent from January through September 2003, with a projected year-end total of more than $1.5 billion.

Customs and Trade Administration

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

Customs Valuation

The WTO Agreement on the Implementation of GATT Article VII (also known as the Agreement on Customs Valuation) is designed to ensure that determinations of the customs value for the application of duty rates to imported goods are conducted in a neutral and uniform manner, precluding the use of arbitrary or fictitious customs values. Adherence to the Agreement on Customs Valuation is important for U.S. exporters, particularly to ensure that market access opportunities provided through tariff reductions are not negated by unwarranted and unreasonable "uplifts" in the customs value of goods to which tariffs are applied. China agreed to implement its obligations under the Agreement on Customs Valuation upon accession, without any transition period. In addition, China's accession agreement reinforces China's obligation not to use minimum or reference prices as a means for determining customs value. It also calls on China to implement the Decision on Valuation of Carrier Media Bearing Software for Data Processing Equipment and the Decision on Treatment of Interest Charges in Customs Value of Imported Goods by December 11, 2003.

On January 1, 2002, shortly after acceding to the WTO, China's Customs Administration issued the *Measures for Examining and Determining Customs Valuation of Imported Goods.* These regulations addressed the inconsistencies that had existed between China's customs valuation methodologies and the Agreement on Customs Valuation. In 2002, China did not uniformly implement these regulations, as U.S. companies reported that they were still encountering valuation problems at many ports. These problems persisted in 2003. For example, even though the 2002 regulations provide that imported goods normally should be valued on the basis of their transaction price, meaning the price the importer actually paid, many Chinese customs officials are still improperly using "reference pricing," which usually results in a higher dutiable value. In addition, some of China's customs officials are reportedly not applying the provision in the 2002 regulations on conditions of sale as it relates to software. Following their pre-WTO accession practice, these officials are still automatically adding royalty and software fees to the dutiable value (for example, when an imported personal computer includes pre-installed software), even though China's new regulations direct them to add those fees only if they are paid to the exporter as a condition of the particular sale in question.

The United States presented its concerns about the continuing customs valuation problems being encountered by foreign companies during a meeting of the WTO Committee on Customs Valuation in May 2003. At this meeting, China indicated that it was continuing to work to establish more uniformity in its adherence to WTO customs valuation rules. The United States also sought to address these issues in part by conducting technical assistance programs for Chinese government officials on WTO compliance in the customs area.

The Customs Administration subsequently issued the *Rules on the Determination of Customs Value of Royalties and License Fees Related to Imported Goods*, effective July 1, 2003. These rules were intended to clarify provisions of the January 2002 regulations that address the valuation of royalties and license fees, including with regard to the condition-of-sale requirement. It is not yet clear whether these rules will lead to more uniform, WTO-consistent implementation by China's customs officials in this area.

Meanwhile, as the end of China's second year of WTO membership was approaching, another concern became more immediate. According to reports from U.S. exporters, China continues to value digital products based on the imputed value of the content, which includes, for example, the data recorded on a floppy disk or CD-ROM. China committed to discontinue that valuation method by December 11, 2003 and instead implement the Decision on Valuation of Carrier Media Bearing Software for Data Processing Equipment. That decision makes clear that duties are to be assessed on the basis of the value of the underlying carrier medium, meaning, for example, the floppy disk or CD-ROM itself. The United States and other WTO members have been concerned that China has not yet issued any regulations to implement the Decision on Valuation of Carrier Media Bearing Software for Data Processing Equipment and, during the October 2003 transitional review before the Committee on Customs Valuation, urged China to act quickly. China indicated that it was in the process of drafting regulations and that it would implement this commitment in a timely manner. The United States will continue to monitor developments in this area closely.

<u>Rules of Origin</u>

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

In March 2001, the State Administration of Quality Supervision and Inspection and Quarantine (AQSIQ) issued regulations and implementing rules intended to bring the rules of origin used by China to check marking requirements into compliance with the Agreement on Rules of Origin.

China has not yet issued the more important regulations that will bring China's rules of origin into conformity with WTO rules for import and export purposes. The Customs Administration has been drafting these regulations, and it will reportedly issue them by the end of the year.

Import Licensing

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

Shortly after China acceded to the WTO, MOFTEC issued regulations revising China's automatic import licensing regime, and it later supplemented these regulations with implementing rules. MOFTEC also issued regulations revising China's non-automatic licensing regime.

The United States has raised various concerns with MOFTEC (and beginning in mid-2003 MOFCOM) regarding the regulations on automatic and non-automatic licensing (including concerns related to the administration of quota and tariff-rate quota systems, SPS measures and inspection-related requirements, discussed below in the sections on Non-tariff Measures, Tariff-rate Quotas on Industrial Goods, Tariff-rate Quotas on Bulk Agricultural Commodities, Sanitary and Phytosanitary Issues and Inspection-Related Requirements). Together with other WTO members, the United States has also presented detailed comments on various aspects of these regulations at meetings of the WTO's Import Licensing Committee, including the transitional reviews held in 2002 and 2003. Where necessary, the United States will continue to urge China to revise the regulations to add clarity and to ensure that the licensing procedures do not have trade-distorting or restrictive effects.

Non-tariff Measures

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

From the outset, China's quota system was beset with problems. The State Council was late in issuing necessary regulations, and the authorities charged with implementing this system – MOFTEC for some products and the State Economic and Trade Commission (SETC) for others – were late in allocating quotas. In the case of autos, for example, MOFTEC did not begin to allocate quotas until late April 2002. Then, because of a lack of transparency, it was difficult to assess whether the quotas were allocated in accordance with the agreed rules. It appeared that MOFTEC was creating false fill rates by filling the quota for autos with auto parts (other than the key auto parts allowed by China's accession agreement). By the end of 2002, MOFTEC had also not yet fully allocated the auto quotas, although part of this delay was due to MOFTEC's crackdown on the illegal secondary market for auto import licenses.

At various times throughout 2002, the United States met bilaterally with China and raised its concerns with the regulations, the slow pace of implementation, the lack of transparency and inappropriate allocations. The United States also raised these issues, in coordination with other concerned WTO members, including the EC and Japan, during appropriate WTO meetings.

In 2003, the problems encountered with the auto quota system in 2002 continued, and MOFTEC was again late in issuing quota allocations, which resulted in uncertainty and significant disruption of wholesale and retail operations for imported autos. Given the persistence of these problems, it appears that China's poor implementation of its auto quota commitments is not due simply to difficulties in implementing a new quota system.

The United States raised its serious concerns with China's continuing implementation problems in bilateral meetings, including the Trade Dialogues held in Beijing in February and November 2003. Together with other WTO members, including the EC and Japan, the United States also addressed these problems during the transitional review before the Market Access Committee, held in October 2003.

In November 2003, with the final year of quotas (2004) approaching, China announced that ceratin U.S. auto companies would be authorized to import sizeable quantities of U.S.-produced autos in 2004 without having to use Chinese enterprises holding quotas. This development effectively ends the auto quota system for these companies as of the end of 2003, one year ahead of schedule.

On another positive note, China lifted its quotas for crane lorries and chassis and for motorcycles on January 1, 2003, one year ahead of the schedule established in its accession agreement.

Tariff-rate Quotas on Industrial Products

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

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

Despite these commitments, SETC was late in issuing both draft and final regulations, and SETC did not begin to allocate the first quotas until near the end of April 2002, nearly four months late. The quota allocations themselves also created a new set of problems, particularly a lack of transparency, which made it difficult to assess whether the quota allocations followed the rules set out in China's goods schedule, and U.S. companies complained of administrative guidance discouraging some TRQ holders from freely utilizing their quotas. Throughout 2002, the United States repeatedly engaged China, at all levels of government, but did not achieve any significant progress. In July 2002, the United States requested formal consultations with China under the headnotes in China's goods schedule. During the ensuing consultations, which took place in September 2002 in Geneva, China was forthcoming in its responses and provided the United States with a better understanding of the challenges facing it, but the United States and China were unable to agree on concrete steps to remedy the situation.

In 2003, as the United States continued to engage China, SETC issued the quota allocations on time and apparently in the correct amount, representing a substantial improvement over 2002. However, U.S. companies continued to complain about administrative guidance discouraging TRQ holders from freely utilizing their quotas. According to reports from these companies, administrative guidance may have been used to limit imports of the principal U.S. fertilizer product, diammonium phosphate (DAP), to 3.5 million metric tons despite SETC's issuance of quota allocations for 5.95 million metric tons. From January through September 2003, U.S. fertilizer exports were down by 47 percent, totaling $274 million as compared to $520 million during the same period in 2002. In September 2003, however, a group of U.S. companies entered into a contract with a state trading enterprise to sell approximately $735 million of DAP in China between September 2003 and December 2005.

Thus, while the September 2003 DAP contract was encouraging, the systemic problems encountered in 2002 did not go away in 2003. The United States and U.S. industry remain concerned as a new TRQ year approaches in 2004. Not only is SETC (which was merged into MOFCOM as part of the mid-2003 government restructuring) still operating with insufficient transparency, but also administrative guidance may be affecting how allocated quota is used. The United States will continue to monitor developments closely in 2004 and work to ensure that China fully complies with its commitments and administers its TRQ system in a transparent and fair manner.

Other Import Regulation

Antidumping

In its accession agreement, China committed to revising its regulations and procedures for antidumping (AD) proceedings, by the time of its accession, in order to make them consistent with the AD Agreement. That agreement sets forth detailed rules prescribing the manner and basis on which a WTO member may take action to offset the injurious dumping of products imported from another WTO member. China also agreed to provide for judicial review of determinations made in its AD investigations and reviews.

As reported in 2002, China made substantial progress in conforming the legal framework of its antidumping regime to the provisions and requirements of the WTO Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (AD Agreement), a trend that China continued over the last year. China has also emerged as a significant user of antidumping measures, completing eleven antidumping investigations in 2003, with seven more in progress. However, China's implementation of its antidumping regime raises several concerns in key areas such as transparency, due process and judicial review. The United States is seeking to clarify and address these concerns both bilaterally and multilaterally.

Shortly before China's accession, the State Council issued new AD regulations, which became effective on January 1, 2002. These regulations replaced the regulations that had governed China's AD regime since its beginning in 1997. In early 2002, MOFTEC, which at that time was charged with making determinations of dumping under the new regulations, issued several sets of rules covering initiation of investigations, questionnaires, sampling, verifications, information disclosure, access to non-confidential information, price undertakings, hearings, interim reviews, refunds and new shipper reviews. SETC, which at that time was charged with making determinations of injury, issued rules covering industry injury investigations and public hearings in January 2003.

In March 2003, a general reorganization of the State Council ministries and commissions consolidated the dumping functions of MOFTEC and the SETC into the newly formed MOFCOM. According to China's statements before the WTO's AD Committee, MOFCOM's Bureau of Fair Trade for Imports and Exports (BOFT) is now charged with making dumping determinations and MOFCOM's Bureau of Industry Injury Investigation (BIII) is now charged with making injury determinations. The State Council Tariff Commission continues to makes the final decision on imposing, revoking or retaining AD duties, based on recommendations provided by the two MOFCOM bureaus, although its authority vis-à-vis MOFCOM is not clearly defined in the new regulations.

While the provisions of China's new regulations generally track those of the AD Agreement, certain omissions and ambiguities remain and have not been adequately clarified in practice. During the transitional review of China's antidumping obligations conducted in October 2003 by the WTO's AD Committee, the United States and other WTO members raised concerns focusing on due process, transparency and judicial review in AD determinations. The United States will continue to seek clarification of these issues through the AD Committee and through bilateral contacts, including technical assistance and information exchanges.

According to U.S. AD experts, the greatest shortcomings to date in China's AD practice relate to transparency. Respondents in Chinese AD actions, from the United States and in some instances other countries, regularly complain about the lack of detailed information made available to parties and the lack of disclosure of the basis for decisions taken by the administering authorities. MOFCOM has made efforts to make non-confidential information submitted during AD proceedings available to interested parties and to the public. While documents regarding the BOFT's dumping investigations are reasonably available on demand, the BIII has apparently never provided to interested parties materials submitted during the course of its injury investigations. Of even greater concern to U.S. AD experts, however, is the highly limited disclosure to interested parties by China's antidumping authorities of the internal analyses and bases for decisions made in each investigation. This dearth of disclosure impairs the ability of U.S. companies and those from other exporting countries to mount an effective defense in Chinese antidumping actions.

With China now having completed antidumping investigations undertaken since its accession to the WTO, the opportunity for parties to seek judicial review has become more important. In August 2002, the Supreme People's Court issued *Rules Regarding Supreme People's Court Hearings on Judicial Review of International Trade Disputes*, which provide guidance concerning judicial review of administrative agency decisions affecting international trade, including those in the AD area. In September of the same year, the Supreme People's Court issued *Provisions of the Supreme People's Court on Certain Issues Concerning the Applicability of Laws in the Hearing and Handling of Antidumping Administrative Cases*. None of these rules have been formally submitted to the

WTO, so there has been no opportunity for effective multilateral review of China's antidumping judicial review procedures. To the United States' knowledge, China's antidumping judicial review rules have never been tested. While eleven of China's antidumping investigations since joining the WTO have reached a final determination, it appears that no parties in those proceedings have sought judicial review.

Countervailing Duties

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

Shortly before China's accession, the State Council issued new CVD regulations, which came into force on January 1, 2002. Later, MOFTEC, which at that time was charged with making determinations of subsidization under China's CVD regime, issued several sets of ministerial rules on initiation of investigations, questionnaires, verifications and hearings. The SETC, which at that time was charged with making determinations of injury in China's CVD proceedings, issued implementing rules covering industry injury investigations and public hearings in January 2003. In March 2003, a general reorganization of the State Council ministries and commissions consolidated the subsidization and injury investigation functions of MOFTEC and SETC into MOFCOM. The Supreme People's Court, meanwhile, issued new rules regarding judicial review in September 2002.

As in the AD area, China continues in its efforts to conform its CVD regulations and procedural rules to the provisions and requirements of the WTO rules. China's regulations and procedural rules generally track those found in the Subsidies Agreement, although there are certain areas where key provisions are omitted or are vaguely worded. During the transitional review conducted in the WTO Subsidies Committee in October 2003, the United States and other WTO members sought to clarify the roles and functions of the various administering authorities in a CVD proceeding, the definition of "subsidy" and "specificity" under China's CVD regulations, how China will determine injury, and China's provisions for ensuring respect for the confidentiality of submissions while providing transparency. The United States will continue to seek needed clarifications through the Subsidies Committee and bilateral contacts.

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

Safeguards

China committed to revising its regulations and procedures for conducting safeguard investigations by the time of its accession, to make them consistent with the WTO Agreement on Safeguards (Safeguards Agreement). That agreement articulates rules and procedures governing WTO members' use of safeguard measures.

Shortly before China's WTO accession, the State Council issued the *Regulations on Safeguards*, which became effective on January 1, 2002. Under these regulations, the former MOFTEC was responsible for determining whether the volume of imports of a given product has increased and (together with the former SETC) whether there is a causal link between any such imports and injury to the domestic industry. MOFTEC issued two sets of provisional procedural rules, one covering initiations and the other hearings. SETC, the agency that was charged with determining injury to the domestic industry issued the *Rules on Investigations and Determinations of Industry Injury for Safeguards* and the *Rules on Public Hearings with regard to Investigations of Injury to Industry* in early 2003. In March 2003, a general reorganization of the State Council ministries and commissions consolidated the safeguard functions of MOFTEC and SETC into the newly formed MOFCOM.

As with the AD and CVD areas, it appears that China has made an effort to establish a WTO-consistent safeguard regime, as the provisions of China's regulations and procedural rules generally track those of the Safeguards Agreement. However, certain omissions and ambiguities remain, and some provisions do not find a counterpart in the Safeguards Agreement and may be inconsistent with it. In the most recent transitional review before the WTO Committee on Safeguards in October 2003, the United States and other WTO members submitted detailed questions seeking clarification of these (and other) issues, including the treatment of confidential information, whether increased tariffs and quotas are the only types of safeguards relief permitted by Chinese law, the responsibility of China's different administering authorities with regard to the application of these different remedies, the application of the injury factors outlined in China's regulations and their consistency and completeness vis-à-vis the analytical requirements of the Safeguards Agreement, and the terms and conditions governing the extension of a safeguard measure. The United States will continue to seek needed clarifications within the Safeguards Committee and in bilateral contacts.

On May 20, 2002, MOFTEC initiated China's only safeguard investigation to date. The investigation addressed imports of certain steel products from various countries, including the United States. U.S. companies export little of the subject merchandise to China, and none of them chose to participate in the investigation. China imposed provisional measures in the form of tariff-rate quotas on nine categories of products the day after initiation, and rendered a final determination approximately six months later, on November 19, 2002. Both provisional and final measures took the form of TRQs. U.S. exporters whose products are subject to the TRQs have complained that China's process for allocating quotas under the measures is unclear, making it difficult for them to determine the quota available and obtain a fair share. In addition, following this investigation, questions and concerns remain regarding other aspects of China's procedures in conducting a safeguard investigation, including how confidential data submitted during the course of an investigation will be protected, especially when outside experts are employed. Another procedural matter of concern, now under discussion, is how the safeguard duties that China collected pursuant to its provisional measures will be refunded for those products for which definitive measures were not imposed.

Export Regulation

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

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

Since its accession to the WTO, China has continued to impose restrictions and fees on exports of a few raw materials and intermediate products not included in Annex 6. In an attempt to justify these restrictions and fees, MOFTEC has invoked an exception in Article XX of GATT 1994 that permits a WTO member to impose restrictive export measures relating to the conservation of exhaustible natural resources, provided that such measures are made effective in conjunction with restrictions on domestic production or consumption, and provided they are not applied in a manner that would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on international trade. Fluorspar is one example of a raw material that is still subject to this type of export regulation. China imposes quotas and license fees on fluorspar exports, apparently with the objective of supporting China's domestic users of fluorspar, which face no comparable restrictions.

In both 2002 and 2003, the United States raised its concerns about continuing export regulation of raw materials and intermediate products bilaterally with China. The United States also worked with other WTO members with an interest in this issue, including Japan, and it raised this issue during the transitional reviews of China's compliance efforts before the Council for Trade in Goods in November 2002 and November 2003. To date, however, China has refused to modify its export regulation practices in this area. The United States will continue to strongly urge China to lift these restrictions in 2004.

Internal Policies Affecting Trade

Non-discrimination

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

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

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

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

With regard to the national treatment rule, China similarly agreed to repeal or revise all inconsistent laws, regulations and other measures. China also specifically acknowledged that its national treatment obligation extended to the price and availability of goods or services supplied by government authorities or state-owned enterprises as well as to the provision of inputs and services necessary for the production, marketing or sale of finished products. Among other things, this latter commitment precludes dual pricing, i.e., the practice of charging foreign or foreign-invested enterprises more for inputs and related services than Chinese enterprises. China also agreed to ensure national treatment in respect of certain specified goods and services, which had traditionally received discriminatory treatment in China, such as boilers and pressure vessels (upon accession), after sales service (upon accession), and pharmaceuticals, chemicals and spirits (one year after accession).

As reported in 2002, China reviewed its pre-WTO accession laws and regulations and revised many of those which conflicted with its WTO MFN and national treatment obligations. Most of these revisions were made to secure national treatment, including with regard to boilers and pressure vessels, after sales service, and the pricing of pharmaceutical products, among other areas. In 2003, China made further revisions covering registration requirements for foreign chemical products and the regulation of spirits.

However, China does not appear to have observed MFN and national treatment requirements in all areas. For example, several U.S. industries reported that China continued to apply the value-added tax (VAT) in a manner that unfairly discriminates between imported and domestic goods, both through official measures and on an *ad hoc* basis, as discussed below in the Taxation section. In addition, it appeared that China applied sanitary and phytosanitary measures in a discriminatory manner in both 2002 and 2003, as discussed below in the Agriculture section.

China's border trade policy continues to generate MFN and other concerns. China provides preferential import duty and VAT treatment to certain products, often from Russia, apparently even when those products are not confined to frontier traffic as envisioned by Article XXIV of GATT 1994. In June 2003, China began to address these concerns when it eliminated preferential treatment for boric acid and approximately 20 other products. However, several other products continue to benefit from preferential treatment.

The United States continued to address the range of MFN and national treatment issues with China in 2003, both bilaterally and in WTO meetings. The United States will continue to pursue these issues in 2004.

Meanwhile, China did undertake a major restructuring of its trade and investment-related ministries in mid-2003, following significant changes in the leadership of China's Communist Party and the national government. One principal component of this restructuring was combining domestic and foreign trade-related functions into one agency (as SETC and parts of SDPC were folded into MOFTEC, which became known as the Ministry of Commerce, or MOFCOM), in part to foster better adherence to the WTO's national treatment principle. In addition, the successor to SDPC, the National Development and Reform Commission, appears to have become much more open to discussing the concerns of foreign businesses, which contrasts sharply with its prior reputation.

Taxation

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

VAT Policies

Ceratin aspects of China's VAT system raises serious national treatment concerns, particularly with regard to the discriminatory rates being applied to imports versus domestically produced fertilizer and semiconductors.

In July 2001, the Ministry of Finance and the State Administration of Taxation issued a circular exempting all phosphate fertilizers except DAP from a 13 percent VAT. DAP, a product that the United States exports to China, competes with similar phosphate fertilizers produced in China, particularly monoammonium phosphate (MAP). The circular also allowed a partial VAT rebate for domestic producers of urea, a nitrogen fertilizer, through the end of 2002. The United States raised this issue bilaterally with China soon after it acceded to the WTO, and in many subsequent bilateral meetings, including the Trade Dialogue meetings held in February and November 2003, among other high-level meetings. The United States also raised this issue at the WTO, both in regular meetings of the Committee on Market Access and during the transitional reviews held in September 2002 and October 2003. So far, however, China has refused to make any changes, although it did allow the special tax treatment for domestic urea to expire at the end of 2002.

China has also attempted to encourage the development of China's domestic integrated circuit (IC) industry through discriminatory VAT policies. In particular, China provides for rebate of a substantial portion of the 17 percent VAT paid by domestic manufacturers on their locally produced ICs. China, meanwhile, charges the full 17 percent VAT on imported ICs, unless they were designed in China. The United States has raised this issue with China in several bilateral meetings, including the two Trade Dialogues held in Beijing in 2003, and at the WTO during the transitional review before the Committee on Market Access in October 2003. In August 2003, in response to the concerns raised by the United States, China reportedly formed an inter-agency group, composed of representatives from MII, the State Taxation Administration, the Customs Administration and MOFCOM, to evaluate the WTO-compatibility of its tax treatment of ICs.

During high-level meetings in Beijing in October 2003 and again during the November 2003 Trade Dialogue, China appeared to have hardened its conviction that its differential tax treatment of both fertilizer and ICs was consistent with its WTO obligations. In 2004, the United States will continue to press China on these issues and will take further appropriate actions seeking elimination of China's differential tax treatment, including WTO dispute resolution, if necessary.

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

Consumption Taxes

National treatment concerns also continue to surround China's consumption tax regulations, which first went into effect in 1993 and apply to a range of consumer products, including spirits and alcoholic beverages, tobacco, cosmetics and skin and hair care preparations, jewelry, fireworks, rubber, motorcycles and automobiles. Under these regulations, China uses different tax bases to compute consumption taxes for domestic and imported products, with the apparent result that the effective consumption tax rate for imported products is substantially higher than for domestic products. Since China's accession, the United States has raised this issue with China, both bilaterally and during the transitional reviews conducted by the WTO Committee on Market Access in September 2002 and October 2003. However, China has so far not revised these regulations. The United States will continue to work for the revision of these regulations in 2004.

Subsidies

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

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

As of the end of 2003, China had still not fulfilled one key requirement of the Subsidies Agreement, which is to notify certain information about its subsidy programs to the WTO (on an annual basis). Timely and informative notifications are vital to satisfying the rights of other WTO members to know and understand the range and operation of a member's subsidy programs and to be assured that the member is not maintaining any prohibited subsidies. Although China submitted a subsidies notification in an annex to its accession agreement, that notification only contained information through 1998 or 1999, and China acknowledged that it was far from comprehensive. China did not provide a notification in 2002, and it has not yet submitted a 2003 notification, which was due on June 30. In the transitional review before the WTO's Subsidies Committee in October 2003, the United States and other WTO members again urged China to submit a full and updated notification as soon as possible.

In 2003, U.S. industry has increasingly complained that subsidized Chinese exports are displacing U.S. products in the U.S. market. U.S. subsidies experts are currently seeking more information about several Chinese programs and policies that may confer prohibited export subsidies or import substitution subsidies. The programs in question benefit various high technology products in the electronics, bio-medicine, and new materials sectors, among others, as well as the integrated circuit industry. The experts also continue to examine subsidies provided by China in special economic areas to determine whether any of them may be contingent upon export performance or the use of domestic over imported goods. In addition, the United States has begun investigating China's subsidization practices in the textiles industry, as well as the steel, petrochemical, machinery and copper and other non-ferrous metals industries. The United States raised these various concerns and sought more information from China at regular meetings and during the October 2003 transitional review before the WTO's Subsidies Committee. The United States will continue to investigate these subsidy practices in 2004 and will raise concerns regarding specific sectors directly with China.

Price Controls

In its accession agreement, China agreed that it would not use price controls to restrict the level of imports of goods or services. In addition, in an annex to the agreement, China listed the limited number of products and services remaining subject to price control or government guidance pricing, and it provided detailed information on the procedures used for establishing prices. China agreed that it would try to reduce the number of products and services on this list and that it would not add any products or services to the list, except in extraordinary circumstances.

China maintains price controls on several products and services covering both state-owned enterprises and private enterprises. These price controls may be in the form of either absolute mandated prices or specific pricing policy guidelines as directed by the government and include items such as natural gas, pharmaceuticals, transportation (including freight transportation), tobacco, and certain other agricultural products. The price controls can be found in the Price Gazette of the People's Republic of China as well as on the website for the National Development and Reform Commission.

The United States will continue to monitor China's progress in eliminating price controls in 2004.

Standards, Technical Regulations and Conformity Assessment Procedures

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

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

In anticipation of its WTO accession, China made significant progress in the areas of standards and technical regulations. China addressed problems that foreign companies had encountered in locating relevant regulations and how they would be implemented, and it took steps to overcome poor coordination among the numerous regulators in China. In October 2001, China announced the creation of the State Administration of China for Standardization (SACS) under AQSIQ. SACS is charged with unifying China's administration of product standards and aligning its standards and technical regulations with international practices and China's commitments under the TBT Agreement. SACS is the Chinese member of the International Organization for Standardization and the International Electro-technical Commission.

China also began to take steps in 2001 to address problems associated with its multiplicity of conformity assessment bodies, whose task it is to determine if standards and technical regulations are being observed. AQSIQ was established as a new ministry-level agency in April 2001. It is the result of a merger of the State Administration for Quality and Technical Supervision and the State Administration for Entry-Exit Inspection and Quarantine. China's officials explained that this merger was designed to eliminate discriminatory treatment of imports and requirements for multiple testing simply because a product was imported rather than domestically produced. China also formed the quasi-independent National Certification and Accreditation Administration, which is attached to AQSIQ and is charged with the task of unifying the country's conformity assessment regime. Despite these changes, however, foreign companies in 2003 still do not have any choice regarding which laboratories they can use to test their products. Foreign products are sent to specially designated laboratories.

In the area of transparency, AQSIQ's TBT inquiry point, established shortly after China acceded to the WTO, has continued to be helpful to U.S. companies as they try to navigate China's system of standards, technical regulations and conformity assessment procedures. In addition, China's designated notification authority, MOFTEC (now called MOFCOM), has been notifying proposed standards, technical regulations and conformity assessment procedures to WTO members, as required by the TBT Agreement. Almost all of these notified TBT measures have emanated from AQSIQ, however, and have not included measures that should be notified from other agencies. In late 2003, in part to address this problem, China reportedly formed a new inter-agency committee, with representatives from approximately 20 ministries and agencies and chaired by AQSIQ, to achieve better coordination on TBT (and SPS) matters.

In 2003, as in 2002, the comment periods established by China for notified TBT measures were unacceptably brief in some cases. In other cases, insufficient time was provided for Chinese regulatory authorities to consider interested parties' comments before a regulation was adopted.

Since issuing regulations in January 2002 to facilitate its adoption of international standards, China has made significant progress, as about one-half of China's nearly 20,000 national standards are reportedly based on international standards. China's goal is to have 70 percent of its national standards based on international standards within 5 years. However, in a number of sectors, including, for example, telecommunications equipment, electrical products, building materials, heating and air conditioning equipment, autos, wireless local area networks, whiskey and fertilizer, concern has grown over the past two years as China is actively pursuing the development of unique requirements, despite the existence of well-established international standards. This course of action will create significant barriers to entry into its markets, as the cost of compliance will be high for foreign companies. At the same time, China will also be placing its own companies at a disadvantage in its export markets, where international standards prevail.

In May 2003, for example, China issued two mandatory standards for encryption over Wireless Local Area Networks (WLANs), applicable to domestic and imported equipment containing

WLAN (also known as Wi-Fi) technologies. These standards, which went into effect in December 2003 without having been notified to the WTO, incorporate the WLAN Authentication and Privacy Infrastructure (WAPI) encryption technique for secure communications. This component of the standards differs significantly from the internationally recognized standard that U.S. companies have adopted for global production, and China is enforcing it by providing the necessary algorithms only to eleven Chinese companies. U.S. and other foreign manufacturers will have to work with and through these companies, some of which are their competitors, and provide them with technical product specifications, if their products are to continue to enter China's market. Working closely with U.S. industry, the United States has repeatedly raised its concerns with China about the WTO compatibility of China's implementation of these standards, including the denial of national treatment to imported products, the use of standards that are more trade-restrictive than necessary to fulfill a legitimate objective, the use of mandatory standards that do not comply with accepted international standards, local content requirements for access to the Chinese market, and the lack of notification of these standards to the WTO. The United States will continue to press China on this issue in 2004.

In October 2003, in order to increase U.S.-China cooperation on standards issues, the United States obtained AQSIQ's support in principle for the establishment of a new U.S. private sector standards office in Beijing. This new office will focus on strengthening ties with Chinese government regulatory authorities, Chinese industry associations and Chinese standards developers and, in particular, on ensuring that close communication exists between U.S. and Chinese standards developers. The United States has also increased its technical assistance to China in the standards area, with programs addressing pharmaceuticals, medical devices, building materials, fertilizer and information and communications technology.

AQSIQ's regulations establishing a new Compulsory Product Certification System, issued in December 2001, took full effect on August 1, 2003, following a transition period that lasted for fifteen months. Under this system, there is now one safety mark, called the "China Compulsory Certification" or "CCC" mark, issued to both Chinese and foreign products. Under the old system, domestic products were only required to obtain the "Great Wall" mark, while imported products needed both the "Great Wall" mark and the "CCIB" mark. U.S. companies report that China is applying the CCC mark requirements inconsistently. Some shipments of imported products that do not require a CCC mark have been denied entry by the Customs Administration, and many domestic products required by AQSIQ's regulations to have the CCC mark are still being sold without the mark. In addition, despite the changes made by these regulations, U.S. companies in some sectors continued to complain in 2003 about continued duplication in certification requirements, particularly for telecommunications products.

In 2003, as in 2002, the United States raised its concerns in the areas of standards, technical regulations and conformity assessment procedures with China bilaterally and during meetings of the WTO's TBT Committee, including the transitional review held in November 2003, where it received support from the EC and Japan. The United States will continue to be in close contact with the relevant Chinese authorities in these areas in 2004 to address our concerns.

Other Internal Policies

State-Owned and State-Invested Enterprises

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

State Trading Enterprises

In its WTO accession agreement, China also agreed to disciplines on the importing and exporting that was still taking place through state trading enterprises. China committed to provide full information on the pricing mechanisms of state trading enterprises and to ensure that their import purchasing procedures are transparent and fully in compliance with WTO rules. China also agreed that state trading enterprises would limit the mark-up on goods that they import in order to avoid trade distortions. The United States and other WTO members requested detailed information from China on the pricing and purchasing practices of state trading enterprises, principally through the transitional reviews before the WTO's Council for Trade in Goods in November 2002 and November 2003. However, China has so far only provided general information, which does not allow a meaningful assessment of China's compliance efforts.

Government Procurement

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

At present, China is not a GPA member. It committed to become an observer to the GPA upon its WTO accession, and in February 2002 it became an observer. It also committed to initiate negotiations for membership in the GPA "as soon as possible," but it has not yet done so. In late 2003, China's Ministry of Finance did, however, establish a working group to study the possibility of initiating negotiations for GPA membership.

In the interim, China agreed that all of its central and local government entities would conduct their procurements in a transparent manner, as reflected in its accession agreement. China also agreed that, if a procurement were opened to foreign suppliers, it would provide MFN treatment by allowing all foreign suppliers an equal opportunity to participate in the bidding process.

In June 2002, China adopted its *Government Procurement Law*, which became effective on January 1, 2003. This law attempts to follow the spirit of the GPA and incorporates provisions from the United Nations Model Law on Procurement of Goods. The law also directs central and sub-central government entities to give priority to "local" goods and services, with limited exceptions, as China is permitted to do, because it is not yet a GPA member. China envisions that this law will improve transparency, reduce corruption and lower government costs, and it is also seen as a necessary step toward reforming China's government procurement system in preparation for China eventually becoming a GPA member.

China has begun the process of drafting regulations implementing the *Government Procurement Law*. In December 2002, the Ministry of Finance (MOF) circulated a draft of the *Measures on the Administration of Bidding of Government-Procured Goods and Services* for public comment. In January 2003, the United States submitted written comments, which focused on promoting transparency and clarifying the scope and coverage of the *Government Procurement Law*. The United States followed up on these comments during bilateral meetings with MOF officials later in the year. MOF has not yet issued the final version of the *Measures on the Administration of Bidding of Government-Procured Goods and Services.*

MOF is also reportedly in the process of drafting several sets of implementing rules, including measures relating to the administration of government software procurement, the administration of bidding for goods and services in government procurement, the administration of government procurement information, the examination of centralized government procurement institutions, the administration of complaints by suppliers and the administration of government procurement experts. According to MOF, it is attempting to finalize these implementing rules by the end of 2003.

U.S. companies have already expressed concern about the implementing rules on government software procurement currently being drafted. These rules reportedly contain guidelines mandating that central and local governments should purchase software products developed in China to the extent possible. In September 2003, the United States organized an industry roundtable to inform the relevant Chinese ministries of the views and concerns of interested U.S. trade associations. U.S. industry officials have pointed out that the creation of a domestic software industry cut off from global standards would lead to inefficiencies and would limit, rather than promote, the development of China's software industry. At the roundtable, Chinese government officials explained that they were considering a definition for "domestic products" that would include products of foreign companies with established roots in China.

In 2004, the United States will continue to urge China to initiate negotiations for GPA membership. It will also monitor the treatment accorded to U.S. suppliers under the *Government Procurement Law* and continue to urge China to develop transparent, non-discriminatory regulations and implementing rules.

Investment

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

Beginning before its accession to the WTO, China revised its laws and regulations on foreign-invested enterprises to eliminate WTO-inconsistent requirements relating to export performance, local content and foreign exchange balancing as well as technology transfer. However, some of the revised laws and regulations continue to "encourage" technology transfer, without formally requiring it. U.S. companies are concerned that this "encouragement" will in practice amount to a "requirement" in many cases, particularly in light of the high degree of discretion provided to Chinese government officials when reviewing investment applications. In addition, according to U.S. companies, some Chinese government officials in 2003 still consider factors such as export performance and local content when deciding whether to approve an investment or to recommend approval of a loan from a Chinese policy bank, which is often essential to the success of an investment project. The United States and other WTO members, including the EC and Japan, raised these concerns during the transitional reviews conducted by the WTO's Committee on Trade-Related Investment Measures in October 2002 and October 2003. The United States will continue to follow this situation closely in 2004.

In a separate commitment, China agreed to revise its Industrial Policy for the Automotive Sector to make it compatible with WTO rules and principles. However, China has not yet revised this policy, and U.S. industry continues to report that some local officials continue to enforce the incompatible provisions of the policy. In mid-year 2003, China began circulating a draft of a new automobile industrial policy for review by select domestic enterprises, and some of these enterprises forwarded the draft to their foreign joint venture partners. It is the United States' understanding that this draft policy, among other things, discourages the importation of auto parts, seeks to restrict imports of complete knocked-down auto kits, and sets targets encouraging the use of domestic technology. China is also reportedly considering a requirement that separate distribution channels be used for domestic and imported autos.

The United States is working closely with U.S. industry and is committed to achieving full implementation of China's commitment to make its automobile industrial policy WTO-compatible. In a series of bilateral meetings with China, including the Trade Dialogue meetings held in Beijing in November 2003, the United States made clear that discriminatory industrial policies, whether for the automotive or other sectors, are not in keeping with China's WTO commitments and create unacceptable distortions in China's economy. In addition, the United States and other WTO members, including the EC and Japan, presented their concerns about the types of provisions being considered by China during the transitional reviews before the Committee on Trade-Related Investment Measures, the Market Access Committee and the Council for Trade in Services, which met in October and December 2003. They also urged China to circulate a draft of the new automobile industrial policy more widely, in accordance with its commitment to provide an opportunity for public comment on new or revised trade-related laws and regulations.

Finally, in 2003, the State Council made no changes to the *Sectoral Guidelines Catalogue for Foreign Investment*. This catalogue, when last issued in March 2002, had reflected China's decision to adhere to its commitment to open up certain sectors to foreign investment, including travel agencies, human resources companies, cinemas, railway cargo and publications distribution (see the Services section below), while it had also signaled the opening-up of a number of other sectors not covered by China's accession agreement. One notable exception to this progress was the area of biotechnology seed development and production, which China changed to the "prohibited" category.

Agriculture

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

In the area of market access, WTO members committed to the establishment of a tariff-only regime, tariff reduction and the binding of all tariffs. As a result of its accession negotiations, China agreed to significant reductions in tariff rates on a wide range of agricultural products. China also agreed to eliminate quotas and implement a system of TRQs designed to provide significant market access for certain bulk commodities upon accession. This TRQ system is very similar to the one governing fertilizers (discussed above in the Import Regulation section).

China's goods schedule sets forth detailed rules intended to limit the discretion of the agriculture TRQ administrator, the State Development and Planning Commission (SDPC), and to require SDPC to operate with transparency and according to precise procedures for accepting quota applications, allocating quotas and reallocating unused quotas.

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

In the area of export subsidies, WTO members committed to ban the use of these subsidies unless they fall within one of four categories of exceptions, the principal one of which allows export subsidies subject to certain reduction commitments. However, like many other WTO members, China agreed to eliminate all export subsidies upon its accession to the WTO and did not take any exceptions.

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

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

China also made several additional commitments that should help to rectify other problematic agricultural policies, either upon accession or after limited transition periods. For example, China agreed to permit non-state trading enterprises to import specified TRQ shares of wheat, corn, cotton and vegetable oil, although these products have been subject to import monopolies by state trading enterprises.

Overall, China's compliance efforts in the agriculture sector continued to produce mixed results in 2003, although progress was achieved in some contentious areas. According to one trade association, there was "welcome progress in some key areas such as tariff reductions. . . . [H]owever, many non-tariff barriers continue to limit the progress anticipated from China's WTO membership."

On the positive side, some U.S. agricultural products experienced dramatic increases in sales to China. Indeed, China has become the United States' fourth largest agricultural export market, as U.S. exports to China totaled $2.9 billion from January through September 2003, representing a 102 percent increase over the same period in 2002. In addition, although the United States had to address one of the most troublesome problems of 2002 – the timing of the requirement for obtaining final safety certificates under China's biotechnology regulations – again in 2003, China agreed to take the necessary steps to avoid possible trade disruptions.

Serious problems were encountered on many fronts, however. The key problems involved China's administration of TRQs on bulk agricultural commodities, the application of sanitary and phytosanitary measures, which seemed to have no scientific basis and impeded market access for many U.S. agricultural products, and inspection requirements. Some progress was made in resolving U.S. concerns in 2003, and U.S. exports of many of the affected products had begun to catch up with industry expectations near the end of the year.

Tariffs

China implemented the required tariff changes on agricultural goods for 2003 on schedule on January 1, 2003, just as it did for industrial goods. These tariff changes further increased market access for many U.S. agricultural exporters, as China continued the scheduled reduction of tariffs rates on agricultural goods of greatest importance to U.S. farmers and ranchers from a 1997 average of 31 percent to 14 percent, in almost all cases over a period of five years running from January 1, 2002.

China continued to implement the dramatic tariff reductions negotiated with regard to many beef products. By January 1, 2004, the tariffs on beef cuts are scheduled to be reduced from 45 percent to 12 percent, and the tariffs on beef carcasses will drop from 45 percent to 20-25 percent. Tariffs on dairy products are also being reduced substantially by January 1, 2004. Butter tariffs are falling from 50 percent to 10 percent, tariffs on milk and cream products are falling from 25 percent to 10-15 percent, and tariffs on some cheeses are falling from 50 percent to 12 percent. Tariffs on many other agricultural products are showing similar declines, as China will be reducing tariffs on grapes to 13 percent, on citrus products to 12 percent, and on apples, pears, shelled almonds and pistachios to 10 percent by January 1, 2004.

The 2002 and 2003 tariff reductions made by China contributed to a marked increase in certain U.S. exports to China. Bulk agricultural commodities not subject to the TRQ system experienced significant improvements, particularly soybeans (see China's Biotechnology Regulations section below). Exports of intermediate agricultural products also fared well, increasing by 45 percent in the first nine months of 2003 to $648 million. Soybean oil exports, for example, increased dramatically, as sales from January through September 2003 totaled $48 million. Exports of animal fats more than doubled, with exports from January through September 2003 totaling nearly $20 million. Among consumer-oriented agricultural products, beef and other red meats ($32 million) continued to keep pace with their record level of exports in 2002 through the first nine months of 2003. Fresh fruit exports were up overall by 50 percent from January through September 2003, with grapes and strawberries doing particularly well. U.S. fish and seafood exports, meanwhile, after having increased from $119 million in 2001 to $135 million in 2002, rose by another 32 percent from January through September 2003 when compared to the same period in 2002.

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

China's Biotechnology Regulations

One of the most contentious agriculture issues that arose during China's first year of WTO membership involved new rules implementing June 2001 regulations relating to biotechnology safety, testing and labeling. The implementing rules, issued by China's Ministry of Agriculture (MOA) shortly before China's WTO Accession, did not provide adequate time for scientific assessment and the issuance of final safety certificates for biotechnology products. As the March 2002 effective date for these implementing rules approached, trade in biotechnology products began to be disrupted. The U.S. products most affected were soybeans, which had seen exports to China grow to more than $1 billion in 2001, while corn and other commodities, such as consumer products made from biotech commodities, remained at risk. Following concerted, high-level pressure from the United States, China agreed to a temporary solution in March 2002, which provided for a nine-month delay, effected through the issuance of temporary safety certificates, good though December 20, 2002. When it became apparent that this extension would not be sufficient, further high-level engagement produced another agreed extension until September 2003.

In early 2003, it became clear that China would not be in a position to issue final safety certificates by September 2003. As a result, following further high-level meetings, China agreed to extend the interim agreement through April 2004. In the Fall of 2003, the United States again urged China to issue final safety certificates in a number of high-level meetings, including the November 2003 Trade Dialogue meetings, in an effort to ensure that further trade disruptions are avoided. In December 2003, China announced that would issue final safety certificates by February 2004.

With some stability added to the China market through the extensions in 2003, U.S. exports of soybeans climbed dramatically. They reached a record level of $1.2 billion from January through September 2003, representing an increase of 195 percent over the same period in 2002. Although definitive data is not yet available, it appears that this growth continued through the end of the year following a temporary slowdown in the wake of AQSIQ's August 2003 announcement that it was planning on suspending some U.S. soybean shipments, beginning at an unspecified future date, based on detections of Phytophthora sojae (see the Sanitary and Phytosanitary Measures section below).

Meanwhile, other U.S. concerns with China's biotechnology regulations and implementing rules remain, particularly with regard to risk assessment, labeling and field trials. In the summer of 2002, MOA had agreed to the creation of a high-level U.S.-China working group to discuss these issues. This group made substantial progress during meetings in September 2002 and July 2003, and it is scheduled to meet again before the end of 2003.

Tariff-rate Quotas on Bulk Agricultural Commodities

Another issue of particular concern involves China's commitments relating to TRQs on bulk agricultural commodities, which include several commodities of particular importance to U.S. farmers, such as wheat, corn, cotton and vegetable oils. Since SDPC (which has been known as the National Development and Reform Commission, or NDRC, since the mid-2003 government restructuring) began implementing these commitments following China's accession, a series of problems have undermined the market access envisioned by WTO members.

When initially setting up its TRQ system for 2002, SDPC was late in issuing both draft and final regulations, and when they were issued, they were flawed. The regulations did not provide for the required transparency, imposed burdensome licensing procedures, and appeared to contravene agreed rules in China's accession agreement by establishing a separate sub-quota for the processing and re-export trade. SDPC was then late beginning the application process, and its subsequent allocation of TRQs did not even begin until late April 2002, approximately four months late. Moreover, all of the available information indicated that SDPC had decided to allocate TRQs in a manner that would protect domestic farm interests and maintain the monopoly enjoyed by state trading enterprises. SDPC operated with only limited transparency, refusing to provide specific details on the amounts and the recipients of the allocations. At the same time, SDPC reserved a significant portion of the TRQs for the processing and re-export trade, despite China's commitment to provide market access and national treatment for imported products. SDPC also allocated a portion of the TRQs for some commodities in smaller than commercially viable quantities, and it employed burdensome licensing requirements.

As these problems became apparent in the first several months of 2002, the United States repeatedly engaged China bilaterally, at all levels of government, and it also raised its concerns at the WTO during meetings of the Committee on Agriculture. In July 2002, the United States requested formal consultations with China under the headnotes contained in China's WTO goods schedule, which took place in September 2002 in Geneva.

Subsequently, SDPC's performance improved in certain respects. SDPC was able to complete the required re-allocation of 2002 TRQs in a timely manner, and it issued 2003 TRQs close to the prescribed time. Nevertheless, the United States remained concerned, particularly because 2002 trade data showed extremely low fill-rates for the TRQ commodities of most interest to U.S. industry. The fill-rates for wheat, corn and cotton were 7 percent, 0.1 percent and 22 percent, respectively.

Following the 2003 TRQ allocations, it became clear that the most serious first year problems – lack of transparency, sub-division of the TRQ, small allocation sizes and burdensome licensing – persisted. The United States again engaged China bilaterally on several occasions, culminating with high-level meetings in Beijing in June 2003. At these meetings, China agreed to take steps to address most of the United States' concerns. China followed through in part in October 2003, when it issued new regulations for shipments beginning January 1, 2004. Key changes made by these regulations include the elimination of separate allocations for general trade and processing trade, the elimination of certain unnecessary licensing requirements, and the creation of a new mechanism for identifying allocation recipients.

The United States will carefully monitor how China enforces its new regulations in 2004. It is essential that NDRC administers these regulations in a manner that is consistent with China's commitments, transparent and in a manner that does not impede market access or commercial decisions.

While the United States' efforts in 2003 focused on ensuring that necessary systemic changes were made by NDRC, exports of some bulk agricultural commodities from the United States increased dramatically due to market conditions. In particular, U.S. cotton exports totaled $337 million during the period from January through September 2003, representing a 478 percent increase when compared to the same period in 2002.

Sanitary and Phytosanitary Issues

In 2003, China subjected U.S. agricultural exports to an increasing number of SPS measures that raised WTO concerns. For example, while the 1999 U.S.-China Agricultural Cooperation Agreement established an agreed level of TCK fungus tolerance in U.S. wheat, and China no longer routinely blocks U.S. wheat exports from the Pacific Northwest on the basis of the TCK fungus, China has now imposed a maximum residue level (MRL) for selenium that is below the international standard and threatens all U.S. wheat exports to China. In addition, China has imposed an MRL for vomitoxin in wheat in the absence of any international standard. With regard to raw poultry and meat, China continues to apply certain standards that do not appear to be based on scientific evidence, which has had the effect of slowing imports from the United States. In particular, in 2002, China declared zero tolerance for pathogens in imported raw poultry and meat. While it is possible to reduce contamination through cooking, the complete elimination of pathogens in raw poultry and meat is not reasonably achievable, nor scientifically justifiable. Moreover, China apparently does not apply this same standard to domestic raw poultry and meat, contrary to WTO national treatment principles. Another problematic area involves China's overly restrictive food additive standards. China continues to block many U.S. processed food products from entering the Chinese market by banning certain food additives that are widely used in other countries and have been approved by the World Health Organization.

In 2003, as in 2002, the United States repeatedly engaged China on these and other SPS issues, both in bilateral meetings, including the Trade Dialogues in February and November 2003, and during meetings of the WTO Committee on Sanitary and Phytosanitary Measures, including the transitional review held in November 2003. To date, however, little progress has been achieved. The United States will continue to press for resolution of these issues in 2004.

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

Meanwhile, AQSIQ has issued a similar decree requiring the certification of live aquatics, which went into effect in November 2003. The United States is pursuing technical discussions with the Chinese authorities on this decree as well.

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

Inspection-related Requirements

The United States continues to have concerns about AQSIQ's administration of licensing procedures. Two AQSIQ measures – the *Administrative Measures for the Entry-Exit Inspection and Quarantine for Grains and Feed Stuff*, which became effective on March 1, 2002, and the *Administrative Measures for Entry Animal and Plant Quarantine*, which became effective September 1, 2002 – require importers to obtain an import inspection permit or a quarantine permit for many agricultural goods before they can enter China, such as livestock, poultry, grains, oilseeds, planting seeds, horticultural products, and hides and skins. The United States has been concerned that AQSIQ is using the procedures provided for by these measures to control the pace and quantity of some imports, which would be contrary to China's market access and import licensing commitments. The United States has also been concerned about the burdensome nature of these procedures and reported selective enforcement by AQSIQ. The United States sought to resolve its concerns in bilateral meetings with China in 2002 and 2003, including the February and November 2003 Trade Dialogues. The United States also raised its concerns during meetings of the Committee on Agriculture, the SPS Committee and the Import Licensing Committee, including the transitional reviews conducted in 2002 and 2003. Some progress appeared to have been achieved in early 2003, as China discontinued arbitrary limits on imported poultry and pork shipments. However, many concerns raised by the United States have not been addressed, and the United States will continue to seek resolutions in 2004.

Export Subsidies

U.S. industry is concerned that China continues to provide export subsidies on corn, despite China's WTO commitment to eliminate all export subsidies upon accession to the WTO. It appears that significant quantities of corn have been exported from China, including corn from Chinese government stocks, at prices that may be 15 to 20 percent below domestic prices in China. As a result, U.S. corn exporters have lost market share for corn in their traditional Asian markets, such as South Korea and Malaysia, while China is exporting record amounts of corn. In 2003, China's already high level of corn exports increased by 80 percent.

The United States raised concerns about possible export subsidies on corn with China in bilateral meetings throughout 2002 and 2003, including the Trade Dialogues held in February and November 2003. It also sought information about China's corn policies during meetings before the Committee on Agriculture, including the transitional reviews held in September 2002 and September 2003. To date, however, it has been difficult to develop the necessary evidence to confirm that China is subsidizing its corn exports. The United States will continue to make every effort to ensure that any use of export subsidies is eliminated.

Intellectual Property Rights

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

Overall, China's efforts to bring its framework of laws, regulations and implementing rules into compliance with the TRIPS Agreement have been largely satisfactory, although some improvements still need to be made. IPR enforcement, however, remains ineffective, and in 2003 the United China repeatedly urged China to take immediate and substantial steps to put it on the path toward compliance with its critical TRIPS Agreement obligation to maintain effective enforcement mechanisms.

China took an important step forward in October 2003 when it created a new IPR Leading Group, signaling a more focused and sustained effort by China to tackle the IPR enforcement problem. Vice Premier Wu, who took charge during the SARS epidemic earlier in 2003, is the Chair of this group. In her remarks at the November 2003 IPR roundtable in Beijing, she explained her perspective that "a country's protection of intellectual property is indispensable [to] its economic development and technological advancement," and she pledged that China would work with "consistent determination" to solve its IPR enforcement problems and "penalize[ ]" those who commit IPR infringement.

Legal Framework

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

As reported in detail in 2002, U.S. experts carefully reviewed China's new IPR laws, regulations and implementing rules and, together with other WTO members, participated in a comprehensive review of them as part of the first transitional review of China before the WTO's Council for Trade-related Aspects of Intellectual Property Rights (TRIPS Council) in September 2002. A further review took place during the transitional review before the TRIPS Council in November 2003. While this process identified various areas where China could make improvements, and the United States and U.S. industry continue to press China to do so, overall the legal changes made by China are major improvements that move China generally in line with international norms in most key areas.

In 2003, China issued several new measures. In the patent area, the State Council issued the *Amendments to the Patent Law Implementing Measures*. In the trademark area, the State Administration of Industry and Commerce issued the *Rules on the Determination and Protection of Well-Known Trademarks*, the *Measures on the Implementation of the Madrid Agreement on Trademark International Registration* and the *Measures on the Registration and Administration of Collective Trademarks and Certification Marks*. In the copyright area, the National Copyright Administration of China issued the *Measures on the Implementation of Administrative Penalties in Copyright Cases*. These regulations and implementing rules have generally been well-received by U.S. companies as steps toward full compliance with China's TRIPS Agreement obligations.

China is also reportedly drafting revisions to its 2001 Internet-related implementing rules. This development is welcomed by U.S. companies because loopholes in those rules have allowed copyright infringement on the Internet to become a growing phenomenon in China.

Meanwhile, by the end of its second year of WTO membership, China still had not acceded to the 1996 World Intellectual Property Organization (WIPO) Internet-related treaties, which entered into force in 2002 and have been ratified by many developed and developing countries. Although China is not obligated under WTO rules to accede to the WIPO treaties, the United States considers these treaties to reflect international norms for providing copyright protection over the Internet. While China's existing regulations and implementing rules do address certain copyright issues related to the Internet, and China is in the process of drafting further Internet-related implementing rules, the United States has urged China to promptly accede to the WIPO treaties and harmonize its regulations and implementing rules with them fully.

Enforcement

The TRIPS Agreement requires China to implement effective enforcement procedures and to provide civil and criminal remedies that have a deterrent effect. Although the central government displayed strong leadership in modifying the full range of China's IPR laws and regulations in an effort to bring them into line with China's WTO commitments, this leadership has not translated into effective IPR enforcement at the local level, as IPR infringement remains a serious problem throughout China. IPR enforcement is hampered by lack of coordination among Chinese government ministries and agencies, local protectionism and corruption, high thresholds for criminal prosecution, lack of training and weak punishments.

In 2002, one trade association explained that "[e]ffective enforcement against [IPR] infringement in China is universally recognized as the chief concern of [IPR] rights-holders, as piracy rates in China in all areas, including copyright, trademark and patents, continue to be excessively high." This statement remains true in 2003. Indeed, according to a July 2003 report by the State Council's Development Research Center, the market value of counterfeit goods in China is between $19 billion and $24 billion, which translates into enormous losses for IPR rights holders. Various U.S. copyright holders report, for example, that inadequate enforcement has resulted in piracy levels in China that have remained at 90 percent or above in 2003 for all copyright sectors, and estimated U.S. losses due to the piracy of copyrighted materials has continued to exceed $1.8 billion annually. Summarizing the consensus of U.S. industry in 2003, another trade association explained that U.S. industry "remains concerned that more than one year following China's commitments to join the WTO, counterfeiting and piracy rates remain among the highest in the world. . . . [T]he industry consensus is that credible criminal penalties and greater administrative penalties, with strong financial support and leadership from the central government, will be essential to reducing counterfeiting and piracy rates in China."

In 2003, IPR infringement in China continued to affect products, brands and technologies from a wide range of industries, including films, music, publishing, software, pharmaceuticals, chemicals, information technology, consumer goods, electrical equipment, automotive parts and industrial products, among many others. This situation not only has had an enormous economic impact, but also presents a direct challenge to China's ability to regulate many products that have health and safety implications for China's population and, as an increasing amount of counterfeit and pirated products are being exported from China, for others around the world.

The United States places top priority on addressing IPR enforcement problems in China. While a domestic Chinese business constituency is increasingly active in promoting IPR enforcement, it is clear that the Chinese government will have to devote considerable resources and political will to IPR enforcement, and there will continue to be a need for sustained efforts from the United States and other WTO members, if significant improvements are to be achieved on this front.

Since China issued its new IPR laws, regulations and implementing rules, the United States has worked with central and local government officials in China in a determined and sustained effort to improve China's IPR enforcement. A variety of U.S. agencies have held regular bilateral discussions with their Chinese counterparts and have conducted numerous technical assistance programs for central and local government officials on TRIPS Agreement rules, IPR enforcement and rule of law issues. In addition, the United States has organized annual roundtable meetings in Beijing designed to bring together U.S. government and industry officials. This year, the United States added Chinese government officials to the roundtable meeting, so that U.S. industry officials would have an opportunity to exchange views and concerns in the IPR area directly with them. The United States' effort has also benefitted from cooperation with Japan and other WTO members to seek improvements in China's IPR enforcement, both on the ground in China and at meetings of the TRIPS Council.

China's IPR laws and regulations provide for three different mechanisms for IPR enforcement – enforcement by administrative authorities, criminal prosecutions and civil actions for monetary damages. However, as the United States and other WTO members have been urging, China needs to take immediate steps to improve each of these enforcement mechanisms, particularly criminal enforcement, if China is to even approach the minimum standards for IPR enforcement established by the TRIPS Agreement.

<u>Administrative Enforcement</u>

China continues to take a large number of administrative enforcement actions against IPR violators. However, they are not having a deterrent effect.

Although the central government continues to promote periodic anti-counterfeiting and anti-piracy campaigns, and these campaigns result in high numbers of seizures of infringing materials, they are largely ineffective. For one thing, the cases subsequently brought by the administrative authorities usually result in extremely low fines. When the administrative authorities decide on fines, the fine amounts are kept artificially low because many administrative authorities do not treat the infringing goods as having the value of the genuine articles, but rather establish value based on the price charged for the counterfeit or pirated goods. In addition, evidence showing that a person was caught warehousing infringing goods is not sufficient to prove an intent to sell them, and as a result the administrative authorities will not even include those goods in the value of the infringing goods when determining the fine amounts. The lack of deterrence from the fines is compounded by the fact that the administrative authorities rarely forward an administrative case on to the Ministry of Public Security for criminal investigation, even for commercial-scale counterfeiting or piracy. As a result, the infringers consider the seizures and fines simply to be a cost of doing business, and they are usually able to resume their operations without much difficulty.

As these centrally mandated campaigns demonstrate, and as the United States and U.S. industry have underscored, it is crucial for the administrative authorities to begin to refer administrative cases to the Supreme People's Procuratorate for criminal prosecution. At the same time, China needs to revise its IPR legal framework to provide for substantially higher administrative fines, and the administrative authorities then need to impose and publicize them so they will have a deterrent effect.

<u>Criminal Enforcement</u>

In the view of the United States and U.S. industry, the most critical steps for China to take in improving its IPR enforcement are in the criminal area. Effective criminal enforcement offers the deterrence needed for China to begin to handle the rampant IPR infringement hurting both foreign and domestic enterprises.

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

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

A significant related concern involves the scope of China's laws and regulations. China needs to broaden its laws and regulations so that they do not apply only when a sale can be proved. They would be much more effective if they also applied to the willful manufacture, storage, distribution and use of counterfeit and pirated goods. Similarly, China's failure to consider the export of counterfeit or pirated goods on a commercial scale as related to a criminal act remains a problem. It would be an important step for China to allow criminal prosecutions for these acts, particularly because nearly 50 percent of infringing goods entering the United States originate in China.

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

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

<u>Civil Enforcement</u>

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

Services

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

In its services schedule, China committed to the substantial opening of a broad range of services sectors through the elimination of many existing limitations on market access, at all levels of government, particularly in sectors of importance to the United States, such as banking, insurance, telecommunications and professional services. These commitments are far-reaching, particularly when compared to the services commitments of many other WTO members.

China also made certain "horizontal" commitments, which are ones that apply to all sectors listed in its services schedule. The two most important of these cross-cutting commitments involve acquired rights and the licensing process. Under the acquired rights commitment, China agreed that the conditions of ownership, operation and scope of activities for a foreign company, as set out in the respective contractual or shareholder agreement or in a license establishing or authorizing the operation or supply of services by an existing foreign service supplier, will not be made more restrictive than they were on the date of China's accession to the WTO. In other words, if a foreign company had pre-WTO accession rights that went beyond the commitments made by China in its services schedule, that company could continue to operate with those rights.

In the licensing area, prior to China's WTO accession, foreign companies in many sectors did not have an unqualified right to apply for a license to operate in China. They could only apply for a license if they first received an invitation from the relevant Chinese regulatory authorities, and even then the decision-making process lacked transparency and was subject to inordinate delay and discretion. In its accession agreement, China committed to licensing procedures that were streamlined, transparent and more predictable.

Overall, many existing problems in the services area continued in 2003. According to a trade association with broad representation among U.S. service suppliers, "several fundamental sector-specific market barriers, as well as transparency and other regulatory issues, remain a great concern to us" in 2003. While commending new regulations and implementing rules issued by China, this trade association also cautioned that "China's full and non-discriminatory enforcement of these [regulations and implementing rules] and provision of a level playing field for foreign participants will also be necessary."

For the most part, China continued to keep pace nominally with the openings required by its WTO accession agreement, while it maintained or erected terms of entry that were so high or cumbersome as to prevent or discourage foreign suppliers from gaining market access. For example, excessive capital requirements restrict market entry for foreign suppliers in many sectors, such as insurance, banking, telecommunications and distribution, among several others. In addition, in some sectors, such as insurance and legal services, branching restrictions have been put into effect that call into question commitments made by China in its Services Schedule. Meanwhile, in other sectors, such as express delivery and construction services, problematic measures threaten to take away previously acquired market access rights.

Progress was made on some fronts in 2003, however. For example, more foreign insurers and financial institutions obtained licenses, and China finally opened up the non-bank motor vehicle financing sector.

Financial Services

<u>Banking</u>

Prior to its accession to the WTO, China had allowed foreign banks to conduct foreign currency business in selected cities. Although China had also permitted foreign banks, on an experimental basis, to conduct local currency business, the experiment was limited to foreign customers in two cities.

In its accession agreement, China committed to a five-year phase-in for banking services by foreign banks. Specifically, China agreed that, immediately upon its accession, it would allow U.S. and other foreign banks to conduct foreign currency business without any market access or national treatment limitations and conduct local currency business with foreign-invested enterprises and foreign individuals, subject to certain geographic restrictions. The ability of U.S. and other foreign banks to conduct domestic currency business with Chinese enterprises and individuals is to be phased in. Within two years after accession, foreign banks will be able to conduct domestic currency business with Chinese enterprises, subject to certain geographic restrictions. Within five years after accession, foreign banks will be able to conduct domestic currency business with Chinese individuals, and all geographic restrictions will be lifted. Foreign banks will also be permitted to provide financial leasing services at the same time that Chinese banks are permitted to do so.

Shortly after China's accession to the WTO, the People's Bank of China (PBOC) issued regulations governing foreign-funded banks, along with implementing rules, which became effective February 1, 2002. The PBOC also issued several other related measures. Although these measures kept pace with the WTO commitments that China made, it became clear that the PBOC had decided to exercise extreme caution in opening up the banking sector. In particular, it imposed working capital requirements and other prudential rules that far exceeded international norms, both for the foreign banks' headquarters and branches, making it more difficult for foreign banks to establish and expand their market presence in China. Initially, in 2002, the PBOC was slow to act on foreign banks' applications for approval to conduct foreign currency business or local currency business with foreign-invested enterprises and foreign individuals. By October 2003, however, a number of foreign banks, including 13 U.S. banks, had branches or representative offices in China, although only major banks were large enough to satisfy the application requirements.

According to the PBOC, the domestic currency business of U.S. banks has grown rapidly since China's WTO accession, even though the banks' clients have been limited to foreign-invested enterprises and foreign individuals. In 2002, deposits grew by 75 percent and assets grew by 14 percent over the previous year. In the first six months of 2003, this growth continued, as deposits were up nearly 20 percent and assets were up 10 percent. With the PBOC's December 2003 announcement that foreign banks will be permitted to conduct domestic currency business with Chinese enterprises, which keeps pace with China's WTO commitments, the growth in U.S. banks' domestic currency business is expected to continue in 2004.

In bilateral meetings in 2002 and 2003, the United States urged the PBOC to reconsider its prudential requirements and to bring them in line with international norms. Together with other WTO members, the United States also raised these same concerns during meetings of the WTO Committee on Trade in Financial Services, including the transitional reviews held in October 2002 and November 2003. In December 2003, some progress took place, as the PBOC reduced working capital requirements for various categories of foreign banks by at least RMB 100 million. The United States will continue to urge China in 2004 to make its banking sector more accessible to foreign banks.

<u>Insurance</u>

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

In its accession agreement, China agreed to phase out existing geographic restrictions on all types of insurance operations during the first three years after accession. It also agreed to expand the ownership rights of foreign companies. Upon accession, foreign life insurers must be permitted to hold 50 percent equity share in a joint venture. Foreign property, casualty and other non-life insurers must be permitted to establish as a branch or as a joint venture with 51 percent foreign equity share upon accession, and they must be able to establish as a wholly foreign-owned subsidiary two years after accession. In addition, foreign insurers handling large scale commercial risks, marine, aviation and transport insurance, and reinsurance must be permitted 50 percent foreign equity share in a joint venture upon accession; they must be able to own 51 percent three years after accession and establish as a wholly foreign-owned subsidiary five years after accession. China further agreed that all foreign insurers will be permitted to expand the scope of their activities to include group, health and pension lines of insurance within five years after accession.

CIRC issued several new insurance regulations shortly after acceding to the WTO, including ones directed at the regulation of foreign insurance companies. These regulations implemented many of China's commitments, but they also created problems in three critical areas – capitalization requirements, transparency and branching. In particular, China's capitalization requirements are significantly more exacting than those of other populous countries with no less an interest in preserving a healthy insurance market, and they limit the ability of foreign insurers to make necessary joint venture arrangements. The regulations also continue to permit considerable bureaucratic discretion and to offer limited predictability to foreign insurers seeking to operate in China's market. To date, this lack of transparency has manifested itself particularly in the licensing process. With regard to branching, China scheduled a commitment to allow non-life firms to establish as a branch in China upon accession and to permit internal branching in accordance with the lifting of China's geographic restrictions. China further agreed that foreign insurers already established in China that were seeking authorization to establish branches or sub-branches would not have to satisfy the requirements applicable to foreign insurers seeking a license to enter China's market. Notwithstanding these commitments, the regulations are vague on foreign insurers' branching rights, and CIRC has so far insisted that non-life insurers that are already in the market as a branch and that wish to branch or sub-branch cannot do so unless they first establish as a subsidiary, a costly – and unnecessary – condition. Further complicating this issue, CIRC has apparently waived this requirement for at least one foreign insurer, but has not explained how or whether other foreign insurers could apply for this waiver.

In close consultation with U.S. insurers, the United States raised these issues in 2002 in several bilateral meetings with CIRC, MOFTEC and the State Council and at WTO meetings, with support from Canada, the EC, Japan and Switzerland. Following high-level bilateral meetings during the run-up to the October 2002 Summit between Presidents Bush and Jiang, China began to show some flexibility. CIRC agreed to establish a working group, composed of U.S. regulators and insurers, to discuss insurance issues, with a particular focus on appropriate capitalization requirements and other prudential standards. The first meeting of the working group took place in December 2002.

Following further bilateral meetings in 2003, including the February 2003 Trade Dialogue in Beijing, China issued draft implementing rules that demonstrate some progress with regard to capitalization requirements and transparency. These draft rules, which were circulated in August 2003 but have not yet been finalized, lower capital requirements for national licenses from RMB 500 million ($60.3 million) to RMB 200 million ($24.1 million) and for branch offices from RMB 50 million ($6.03 million) to RMB 20 million ($2.41 million). They also clarify licensing procedures. Since the issuance of these draft rules, the United States has continued to press its concerns in the insurance area, particularly with regard to branching, in high-level meetings in Beijing in September and October 2003 and during the November 2003 Trade Dialogue meetings.

In another positive development, CIRC has lifted certain geographic restrictions applicable to foreign life insurers ahead of schedule. In early 2002, CIRC approved life insurance operations for U.S. insurers in Beijing, Suzhou and Tianjin, two years before China had committed to do so in its services schedule. In 2003, CIRC approved life insurance operations for a U.S. insurer in Chongqing nearly one year ahead of schedule. Other foreign life insurers must now be provided the same access to those cities.

By the end of 2003, the operations of foreign insurers in China had grown significantly. While foreign insurers had only about 2 to 3 percent of the national market (when measured in terms of premiums paid), they reportedly had captured 12 percent and 17 percent market shares in Shanghai and Guangzhou, respectively. In addition, U.S. industry reports that its market share in Beijing has been growing rapidly.

In 2004, the United States will continue its efforts to persuade CIRC to provide market access on a fair and equitable basis and not to use its regulatory powers to restrict market access for foreign insurers. The United States will also monitor closely developments with regard to the August 2003 draft implementing rules.

<u>Motor Vehicle Financing</u>

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

Despite these commitments, China did not open up this sector to foreign financial institutions upon its accession, leaving China's commercial banks as the only financial institutions able to offer auto loans. It was not until near the end of its second year of WTO membership that China finally issued all of the measures necessary to allow foreign financial institutions to offer auto loans.

In June 2002 and again in September 2002, the Chinese regulator, the China Banking Regulatory Commission (CBRC), released draft regulations for comment. As drafted, these regulations represented an important step in leveling the playing field for foreign and Chinese financial institutions, but they also raised concerns about their consistency with China's commitments. The key WTO issues involved excessive capitalization requirements, excessive net asset requirements and an unnecessarily long approval process. Working closely with U.S. industry, the United States filed written comments with the CBRC on the June 2002 draft of the regulations and again on the September 2002 draft, which had reflected some improvements. In addition, the United States emphasized the seriousness of its concerns in bilateral meetings with the CBRC and during meetings of the Council for Trade in Services, including the transitional review held in October 2002. The United States also urged China to issue final regulations quickly, so that this sector could be opened to foreign financial institutions.

Nearly one year later, in October 2003, the CBRC issued final regulations. Although the final regulations reduced the capital requirements from the levels set in the earlier drafts, they still remain relatively high, as the minimum registered capital is RMB 300 million ($36.2 million), and the minimum paid-in capital is RMB 500 million ($60.3 million).

Despite the issuance of these regulations, the motor vehicle financing sector was still not open to foreign financial institutions. The CBRC had not yet issued implementing rules setting forth the procedures for foreign financial institutions to apply for licenses to begin operations. In high-level bilateral meetings in October 2003, the United States pressed for the immediate issuance of implementing rules, and China indicated that it would do it as soon as possible. In November 2003, shortly before Trade Dialogue meetings in Beijing, China issued the implementing rules.

During the November 2003 Trade Dialogue meetings, the United States emphasized the importance of quick action by CBRC on license applications, as U.S. companies were beginning to take steps to obtain licenses to begin operations. The United States will work closely with these companies to ensure that the CBRC acts promptly on their applications and applies its new regulations and implementing rules in accordance with China's commitments.

Legal Services

Prior to its WTO accession, China had imposed various restrictions in the area of legal services. It maintained a prohibition against representative offices of foreign law firms practicing Chinese law or engaging in profit-making activities with regard to non-Chinese law. It also imposed restrictions on foreign law firms' formal affiliation with Chinese law firms, limited foreign law firms to one representative office and maintained geographic restrictions.

China's accession agreement provides that, upon China's accession to the WTO, foreign law firms may provide legal services through one profit-making representative office, which must be located in one of several designated cities in China. The foreign representative offices may advise clients on foreign legal matters and provide information on the impact of the Chinese legal environment, among other things. They may also maintain long-term "entrustment" relationships with Chinese law firms and instruct lawyers in the Chinese law firm as agreed between the two law firms. In addition, all quantitative and geographic limitations were to have been phased out within one year of China's accession to the WTO, which means that foreign law firms should have been able to open more than one office anywhere in China beginning on December 11, 2002.

In December 2001, the State Council issued the *Regulations on the Administration of Foreign Law Firm Representative Offices*. In July 2002, the Ministry of Justice issued implementing rules. While these new measures removed some market access barriers, they also generated concern among foreign law firms doing business in China. In many areas, these measures were ambiguous. For example, it appeared that these measures created an economic needs test for foreign law firms that want to establish offices in China, contrary to China's GATS commitments. These measures also seemed to take an overly restrictive view of the types of legal services that foreign law firms may provide. In addition, the procedures for establishing a new office or an additional office were unnecessarily time-consuming.

In consultation with U.S. law firms, the United States carefully reviewed the new measures and expressed its concerns in written comments in 2002. The United States also held bilateral meetings with China's Ministry of Justice and MOFTEC in 2002 and again in 2003, including during the Trade Dialogue meetings in Beijing in February 2003. In addition, together with other WTO members, the United States presented its concerns to China in connection with the transitional reviews before the Council for Trade in Services, held in October 2002 and December 2003.

Some progress was made in 2003, as a number of U.S. and other foreign law firms were able to open a second office in China. The United States will continue to work with China in 2004 in an attempt to resolve its outstanding concerns.

Telecommunications

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

Importantly, China also accepted key principles from the WTO Agreement on Basic Telecommunications Services. As a result, China became obligated to separate the regulatory and operating functions of MII (which has been both the telecommunications regulatory agency in China and the operator of China Telecom) upon its accession. China also became obligated to adopt pro-competitive regulatory principles, such as cost-based pricing and the right of interconnection, which are necessary for foreign-invested joint ventures to compete with China Telecom.

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

At the same time, China has not yet established an independent regulator in the telecommunications sector. The current regulator, MII, while nominally separate from the current telecommunications operators, maintains extensive influence and control over their operations and continues to use its regulatory authority to disadvantage foreign firms.

Over the last year, the problems in the telecommunications sector have increased. Most recently, in its April 2003 Catalogue of Telecommunications Services, MII reclassified several telecommunications services from the value-added category to the basic category, contrary to widely accepted international practice and, in some instances, in apparent contravention of the spirit, if not the letter, of China's scheduled commitments. MII also placed restrictions on what new services could be classified under the value-added category. These moves are likely to limit the ability of U.S. firms to access China's telecommunications market. Under China's Services Schedule, basic services are on a slower liberalization schedule, and MII subjects them to higher capitalization requirements. Indeed, MII requires suppliers of basic services to satisfy an excessive registered capital requirement of RMB 2 billion ($241.2 million).

Meanwhile, MII continues to process applications very slowly for the few foreign-invested telecommunications enterprises that have attempted to satisfy MII's licensing requirements. For example, as China nears the end of its second year of WTO membership, not one application for a license to provide value-added services has completed the MII licensing process.

The United States has repeatedly urged China to establish an independent regulator and has raised other concerns as they developed, using both bilateral meetings, including the Trade Dialogues in February and November 2003, and the transitional reviews before the Council for Trade in Services in October 2002 and December 2003. The United States will continue to press China on these matters in 2004.

Express Delivery Services

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

Nevertheless, shortly after becoming a WTO member, China issued two problematic measures. These measures required Chinese and foreign-invested international express delivery companies, including those that were already licensed by MOFTEC to provide international express delivery services (except for the delivery of private letters), to apply for and obtain so-called "entrustment" authority from China's postal authorities, China Post, their direct competitor, if they wanted to continue to provide express delivery services. The measures also placed new weight and rate restrictions on the letters that the companies could handle, assuming that they could obtain entrustment authority, in apparent contravention of China's horizontal "acquired rights" commitment (discussed at the beginning of the Services section).

Working closely with U.S. express delivery companies and other affected WTO members, particularly the EC and Japan, the United States led a sustained effort that eventually convinced China to revise these measures. In September 2002, China issued a new measure, which eliminated the weight and rate restrictions and eased burdensome aspects of the entrustment application process. In bilateral meetings, China also provided assurances that the regulatory and operational functions of China Post would be split up and that MOFTEC would seek to ensure that China Post did not abuse its regulatory authority. Subsequently, in October 2002, China issued another measure streamlining the entrustment application process even further and effectively eliminated China Post's ability to exercise its discretionary authority to reject entrustment applications from foreign-invested express delivery companies already licensed by MOFTEC. The measure also provided that these companies do not have to apply for separate entrustment certificates for existing or new branches.

In November 2002, U.S. express delivery companies and their Chinese joint venture partners subsequently applied for and obtained the needed entrustment authority from China Post. Since then, they have been able to continue to operate without disruption, while expanding their business operations in China.

In July 2003, however, China circulated draft amendments to its postal services law, which generated two immediate concerns among U.S. companies. First, the draft amendments purported to give China Post a monopoly over the delivery of letters under 500 grams, which would have constituted a new restriction on the scope of activities of existing foreign-invested express delivery companies, contrary to China's horizontal "acquired rights" commitment (discussed at the beginning of the Services section). Second, the draft amendments did not address the need for an independent regulator. In the ensuing months, U.S. express delivery companies and their joint venture partners submitted written comments to the State Council, which was in charge of the draft amendments, and the United States held a series of bilateral meetings with China.

In September, October and November 2003, the State Council circulated new sets of draft amendments, as written comments continued to be submitted and bilateral meetings continued to take place, including the November 2003 Trade Dialogue in Beijing. While each set of draft amendments included a different definition of the China Post monopoly, the most recent draft amendments again provided China Post with a monopoly on letters weighing less than 500 grams. These draft amendments also included other problematic provisions. They appeared to create a new licensing process to replace the existing entrustment process, and they seemed to require express couriers to pay four percent of their revenue from the delivery of letters into a universal service fund. As the end of 2003 drew near, no final amendments had been issued, and the United States was continuing to work closely with U.S. express delivery companies in urging China to issue a sensible and WTO-consistent set of amendments.

Construction and Related Engineering Services

Upon its WTO accession, China committed to permit foreign service suppliers to supply construction and related engineering services through joint ventures with foreign majority ownership, subject to the requirement that those services only be undertaken in connection with foreign-invested construction projects and subject to registered capital requirements that were slightly different from those of Chinese enterprises. Within three years of accession, China agreed to remove those conditions, and it also agreed to allow wholly foreign-owned enterprises to supply construction and related engineering services for four specified types of construction projects.

In September 2002, the Ministry of Construction and MOFTEC jointly issued the *Rules on the Administration of Foreign-Invested Construction Enterprises* (known as Decree 113) and the *Rules on the Administration of Foreign-Invested Construction Engineering Design Enterprises* (known as Decree 114). These decrees opened up construction and related engineering services to wholly foreign-owned enterprises, two years ahead of schedule, and to joint ventures with majority foreign ownership. At the same time, however, these decrees created concerns for U.S. and other foreign firms by imposing new and more restrictive conditions than existed prior to China's WTO accession, when they were permitted to work in China on a project-by-project basis pursuant to Ministry of Construction rules. In particular, these decrees for the first time require foreign firms to obtain qualification certificates, effective October 1, 2003. In addition, these decrees for the first time require foreign-invested firms supplying construction services to incorporate in China, and they impose high minimum registered capital requirements and foreign personnel residency requirements that are difficult for many foreign firms to satisfy.

In consultation with U.S. industry, the United States, in a high-level intervention, pressed its concerns about Decrees 113 and 114 and sought a delay before the decrees' problematic requirements would become effective. In September 2003, the Ministry of Construction agreed to extend the implementation date from October 1, 2003 until April 1, 2004. The United States and U.S. industry will use this extension to pursue these issues further with the Ministry of Construction and MOFCOM.

Other Services

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

Legal Framework

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

Transparency

Public Comment

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

Last year, the principal focus of China's first year of WTO membership was on its framework of laws and regulations governing trade in goods and services, at both the central and local levels. According to MOFTEC, the central government reviewed more than 2,500 trade-related laws and regulations for WTO consistency, and by mid-2002 it had reportedly repealed 830 of those laws and regulations and amended 325 more. It had also reportedly adopted 118 new laws and regulations. Similar reviews took place at the local government level in 2002, although they were generally not as far along as the central government's review.

In the first nine months of 2003, the central government amended or issued nearly 100 more laws and regulations in an effort to meet China's WTO obligations. These laws and regulations covered the range of WTO areas, including trade in goods, trade in services, IPR and trade remedies. In addition, according to MOFCOM, China's 31 provinces and autonomous regions and 49 major cities made more progress than in 2002, as they repealed a total of 490 trade-related measures and amended 185 more.

Despite the tremendous amount of work that China has put into overhauling its framework of trade-related laws and regulations, China's ministries and agencies have a poor record of providing an opportunity for public comment *before* new or modified laws and regulations are implemented. Although the State Council issued regulations in December 2001 addressing the procedures for the formulation of administrative regulations and rules and expressly allowing public comment, many of China's ministries and agencies in 2002 continued to follow the practice prior to China's accession to the WTO, and no notable progress took place in 2003. Typically, the ministry or agency drafting a new or revised law or regulation consulted with and submitted drafts to other ministries and agencies, Chinese experts and affected Chinese companies. At times, it also consulted with select foreign companies, although it would not necessarily share drafts with them. As a result, as the end of the second year of China's WTO membership draws near, only a small proportion of new or revised laws and regulations have been issued after a period for public comment, and even in those cases the amount of time provided for public comment has generally been too short.

According to reports from various sources, it appears that several major trade-related laws and regulations are scheduled to be issued before the end of 2003, including amendments to the *Foreign Trade Law*, a new commercial banking law, amendments to the *Postal Services Law*, regulations on rules of origin for imports and exports, insurance regulations, import and export tariff regulations, government procurement implementing rules, a new automobile industrial policy, construction engineering design regulations and IPR customs protection regulations. To date, however, only the draft insurance regulations have been circulated for public comment. This situation is causing concern among U.S. companies because each of these laws and regulations when implemented will likely have a major impact on the operations of foreign companies doing business in China.

Meanwhile, China's ministries and agencies have a much better record when it comes to making new or revised laws and regulations available to the public. In accordance with State Council regulations issued in December 2001, which require the publication of new or amended regulations thirty days before their implementation, almost all new or revised laws and regulations have been available (in Chinese) soon after issuance and prior to their effective date, an improvement over pre-WTO accession practice. Indeed, these laws and regulations are often published not only in official journals, but also on the Internet. At the same time, however, China continues to lag behind in its obligation to provide translations of these laws and regulations.

In numerous bilateral meetings with the State Council, MOFTEC/MOFCOM and other Chinese ministries in 2002 and 2003, including the Trade Dialogues held in Beijing in February and November 2003 and other high-level meetings, the United States emphasized the importance of China's adherence to the notice-and-comment commitment in China's accession agreement, both in terms of fairness to WTO members and the benefits that would accrue to China. In addition, the United States provided technical assistance to facilitate Chinese ministries' understanding of the workings, and benefits, of an open and transparent rulemaking process. Together with other WTO members, the United States also raised this issue during regular WTO meetings and as part of the transitional reviews being conducted in 2002 and 2003 before various WTO councils and committees. The United States will continue to work to secure China's full compliance with this fundamental commitment in 2004.

Enquiry Points

Another important transparency commitment requires China to establish enquiry points, where any WTO member or foreign company or individual may obtain information. As reported last year, China complied with this obligation by establishing a WTO Enquiry and Notification Center, now operated by MOFCOM's Department of WTO Affairs, in January 2002. Other ministries and agencies have also established formal or informal, subject-specific enquiry points. Since the creation of these various enquiry points, U.S. companies have generally found these various enquiry points to be responsive and helpful, and they have generally received timely replies. In addition, some ministries and agencies have begun to create websites to provide answers to frequently asked questions as well as further guidance and information.

Uniform Application of Laws

In its accession agreement, China committed, at all levels of government, to apply, implement and administer its laws, regulations and other measures relating to trade in goods and services in a uniform and impartial manner throughout China, including in special economic areas. In support of this commitment, China agreed to establish an internal review mechanism to investigate and address cases of non-uniform application of laws based on information provided by companies or individuals.

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

In 2002, China also established an internal review mechanism, now overseen by MOFCOM's Department of WTO Affairs, to handle cases of non-uniform application of laws. The actual workings of this mechanism remain unclear, however.

During 2003, as in 2002, some problems with uniformity persisted. These problems are discussed above in the sections on Customs and Trade Administration, Taxation, Investment and Intellectual Property Rights.

Judicial Review

China agreed to establish tribunals for the review of all administrative actions relating to the implementation of laws, regulations, judicial decisions and administrative rulings on trade-related matters. These tribunals must be impartial and independent of the government authorities entrusted with the administrative enforcement in question, and their review procedures must include the right of appeal.

Beginning before China's accession to the WTO, China had taken steps to improve the quality of its judges. For example, in 1999, the Supreme People's Court began requiring judges to be appointed based on merit and educational background and experience, rather than through politics or favoritism. However, existing judges, many of whom have had no legal training, were grandfathered in. In part because of this situation, many U.S. companies in 2003 continued to express serious concern about the independence of China's judiciary. In their experience and observation, Chinese judges are often influenced by political, government or business pressures, particularly outside of China's big cities.

Meanwhile, in 2003, the United States monitored how the courts designated by the Supreme People's Court's *Rules on Certain Issues Related to Hearings of International Trade Administrative Cases*, which went into effect on October 1, 2002, have handled cases involving administrative agency decisions relating to international trade in goods or services or intellectual property rights. So far, however, there is little data, as few foreign companies have had experience with these courts.

APPENDIX 1

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

1. U.S.-China Business Council
2. American Chamber of Commerce-China/American Chamber of Commerce-Shanghai
3. U.S. Chamber of Commerce
4. National Association of Manufacturers
5. Semiconductor Industry Association
6. International Intellectual Property Alliance
7. National Cotton Council
8. The Fertilizer Institute
9. Coalition of Services Industries
10. Pharmaceutical Research and Manufacturers Association
11. National Electrical Manufacturers Association
12. Distilled Spirits Council of the United States, Inc.
13. U.S. Grains Council
14. U.S. Council of International Business
15. Association of American Publishers, Inc.
16. Conference of Asia Pacific Express Carriers
17. Recording Industry Association of America
18. National Food Processors Association
19. U.S. Information Technology Office
20. Coalition for a Sound Dollar
21. American Iron and Steel Institute
22. International AntiCounterfeiting Coalition, Inc.
23. U.S. Wheat Associates/Wheat Export Trade Education Committee

APPENDIX 2

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

Washington, D.C.
October 3, 2003

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

2. Myron Brilliant
   Vice President, Asia
   U.S. Chamber of Commerce

3. William Primosch
   Director, International Business Policy
   National Association of Manufacturers

4. Kevin Dempsey
   Dewey Ballantine
   On Behalf of Semiconductor Industry Association

5. Eric H. Smith
   President
   International Intellectual Property Alliance

6. John Maguire
   Vice President
   National Cotton Council

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

8. Robert Vastine
   President
   Coalition of Service Industries