
2007 REPORT TO CONGRESS ON CHINA'S WTO COMPLIANCE



United States Trade Representative

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December 11, 2007

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APPENDIX 2 (List of Witnesses)

FOREWORD

This is the sixth 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 prior reports, 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. The report identifies areas where progress has been achieved and underscores shortcomings, as appropriate, with regard to the commitments that became effective upon China's accession to the WTO as well as those commitments scheduled to be phased in over time.

The focus of the report's analysis continues to be on trade concerns raised by U.S. stakeholders that, in the view of the U.S. Government, merit attention within the WTO context. The report does not provide an exhaustive analysis of the many areas in which China's WTO compliance efforts have or have not, in the view of the U.S. Government, satisfied particular commitments made in China's WTO accession agreement.

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 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 25, 2007, asking for written comments and testimony from the public and scheduling a public hearing before the TPSC, which took place on September 27, 2007. 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

After six years of membership in the World Trade Organization, China is no longer a new WTO member. Almost all of the specific commitments that China made when it acceded to the WTO on December 11, 2001, were due to be implemented over a period of five years, ending one year ago. Accordingly, the United States has been working to hold China fully accountable – just as we, and others, hold ourselves accountable – as a mature member of the international trading system, placing a strong emphasis on China's adherence to WTO rules. Over the last year, the United States intensified its frank bilateral engagement with China. The United States also took enforcement actions at the WTO in key areas where dialogue had not resolved our WTO-related concerns, and through our reliance on rules-based dispute settlement the United States, and China, did make some progress. The focus of this bilateral and multilateral engagement included significant market impediments and trade-distortive practices as well as other Chinese government policies and practices where the United States has needed to respond in order to defend fundamental WTO principles.

The United States brought three new WTO cases against China in 2007. In the first one, the United States challenged several prohibited subsidy programs benefiting a wide cross-section of China's manufactured goods, and we were pleased that China later agreed to settle this case by committing to eliminate all of the subsidies at issue. The United States also filed a challenge to key aspects of China's IPR enforcement regime, along with a challenge to market access restrictions affecting the importation and distribution of copyright-intensive products such as theatrical films, DVDs, music, books and journals. Each of these three WTO cases implicates fundamental WTO obligations, as does the WTO case filed by the United States in 2006 challenging China's use of prohibited local content requirements in the auto sector.

While pursuing these multilateral enforcement initiatives, the United States also pursued intensified, focused bilateral dialogue with China. Working together, the United States and China pursued a set of formal and informal bilateral dialogues and meetings, including numerous working groups and plenary meetings under the auspices of the U.S.-China Joint Commission on Commerce and Trade (JCCT) and the U.S.-China Strategic Economic Dialogue (SED). Through these avenues, the United States sought resolutions to particular pressing trade issues and encouraged China to accelerate its movement away from reliance on government intervention and toward full institutionalization of market mechanisms. This bilateral engagement produced near-term results in several areas in 2007, including the suspension of overly burdensome testing and certification requirements for medical devices, the granting of biotechnology safety certificate approvals, increased insurance market access, expanded business scopes for foreign banks and securities companies, and a new civil aviation agreement. On other pressing trade issues, the United States and China continue to work together in search of pragmatic solutions.

As noted above, constructive bilateral engagement during the WTO dispute settlement process also facilitated the resolution of one of the WTO disputes brought by the United States, along with Mexico, in 2007. Following two rounds of formal WTO consultations in Geneva in March and June, the United States and China were able to reach agreement in November on the immediate elimination of all of the prohibited subsidies being challenged by the United States. Hopefully, China's willingness to take this step represents a conscious decision by China's policymakers to abandon the type of economic thinking that had relied on this highly distortive type of government intervention in the past. At a minimum, as U.S. Trade Representative Schwab remarked, it showed that "two great trading nations can work together to resolve disputes to their mutual benefit." It also demonstrated that the Administration's policy of serious dialogue and resolute enforcement is delivering real results.

All of these developments demonstrate the substantial ongoing benefits to the United States – including U.S. workers, businesses, farmers, service providers and consumers – from China's WTO membership. Prodded by the United States and other WTO members since acceding to the WTO, China has taken many impressive steps to reform its economy, making progress in implementing a set of sweeping commitments that required it to reduce tariff rates, eliminate non-tariff barriers, provide national treatment and improved market access to goods and services imported from the United States and other WTO members, improve transparency and protect intellectual property rights. Although not complete in every respect, China's implementation of its WTO commitments has led to significant increases in U.S.-China trade, including U.S. exports to China, while deepening China's integration into the international trading system and facilitating and strengthening the rule of law and economic reforms that China began nearly three decades ago. That said, more still needs to be done.

In 2007, U.S. industry began to focus less on the implementation of specific commitments that China made upon entering the WTO and more on China's shortcomings in observing basic obligations of WTO membership as well as Chinese policies and practices that undermine previously implemented commitments. According to one major trade association's testimony this Fall before USTR and the other agencies that comprise the Trade Policy Staff Committee:

[M]any of the market access concerns on which U.S. companies increasingly focus are no longer the result of China's failure to implement specific WTO commitments. Rather, these concerns focus on China's laws, policies, and practices that deviate from the WTO's national treatment principle, its inadequate protection of intellectual property rights, its insufficiently transparent legal and regulatory processes, and its opaque development of technical and product standards that may favor local companies. . . . [T]he hurdles U.S. companies must overcome result from China's falling short of full adherence to the

general principles of the WTO and not from an unwillingness to implement the specific commitments of its entry agreement.

At the root of many of these problems is China's continued pursuit of problematic industrial policies that rely on excessive Chinese government intervention in the market through an array of trade-distorting measures. This government intervention, evident in many areas of China's economy, is a reflection of China's historic yet unfinished transition from a centrally planned economy to a free-market economy governed by rule of law. As another major trade association explained in its written comments, "[t]he legacies of China's command economy continue to be a drag on China's complete integration into the global economy and, as a result, cause a variety of problems for China's trading partners."

During the fifteen years of negotiations leading up to China's WTO accession, the United States and other WTO members worked hard to address concerns created by China's historic economic structure. Given the state's large role in China's economy, the United States and other WTO members carefully negotiated conditions for China's WTO accession that would, when implemented, lead to significantly reduced levels of government intervention in the market and significantly fewer distortions in trade flows. Through the first few years after China's accession to the WTO, China made noteworthy progress in adopting economic reforms that facilitated its transition toward a market economy. However, beginning in 2006 and continuing throughout 2007, progress toward further market liberalization began to slow. It became clear that some Chinese government agencies and officials have not yet fully embraced key WTO principles of market access, non-discrimination and transparency. Differences in views and approaches between China's central government and China's provincial and local governments also have continued to frustrate economic reform efforts, while China's difficulties in generating a commitment to the rule of law have exacerbated this situation.

Looking ahead, one of the critical issues for the international trading system will be to ensure that China's leadership does not retreat from the substantial progress made to date. Evidence of a possible trend toward a more restrictive trade regime appears most visibly in a series of diverse Chinese measures over the past two years signaling new restrictions on market access and foreign investment in China. One trade association with broad representation explains:

Recent public policy debates in China have indicated a dampening of enthusiasm in some quarters for foreign participation in the economy. Some policy makers also appear to want to expand the [Chinese] government's role in directing the economy and in developing internationally competitive Chinese enterprises, while also restricting the role of international companies in certain sectors. Designation of "pillar" industries, promoting "indigenous innovation," and establishing

“national economic security” criteria to review deals are troublesome signposts that do not imply full market access for U.S. companies.

As 2007 was drawing to a close, the United States and China were completing months of preparations for two high-level meetings scheduled to take place back-to-back in Beijing in mid-December. The first one is the annual meeting of the JCCT, chaired by Commerce Secretary Gutierrez and U.S. Trade Representative Schwab on the U.S. side and Vice Premier Wu on the Chinese side, which focuses on seeking resolutions to discrete, pressing trade issues. That meeting will be followed by the semi-annual SED meeting, whose purpose is to manage the complex U.S.-China economic relationship on a long-term, strategic basis under the guidance of Treasury Secretary Paulson and Vice Premier Wu and with the participation of several other ministers on each side.

At present, several specific areas continue to cause particular concern for the United States and U.S. industry, in terms of China’s full adherence to its WTO obligations. The key concerns in each of these areas are summarized below.

Intellectual Property Rights

Since its accession to the WTO, China has put in place a relatively good set of laws and regulations aimed at protecting the intellectual property rights of domestic and foreign right holders. However, some critical measures still need to be revised, and China’s enforcement of its laws protecting the intellectual property rights covered by the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (the TRIPS Agreement) has often been ineffective. U.S. industry reports show no significant reduction in IPR infringement levels again in 2007, confirming that counterfeiting and piracy in China remain at unacceptably high levels and cause serious harm to U.S. businesses across many sectors of the economy. Indeed, despite anti-piracy campaigns in China and an increasing number of IPR cases in Chinese courts, the U.S. copyright industries’ most recent estimates indicate that 85 percent to 93 percent of all copyrighted products sold in China in 2006 were pirated, showing little or no improvement over the previous year. USTR’s annual Special 301 report, issued in April 2007, confirmed this lack of progress, as USTR continued to place China on the Priority Watch List and subject it to Section 306 monitoring.

In 2007, as in prior years, the United States placed the highest priority on improving IPR enforcement in China. The United States pursued extensive bilateral discussions with China, focusing on concrete steps that China could take to improve its legal protections and enforcement efforts so that significant reductions in IPR violations in China could be realized. These efforts achieved an agreement between the two countries’ customs authorities to cooperate on border enforcement, but other critical enforcement concerns remained unaddressed. For

example, China continued to deflect calls from the United States and other WTO members for better utilization of criminal remedies to combat rampant IPR infringement in China, claiming that its approach to enforcement was showing results. The available statistics on continuing rampant IPR infringement in China raise obvious questions about this claim.

In April 2007, after nearly three years of sustained bilateral engagement aimed at addressing U.S. concerns about specific deficiencies in China's legal regime for protecting and enforcing copyrights and trademarks, the United States requested formal WTO consultations. When the ensuing consultations did not lead to an agreed resolution, the United States sought the establishment of a WTO panel to hear the case, and a panel was established in September 2007, with 12 other WTO members joining in as third parties. A panel decision is currently expected in 2008.

The United States remains committed to working constructively with China on a bilateral basis to significantly reduce IPR infringement levels in China and continues to devote considerable staff and resources, both in Washington and in Beijing, to address the many challenges in this area. At the same time, when bilateral discussions prove unable to resolve key issues, the United States remains prepared to take further action on these issues, including WTO dispute settlement where appropriate, given the importance of China developing an effective, TRIPS Agreement-compliant system for IPR enforcement.

Industrial Policies

China continued to pursue industrial policies that seek to limit market access for non-Chinese origin goods and foreign service providers and offer substantial government resources to support Chinese industries and increase exports. In some cases, the objective of these policies seems to be to promote the development of Chinese industries that are higher up the economic value chain than the industries that make up China's current labor-intensive base. In other cases, China appears simply to be protecting less competitive state-owned enterprises.

In 2007, examples of the trade-distortive measures implementing these industrial policies remain readily evident. China continues to apply auto parts regulations that prolong prohibited local content requirements for motor vehicles while the WTO-consistency of those regulations is being challenged in panel proceedings at the WTO. China is also making increasingly restrictive use of export quotas and export duties on a number of raw materials where it is the world's leading producer. Through these export restrictions, China is able to drive up world prices while lowering domestic prices, thereby providing substantial artificial advantages to a wide range of downstream producers in China when they compete against foreign downstream producers in the China market and around the world. In addition, even after re-committing to technology neutrality for 3G telecommunications standards at the April 2006 JCCT meeting, China's

regulatory authorities continue to promote the home-grown TD-SCDMA standard and to expand its test market. China also continues to pursue unique national standards in a number of areas of high technology where international standards already exist, and it pressures foreign companies seeking to participate in the standards-setting process to license their technology or intellectual property on unfavorable terms. Meanwhile, a July 2005 industrial policy that calls for the state's management of major aspects of China's steel industry remains in effect, and excessive government subsidization continues to benefit a range of domestic industries in China. China has also sought to protect many domestic industries through an increasingly restrictive investment regime, as recent measures impose requirements for state control of "critical" equipment manufacturers, establish rules for foreign mergers and acquisitions that confer broad and vaguely defined powers on the government to block investments in a range of industries, and prevent further foreign investment in "pillar" industries. Some of these industrial policy measures raise questions about China's compliance with its WTO obligations in the areas of national treatment, market access, export restrictions, technology transfer and subsidies, among others.

While bilateral discussions yielded little progress in resolving U.S. concerns regarding most of these industrial policy measures in 2007, the United States was able to leverage its use of the WTO dispute settlement mechanism, as noted above, to gain China's agreement to eliminate several prohibited subsidy programs that had been providing substantial benefits to a wide range of manufactured goods being sold in China and being exported to the United States and other markets around the world. Reached in November 2007 after months of negotiations, this agreement committed China to discontinue all of the challenged subsidies by January 1, 2008, and not to reinstate them in the future.

In 2008, the United States will continue to pursue vigorous bilateral engagement to resolve the serious disagreements that remain over a number of China's industrial policy measures, including China's highly trade-distorting use of export restrictions on raw materials. If dialogue fails to address U.S. concerns, however, the United States will not hesitate to take further actions seeking elimination of these industrial policy measures, including WTO dispute settlement, where appropriate.

Trading Rights and Distribution Services

Many in U.S. industry consider trading rights and distribution services to be "the most important of the WTO commitments China has so far implemented," according to one trade association with broad representation. These commitments called for full liberalization of trading rights – the right to import and export – and distribution services, including wholesale and retail services, franchising services and related services, by December 11, 2004. With determined U.S. engagement, China has implemented these critical commitments in most sectors, and many U.S. companies and individuals are now not only able to import and export goods directly without

having to use a middleman, but are also able to establish their own distribution networks within China.

Nevertheless, some serious problems still remain. In particular, despite extensive and persistent bilateral engagement by the United States, China has continued to maintain import and distribution restrictions on copyright-intensive products such as theatrical films, DVDs, music, books and journals, in apparent contravention of China's trading rights and distribution services commitments. These restrictions reduce and delay market access for these copyrighted products, creating additional incentives for infringement in China's market. Once it became clear that bilateral discussions were not leading to changes to address U.S. concerns, the United States invoked the WTO dispute settlement mechanism by filing a request for formal WTO consultations in April 2007. After two rounds of consultations in Geneva failed to resolve the dispute, the United States requested the establishment of a WTO panel to hear the case, and a panel was established in November 2007.

In two other key areas, the United States continued to engage China bilaterally as 2007 was drawing to a close. First, while China has taken steps to implement its commitment to open its market for sales away from a fixed location, also known as "direct selling," China continued to subject foreign direct sellers to unwarranted restrictions on their business operations. In addition, China continued to discriminate against foreign retailers seeking to open new stores by making them satisfy burdensome requirements not applicable to domestic retailers. The United States will continue to pursue these important issues in 2008 to ensure that China fully meets its applicable WTO commitments.

Agriculture

U.S. agricultural exports to China in 2006 totaled more than \$7.6 billion, making China the United States' fourth largest agricultural export market. To date, 2007 has been a comparably successful year, characterized overall by steady growth. For example, U.S. exports of bulk agricultural commodities continued to perform strongly, with soybean exports increasing dramatically. China also remains the leading export destination for U.S. cotton, among other products.

While U.S. exports of agricultural commodities largely fulfill the potential envisioned by U.S. negotiators during the years leading up to China's WTO accession, trade with China in the agricultural sector remains among the least transparent and predictable of the world's major markets, as it continues to be plagued by uncertainty, largely because of selective intervention in the market by China's regulatory authorities. As in past years, capricious practices by Chinese customs and quarantine officials can delay or halt shipments of agricultural products into China, while SPS measures with questionable scientific bases and a generally opaque regulatory regime

frequently bedevil traders in agricultural commodities, who require as much predictability and transparency as possible in order to preserve margins and reduce the already substantial risks involved in agricultural trade.

In 2007, the principal targets of questionable practices by China's regulatory authorities were poultry, pork and soybeans, and anticipated growth in U.S. exports of these products was impeded. In addition, China continued to block the importation of U.S. beef and beef products, even after these products had been declared safe to trade under international guidelines.

In 2008, the United States will continue to pursue vigorous bilateral engagement with China in order to obtain progress on its outstanding concerns. The United States also will not hesitate to take other actions to resolve its concerns if dialogue fails.

Services

Overall, the United States enjoyed a substantial surplus in trade in services with China in 2006, as in prior years, and the market for U.S. service providers in China remains promising. However, in some sectors, it appears that China's commitments to increase market access and remove restrictions have still not been fully realized. Chinese regulatory authorities continue to frustrate efforts of U.S. providers of banking, insurance, telecommunications, construction and engineering, legal and other services to achieve their full market potential in China through the use of an opaque regulatory process, overly burdensome licensing and operating requirements, and other means.

In 2007, U.S. engagement through the SED meeting in May led to some limited progress. China committed to eliminate the backlog of U.S. non-life insurers' applications for conversion from a branch to a subsidiary, and it followed through on that commitment. In addition, China committed to act on the applications of foreign banks incorporated in China seeking to issue their own domestic currency credit and debit cards, although it has not yet done so, hindering the banks' ability to attract Chinese individuals as new customers. China has also failed, to date, to fulfill a commitment that it made at the April 2006 JCCT meeting to lower excessive capital requirements that have been blocking market access for foreign providers of basic telecommunications services.

Meanwhile, two serious WTO concerns that arose in 2006 have so far resisted resolution through high-level bilateral engagement. In particular, Xinhua, the Chinese state news agency, persisted in its refusal to withdraw rules issued in September 2006 imposing new restrictions on foreign providers of financial information services, raising questions about China's implementation of specific WTO commitments that it had made. In addition, questions were raised about China's failure to implement important commitments scheduled to be phased in by December 11, 2006,

which would allow foreign credit card companies to provide electronic payments processing services for domestic currency transactions.

In 2008, the United States will continue to engage China and will closely monitor developments in an effort to ensure that China fully adheres to its services commitments. If necessary, the United States also will not hesitate to take further actions seeking to enforce China's WTO commitments, including WTO dispute settlement, where appropriate.

Transparency

One of the fundamental principles of the WTO Agreement, reinforced throughout China's WTO accession agreement, is transparency. Transparency permits markets to function effectively and reduces opportunities for officials to engage in trade-distorting practices behind closed doors. While China's transparency commitments in many ways require a profound historical shift, China made important strides to improve transparency across a wide range of national and provincial authorities during the first four years of its WTO membership. However, two shortcomings stood out. As of December 11, 2005, China had still not adopted a single official journal for publishing all trade-related measures, and it had yet to regularize the use of notice-and-comment procedures for new or revised trade-related measures prior to implementation. In 2006, after the United States elevated this issue to the JCCT level, China finally adopted a single official journal, although much work remains for China to ensure full participation by all relevant government entities. The United States has also pushed China to adopt a mandatory notice-and-comment practice, and this issue will be a key topic for discussion at the SED meeting taking place in December 2007. To date, however, notice-and-comment remains an optional practice in China. As a result, many of China's regulatory regimes continue to suffer from systemic opacity, frustrating efforts of foreign – and domestic – businesses to achieve all of the potential benefits of China's WTO accession.

Conclusion

In 2008, the Administration will continue its concerted efforts to ensure that China fully implements its outstanding WTO commitments and fully adheres to its fundamental obligations as a WTO member, with particular emphasis on reducing Chinese government intervention in the market, lowering IPR infringement levels in China and making China's trade regime more predictable and transparent. Throughout this process, the Administration will continue to solve problems with dialogue if possible, legal action when necessary, and work within the rules-based international trading system. The Administration will continue to work cooperatively and pragmatically with China – through the robust set of formal and informal U.S.-China bilateral dialogues and meetings, including the JCCT and the SED – to ensure that the benefits of China's WTO membership are realized by the United States and the world and that problems in our trade relationship are appropriately resolved. When bilateral dialogue is not successful, however,

the Administration will not hesitate to employ the full range of enforcement tools available, whether it be the dispute settlement mechanism at the WTO or the enforcement of U.S. trade laws – under the WTO’s rules-based system – to ensure that U.S. interests are not harmed by unfair trade practices.

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

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

WTO members formally approved an agreement on the terms of accession for China on November 10, 2001, at the WTO'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, running from the date of China's WTO accession), 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

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 global business world, 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 continue to 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. These commitments were scheduled to be fully phased in (subject to a few product exceptions) by December 11, 2004, when existing restrictions on companies already invested in China were to be removed, and U.S. companies were to be fully able to import and sell goods in China or export goods from China. It was envisioned that these changes would enhance the efficiency with which a wide range of U.S. companies could distribute and provide related logistics services for imported or domestically produced goods in China, while also enabling U.S. companies to integrate their China operations more easily with their global networks.

Overall, China remains in basic compliance with its trading rights commitments, although one significant exception involves the importation of copyright-intensive products such as theatrical films, DVDs, music, books and journals, which China still reserves for state trading. Meanwhile, China has made substantial progress in implementing its distribution services commitments, although some technical challenges remain. However, as in the trading rights area, one significant exception involves the distribution of copyright-intensive products such as theatrical films, DVDs, music, books and journals, which China continues to restrict. After extensive dialogue with China failed to resolve U.S. concerns, the United States turned to the WTO dispute settlement process in April 2007, launching a challenge to China's restrictions on the importation and distribution of these products.

Trading Rights

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 manufacturing and trading enterprises, which could import or export goods falling within their approved scopes of business. China also granted trading rights to certain foreign-invested enterprises, allowing them to import inputs for their production purposes and export their finished products.

In its accession agreement, responding to concerns raised by members of the WTO working party on China's accession, China committed to substantial liberalization in the area of trading rights. China agreed 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, the same deadline for China to eliminate most restrictions in the area of distribution services. The only exceptions applied to products listed in an annex to China's accession agreement, such as grains, cotton and tobacco, for which China reserved the right to engage in state trading. China also agreed to take a number of liberalization steps during the years prior to its adoption of an automatic trading rights system, including trading rights for Chinese enterprises immediately upon China's accession, followed by trading rights for joint ventures with minority foreign ownership within one year after China's accession and trading rights for joint ventures with majority foreign ownership within two years after China's accession.

As previously reported, during the phase-in period, China timely implemented its commitments relating to Chinese enterprises, but fell behind in implementing the commitments for joint ventures with minority foreign ownership (scheduled for implementation by December 11, 2002) and joint ventures with majority foreign ownership (scheduled for implementation by December 11, 2003). It was not until April 2004, after the United States had made trading rights one of its priority issues during the run-up to the April 2004 JCCT meeting, that China finally began to take steps to implement its commitments more fully. Shortly before that meeting, the National People's Congress issued a revised *Foreign Trade Law*. It provided for trading rights to be automatically available through a registration process for all domestic and foreign entities and individuals, effective July 1, 2004, almost six months ahead of the scheduled full liberalization required by China's accession agreement. In June 2004, China's Ministry of Commerce (MOFCOM) issued implementing rules setting out the procedures for registering as a foreign trade operator in time for the new registration process to be operational on the July 1 effective date. U.S. companies have continued to report few problems with this trading rights registration process.

However, China has not yet implemented its trading rights commitments insofar as they relate to the importation of copyright-intensive products such as theatrical films, DVDs, music, books and journals. Under the terms of China's accession agreement, China's trading rights commitments apply fully to these products, as they are not among the products for which China reserved the right to engage in state trading. As a result, trading rights for these products should have been automatically available to all Chinese enterprises, Chinese-foreign joint ventures, wholly foreign-owned enterprises and foreign individuals as of December 11, 2004. Nevertheless, China continues to wholly reserve the right to import these products to state trading enterprises, as reflected in a host of measures, including the *Regulations on Administration of the Films Industry*, issued by the State Council in December 2001, the *Provisional Rules on the Entry Criteria for Operating Film Enterprises*, issued by the State Administration of Radio, Film and Television (SARFT) and MOFCOM in October 2004, the *Administrative Regulations on Publishing*, issued by the State Council in December 2001, the *Administrative Regulations on*

Audiovisual Products, issued by the State Council in December 2001, the *Catalogue for Guidance of Foreign Investment Industries*, issued by the National Development and Reform Commission (NDRC) and MOFCOM in November 2004, the *Several Opinions on Introducing Foreign Investment into the Cultural Sector*, issued by the Ministry of Culture, SARFT, the General Administration of Press and Publication (GAPP), NDRC and MOFCOM in July 2005, the *Measures for the Administration of Import of Audio and Video Products*, issued by the Ministry of Culture and the General Administration of Customs in April 2002, the *Measures for Administration of Chinese Foreign Contractual Distribution Ventures of Audiovisual Products*, issued by the Ministry of Culture and MOFCOM in February 2004, the *Administrative Regulations on Electronic Publications*, issued by GAPP in December 1997, and the *Procedure for Examination and Approval of Establishment of Publication Importation Entities*, issued by GAPP in December 2005. After raising this matter and China's related restrictions on distribution in numerous bilateral meetings with China and at the WTO during the annual transitional reviews before the Committee on Market Access and before the Council for Trade in Goods since 2005, the United States initiated a WTO dispute settlement case against China in April 2006, challenging China's restrictions on the importation and distribution of copyright-intensive products such as theatrical films, DVDs, music, books and journals. Subsequent WTO consultations held in June and July 2007 failed to lead to an agreed resolution, and the United States filed a request for the establishment of a WTO panel in September 2007. A panel was established at a November 2007 meeting of the WTO's Dispute Settlement Body, with the European Communities (EC), Japan, Korea and Australia joining in as a third parties.

Distribution Services

Prior to its WTO accession, China generally did not permit foreign enterprises 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. These services were largely reserved to Chinese enterprises, although some foreign-invested enterprises were allowed to engage in distribution services within China under certain circumstances. For example, 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* by MOFCOM's predecessor, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), in December 1987. Similarly, wholly foreign-owned enterprises had this same right under the *Detailed Rules for the Implementation of the Law on Wholly Foreign-Owned Enterprises*, issued by MOFTEC in April 2001.

In its WTO 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 (except for sales away from a fixed location), as described below.

Overall, China has made substantial progress in implementing its distribution services

commitments. While delays in implementation and confusion over eligibility characterized much of 2005, these problems largely disappeared in 2006 after MOFCOM began allowing provincial-level authorities to grant wholesale and retail distribution licenses, although some technical challenges remain. At the same time, foreign retailers seeking licenses for new outlets face discriminatory requirements, and China continues to place excessive restrictions on direct selling, or sales away from a fixed location. In addition, the distribution of some products remains unjustifiably restricted, including copyright-intensive products (such as theatrical films, DVDs, music, books and journals), pharmaceuticals and crude oil and processed oil. The restrictions on the copyright-intensive products are currently the subject of a WTO dispute settlement case brought by the United States. In 2008, the United States will continue to work closely with U.S. companies as they seek to overcome these remaining market access barriers and discriminatory requirements and provide the full range of distribution services in China.

Meanwhile, U.S. and other foreign companies will continue to face challenges unrelated to China's WTO obligations, particularly as they attempt to create nationwide distribution networks in China. Currently, distribution networks remain highly fragmented in China, as there are no Chinese distribution companies with nationwide networks and no Chinese distribution company holds a market share greater than two percent, due largely to infrastructure limitations and restrictive provincial and local requirements. Nevertheless, the central government has a strong interest in addressing these impediments and developing nationwide distribution networks, which will foster economic and employment growth and help revitalize rural areas in China.

Wholesaling Services and Commission Agents' Services

China committed that, immediately upon its accession to the WTO, it would permit Chinese-foreign joint ventures and wholly foreign-owned enterprises to distribute at the wholesale level within China any 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 within China for almost all goods, whether made in China or imported, through joint ventures with minority foreign ownership. Excepted goods included 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 within China 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 within China through wholly foreign-owned enterprises. In addition, by this time, the exceptions for books, newspapers, magazines, pharmaceutical products, pesticides and mulching films were to be eliminated. The exceptions for chemical fertilizers, processed oil and crude oil (but not salt and tobacco) were to be eliminated within five years after accession (or by December 11, 2006).

As previously reported, China fell behind in implementing its commitments regarding wholesaling services and commission agents' services insofar as they related to joint ventures

with minority foreign ownership (scheduled for implementation by December 11, 2002) and joint ventures with majority foreign ownership (scheduled for implementation by December 11, 2003). It was not until April 2004, after the United States had made distribution services – including wholesale services – one of its priority issues during the run-up to the April 2004 JCCT meeting, that China finally began to take steps to implement its commitments more fully. Shortly before that meeting, MOFCOM issued the *Measures on the Management of Foreign Investment in the Commercial Sector*, superseding the *Procedures for Pilot Projects for Commercial Enterprises with Foreign Investment*, which had been in force since June 1999. These regulations belatedly lifted market access and national treatment restrictions on joint ventures engaging in wholesale services effective June 2004. In addition, the regulations extended this liberalization to wholly foreign-owned enterprises and removed product exceptions for books, newspapers, magazines, pesticides and mulching films as of the scheduled phase-in date of December 11, 2004, and provided that a separate measure would be issued to remove the product exception for pharmaceuticals. The regulations also required enterprises to obtain central or provincial-level MOFCOM approval before providing wholesale services, and they appeared to set relatively low qualifying requirements, as enterprises needed only to satisfy the relatively modest capital requirements of the *Company Law* rather than the high capital requirements found in many other services sectors.

Initially, MOFCOM's application and approval process remained opaque and was beset with problems, as the central and local approving authorities were still in the process of determining the appropriate procedures and documentation requirements. Large backlogs of distribution licenses developed, and the approving authorities imposed a variety of restrictions on the scope of products and services that could be supplied when they did grant licenses. Meanwhile, a separate set of problems plagued existing enterprises seeking to expand their business scope to include wholesale distribution, in part because the Chinese authorities were still trying to sort out historical tax treatment and Free Trade Zone (FTZ) issues.

During the run-up to the July 2005 JCCT meeting, as the United States made full implementation of China's wholesale (and retail) distribution services commitments an issue of high priority, the Chinese authorities reduced much of the backlog of distribution license applications. In addition, in July 2005, MOFCOM and the General Administration of Customs (Customs Administration) issued the *Circular on Issues Concerning the Trade Administration of Bonded Zones and Bonded Logistics Parks*, which clarified the handling of applications from enterprises located in FTZs. At the July 2005 JCCT meeting, China committed to improve the transparency of the application and approval process. Consistent with this commitment, in September 2005, MOFCOM issued the *Application and Approval Guidelines for Foreign Investments*, which clarified many aspects of the application and approval process. Some improvements subsequently took place in the application and approval process, but it was not until MOFCOM issued the *Notice on Entrusting National Economic and Technological Development Zones with the Authority to Approve Foreign-Funded Distribution Firms and International Forwarding Agents* in February 2006 that the problems with the application and approval process largely disappeared. These developments have made the application and approval process more efficient and less time-consuming and have enabled U.S. companies to improve the efficiency of their China supply

chain management, and as a result many of them have been able to restructure their legal entities to integrate their China operations into their global business more fully and efficiently.

At the same time, U.S. companies in some industries continue to have concerns with regard to product and services restrictions that China has yet to remove.

As in the area of trading rights, China continues to impose restrictions on foreign enterprises' distribution of copyright-intensive products such as theatrical films, DVDs, music, books and journals, despite its commitments to remove most market access and national treatment restrictions applicable to the distribution of these products by no later than December 11, 2004. China's continuing restrictions are set forth in a number of different measures, including the *Administrative Regulations on Publishing*, issued by the State Council in December 2001, the *Administrative Regulations on Audiovisual Products*, issued by the State Council in December 2001, the *Provisions on Guiding the Orientation of Foreign Investment*, issued by the State Council in February 2002, the *Catalogue for Guidance of Foreign Investment Industries*, issued by NDRC and MOFCOM in November 2004, the *Several Opinions on Introducing Foreign Investment into the Cultural Sector*, issued by the Ministry of Culture, SARFT, GAPP, NDRC and MOFCOM in July 2005, the *Administrative Regulations on Management of Foreign-Invested Book, Magazine and Newspaper Distribution Enterprises*, issued by GAPP and MOFTEC in March 2003, the *Administrative Regulations on the Publication Market*, issued by GAPP in July 2003 and revised in June 2004, the *Administrative Regulations on Electronic Publications*, issued by GAPP in December 1997, the *Administrative Measures on Subscription of Imported Publications*, issued by GAPP in December 2004, the *Procedure for Examination and Approval of Establishment of Chinese-Foreign Entities, Cooperative Joint Ventures, and Wholly Foreign Owned Publication Distribution Enterprises*, issued by GAPP in December 2005, and the *Measures for Administration of Chinese Foreign Contractual Distribution Ventures of Audiovisual Products*, issued by the Ministry of Culture and MOFCOM in February 2004. After raising this matter and China's related restrictions on importation in numerous bilateral meetings with China and at the WTO during the annual transitional reviews before the Council for Trade in Services since 2005, the United States initiated a WTO dispute settlement case against China in April 2006 covering the importation and distribution restrictions applicable to copyright-intensive products such as theatrical films, DVDs, music, books and journals, as discussed above in the Trading Rights section.

With regard to the distribution of automobiles by foreign enterprises, China began to implement several measures in 2005, including the *Implementing Rules for the Administration of Brand-Specific Automobile Dealerships*, jointly issued by MOFCOM, the NDRC and the State Administration for Industry and Commerce (SAIC) in February 2005. In November 2005 the NDRC followed up with the *Rules for Auto External Marks*, and in January 2006 MOFCOM issued the *Implementing Rules for the Evaluation of Eligibility of Auto General Distributors and Brand-specific Dealers*. While U.S. industry has generally welcomed these measures, they do contain some restrictions on foreign enterprises that may not be applied to domestic enterprises. As in 2007, the United States will closely monitor how China applies these measures in 2008 in an effort to ensure that foreign enterprises are not adversely affected by these restrictions.

With regard to the distribution of pharmaceuticals, despite the fact that the exception for pharmaceuticals contained in China's accession agreement expired as of December 11, 2004, China did not issue any further regulations and continued to require foreign pharmaceutical companies to sell their finished products through Chinese wholesalers (after hiring Chinese importers to bring their finished products into the country) until mid-2005, when it began allowing the acceptance of applications from foreign pharmaceutical companies for wholesale distribution licenses under the April 2004 distribution regulations and the pre-existing *Rules on the Management of Drug Business Licenses*, issued by the State Food and Drug Administration (SFDA). Since then, U.S. and other foreign pharmaceutical companies have been able to obtain wholesale distribution licenses. At the same time, despite overall progress in this area, many other restrictions affecting the pharmaceuticals sector make it difficult for foreign pharmaceutical companies to realize the full benefits of China's wholesale distribution commitments. The United States is continuing to engage the Chinese regulatory authorities in these areas as part of an effort to promote comprehensive reform of China's healthcare system and to reduce the unnecessary trade barriers that they face.

Meanwhile, U.S. industry is concerned about China's implementation of significant market-opening commitments, scheduled for December 11, 2006, designed to permit foreign enterprises to engage in wholesale distribution of crude oil and processed oil, e.g., gasoline. In early December 2006, China issued regulations – without providing an opportunity for prior public comment – imposing high thresholds and other potential impediments on foreign enterprises seeking to enter the wholesale distribution sector, such as requirements relating to levels of storage capacity, pipelines, rail lines, docks and supply contracts. Based on reports that it had received regarding earlier, selectively circulated drafts, the United States had pressed for the issuance of a draft for public comment and had highlighted the importance of full implementation of its commitments in bilateral meetings with China earlier in 2006 and during the transitional review before the Council for Trade in Services, held in November 2006. In close consultation with U.S. industry, the United States will continue to monitor China's implementation of the December 2006 regulations in 2008 in an effort to ensure that U.S. industry realizes the full benefits of China's commitments in this sector.

Retailing Services

In addition to committing to permit Chinese-foreign joint ventures and wholly foreign-owned enterprises to distribute at the retail level within China any 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 could operate in six of the eight cities). Excepted goods included books, newspapers and magazines, tobacco, chemical fertilizers, processed oil, pharmaceutical products, pesticides and mulching films. 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 were 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 were to be eliminated, and the exceptions for pharmaceutical products, pesticides, mulching films and processed oil were also to be eliminated. The exception for chemical fertilizers was to be eliminated within five years after accession (or by December 11, 2006).

As previously reported, China fell behind in implementing its retailing services commitments for joint ventures with minority foreign ownership (scheduled for implementation upon China's accession) and joint ventures with majority foreign ownership (scheduled for implementation by December 11, 2003). Following repeated bilateral and multilateral U.S. engagement during the run-up to the April 2004 JCCT meeting, MOFCOM issued the April 2004 distribution regulations, which belatedly lifted market access and national treatment restrictions on joint ventures engaging in retail services effective June 1, 2004, except for allowed geographic and quantitative restrictions and product exceptions for pharmaceuticals, pesticides, mulching films and processed oil. These regulations also extended this liberalization to wholly foreign-owned enterprises and removed the product exceptions for pesticides and mulching films and all remaining geographic and quantitative restrictions as of the scheduled phase-in date of December 11, 2004, while the regulations removed the product exception for chemical fertilizer as of the scheduled phase-in date of December 11, 2006. As in the wholesale area, the regulations require enterprises to obtain central or provincial-level MOFCOM approval before providing retail services, and they appear to set relatively low qualifying requirements, including relatively modest capital requirements, although in practice foreign (but not domestic) retailers reportedly must meet higher capital requirements.

Many of the same problems that plagued the application and approval process in the wholesale area in 2005 also arose in the area of retailing services, and the United States repeatedly pressed China to accelerate and improve the implementation of its commitments, just as it did in the wholesale area. The changes that took place in the application and approval process as a result of the July 2005 JCCT meeting helped to remedy these problems, particularly MOFCOM's issuance of the *Notice on Entrusting National Economic and Technological Development Zones with the Authority to Approve Foreign-Funded Distribution Firms and International Forwarding Agents* in February 2006.

Nevertheless, other concerns remained, particularly with regard to possible discriminatory application of a provision in the April 2004 distribution regulations allowing the approving authorities to withhold retail distribution license approvals when, as is the case in many cities, urban commercial network plans have not yet been formulated. Subsequently, in April 2006, MOFCOM issued a notice explaining that foreign-invested enterprises would not be granted

approvals for projects in cities that had not yet finalized their urban commercial network plans. The United States raised concerns about this notice, both bilaterally and during the transitional review before the WTO's Council for Trade in Services in November 2006, because it appeared that domestic enterprises were continuing to receive approvals for their projects in cities without urban commercial network plans in place.

In 2007, the U.S. retail industry became concerned about other extra burdens that it faces, in comparison to domestic retailers, when attempting to expand their operations in China. For example, the licensing process for a foreign retailer seeking to establish a new store begins with a MOFCOM process, which is multi-layered and slow-moving, requiring approvals at the local, provincial and central government levels. Only after the MOFCOM process is completed can the foreign retailer obtain an actual license from SAIC. In contrast, domestic retailers can quickly obtain licenses directly from SAIC. In addition, domestic retailers do not need to satisfy substantive requirements that are imposed on foreign companies, such as an additional minimum capital requirement for each new store or, as discussed above, a requirement that the location city for the new store have an urban commercial network plan in place. The United States raised its concerns about this discriminatory treatment with China during the run-up to the May 2007 SED meeting and subsequently during the transitional review before the Council for Trade in Services in November 2007. The United States has also been raising its concerns during the run-up to the JCCT meeting scheduled for December 2007 and will continue these efforts, if necessary, in 2008.

Meanwhile, questions continue to arise concerning whether China is fully implementing its commitment to allow foreign enterprises to sell processed oil, e.g., gasoline, at the retail level. As explained above, China's first tranche of retail services commitments did not apply to processed oil, as it was one of the excepted goods under China's Services Schedule. However, that exception expired on December 11, 2004, and by that time China committed to permit wholly foreign-owned enterprises to operate gas stations. Instead, China insists that gas stations fall under the chain store provision in its Services Schedule, which permits only joint ventures with minority foreign ownership for "those chain stores which sell products of different types and brands from multiple suppliers with more than 30 outlets." From a business perspective, the ability of foreign enterprises to engage in retail distribution of processed oil will become particularly important once China fully implements its commitments to permit foreign enterprises to engage in wholesale distribution of crude oil and processed oil, required by December 11, 2006. However, as discussed above, the regulations that China issued in the wholesale area in December 2006 impose a number of stringent requirements that appear designed to substantially limit foreign participation in this sector. The United States is working with U.S. industry to assess China's implementation of the regulations on wholesale distribution of crude oil and processed oil and will continue to engage the Chinese government in 2008 in an effort to ensure that U.S. industry realizes the full benefits to which it is entitled in this sector.

Franchising Services

As part of its distribution commitments, China committed to permit the cross-border supply of franchising services immediately upon its accession to the WTO. It also committed to permit foreign enterprises to provide franchising services in China, without any market access or national treatment limitations, by December 11, 2004.

In December 2004, as previously reported, MOFCOM issued new rules governing the supply of franchising services in China, the *Measures for the Administration of Commercial Franchises*, effective February 2005. These rules raised a number of concerns. Of particular concern was a requirement that a franchiser own and operate at least two units in China for one year before being eligible to offer franchises in China, as it conflicts with the business models of many U.S. franchising companies, including some large hotel chains. The rules also impose high capital requirements and require broad and vague information disclosure by franchisers, with uncertain liability if these disclosure requirements are not met.

Together with U.S. industry, the United States expressed strong concern about these rules and urged China to reconsider them. In 2007, China eased the requirement that a franchiser own and operate at least two units in China by allowing a franchiser to offer franchise services in China if it owns and operates two units anywhere in the world. The United States welcomed this action and will monitor developments in this area closely in 2008.

Sales away from a fixed location

China first permitted direct selling in 1990, and numerous domestic and foreign enterprises soon began to engage in this business. In the ensuing years, however, serious economic and social problems arose, as so-called “pyramid schemes” and other fraudulent or harmful practices proliferated. China outlawed direct selling in 1998, although some direct selling companies were permitted to continue operating in China after altering their business models.

In its WTO accession agreement, China did not agree to any liberalization in the area of sales away from a fixed location, or direct selling, during the first three years of its WTO membership. By December 11, 2004, however, China committed to lift market access and national treatment restrictions in this area.

As previously reported, China was late in implementing its direct selling commitment. The Chinese authorities issued implementing measures – the *Measures for the Administration of Direct Selling* and the *Regulations on the Administration of Anti-Pyramid Sales Scams* – in August 2005, nine months late. In September 2006, MOFCOM also issued the *Administrative Measures on the Establishment of Service Network Points for the Direct Sales Industry*, which clarified some aspects of the earlier measures.

The August 2005 direct selling measures contained several problematic provisions. For example, one provision essentially outlaws multi-level marketing practices allowed in every country in which the U.S. industry operates – reportedly 170 countries in all – by refusing to allow direct selling enterprises to pay compensation based on team sales, where upstream personnel are

compensated based on downstream sales. The United States has pointed out that China could revise this provision to permit team-based compensation while still addressing its legitimate concerns about pyramid schemes. Other problematic provisions include a three-year experience requirement that only applies to foreign enterprises, not domestic ones, a cap on single-level compensation, restrictions on the cross-border supply of direct selling services and high capital requirements that may limit smaller direct sellers' access to the market. The September 2006 direct selling measure also includes vague requirements that could prove excessively burdensome for small and medium-sized direct sellers.

After the direct selling measures went into effect in December 2005, many companies began to apply for direct selling licenses but were confused by the opaque license review process. Despite MOFCOM's regulatory requirement that direct selling licenses be reviewed within ninety days, many foreign and domestic companies waited for many months for MOFCOM and SAIC to review their license applications. Accordingly, the United States urged China to address the slow pace and lack of transparency in the licensing process, along with the problematic restrictions in the direct selling measures, during the run-up to the April 2006 JCCT meeting. In response, MOFCOM agreed to hold an informal dialogue with U.S. and other foreign industry representatives in the following months to better understand their concerns about the direct selling measures and to facilitate their efforts to navigate the application and approval process for obtaining licenses. Since then, nine U.S. companies have obtained licenses, although few of them have been able to obtain licenses that allow them to conduct direct selling in more than one province in China.

Meanwhile, working closely with U.S. industry, the United States has continued to urge China to reconsider the problematic provisions in its direct selling measures in order to facilitate legitimate commerce and to comply with its WTO commitments. The United States pressed its concerns not only in connection with the April 2006 JCCT meeting, but also in subsequent bilateral meetings as well as during the November 2006 and November 2007 transitional reviews before the WTO's Council for Trade in Services. The United States will continue these efforts in 2008.

Import Regulation

Tariffs

Through its bilateral negotiations with interested WTO members leading up to its accession, 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.

As in prior years, China implemented its scheduled tariff reductions for 2007 on schedule. These reductions, made on January 1, involved only a few products, most of which were chemical products, as almost all of China’s tariff reductions took place during the first five years of China’s WTO membership.

U.S. exports continued to benefit from China’s 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 the ensuing years, achieving the elimination of all ITA tariffs on January 1, 2005, as the tariffs dropped to zero from a pre-WTO accession average of 13.3 percent. U.S. exports of ITA goods continued to perform well in 2007, as they were projected to exceed \$14 billion by the end of the year, increasing by more than 9 percent from January through September 2007, when compared to the same time period in 2006.

U.S. exports also continued to benefit from China’s timely implementation of another significant tariff initiative, the WTO’s Chemical Tariff Harmonization Agreement, completed in 2005. U.S. exports of chemicals covered by this agreement increased by more than 32 percent from January through September 2007, when compared to the same time period in 2006, and are on a pace to surpass the healthy total of \$6.6 billion in 2006.

Overall, China’s tariff changes since WTO accession have significantly increased market access for U.S. exporters in a range of industries, as China reduced tariffs on goods of greatest importance to U.S. industry from a base average of 25 percent (in 1997) to 7 percent during the first five years of its WTO membership, while it made similar reductions throughout the agricultural sector (see the Agriculture section below). China’s reduced tariffs contributed to another significant increase in overall U.S. exports, which rose approximately 17 percent from January through September 2007, when compared to the same time period in 2006.

Customs and Trade Administration

Like other acceding WTO members, China agreed to take on the WTO obligations that address the means by which customs and other trade administration officials check imports and establish 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 (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 called 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.

In January 2002, shortly after China acceded 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. The Customs Administration subsequently issued the *Rules on the Determination of Customs Value of Royalties and License Fees Related to Imported Goods*, effective July 2003. These rules were intended to clarify provisions of the January 2002 regulations that address the valuation of royalties and license fees. In addition, by December 11, 2003, China had issued a measure on interest charges and a measure requiring duties on software to be assessed on the basis of the value of the underlying carrier medium, meaning, for example, the CD-ROM or floppy disk itself, rather than based on the imputed value of the content, which includes, for example, the data recorded on a CD-ROM or floppy disk.

As of December 2007, China has still not uniformly implemented these various measures. U.S. exporters continue to report that they are encountering valuation problems at many ports.

According to U.S. exporters, even though the Customs Administration’s measures 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. For example, imports of wood products are often subjected to reference pricing. In addition, some of China’s customs officials are reportedly not applying the rules set forth in the Customs Administration’s measures as they relate to software royalties and license fees. Following their pre-WTO accession practice, these officials are still automatically adding royalties and license fees to the dutiable value (for example, when an imported personal computer includes pre-installed software), even though the rules expressly direct them to add those fees only if they are import-related and a condition of sale for the goods being valued.

U.S. exporters have also continued to express concerns about the Customs Administration's handling of imports of digital media that contain instructions for the subsequent production of multiple copies of products such as DVDs. The Customs Administration has been inappropriately assessing duties based on the estimated value of the yet-to-be-produced copies.

More generally, U.S. exporters continue to be concerned about inefficient and inconsistent customs clearance procedures in China. These procedures vary from port to port, lengthy delays are not uncommon, and the fees charged appear to be excessive, giving rise to concerns about China's compliance with its obligations under Article VIII of GATT 1994.

When the United States first presented its concerns about the customs valuation problems being encountered by U.S. companies, China indicated that it was working to establish more uniformity in its adherence to WTO customs valuation rules. Since then, the United States has sought to assist in this effort in part by conducting technical assistance programs for Chinese government officials on WTO compliance in the customs area. In addition, in 2007, as in prior years, the United States raised its concerns about particular customs valuation problems during the transitional review before the WTO's Committee on Customs Valuation.

Rules of Origin

Upon its accession to the WTO, China became subject to the WTO Agreement on Rules of Origin, which sets forth rules designed to increase transparency, predictability and consistency in both the establishment 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 confirming that marking requirements have been met. 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, shortly after China's accession to the WTO, 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. U.S. exporters have not raised concerns with China's implementation of these measures.

Almost three years after China's WTO accession, in September 2004, China issued the *Regulations of the Place of Origin for Imported and Exported Goods*, the important overdue regulations intended to bring China's rules of origin into conformity with WTO rules for import and export purposes. These regulations supersede the *Interim Provisions on the Place of Origin for Imported Goods*, issued by the Customs Administration in 1986, and the *Rules on the Place*

of Origin for Exported Goods, issued by the State Council in 1992. The Customs Administration subsequently issued implementing rules addressing the issue of substantial transformation – the *Rules on Substantial Transformation Criteria Under the Non-Preferential Rules of Origin* – in December 2004. U.S. exporters have not raised concerns with China’s implementation of these measures.

Import Licensing

The Agreement on Import Licensing Procedures (Import Licensing Agreement) establishes rules for all WTO members, including 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 establish 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 import restrictions, such as tariff-rate quotas, or to administer safety or other requirements, such as 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 subsequently raised various concerns with MOFTEC (and its successor, MOFCOM) regarding the regulations on automatic licensing and the regulations on non-automatic licensing in an effort to promote clarity and to ensure that the licensing procedures did not have trade-distorting or restrictive effects. Together with other WTO members, including the EC and Japan, the United States also presented detailed comments on various aspects of these regulations at meetings of the WTO’s Import Licensing Committee, including the transitional reviews, in 2002, 2003 and 2004. In 2007, as in prior years, the United States continued to monitor MOFCOM’s implementation of these regulations.

In May 2005, after Chinese steel producers negotiated contracts with major foreign iron ore suppliers, the Chinese government began imposing new import licensing procedures for iron ore without prior WTO notification. Even though the WTO’s Import Licensing Agreement calls for import licensing procedures that do not have a restrictive effect on trade, China reportedly restricted licenses to 48 traders and 70 steel producers and did not make public a list of the qualified enterprises or the qualifying criteria used. The United States and Australia sought to clarify the operation of the import licensing procedures applicable to iron ore during the

transitional reviews before the Committee on Import Licensing in October 2005 and the Council for Trade in Goods in November 2005. While China maintained that the Chinese government did not impose any qualifying criteria, it did acknowledge that two organizations affiliated with the Chinese government, the China Iron and Steel Association and the China Chamber of Commerce for Metal, Minerals and Chemicals Importers and Exporters, had been discussing a set of rules regarding qualifying criteria such as production capacity and trade performance. In 2006, the United States continued to monitor this situation, which could set a troubling precedent for the handling of imports of other raw materials. Because China seemed determined to restrict the availability of import licenses, the United States raised its concerns with China bilaterally in October 2006 during a meeting of the U.S.-China Steel Dialogue (Steel Dialogue), created earlier in the year under the auspices of the JCCT. The United States also addressed this issue during the transitional review before the Committee on Import Licensing, held in October 2006, as did Australia. In 2007, China reduced the number of licensed traders from 48 to 42 and reportedly instituted further restrictions on qualifying criteria for iron ore import licenses, including tighter limitations on the size of the enterprises eligible to import iron ore and shipment sizes. The United States will continue to monitor developments in this area closely in 2008.

The United States has also focused considerable attention on import licensing issues that have arisen in a variety of other specific contexts since China's WTO accession. In 2007, these include the administration of tariff-rate quota systems for fertilizer and cotton (discussed below in the sections on Tariff-rate Quotas on Industrial Goods and Tariff-rate Quotas on Bulk Agricultural Commodities), various sanitary and phytosanitary (SPS) measures (discussed below in the section on Sanitary and Phytosanitary Issues) and inspection-related requirements for soybeans, meat and poultry (discussed below in the section on Inspection-Related Requirements).

Non-tariff Measures

In its WTO accession agreement, China agreed that it would eliminate numerous trade-distortive non-tariff measures (NTMs), including import 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. These other NTMs included import quotas on industrial goods such as air conditioners, sound and video recording apparatus, color TVs, cameras, watches, crane lorries and chassis, and motorcycles as well as licensing and tendering requirements applicable to a few types of industrial goods, such as machine tools and aerials.

As has been previously reported, China's import quota system was beset with problems, despite consistent bilateral engagement by the United States. 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. Because of a lack of transparency, it was also difficult to assess whether the

quotas were allocated in accordance with the agreed rules. Some of the more difficult problems were encountered with the auto import quota system, resulting at times in significant disruption of wholesale and retail operations for imported autos. While these problems prevented the United States and other WTO members from realizing the full contemplated benefits of these import quotas, China did fully adhere to the agreed schedule for the elimination of all of its import quotas as well as all of its other NTMs, the last of which China eliminated in January 2005. In some cases, China even eliminated NTMs ahead of schedule, as it did with the import quotas on crane lorries and chassis, and motorcycles.

Tariff-rate Quotas on Industrial Products

In its WTO accession agreement, China agreed to implement a system of tariff-rate quotas (TRQs) designed to provide significant market access for three industrial products, including fertilizer, a major U.S. export. Under this 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.

As previously reported, since China began implementing its TRQ system for industrial products in 2002, U.S. exporters have expressed concern about 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 about the Chinese government's issuance of administrative guidance that discouraged some TRQ holders from freely utilizing their quotas. Despite repeated bilateral engagement and multilateral engagement at the WTO, including formal consultations with China in Geneva under the headnotes in China's Goods Schedule, concerns about transparency and administrative guidance have persisted. At the same time, U.S. fertilizer exports to China have continued to decline significantly, dropping from \$676 million in 2002 to \$459 million in 2003 and to \$306 million in 2004. Following a modest increase to \$355 million in 2005, U.S. fertilizer exports to China declined sharply to \$232 million in 2006.

In October 2006, perhaps in an attempt by the central authorities to reign in provincial and local efforts to build further unneeded fertilizer capacity, the Tariff Policy Commission of the State Council announced a temporary reduction of the in-quota tariff rate for fertilizer from four percent to one percent, effective November 2006. Although it was initially anticipated that U.S. fertilizer exports to China might increase following this reduction and the scheduled phase-in of foreign enterprises' rights to engage in wholesale and retail distribution of fertilizer within China as of December 11, 2006, U.S. fertilizer exports sharply declined again in 2007. The data for January through September 2007 showed a decline of 48 percent, totaling \$79 million as compared to \$151 million during the same period in 2006.

Other Import Regulation

Antidumping

In its WTO 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 WTO Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (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.

China has become a leading user of AD measures since its accession to the WTO. Currently, China has in place 97 antidumping measures, some of which pre-date China's membership in the WTO, affecting imports from 18 countries and regions. China also has 7 AD investigations in progress. The greatest shortcomings in China's AD practice continue to be in the areas of transparency and procedural fairness. The United States continues to press China both bilaterally and multilaterally to clarify and address these concerns.

China has put in place much of the legal framework for its AD regime. China continues to add pieces of legislation to this framework, although not all of these new rules and regulations have been notified to the WTO in a timely fashion. Shortly before China's accession to the WTO, the State Council issued new AD regulations that went into effect in January 2002 and charged MOFTEC with making determinations of dumping. In early 2002, MOFTEC issued several sets of provisional 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 the time was charged with making determinations of injury, issued rules covering industry injury investigations and public hearings in January 2003. These regulations were updated and notified to the WTO's AD Committee following the consolidation of the AD functions of MOFTEC and SETC into the newly formed MOFCOM in March 2003. A revised version of China's governing statute, the *Foreign Trade Law*, which included expanded trade remedy language, came into force in July 2004 and was also eventually notified to the AD Committee. More recently, in August 2006, MOFCOM issued the *Regulations on Information Accession and Information Disclosure in Industry Injury Investigations*, which was notified to the AD Committee in October 2007.

China has also issued rules governing judicial review of AD cases. In August 2002, the Supreme People's Court issued the *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 disputes involving AD cases. In September 2002, the Supreme People's Court issued the *Provisions of the Supreme People's Court on Certain Issues Concerning the Applicability of Laws in the Hearing and Handling of Antidumping Administrative Cases*. China did not notify these measures to the AD Committee until January 2007, delaying effective multilateral review of critical elements of China's judicial review mechanism.

To date, no interested party has filed for judicial review of a Chinese antidumping proceeding. However, as China continues to launch AD investigations and apply AD measures against imports, the opportunity for interested parties to seek judicial review will become more critical.

Within MOFCOM, the Bureau of Fair Trade for Imports and Exports (BOFT) is charged with making dumping determinations and the Bureau of Industry Injury Investigation (IBII) is charged with making injury determinations. In cases where the subject merchandise is an agricultural product, the Ministry of Agriculture may be involved in the injury investigation. The State Council Tariff Commission continues to make the final decision on imposing, revoking or retaining AD duties, based on recommendations provided by the BOFT and the IBII, although its authority relative to MOFCOM has not been clearly defined in the regulations and rules since MOFCOM was established.

In practice, China's conduct of AD investigations in many respects continues to fall short of full adherence to the fundamental tenets of transparency and procedural fairness embodied in the AD Agreement. For example, respondents from the United States and other WTO members that have been subject to Chinese AD investigations continue to express concerns about the lack of detailed information made available to interested parties. While the BOFT has improved somewhat at making documents from AD investigations reasonably available on demand, the IBII continues to have an uneven record with regard to making available to foreign respondents materials generated and submitted during the course of its injury investigations, particularly documents submitted by China's domestic industries. In addition, both BOFT and IBII still fail to make available adequate non-confidential summaries of submissions by Chinese producers, thereby precluding interested parties from gaining a full understanding of potentially important facts and data in the record of an investigation. Compounding this problem is the highly limited disclosure by China's AD authorities of the essential facts underlying decisions and calculations made in the course of dumping and injury investigations. Foreign respondents also continue to criticize China's AD authorities for not providing adequate opportunities for interested parties to provide input for their deliberations, particularly with regard to the IBII's injury determinations. Similarly, foreign respondents continue to criticize the cursory nature of decision making in the IBII's injury investigations, including the analysis regarding the causal link between injury and dumping.

At the WTO, the United States continues to address problems with China's AD practice in regular meetings of the AD Committee. The United States also continues to make vigorous use of the Transitional Review Mechanism to clarify issues and voice concerns regarding China's AD practices. During the most recent transitional review before the AD Committee in October 2007, the United States and other WTO members, including the EC and Japan, reiterated their longstanding concerns regarding transparency and procedural fairness.

The United States also vigorously engages China bilaterally on these matters. In April 2004, the United States and China agreed to establish the Trade Remedies Working Group under the auspices of the JCCT. This working group has given U.S. AD experts a dedicated forum to engage China's AD authorities directly and in detail on issues facing U.S. exporters subject to

Chinese AD investigations. The working group has held several meetings since its creation in April 2004, with the most recent meeting taking place in April 2007. U.S. AD experts also have frequent informal exchanges with China's AD authorities, which help to promote greater transparency and accountability in China's AD regime.

At the same time, the United States continues to work closely with U.S. companies affected by Chinese AD investigations in an effort to help them better understand the Chinese system. The United States also advocates on their behalf in connection with ongoing AD investigations, with the goal of obtaining fair and objective treatment for them, consistent with the AD Agreement.

As previously reported, in the antidumping investigation of unbleached kraft linerboard (a cardboard-like packaging material) that MOFCOM initiated in March 2004, U.S. respondents raised a variety of substantive and procedural issues, with one of their principal arguments being that Chinese producers had not suffered any material injury. The United States actively supported many of the positions taken by the U.S. respondents, particularly with regard to the injury issue, which raised WTO concerns. Nevertheless, in September 2005, MOFCOM issued its final determination, finding both dumping and injury, and began imposing antidumping duties on imports of U.S. kraft linerboard. Working closely with U.S. industry, the United States pressed MOFCOM to reverse its injury finding and withdraw the antidumping duties, but these efforts were rebuffed. In early January 2006, the United States notified China as a courtesy that it would be filing a request for WTO consultations the following week. Over the weekend, MOFCOM issued an "administrative reconsideration" in which it rescinded the antidumping duties on kraft linerboard imports.

It also appears that the United States' focus on China's WTO obligations may have played a role in MOFCOM's March 2007 termination of the AD investigation of butanols imported from the United States. When the United States made its appearance at the public hearing held by the IBII, the United States emphasized the importance of the IBII's adherence to China's WTO obligations, not only in the areas of transparency and procedural fairness but also with regard to the substantive requirement of a causal link between any injury to the domestic industry and the dumping found to exist. MOFCOM's subsequent termination of the investigation was based on a finding that the facts did not support the domestic industry's allegation of injury.

Countervailing Duties

In its WTO accession agreement, China 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). The Subsidies Agreement 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 independent review.

As previously reported, shortly before China's accession, the State Council issued new CVD regulations, which came into force in January 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. Updated regulations were later notified to the WTO, as was the revised *Foreign Trade Law*, as discussed above under the heading of Antidumping.

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 Subsidies Agreement and the commitments in its WTO accession agreement. 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. Since China's accession to the WTO, the United States and other WTO members have sought clarifications on a variety of issues concerning China's regulatory framework and have pressed China for greater transparency both during regular meetings and the annual transitional reviews before the Subsidies Committee. The United States will continue to seek clarifications as needed in 2008.

China has not initiated a CVD investigation, either pre- or post-WTO accession. Consequently, it is not yet possible to assess whether China applies its regulations and procedural rules in conformity with WTO rules.

Safeguards

In its WTO accession agreement, China committed to revising its regulations and procedures for conducting safeguard investigations by the time of its WTO accession in order 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.

As previously reported, shortly before China's WTO accession, the State Council issued the *Regulations on Safeguards*, which became effective in January 2002. Under these regulations, MOFTEC became responsible for determining whether the volume of imports of a given product has increased and (together with SETC) whether there is a causal link between any such imports and injury to the domestic industry. Shortly thereafter, MOFTEC issued two sets of provisional procedural rules, one covering initiations and the other hearings. In 2003, 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*. Later that year, a general reorganization of the State Council ministries and commissions consolidated the safeguard functions of MOFTEC and SETC into MOFCOM. In 2004, the State Council issued revised *Regulations on Safeguards*, and MOFCOM issued revised implementing rules to reflect this change.

As with the AD and CVD areas, it appears that China has made an effort to establish a WTO-consistent safeguard regime. While the provisions of China's regulations and procedural rules generally track those of the Safeguards Agreement, there are some potential inconsistencies, and certain omissions and ambiguities remain. In addition, some provisions do not find a counterpart in the Safeguards Agreement. In earlier transitional reviews before the WTO's Committee on Safeguards, the United States noted several areas of potential concern, including transparency, determination of developing country status, treatment of non-WTO members, protection of confidential data, access to non-confidential information, refunding of safeguard duties collected pursuant to provisional measures when definitive measures are not imposed, and the conditions governing the extension of a safeguard measure.

To date, as previously reported, China has conducted only one safeguard proceeding, which resulted in the imposition of tariff-rate quotas on imports of nine categories of steel products from various countries, including the United States, in November 2002. Although U.S. companies exported little of this merchandise to China, there were complaints from interested parties that China's process for allocating quotas under the safeguard measures was unclear, making it difficult for them to determine the quota available and obtain a fair share. China terminated the safeguard measures in December 2003.

Export Regulation

China's WTO accession agreement reinforces China's obligation to only maintain export restrictions allowed under WTO rules. In this regard, Article XI of the GATT 1994 generally prohibits WTO members from maintaining export restrictions (other than duties, taxes or other charges), although certain limited exceptions are allowed. China also agreed to eliminate all taxes and charges on exports, including export duties, except as included in Annex 6 to the Protocol of Accession or 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 any such fees and charges shall not represent an indirect protection to domestic products or a taxation of exports for fiscal purposes.

Despite these commitments, since its accession to the WTO, China has continued to impose restrictions on exports of raw materials, including quotas, related licensing requirements and duties, as China's state planners have continued to guide the development of downstream industries. These export restrictions are widespread. For example, China maintains export quotas and sometimes export duties on antimony, coke, fluorspar, indium, magnesium carbonate, molybdenum, rare earths, silicon, talc, tin, tungsten and zinc, all of which are of key interest to U.S. downstream producers.

Normally, these types of export restrictions significantly distort trade, and for that reason the WTO rules outlaw them. In the case of China, the trade-distortive impact is exacerbated because China is the world's leading producer of each of the raw materials at issue (except for molybdenum, for which China is the world's second leading producer).

China's export restrictions affect U.S. and other foreign producers of a wide range of downstream products, such as steel, chemicals, ceramics, semiconductor chips, refrigerants, medical imagery, aircraft, refined petroleum products, fiber optic cables and catalytic converters, among numerous others. The export restrictions create disadvantages for these foreign producers by artificially increasing China's export prices for their raw material inputs, which also drives up world prices. At the same time, the export restrictions artificially lower China's domestic prices for the raw materials due to significant domestic oversupply, enabling China's domestic downstream producers to produce lower-priced products from the raw materials and thereby creating significant advantages for China's domestic downstream producers when competing against foreign downstream producers both in the China market and in export markets.

In an attempt to justify some of China's export restrictions, MOFCOM has cited Article XX(g) of GATT 1994, which permits a WTO member to impose 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. However, serious questions arise concerning whether China meets this standard because it does not appear to impose restrictions on the domestic side that are in any way comparable to its export restrictions. China's treatment of coking coal, a key steel input, provides a relevant example. China imposes a resource tax on all coal used in producing coking coal, or coke, in China, whether destined for domestic sale or export. Nevertheless, while the resource tax applies equally to domestic sales and exports, China also places other restrictions on coke, but they only apply to exports. China limits exports of coke to 14 million metric tons (MT) per year and additionally imposes 15 percent duties on coke exports. With these export restrictions in place and no comparable restrictions on the domestic side, China produced 298 million MT of coking coal in 2006, and all but 14 million MT of this production was sold in the domestic market.

Beginning shortly after China's WTO accession, the United States repeatedly raised its concerns about China's continued use of export restrictions, particularly on coke and fluorspar, both bilaterally and at the WTO during the annual transitional reviews before the Committee on

Market Access and the Council for Trade in Goods. The United States also worked with other WTO members with an interest in this issue, including the EC and Japan. In response to these efforts, as previously reported, China refused to modify its policies in this area. In fact, over time, China's state planners have increased the artificial advantages afforded to China's downstream producers by making the export quotas more restrictive and by imposing or increasing export duties on many raw materials at issue.

During the run-up to the JCCT meeting scheduled for December 2007, the United States has been pressing China to eliminate the export quotas and export duties on the 12 raw materials of key interest to U.S. industry, which includes antimony, coke, fluorspar, indium, magnesium carbonate, molybdenum, rare earths, silicon, talc, tin, tungsten and zinc. The United States will continue to pursue this matter in 2008, if necessary, to ensure that China fully meets its WTO commitments and will take further actions seeking the elimination of China's export restrictions, including through WTO dispute settlement, where appropriate.

China's state planners also attempt to manage the export of many intermediate and downstream products, often by raising or lowering the value-added tax (VAT) rebate available upon export and sometimes by imposing or retracting export duties. These practices have caused tremendous disruption, uncertainty and unfairness in the markets for particular products.

Sometimes, as in the case of China's export quotas, the objective of these adjustments is to make larger quantities of a product available domestically at lower prices than the rest of the world. For example, China decided in 2006 to eliminate the 13 percent VAT rebate available on the export of refined metal lead and then, in 2007, imposed a duty of 10 percent on refined metal lead exports. These actions caused a steep decline in China's exports of this intermediate product and have contributed to a sharp rise in world prices, which have gone from approximately \$1,300 per metric ton (MT) at the time of China's elimination of the export VAT rebate in 2006 to approximately \$3,200 per MT in recent months. Meanwhile, Chinese domestic prices have reportedly declined because of China's captive refined metal lead production, giving China's downstream producers a substantial competitive advantage over foreign downstream producers.

In other recent situations, China has reduced or eliminated VAT export rebates in an attempt to reign in out-of-control expansion of production capacity in particular sectors. China resorts to this practice in part because it has not yet developed a fully functioning market economy and therefore cannot simply leave it to the market to bring about the necessary adjustments. In some instances, the adjustments have benefited U.S. producers by slowing surges in low-priced exports from China to the United States. However, the adjustments can also have harmful consequences, whether or not intended. For example, in November 2006 and April 2007, China reduced export VAT rebates that had been available on a wide range of semi-finished and finished steel products, as part of its efforts to discourage further unneeded creation of production capacity for these products in China. At the same time, these export VAT rebate reductions did not target all steel products, and the result was that Chinese steel producers shifted their production to steel products for which full export VAT rebates were still available, particularly steel pipe and tube

products, causing a tremendous surge in exports of these products – many of which found their way into the U.S. market.

The United States and other WTO members questioned China's export VAT rebate practices during China's first Trade Policy Review at the WTO, held in April 2006, and have urged China to undertake the economic reforms necessary for it to complete its transition to a market economy. The United States has also raised these concerns during bilateral meetings, such as the Steel Dialogue meetings in October 2006 and August 2007 and the April 2007 meeting of the Structural Issues Working Group, an entity that was created at the April 2004 JCCT meeting. In addition, in the case of export duties not authorized by Annex 6 to its Protocol of Accession, the United States has urged China to eliminate them, given China's specific commitment not to use them.

To date, China has been willing to take steps to remedy some of the unintended consequences of its export VAT rebate reductions when the United States has brought it to China's attention. In July 2007, for example, China issued a notice extending export VAT rebate reductions to most steel pipe and tube products, with the notable exception of oil country tubular goods.

In 2008, the United States will continue to engage China in this area. The United States' basic message will continue to be that China needs to pursue the additional economic reforms that will allow China to rely on the market, rather than government intervention, to bring about needed production capacity adjustments in particular sectors of the economy.

Internal Policies Affecting Trade

Non-discrimination

In its WTO accession agreement, China agreed to assume the obligations of GATT 1994, the WTO agreement that establishes 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 Article I of GATT 1994) 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 Article III of GATT 1994) 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 own 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 WTO accession agreement, China agreed to repeal or revise all laws, regulations and other measures that were inconsistent with the MFN 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 that 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 previously reported, China reviewed its pre-WTO accession laws and regulations and revised many of those which conflicted with its WTO MFN and national treatment obligations in 2002. Many 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 still does not appear to observe MFN and national treatment requirements in all areas. For example, several U.S. industries reported that China continued to apply the value-added tax 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 and Subsidies sections. In addition, China's industrial policies on automobiles and steel appear to discriminate against foreign producers as well as imported goods, as discussed below in the Investment section. It also appears that China has applied sanitary and phytosanitary measures in a discriminatory manner since it acceded to the WTO, as discussed below in the Agriculture section. The United States continued to address these and other MFN and national treatment issues with China in 2007, both bilaterally and in WTO meetings, such as the transitional reviews before the Committee on Market Access, the Committee on Trade-Related Investment Measures

(TRIMS Committee), the Committee on Sanitary and Phytosanitary Measures (SPS Committee), the Subsidies Committee, the Council for Trade in Goods, the Committee on Trade in Financial Services and the Council for Trade in Services. The United States will continue to pursue these issues vigorously in 2008.

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.

Since China's WTO accession, certain aspects of China's taxation system have raised serious national treatment concerns. One of these issues – the discriminatory VAT rates applied to imports versus domestically produced semiconductors – was resolved in 2004, although other issues remain. In addition, China continued to use its income tax and VAT systems to provide subsidies that appear to be prohibited under the WTO Subsidies Agreement, as discussed below in the Subsidies section.

As previously reported, in an effort to develop its domestic integrated circuit (IC) industry, China began announcing discriminatory VAT policies in late 2001, although they did not become operational until 2004. Pursuant to a series of measures, China provided for the rebate of a substantial portion of the 17 percent VAT paid by domestic manufacturers on their locally produced ICs. A similar VAT rebate was available to imported ICs, but only if they had been designed in China. China charged the full 17 percent VAT on all other imported ICs. These policies disadvantaged U.S. exports of ICs to China, which totaled approximately \$2 billion in 2003, and put pressure on foreign enterprises to shift investment in IC manufacturing to China. Following extensive but unsuccessful bilateral engagement, the United States initiated dispute settlement by requesting formal WTO consultations with China in March 2004. In the ensuing consultations, which took place in April 2004 in Geneva, with third party participation by Japan, the EC and Mexico, the United States laid out its claims under Article III of GATT 1994, which sets forth the WTO's national treatment principle. Through these consultations and a series of bilateral meetings in Washington and Beijing, a settlement was reached in July 2004, pursuant to which China agreed to withdraw the challenged measures.

China has also used VAT policies to benefit domestic fertilizer production. In July 2001, the Ministry of Finance (MOF) and the State Administration of Taxation (SAT) issued a circular exempting all phosphate fertilizers except diammonium phosphate (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. 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 high-level meetings. The United States has also raised this issue at the WTO, both in regular meetings of the Committee on Market Access and during the annual transitional reviews, including in 2007. China did allow the special tax treatment for domestic urea to expire at the end of 2002, but it has refused to make any other changes. The United States will continue to press its concerns regarding this issue in 2008, although at present a larger concern for U.S. fertilizer exporters remains the out-of-control expansion of China's domestic production of fertilizer, which has saturated China's market and greatly reduced demand for imported fertilizer.

Meanwhile, several U.S. industries have continued to express concerns 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 continued to emphasize the value to China of a properly functioning VAT system as a revenue source.

China's border trade policy also 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 19 other products. However, several other products continue to benefit from preferential treatment. During the transitional reviews before the WTO's Council for Trade in Goods, the United States has urged China to eliminate the preferential treatment for these remaining products.

National treatment concerns also continue to arise in connection with 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 to the WTO, the United States has raised this issue with China, both bilaterally and during the annual transitional reviews conducted by the WTO Committee on Market Access and the Council for Trade in Goods. To date, China has not revised these regulations.

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 subsidies prohibited under Article 3 of the Subsidies Agreement, which includes 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 that 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, in certain circumstances, 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, in certain circumstances, when determining whether preferential government benefits have been provided to a Chinese enterprise via a loan, WTO members can use foreign or other market-based criteria rather than Chinese benchmarks to ascertain the benefit of that loan and its terms. Special rules also govern the actionability of subsidies provided to state-owned enterprises.

As previously reported, following increasing pressure from the United States and other WTO members, China finally submitted its long-overdue subsidies notification to the WTO's Subsidies Committee in April 2006. Although the notification reported on more than 70 subsidy programs, it was also notably incomplete, as it failed to notify any subsidies provided by China's state-owned banks or by provincial and local government authorities. In addition, while China notified several subsidies that appear to be prohibited, it did so without making any commitment to withdraw them, and it failed to notify other subsidies that appear to be prohibited. The United States has devoted significant time and resources to monitoring and analyzing China's subsidy practices, and these efforts helped to identify significant omissions in China's subsidy notification. In accordance with Subsidies Committee procedures, the United States submitted extensive written questions and comments on China's subsidies notification in July 2006, as did several other WTO Members, including the EC, Japan, Canada, Mexico, Australia and Turkey. China responded to those submissions in September 2007, although many of China's responses are inadequate and fail to provide much of the information required by WTO rules.

The United States began seeking changes to China's subsidies practices immediately after China submitted its subsidies notification in April 2006. Through a series of bilateral meetings in Beijing, including high-level meetings, the United States made clear that China needed to withdraw both the prohibited subsidies that it had notified and several additional prohibited subsidies that it had not notified. The subsidies at issue provide refunds, reductions and

exemptions from income tax, VAT and other payments and benefit a wide range of industries in China. In addition, they take the form of both export subsidies, which make it more difficult for U.S. manufacturers to compete against Chinese manufacturers in the U.S. market and third-country markets, and import substitution subsidies, which make it more difficult for U.S. manufacturers to export their products to China. By February 2007, it had become clear that continued bilateral dialogue would not resolve this matter, and the United States, together with Mexico, initiated WTO dispute settlement proceedings against China. Joint consultations were subsequently held in Geneva in March 2007 and then in June 2007. In July 2007, the United States and Mexico filed requests for the establishment of a panel to hear the dispute, and a panel was established at the August 2007 meeting of the WTO's Dispute Settlement Body. Three months later, in November 2007, the parties to the dispute reached a settlement in which China agreed to eliminate all of the subsidies at issue by January 1, 2008, and not to reinstate them.

Meanwhile, many U.S. industries, including the steel, paper and textiles industries, among others, continued to express concern about the injurious effects of various Chinese subsidies in the U.S. market as well as in China and third-country markets. These concerns had led to the U.S. paper industry's filing of a petition with the Commerce Department in October 2006 requesting the initiation of a CVD investigation based on allegations of subsidized imports of coated free sheet paper from China causing injury in the U.S. market. The petition requested a change to the Commerce Department's longstanding policy of not applying U.S. CVD law to China or any other country considered a "non-market economy" for antidumping purposes. The Commerce Department initiated an investigation in November 2006, and during the course of the ensuing investigation it changed its policy and began applying U.S. CVD law to China after finding that reforms to China's economy in recent years had removed the obstacles to applying the CVD law that were present in the "Soviet-era economies" at issue when the Commerce Department first declined to apply the CVD law to non-market economies in the 1980s. In its final determination, issued in October 2007, the Commerce Department found that China's paper industry benefited from a wide range of countervailable subsidies. In November 2007, however, the U.S. International Trade Commission found that imports of coated free sheet paper from China were not materially injuring the U.S. paper industry, which means that the investigation will be terminated.

In 2007, several other U.S. industries concerned about subsidized Chinese imports have filed CVD petitions. So far this year, the Commerce Department has initiated CVD investigations of steel pipe, laminated woven sacks, tires, magnets, thermal paper and sodium nitrite imports from China. The subsidies alleged in these petitions include preferential loans, income tax and VAT exemptions and reductions, the provision of goods and services on non-commercial terms, and a variety of provincial and local government subsidies.

In 2008, the United States will continue to pursue its own research and analysis of possible Chinese subsidy programs and will closely monitor the implementation of China's new *Enterprise Income Tax Law*, which becomes effective January 2008 and appears to provide preferences to high technology enterprises, among others. The United States will also continue to raise its concerns with China's subsidies practices in bilateral meetings with China, including

through future meetings of the Structural Issues Working Group and the Steel Dialogue. At the WTO, using both regular meetings and transitional reviews before the Subsidies Committee, U.S. engagement will focus on the need for China to adhere more fully to its subsidy reporting obligations. Although China has made some progress in providing information on its subsidy programs, it has failed to notify any subsidies provided by its state-owned banks or by provincial and local government authorities. This failure leaves a significant gap in China's subsidies reporting and is particularly troubling given the important role played by sub-national governments in China's banking system and in the development of Chinese industry.

Price Controls

In its WTO 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.

In 2007, China continued to maintain price controls on several products and services provided by both state-owned enterprises and private enterprises. Published through the China Economic Herald and NDRC's website, these price controls may be in the form of either absolute mandated prices or specific pricing policy guidelines as directed by the government. Products and services subject to government-set prices include pharmaceuticals, tobacco, natural gas and certain telecommunications services. Products and services subject to government guidance prices include gasoline, kerosene, diesel fuel, fertilizer, cotton, various grains, various forms of transportation services, professional services such as engineering and architectural services, and certain telecommunications services.

The United States obtained additional information about China's use of price controls from the WTO Secretariat's Trade Policy Review report on China, issued in February 2006. The United States also sought and obtained clarifications from China in connection with China's Trade Policy Review, which took place in April 2006. In addition, as in prior years, the United States sought updated information from China on its use of price controls and future plans during the transitional review before the Subsidies Committee, held in October 2007, although China provided little responsive information. The United States will continue to monitor China's progress in eliminating price controls in 2008, including in connection with China's next Trade Policy Review, scheduled for May 2008.

Meanwhile, in July 2006 and October 2007, NDRC released proposals for managing the prices of medical devices, with the stated objectives of avoiding excessive mark-ups by distributors and reducing health care costs. Among other things, the proposals impose limits on the allowable mark-ups on medical devices. The proposals also require manufacturers to provide sensitive pricing information. The United States and U.S. industry have been concerned about the

proposals' limits on price mark-ups, which would reduce competition as well as patient and physician choice, and the proposals' collection of sensitive pricing data, the publication of which could be very damaging to U.S. companies' operations in China. Indeed, municipalities such as Beijing and Shanghai moved forward with medical device procurement tendering programs in 2007 that have threatened the confidentiality of pricing information.

In 2006 and 2007, the United States and U.S. industry repeatedly raised their concerns about NDRC's proposals. U.S. industry has been able to engage in a dialogue with NDRC, and the United States has pressed China during the run-up to the JCCT meeting scheduled for December 2007. While acknowledging China's legitimate concerns regarding the need to provide effective and affordable medical devices to patients and the need to address inefficiency, excessive mark-ups and irregular business practices among wholesalers and distributors of medical devices, the United States has urged China to develop an approach that will not inhibit increased imports of the same innovative and effective health care products that China is seeking to encourage. The United States will continue these efforts in 2008.

Standards, Technical Regulations and Conformity Assessment Procedures

With its accession to the WTO, China assumed obligations under the Agreement on Technical Barriers to Trade (TBT Agreement), which establishes rules and procedures regarding the development, adoption and application of standards, technical regulations and the conformity assessment 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 WTO accession agreement, China also specifically committed that it would ensure that its conformity assessment bodies operate in a transparent manner, 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 Annex 3 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 addition, in the Services Schedule accompanying its WTO accession agreement, China committed to permit foreign service suppliers that have been engaged in inspection services in their home countries for more than three years to establish minority foreign-owned joint venture

technical testing, analysis and freight inspection companies upon China's accession to the WTO, with majority foreign ownership no later than two years after accession and wholly foreign-owned subsidiaries four years after accession. China further agreed that qualifying joint venture and wholly foreign-owned enterprises would be eligible for accreditation in China and accorded national treatment.

In 2007, China's actions continued to generate concerns for the United States and other WTO members in the areas of standards, technical regulations and conformity assessment procedures, particularly with regard to transparency, national treatment, China's pursuit of unique Chinese national standards, and duplicative testing and certification requirements. In addition, new concerns arose with regard to encryption standards, mobile telephone battery standards and border inspection requirements for medical devices.

Restructuring of Regulators

As previously reported, 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 Standardization Administration of China (SAC) under AQSIQ. SAC 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. SAC 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 (CNCA), which is attached to AQSIQ and is charged with the task of unifying the country's conformity assessment regime.

Despite these changes, U.S. industry still has concerns about significant conformity assessment and testing-related issues in China. For example, U.S. exporters representing several sectors continue to report that China's regulatory requirements are not enforced as strictly or uniformly against domestic producers as compared to foreign producers. In addition, in some cases, China's regulations provide only that products will be inspected or tested upon entry into China's customs territory, without any indication as to whether or how the regulations will be applied to domestic producers.

Transparency

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, MOFCOM, has been notifying proposed technical regulations and conformity assessment procedures to the TBT Committee so that interested parties in WTO members are able to comment on them, as required by the TBT Agreement. However, in 2007, as in prior years, almost all of the notified measures have emanated from AQSIQ, SAC or CNCA and have rarely included measures from other agencies that appear to require notification, such as the Ministry of Health, the Ministry of Information Industry (MII), the State Environmental Protection Administration (SEPA) and SFDA. Four years ago, in part to address this problem, China had 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 sanitary and phytosanitary) matters, but progress has been inconsistent in this area.

As a result, some of China's TBT measures continue to enter into force without having first been notified to the TBT Committee, and without foreign companies having had the opportunity to comment on them or even being given a transition period during which to make necessary adjustments. In addition, as the United States has consistently highlighted during regular meetings and the annual transitional reviews before the TBT Committee, the comment periods established by China for the TBT measures actually notified continue to be unacceptably brief in some cases. In other cases, some U.S. companies reported that even when sufficient time was provided, written comments submitted by U.S. and other foreign interested parties seemed to be wholly disregarded. In still other cases, insufficient time was provided for Chinese regulatory authorities to consider interested parties' comments before a regulation was adopted.

One significant example of the transparency problems encountered by U.S. and other foreign governments and industries this year is AQSIQ's issuance of the *Administrative Measures on Examination and Supervision of Imported Medical Devices* in June 2007, with an effective date of December 1, 2007. This measure, known as Decree 95, establishes a unique examination and supervision regime for imported medical devices, but China did not notify it to the TBT Committee. Instead, China maintained that it did not have to notify this measure because the law that it implemented, the *Law on Import and Export Commodity Inspection*, had previously been notified. However, the TBT Agreement notification obligation applies regardless of whether the measure is a law or a regulation implementing a law and regardless of how a WTO member characterizes the measure under its own legal system. The United States and other WTO members routinely notify measures like Decree 95.

Standards and Technical Regulations

Shortly after its accession to the WTO, China began the task of bringing its standards regime more in line with international practice. One of its first steps was AQSIQ's issuance of rules

designed to facilitate China's adoption of international standards. China subsequently embarked on the task of reviewing all of China's existing 21,000 standards and technical regulations to determine their continuing relevance and consistency with international standards. During transitional reviews before the TBT Committee, China has periodically reported on the status of this review process and the number of standards and technical regulations that have been nullified, but it remains unclear whether these actions have had a beneficial impact on U.S. market access.

The United States continues to make efforts to assist China as it improves its standards regime through bilateral exchanges, education and training. For example, in May 2005, a new U.S. private sector standards office, using funding from the U.S. Department of Commerce, opened in Beijing. Its goals are to strengthen ties with Chinese government regulatory authorities, Chinese industry associations and Chinese standards developers and, in particular, to ensure that close communication exists between U.S. and Chinese standards developers. The United States also continued to provide technical assistance to China. Since 2004, this technical assistance has focused on broad standards-development issues, such as the relationship between intellectual property rights and standards, and specific standards in a number of industries, including information and telecommunications technology, chemicals, steel, petroleum, water conservation, energy efficiency, hydrogen infrastructure, elevators, electrical safety, gas appliances, distilled spirits, heating, ventilation and air conditioning, and building fire safety. The United States has also conducted programs addressing China RoHS and China's new chemical management system.

In 2006, the U.S. Trade and Development Agency (TDA) launched the U.S.-China Standards and Conformity Assessment Cooperation Project in Beijing. This project, with funding from TDA and U.S. industry, provides education and training to Chinese policy makers and regulators with regard to U.S. standards and conformity assessment procedures. In addition, the American National Standards Institute, with funding and participation from the U.S. Department of Commerce, announced the launching of a Standards Portal in cooperation with SAC. The Standards Portal contains dual language educational materials on the structure, history and operation of the U.S. and Chinese standards systems, a database of U.S. and Chinese standards and access to other standards from around the world.

At the same time, concern has grown over the past few years as China is actively pursuing the development of unique requirements, despite the existence of well-established international standards, as a means for protecting domestic companies from competing foreign standards and technologies. Indeed, China has already adopted unique standards for digital televisions, and it is trying to develop unique standards and technical regulations in a number of other sectors, including, for example, autos, telecommunications equipment, Internet protocols, wireless local area networks, radio frequency identification tag technology, audio and video coding and fertilizer as well as software encryption and mobile phone batteries. This strategy has the potential to create significant barriers to entry into China's market, as the cost of compliance will be high for foreign companies, while China will also be placing its own companies at a disadvantage in its export markets, where international standards prevail.

WAPI Encryption Standards

As previously reported, a particularly troubling example of China's pursuit of unique requirements arose in May 2003, when 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 were originally scheduled to go into effect in December 2003 and were never notified to the TBT Committee, incorporated the WLAN Authentication and Privacy Infrastructure (WAPI) encryption technique for secure communications. This component of the standards differed significantly from the internationally recognized standard that U.S. companies have adopted for global production, and China was set to enforce it by providing the necessary algorithms only to eleven Chinese companies. U.S. and other foreign manufacturers would have had to work with and through these companies, some of which were their competitors, and provide them with technical product specifications, if their products were to continue to enter China's market. Focusing on the WTO compatibility of China's implementation of the standards, the United States repeatedly raised its concerns with China throughout the remainder of 2003 and made WAPI one of the United States' priority issues during the run-up to the April 2004 JCCT meeting. The United States was particularly concerned about the precedent that could be established if China were allowed to enforce unique mandatory standards in the fast-developing information technology sector. The United States and China were ultimately able to resolve the issue at the JCCT meeting, as China agreed to an indefinite delay in the implementation of the WAPI standards. China has since submitted a voluntary WAPI standard for consideration by the International Organization for Standardization (ISO). The technical merits of the WAPI standard were considered by the ISO in 2005, and its adoption as an international standard was rejected by an ISO vote in March 2006. Separately, China announced in December 2005 that products incorporating the WAPI standards should be given preference in government procurement, although the trade effects of this policy appear to be limited.

3G Telecommunications Standards

The United States also elevated another standards issue to the JCCT level beginning in 2004. The U.S. telecommunications industry was very concerned about increasing interference from Chinese regulators, both with regard to the selection of 3G telecommunications standards and in the negotiation of contracts between foreign telecommunications service providers and their Chinese counterparts. The United States urged China to take a market-based and technology neutral approach to the development of next generation wireless standards for computers and mobile telephones. At the April 2004 JCCT meeting, China announced that it would support technology neutrality with regard to the adoption of 3G telecommunications standards and that telecommunications service providers in China would be allowed to make their own choices about which standard to adopt, depending on their individual needs. China also announced that Chinese regulators would not be involved in negotiating royalty payment terms with relevant intellectual property rights holders. However, by the end of 2004, it had become evident that there was still pressure from within the Chinese government to ensure a place for China's home-grown 3G telecommunications standard, known as TD-SCDMA.

In 2005, China's regulators continued to take steps to promote the TD-SCDMA standard. It also became evident that they had not ceased their attempts to influence negotiations on royalty payments. More recently, in February 2006, China declared TD-SCDMA to be a "national standard" for 3G telecommunications, raising concerns among U.S. and other foreign telecommunications service providers that Chinese mobile telecommunications operators will face Chinese government pressure when deciding what technology to employ in their networks. As a result, the United States again raised the issue of technology neutrality in connection with the April 2006 JCCT meeting. At that meeting, China restated its April 2004 JCCT commitment to technology neutrality for 3G standards, agreeing to ensure that mobile telecommunications operators would be allowed to make their own choices as to which standard to adopt. China also agreed to issue licenses for all 3G standards in a technologically neutral manner that does not advantage one standard over others. To date, China has not issued any 3G licenses to foreign firms, yet its test market for the TD-SCDMA standard continues to expand. The United States will carefully monitor developments in this area in 2008 and engage China as necessary to ensure that China's regulators adhere to China's JCCT commitments.

Recycled Scrap

As previously reported, in 2004, AQSIQ began requiring exporters of recycled scrap to comply with a new registration system. U.S. exporters, which account for nearly \$2 billion of recycled scrap exports to China annually, were concerned because AQSIQ imposed a deadline for registering, and the registration process included a number of procedural and substantive requirements that lacked clarity. Following U.S. engagement, AQSIQ provided needed clarifications and subsequently showed some flexibility by agreeing to extend the registration deadline. By the end of 2004, 87 percent of applicants, including hundreds of U.S. exporters, had reportedly become registered suppliers of recycled scrap. AQSIQ also indicated that it would institute a rolling application process, which it began in 2005. Despite these improvements, U.S. exporters reported problems with AQSIQ's registration system in 2007, such as inconsistent or unexplained rejections of license applications, rejections of shipments at the point of entry, new requirements imposed with little or no notice, and unclear procedures for license renewals. The United States will engage China as necessary in 2008 to ensure that AQSIQ's registration system for scrap exporters does not restrict legitimate trade.

Patents Used in Chinese National Standards

In late 2004, new concerns arose following SAC's issuance of a draft measure – the *Interim Regulations for National Standards Relating to Patents* – and public statements by key Chinese government officials that appeared to call for compulsory licensing of patented technologies that are used for national standards in China. Standards organizations normally require enterprises that contribute patented technology to a standard to license their patents on "reasonable and non-discriminatory" terms, which entitles them to set reasonable limits on the use of their technology and to receive reasonable compensation. Although the initial draft of this measure did not expressly call for compulsory licensing and subsequent drafts have not been released for public comment, public statements by key Chinese government officials have generated U.S. industry

concern that the final version of the measure may require foreign enterprises to share their patented technologies on a royalty-free basis in exchange for the opportunity to participate in developing standards, which is the approach that has been followed by some Chinese standards organizations on an *ad hoc* basis. While the current status of this measure is unclear, the United States has urged China to circulate an updated draft for public comment and will closely monitor developments in this area in 2008. The United States will also closely monitor China's efforts to develop a new *Standardization Law* in 2008. Reportedly, a draft of that law has been circulated among China's ministries and is undergoing vigorous debate before the State Council.

Distilled Spirits Standards

As previously reported, China notified a proposed revision of its distilled spirits standard in August 2006, after several years of bilateral engagement and discussions at the WTO during meetings of the TBT Committee. This proposed revision was welcomed by U.S. industry, as it would eliminate the requirement for tolerance levels of superior alcohols, or fusel oil, and bring China's standard in line with international norms. China issued this same standard in final form and began implementing it in 2007.

Software Encryption Standards

In August 2007, China notified to the TBT Committee a series of 13 proposed technical regulations relating to information security for various information technology products, primarily software. The proposed regulations appear to mandate the use of Chinese national standards on encryption, which may deviate from recognized international standards. It is also unclear whether use of the Chinese standards will require access to algorithms held by Chinese regulators, and if so on what basis those algorithms will be made available. The proposed regulations also appear to expand the scope of products requiring China's "China Compulsory Certification" or "CCC" mark (discussed below under the heading of Conformity Assessment Procedures) to the area of information security, which is normally not subject to conformity assessment procedures under international practice. China requested that comments be provided within 60 days, but did not specify implementation dates for the proposed regulations.

These proposed regulations generated immediate concerns for the United States and U.S. industry, in part because of past actions that China has taken in this area, including China's issuance of mandatory encryption standards for Wi-Fi technologies in 2003 (discussed above) and rules that China issued in 1999 requiring the registration of a wide range of hardware and software products containing encryption technology. U.S. industry has since submitted preliminary comments on the proposed regulations to China's TBT inquiry point, and the United States has urged China to allow time for further comments so that China can fully evaluate the technical complexities of the proposed regulations and their potential impact on U.S. industry. The United States will continue to work with U.S. industry and monitor developments in this area closely in 2008.

Mobile Telephone Battery Standards

In July 2007, U.S. industry became aware that China's Ministry of Information Industry (MII) was developing a standard that would specify requirements for the size, electrical performance, safety performance and labeling of mobile telephone batteries. MII released a draft of this standard to U.S. industry in September 2007.

Although the draft battery standard on its face is voluntary, the United States and U.S. industry are concerned that it will be integrated into a technical regulation, such as MII's type-approval scheme or the CCC mark program, thereby effectively making compliance mandatory. This result would be problematic because the draft standard appears to diverge from international standards. In addition, it would significantly hamper mobile telephone innovation by focusing on the design of the battery rather than its performance, and it would have the opposite effect of MII's stated justification of promoting consumer convenience and reducing e-waste.

Working closely with U.S. industry, the United States has raised its concerns in this area bilaterally with MII and at the WTO during the transitional review before the TBT Committee, held in November 2007. The United States will monitor developments in this area closely in 2008.

Conformity Assessment Procedures

As previously reported, CNCA regulations establishing a new Compulsory Product Certification System, issued in December 2001, took full effect in August 2003. Under this system, there is now one safety mark – the 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. In 2007, as in prior years, U.S. companies continued to express concerns that the regulations lack clarity regarding the products that require a CCC mark. They have also reported that China is applying the CCC mark requirements inconsistently and that many domestic products required by CNCA's regulations to have the CCC mark are still being sold without the mark. In addition,

despite the changes made by the regulations, U.S. companies in some sectors continued to express concerns in 2007 about duplication in certification requirements, particularly for radio and telecommunications equipment, medical equipment and automobiles.

Meanwhile, to date, China has granted at least 146 Chinese enterprises accreditation to test and certify for purposes of the CCC mark. Despite China's commitment that qualifying minority foreign-owned (upon China's accession to the WTO) and majority foreign-owned (two years later) joint venture conformity assessment bodies would be eligible for accreditation and would be accorded national treatment, China so far has not granted accreditation to any foreign-invested conformity assessment bodies. China has also not developed any alternative, less trade-restrictive approaches to third-party certification, such as recognition of a supplier's declaration of conformity. As a result, U.S. exporters to China are often required to submit their products to Chinese laboratories for tests that may be unwarranted or have already been performed abroad, resulting in greater expense and a longer time to market. One U.S.-based conformity assessment body has entered into a Memorandum of Understanding (MOU) with China allowing it to conduct follow-up inspections (but not primary inspections) of manufacturing facilities that make products for export to China requiring the CCC mark. However, China has not been willing to grant similar rights to other U.S.-based conformity assessment bodies, explaining that it is only allowing one MOU per country. Reportedly, Japan has MOUs allowing two conformity assessment bodies to conduct follow-up inspections, as does Germany.

In 2007, as in prior years, the United States raised its concerns about the CCC mark system and China's failure to allow foreign-invested conformity assessment bodies with China bilaterally and during meetings of the WTO's TBT Committee, including the transitional review held in November 2007, 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 2008.

The United States also sought to address one of the more significant problem areas – duplicative certification requirements for imported medical equipment – through the April 2006 JCCT meeting. The United States was able to obtain China's commitment to eliminate the redundancies to which imported medical equipment has been subjected. To date, however, China has only taken steps to address duplicative product testing. China has not yet addressed the more burdensome duplicative factory audits and certification requirements applicable to imported electro-medical equipment or additional product-specific concerns, such as redundancies on border inspections for imported pacemakers. In fact, China has added a layer of redundancy with Decree 95 (discussed below). The United States raised its concerns in this area in a series of bilateral meetings in 2006 and 2007 as well as during the transitional reviews before the TBT Committee, held in November 2006 and November 2007. The United States is currently pursuing China's full implementation of this JCCT commitment during the run-up to the JCCT meeting scheduled for December 2007.

The United States continues to be concerned by China's *Administrative Measures for Controlling Pollution Caused by Electronic Information Products*, issued by MII and several other Chinese agencies effective on March 1, 2007. This regulation is modeled after an existing

European Union regulation and is known as “China RoHS.” While both regulations seek to ban lead and other hazardous substances from a wide range of electrical and electronic products, there are significant differences between the two regulatory approaches. Throughout the process of MII’s developing the China RoHS regulation, there was no formal process for interested parties to provide comments or consult with MII, and as a result foreign stakeholders had only limited opportunity to comment on proposals or to clarify MII’s implementation intentions. China did eventually notify the regulation to the TBT Committee, but the regulation does not answer questions regarding such basic information as the specific products that will be covered. Specifically, China has neither issued the catalogue of products for which mandatory testing will be required under this measure, nor provided any details on the testing and certification protocols, although China has indicated that it will be doing so soon. U.S. and other foreign companies are concerned that they will have insufficient time to adapt their products to China’s requirements and that in-country testing requirements will be burdensome and costly.

AQSIQ issued Decree 95 – the *Administrative Measures on Examination and Supervision of Imported Medical Devices* – in June 2007, with an effective date of December 1, 2007. Decree 95 is a significant measure that imposes an examination and supervision regime on imported medical devices. However, China issued Decree 95 in final form, without having notified a proposed Decree 95 to the WTO’s TBT Committee and given WTO members an opportunity to comment, as required by the TBT Agreement.

In regulating imported medical devices, Decree 95 establishes three risk categories for imported medical devices, and it divides importers into three levels of trustworthiness based on their experience and other factors. Decree 95 then requires certain percentages (ranging from 10 to 100 percent) of shipments of imported medical devices to be inspected, depending on the risk category of the product and the trustworthiness of the importer. Decree 95 creates significant redundancies because its excessive inspection requirements apply to imported medical devices that have already satisfied the existing certification requirements imposed by SFDA and CNCA prior to being exported to China. Decree 95 also appears to go substantially further than common international practice, where border inspection is generally done only on a very small percentage of previously certified devices, in response to targeted concerns.

U.S. industry has expressed strong concerns about the breadth of Decree 95 and its redundancy with the certification schemes administered by SFDA and in some cases CNCA. It has also been concerned about the short amount of time that Decree 95 allows for U.S. companies to make necessary adjustments. Working closely with U.S. industry, the United States has raised these concerns with in meetings with AQSIQ and MOFCOM and during the run-up to the JCCT meeting scheduled for December 2007. The United States has also facilitated a government-industry dialogue. Through these efforts, the United States pressed China to suspend Decree 95 before its December 1, 2007 implementation date and to engage in continued dialogue with foreign governments and industry to develop alternate requirements that are more consistent with common international practice in this area. On November 30, AQSIQ issued a notice suspending the implementation of Decree 95.

As these various developments on the conformity assessment front indicate, China's regulatory authorities appear to be turning more and more to in-country testing for a broader range of products in 2007. This policy direction is troubling, as it goes in the opposite direction of global conformity assessment practices, which favor processes that accept test results from internationally recognized laboratories, mutual recognition of conformity assessment schemes, recognition of third-party accrediting bodies, the concept of a "supplier's declaration of conformity" and other similar trade-facilitating conformity assessment mechanisms. The United States is unaware of any meaningful efforts by China to move toward a system that recognizes test results or conformity assessment certifications from bodies other than Chinese government-run testing, certification, or accreditation entities. Instead, in 2007, China has developed plans to expand the CCC mark scheme and its mandatory testing requirements to "information security," an area in which most countries do not engage in government certification. China is preparing to implement in-country government testing for compliance with its China RoHS regulations. In addition, China issued a measure, which is currently suspended, establishing a burdensome new regime for government inspection of imported medical devices that have already satisfied applicable Chinese certification requirements before being exported to China. Working with U.S. industry, the United States will urge China in 2008 to reverse this trend and move in the direction of global conformity assessment practices.

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 of goods or services for commercial sale by state-owned and state-invested enterprises, or relating to the production of goods or supply of services for commercial sale or for non-governmental purposes by state-owned and state-invested enterprises, 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.

In the first few years after China's accession to the WTO, U.S. officials did not hear many complaints from U.S. companies regarding WTO compliance problems in this area, although a lack of available information has continued to make it a difficult area to assess. In 2006, for example, China issued a number of measures restricting the ability of state-owned and state-invested enterprises to accept foreign investment, as discussed below in the Investment section. China also announced in 2006 that it would retain "absolute control" over seven sectors, including telecommunications, coal, power production and transmission, petrochemicals and oil, shipping, civil aviation and armaments. The effect of this policy on competition and foreign investment in these sectors remains unclear.

In August 2007, after several years of development, China issued its *Anti-Monopoly Law*, which is scheduled to become effective in August 2008. Although the final version of the law contained many improvements over drafts that had been previously circulated, some provisions continue to generate concern. For example, one provision requires protection for the lawful operations of state-owned enterprises and government monopolies in industries deemed nationally important. At present, it is not clear how China will implement this policy. As China works on implementing measures, the United States has been urging China not to use its Anti-Monopoly Law to enforce industrial policy objectives. The United States has also specifically pressed China to ensure that any implementing measures do not create disguised or unreasonable barriers to trade and do not provide less favorable treatment to foreign goods and services or foreign investors and their investments.

State Trading Enterprises

In its WTO accession agreement, China agreed to disciplines on the importing and exporting activities of 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. Since China's WTO accession, the United States and other WTO members have sought information from China on the pricing and purchasing practices of state trading enterprises, principally through the transitional reviews at the WTO. So far, however, China has 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 currently covers the United States and 39 other WTO members that have joined it. The GPA applies to the procurement of goods and services by central and sub-central government agencies and government enterprises specified by each party, subject to thresholds and certain exceptions. It requires GPA parties to provide MFN and national treatment to the goods, services and suppliers of other GPA parties and to apply detailed procedures designed to ensure transparency, fairness and predictability in the procurement process.

At present, China is not a party to the GPA. It committed to become an observer to the WTO Committee on Government Procurement upon its WTO accession, and in February 2002 it became an observer. China also committed, in its WTO accession agreement, to initiate negotiations for accession to the GPA "as soon as possible."

China's government procurement market is significant in size, and U.S. firms have made clear that China's timely GPA accession is a top priority for them. As a result, shortly after China became an observer to the WTO Committee on Government Procurement, the United States began pressing China both bilaterally and in WTO meetings to move as quickly as possible

toward GPA accession. At the July 2005 JCCT meeting, China agreed to commence “technical discussions” with the United States and other WTO members in preparation for the initiation of negotiations to join the GPA. The first round of technical discussions between China and the United States took place in February 2006. During the run-up to the April 2006 JCCT meeting, the United States pressed China to commit to the initiation of negotiations for accession to the GPA by a date certain. At the ensuing meeting, China agreed to initiate GPA negotiations by December 2007, and the two sides agreed to continue preparatory technical discussions. The United States has since provided additional technical assistance to the Chinese authorities, both through face-to-face meetings and in writing, and China has re-confirmed that it will initiate GPA negotiations by December 2007. Once China initiates these negotiations, the United States will work with China and other interested WTO members in an effort to ensure that China’s accession to the GPA takes place expeditiously and on robust terms.

Until it joins the GPA, China has committed in its WTO accession agreement that all of its central and local government entities will conduct their procurements in a transparent manner. China also agreed that, where it opens a procurement to foreign suppliers, it will provide MFN treatment by allowing all foreign suppliers an equal opportunity to participate in the bidding process.

In June 2002, China adopted a *Government Procurement Law*, which became effective in January 2003. This law attempts to follow the spirit of the GPA and incorporates provisions from the United Nations Model Law on Procurement of Goods. However, China’s 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 party to the GPA. China envisioned that this law would improve transparency, reduce corruption and lower government costs. This law was also seen as a necessary step toward reforming China’s government procurement system in preparation for China’s eventual accession to the GPA. Since the adoption of the *Government Procurement Law*, MOF has issued various implementing measures, including regulations that set out detailed procedures for the solicitation, submission and evaluation of bids for government contracts relating to goods and services and help to clarify the scope and coverage of the *Government Procurement Law*. MOF also issued measures relating to the announcement of government procurements and the handling of complaints by suppliers relating to government procurement.

It is notable, however, that the *Government Procurement Law* does not cover tendering and bidding for public works projects, which represent at least one-half of China’s government procurement market. Those projects are subject to a different regulatory regime, established by China’s *Tendering and Bidding Law* in January 2000.

As previously reported, beginning in 2003, U.S. companies expressed concerns about implementing rules on government software procurement being drafted by MOF. At a time when China’s already large software market was projected to grow by more than 50 percent annually, the initial draft of these rules reportedly contained guidelines mandating that central and local governments – the largest purchasers of software in China – purchase only software

developed in China to the extent possible. The United States was concerned not only about U.S. software exporters continuing access to China's large and growing market for packaged and custom software – \$7.5 billion in 2004 – but also about the precedent that could be established for other sectors if China proceeded with MOF's proposed restrictions on the purchase of foreign software by central and local governments. Working closely with U.S. industry, the United States strongly expressed its concerns to China during a series of bilateral meetings and subsequently made this issue one of its priority issues during the run-up to the July 2005 JCCT meeting. At that meeting, China took note of the United States' strong concerns and indicated that it would indefinitely suspend the drafting of implementing rules on government software procurement.

Soon afterwards, however, a similar issue arose in December 2005, when China announced that products incorporating the WAPI standards should be given preference in government procurement, as discussed above (in the Standards and Technical Regulations section). In addition, the issue of preferences for the purchase of domestic goods again appeared, when the State Council issued China's *Medium to Long-term Science and Technology Master Plan* in early 2006. The NDRC and several other ministries and agencies are in charge of developing regulations to implement this strategy, which includes preferences for the purchase of domestic goods as an important industrial policy tool. More recently, in August 2007, China issued another set of rules for government-supported e-government projects requiring priority to be given to the purchase of domestic goods and services. The United States is concerned that these measures may unfairly discriminate against U.S. firms and has therefore been closely monitoring developments in this area. However, so far, the trade effects of these measures appear to be limited.

In 2008, as in prior years, the United States will continue to monitor the treatment accorded to U.S. suppliers under China's government procurement regime and will continue to urge China to apply its new regulations and implementing rules in a transparent, non-discriminatory manner. The United States will also continue to encourage China to develop its government procurement system in a manner that will facilitate its expeditious accession to the GPA.

Investment

Upon its accession to the WTO, China assumed the obligations of the Agreement on Trade-Related Investment Measures (TRIMS Agreement), which 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 (known as 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 (known as trade balancing requirements). In its WTO 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.

Before its accession to the WTO, China began revising its laws and regulations on foreign-invested enterprises to eliminate WTO-inconsistent requirements relating to export performance, local content, foreign exchange balancing and technology transfer. However, six years after China's WTO accession, some of the revised laws and regulations continue to "encourage" technology transfer, without formally requiring it. U.S. companies remain concerned that this "encouragement" in practice can 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. Similarly, some laws and regulations "encourage" exportation or the use of local content. Moreover, according to U.S. companies, some Chinese government officials in 2007 – even in the absence of encouraging language in a law or regulation – 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, have raised concerns in this area during the annual transitional reviews conducted by the TRIMS Committee. The United States will continue to follow this situation closely in 2008.

In a separate commitment, as previously reported, China agreed to revise its Industrial Policy for the Automotive Sector to make it compatible with WTO rules and principles by the time of its accession. However, China missed this deadline, and U.S. industry reported that some local officials were continuing to enforce the WTO-incompatible provisions of the policy. Following repeated engagement by the United States and other WTO members, including the EC, Japan and Canada, China issued its new automobile industrial policy in May 2004. This policy included provisions discouraging the importation of auto parts and encouraging the use of domestic technology. It also required new automobile and automobile engine plants to include substantial investment in research and development facilities, even though China expressly committed in its WTO accession agreement not to condition the right of investment on the conduct of research and development.

In 2005, China began to issue measures implementing the new automobile industrial policy. One measure that generated strong criticism from the United States, the EC, Japan and Canada was the *Measures on the Importation of Parts for Entire Automobiles*, which was issued by the NDRC in February 2005 and became effective in April 2005. These rules impose charges that unfairly discriminate against imported auto parts and discourage automobile manufacturers in China from using imported auto parts in the assembly of vehicles. Specifically, the rules require all vehicle manufacturers in China that use imported parts to register with China's Customs Administration and provide specific information about each vehicle they assemble, including a list of the imported and domestic parts to be used, and the value and supplier of each part. If the number or value of imported parts in an assembled vehicle exceeds specified thresholds, the regulations require the vehicle manufacturer to pay a charge on each of the imported parts in an

amount equal to the tariff on complete automobiles (typically 25 percent), which is substantially higher than the tariff applicable to auto parts (typically 10 percent). These rules appear to be inconsistent with several WTO provisions, including Article III of GATT 1994 and Article 2 of the TRIMS Agreement, as well as the commitment in China's accession agreement to eliminate all local content requirements relating to importation.

Repeated and high-level engagement by the United States, including at the July 2005 JCCT meeting, made clear that China was not prepared to address the United States' concerns and revise the rules on auto parts. Similar efforts by the EC, Japan and Canada were also unsuccessful. In late March and early April 2006, the United States, the EC and Canada initiated dispute settlement against China by filing formal WTO consultations requests. Joint consultations were held in May 2006. However, these consultations did not lead to any serious discussion of possible agreed resolutions. In September 2006, the United States, the EC and Canada filed requests for the establishment of a panel to hear the dispute. A panel was established at the October 2006 meeting of the WTO's Dispute Settlement Body. Proceedings before the WTO panel took place in May and July 2007, and the panel is scheduled to issue its decision in 2008.

China issued another major industrial policy – the Steel and Iron Industry Development Policy – in July 2005. Although many aspects of this new policy have not yet been implemented, it still includes a host of objectives and guidelines that raise serious concerns. As previously reported, this policy restricts foreign investment in a number of ways. For example, it requires that foreign investors possess proprietary technology or intellectual property in the processing of steel. Given that foreign investors are not allowed to have a controlling share in steel and iron enterprises in China, this requirement would seem to constitute a *de facto* technology transfer requirement, in conflict with the commitment in China's accession agreement not to condition investment on the transfer of technology. This policy also appears to discriminate against foreign equipment and technology imports. Like other measures, this policy encourages the use of local content by calling for a variety of government financial support for steel and iron projects utilizing newly developed domestic equipment. Even more troubling, however, it calls for the use of domestically produced steel-manufacturing equipment and domestic technologies whenever domestic suppliers exist, apparently in contravention of the commitment in China's accession agreement not to condition the right of investment or importation on whether competing domestic suppliers exist.

This policy is troubling because it attempts to dictate industry outcomes and involves the government in making decisions that should be made by the marketplace. It prescribes the number and size of steel producers in China, where they will be located, the types of products that will and will not be produced, and the technology that will be used. This high degree of government direction and decision-making regarding the allocation of resources into and out of China's steel industry raises concerns not only because of the commitment that China made in its WTO accession agreement that the government would not influence, directly or indirectly, commercial decisions on the part of state-owned or state-invested enterprises, but also more generally because it represents another significant example of China reverting to a reliance on

government management of market outcomes instead of moving toward a reliance on market mechanisms. Indeed, it is precisely that type of regressive approach that is at the root of many of the WTO compliance problems encountered by U.S. industry.

The United States has raised its various concerns with China's new steel policy, both bilaterally and at the WTO. In March 2006, the United States and China held the inaugural meeting of a new JCCT dialogue on the steel industry, made critical by the continuing rapid expansion of China's steel capacity and production and the sharp increase in steel exports from China that began in 2005. The two sides held a second Steel Dialogue meeting in October 2006, with participation from U.S. and Chinese steel industry officials, with the objectives of increasing mutual understanding of the challenges faced by each industry and discussing strategies for addressing trade imbalances, including the benefits of increased reliance on market mechanisms. A third Steel Dialogue meeting was held in August 2007. At the WTO, the United States continued to press its concerns, in regular meetings and through the transitional reviews before the Committee on Import Licensing, the TRIMS Committee, the Subsidies Committee and the Council for Trade in Goods in 2005, 2006 and 2007, with support from other WTO members, including Canada, Mexico, the EC and Japan. The United States also focused on China's steel policy in connection with China's first Trade Policy Review at the WTO, held in April 2006. The United States will continue to closely scrutinize China's steel policy and its implementation in 2008.

Meanwhile, in January 2005, as previously reported, the State Council issued a revised *Sectoral Guidelines Catalogue for Foreign Investment*. Like the prior version of this catalogue, issued in March 2002, the revised catalogue generally reflects China's decision to adhere to its commitments to open up certain sectors to foreign investment, although notable exceptions involved the importation and distribution of copyright-intensive products such as theatrical films, DVDs, music, books and journals (as discussed above in the Trading Rights and Distribution Services sections). In addition, while China continued to allow foreign investment in a number of sectors not covered by its WTO accession agreement, one notable exception to this progress continues to be the area of production and development of genetically modified plant seeds, which China still places in the "prohibited" category.

In 2007, the United States learned that China had begun work on a revised foreign investment catalogue. The United States requested, both bilaterally and in connection with the transitional review before the TRIMS Committee in October 2007, that China provide an opportunity for public comment on the revised catalogue before the State Council finalized it. However, the State Council issued the revised catalogue in final form in November 2007 without having provided an opportunity for public comment. The November 2007 catalogue places new restrictions on industries on several industries, including chemicals, auto parts, rare earths processing, biofuel production and edible oil processing, while the prohibitions and restrictions facing copyright-intensive products and genetically modified plant seeds remain in place. It also moves the mining of raw materials such as antimony, fluorite, molybdenum, tin and tungsten from the "restricted" category to the "prohibited" category. From a positive standpoint, the catalogue encourages foreign investment in highway cargo transport and modern logistics, while

it removes from the “encouraged” category projects of foreign-invested enterprises that export all of their production.

Beginning in 2006, the United States and U.S. industry became particularly concerned about new restrictions on investment being proposed and implemented by China. Often, these restrictions are accompanied by other problematic industrial policies, such as the increased use of subsidies, preferences for using domestic rather than imported goods, and the development of China-specific standards.

One example can be found in the *State Council Opinions on the Revitalization of the Industrial Machinery Manufacturing Industries*, issued in June 2006. This measure identifies 16 types of equipment manufacturing as the focus of a new initiative, including large equipment for clean and efficient power generation, critical semiconductor manufacturing equipment, civilian aircraft and aircraft engines, pollution control equipment, textiles machinery and large excavators. The new initiative calls for a variety of policy supports designed to promote, develop and expand the market share of domestic companies in these sectors, including preferential import duties on parts and material needed for research and development, encouragement for procuring domestically manufactured new major technical equipment, a dedicated fund to facilitate capital market financing for domestic firms, and strict review of imports. At the same time, the measure indicates that new controls on foreign investment are being contemplated for these sectors, including new approval requirements when foreign entities seek majority ownership or control and the strengthening of the management of equipment and machinery imports.

In August 2006, China made a further move toward a more restrictive investment regime when it issued – without advance notice or an opportunity for public comment – new regulations on mergers and acquisitions (M&A regulations) involving foreign investors. These regulations were the joint effort of MOFCOM, SAT, SAIC, the State-owned Assets Supervision and Administration Commission, the China Securities Regulatory Commission and the State Administration of Foreign Exchange. The regulations strengthen MOFCOM’s supervisory role over foreign investment, in part by requiring MOFCOM’s approval of M&A transactions that it believes impact “national economic security” or involve famous Chinese brands. The regulations also place MOFCOM in the role of determining if the domestic acquisition target has been appropriately valued.

In November 2006, the NDRC released a five-year plan on foreign investment, which promised greater scrutiny over foreign capital utilization. This plan calls for the realization of a “fundamental shift” from “quantity” to “quality” in foreign investment from 2006 to 2010, with the state’s focus changing from shoring up domestic capital and foreign exchange shortfalls to introducing advanced technology, management expertise and talent. The plan also directs that more attention be paid to ecology, the environment and energy efficiency and demands tighter tax supervision of foreign enterprises. The new policy is intended to restrict foreign enterprises’ acquisition of “dragon head” enterprises, prevent the “emergence or expansion of foreign capital monopolies,” protect national economic security, particularly “industry security,” and prevent “abuse of intellectual property.”

In December 2006, the State Assets and Supervision and Administration Commission (SASAC), charged with overseeing China's interests in state owned enterprises, published an expansive list of sectors that it deemed critical to the national economy, including "pillar" industries such as equipment manufacturing, automotive, electronic information, construction, iron and steel, non-ferrous metal, chemical, survey and design, and science and technology industries. SASAC committed to restrict foreign participation in these sectors by preventing further foreign investment state-owned enterprises operating in these sectors.

In August 2007, as discussed above, China issued its *Anti-Monopoly Law*. Among other things, this law indicates that China will establish a review process to screen inward investment for national economic security implications.

U.S. industry has expressed tremendous concern about China's increasing use of these and other investment restrictions, which are often seen as protectionist tools used by China's state planners to shield inefficient or monopolistic enterprises from competition. Even recognizing that certain sectors may have particular sensitivity in China due to security or other concerns, U.S. industry views China's investment restrictions – including the increasing restrictions on foreign acquisitions of Chinese companies – as deeply worrisome and counter to the market-oriented principles that have been the basis for much of China's economic success over the past few decades. According to U.S. industry, these investment restrictions are more likely to retard the growth and development of the Chinese economy than to accomplish the state planners' ultimate objective of creating internationally competitive domestic enterprises.

The United States has raised its concerns about China's investment restrictions, both bilaterally with China during the run-up to the JCCT meeting scheduled for December 2007 and at the WTO during the transitional reviews before the TRIMS Committee and the Council for Trade in Goods, held in 2006 and 2007. The United States will continue to monitor developments in this area closely in 2008.

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 – originally the State Development and Planning Commission (SDPC), which

is now called the NDRC – and to require it 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 for 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, adoption 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, developed through risk assessment procedures and adopted with transparency, 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 intended 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, rice, cotton, wool and vegetable oil, although these products had been subject to import monopolies by state trading enterprises.

While tariff reductions have certainly encouraged U.S. exports to China, which reached record highs for many agricultural products in 2007, the increases continued to be largely the result of greater demand. At the same time, a variety of non-tariff barriers continued to impede U.S. agricultural trade with China, particularly in the area of sanitary and phytosanitary measures, where China's actions often have not appeared to be guided by scientific principles. As in prior years, the United States and China have been able to resolve some of these issues through protracted negotiations, but others appear to have reached an impasse.

On the positive side, U.S. agricultural products continued to experience strong sales to China. China is now the United States' fourth largest agricultural export market, as U.S. exports to China totaled \$6.0 billion from January through September 2007, an increase (8.3 percent) over the same period in 2006, which was a record year for U.S. agricultural exports to China. In fact, in 2006, U.S. agricultural exports exceeded \$7.6 billion, more than three times the level in 2002.

Meanwhile, commitments announced at the April 2004, July 2005 and April 2006 JCCT meetings on the issue of U.S. beef market access to China following the discovery of bovine spongiform encephalopathy (BSE) in the United States resulted only in limited and sporadic progress. This issue is emblematic of the continuing problems U.S. exporters face with non-transparent application of sanitary and phytosanitary measures, many of which have appeared to lack scientific bases and have impeded market access for many U.S. agricultural products.

China's unnecessary and seemingly arbitrary inspection-related import requirements also continued to impose burdens and regulatory uncertainty on U.S. agricultural producers exporting to China in 2007. Products most affected in 2007 included poultry, pork and soybeans. In addition, registration requirements for animal feeds were unnecessarily burdensome and limited the ability of U.S. exporters to access China's market, while China's administration of TRQs on bulk agricultural commodities was still not functioning entirely as envisioned in China's WTO accession agreement, as it continued to be impaired by inadequate transparency.

In 2008, as in prior years, the United States will continue to pursue vigorous engagement with China in order to obtain progress on outstanding concerns. As part of this effort, the United States will continue to use the high-level U.S.-China agricultural working group, created at the April 2004 JCCT meeting, as well as the JCCT process itself to make progress on the range of issues in the agriculture area. In addition, the United States will take further actions seeking to address its concerns, including WTO dispute settlement, where appropriate.

Tariffs

Tariffs on agricultural goods of greatest importance to U.S. farmers and ranchers are being lowered 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, or by January 1, 2006. China implemented the few required tariff reductions on agricultural goods for 2007 on schedule on January 1, 2007, just as it did for industrial goods.

The accumulated tariff reductions made by China, coupled with increased demand, contributed to a marked increase in certain U.S. exports to China. Exports of some bulk agricultural commodities have increased dramatically in recent years, and continue to perform strongly, including soybeans and cotton. Exports of forest products such as lumber continued to perform strongly, increasing by 7.7 percent for the first nine months of 2007. Fish and seafood exports, after having increased from \$119 million in 2001 to \$135 million in 2002, and then to \$176 million in 2003, \$258 million in 2004, \$351 million in 2005 and \$440 million in 2006, increased again in 2007, exceeding the total for 2006 in the first nine months of 2007 (\$470 million). Meanwhile, exports of consumer-oriented agricultural products increased by 46 percent from January through September 2007, when compared to the same period in 2006.

However, the full market access potential of China's tariff cuts was not realized for some products. As discussed below, a variety of non-tariff barriers continue to impede market access for U.S. agricultural exports to China, particularly exports of consumer-ready and value-added products.

China's Biotechnology Regulations

As previously reported, one of the most contentious agriculture trade 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 formal 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 products, 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 through 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 and later an extension until April 2004. China finally issued a formal safety certificate for a U.S. biotechnology soybean variety known as Roundup Ready soybeans in February 2004. In addition, by the time of the April 2004 JCCT meeting, China had also issued formal safety certificates for six corn events, seven canola events and two cotton events. China issued a formal safety certificate for another corn event a few months later, leaving only one corn event still awaiting formal approval. China issued a formal safety certificate for this last corn event at the time of the July 2005 JCCT meeting.

With some stability added to the China soybean market through the extensions in 2003 and the issuance of the formal safety certificate for Roundup Ready soybeans in February 2004, U.S. exports of soybeans performed strongly. In 2003, U.S. soybean exports reached a record level of \$2.9 billion, representing an increase of 190 percent over 2002. In 2004, U.S. soybean exports declined to \$2.3 billion, although this figure was still twice the level of any year prior to 2003.

In 2005, U.S. soybean exports remained approximately steady at \$2.2 billion before rising to \$2.5 billion in 2006. In the first nine months of 2007, U.S. soybean exports totaled \$1.8 billion, an increase of 42 percent over the same period in 2006, and China remained the leading export destination for U.S. soybeans.

Other U.S. concerns with China's biotechnology regulations and implementing rules remain. For example, China requires a product to be approved in the United States before it can be submitted in China for approval, and China's National Biosafety Committee normally reviews new product applications only during two meetings each year. Both of these practices present significant and unnecessary delays for bringing U.S. goods into the China market. China's lack of clarity on the requirements applicable to products stacked with multiple traits is a cause for additional concern, as are China's sometimes duplicative and unprecedented testing requirements.

In November 2006, MOA finally issued an announcement about the renewal requirements for safety certificates covering imported biotechnology crops. Because safety certificates for cotton, soybeans, corn and canola expired beginning in February 2007, it was possible that trade in these products would be disrupted. However, U.S. intervention secured an extension of these approvals for another five years.

In 2007, meanwhile, MOA developed, issued and implemented some troubling new regulations without circulating them for public comment in advance or even consulting with relevant stakeholders such as the United States and U.S. industry. For example, in January 2007, MOA added a new requirement that biotechnology seed companies turn over key intellectual property as part of the application process when seeking safety certificates. In March 2007, MOA halted a pilot program, which had been developed over two years of bilateral discussions, aimed at allowing the review of products under development in the United States prior to completion of the U.S. approval process. As a result, the MOA approval process can still only begin after the completion of the U.S. approval process. Even if the MOA approval process proceeds quickly, trade may still be disrupted, as importers need time to apply for vessel based safety certificates and Quarantine Inspection Permits, both of which require valid safety certificates for biotechnology products and can take up to 30 working days. The United States has raised its concerns about these developments in several bilateral meetings, including JCCT working group meetings and other meetings during the run-up to the JCCT meeting scheduled for December 2007.

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 (and later NDRC) began implementing these commitments following China's accession, a series of problems have undermined the market access envisioned by WTO members. Although progress has been made on some of these issues, NDRC's lack of transparency continues to create significant concern.

As previously reported, in 2002, the first year of this TRQ system, it appeared 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, 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, and those consultations took place in September 2002 in Geneva.

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 on its June 2003 commitments in part in October 2003, when NDRC 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.

In 2004, as the United States focused on how NDRC was enforcing its new regulations in a series of bilateral meetings during the run-up to the April 2004 JCCT meeting, improvements in NDRC's TRQ administration became evident. NDRC implemented the regulatory provision calling for the elimination of separate allocations for general trade and processing trade, increased the size of quota allocations, and improved its handling of reallocations. At the same time, transparency continues to be problematic, although some improvement did take place for some of the commodities subject to TRQs.

While these systemic changes were taking place, exports of some bulk agricultural commodities from the United States continued to show substantial increases, largely due to market conditions. In particular, despite some continuing problems with NDRC's handling of the cotton TRQs, U.S. cotton exports totaled a record \$1.4 billion in 2004, which was reached again in 2005, followed by a new record of \$2.1 billion in 2006. U.S. wheat exports totaled an unusually high amount of \$495 million in 2004, as the TRQ allocations for wheat did not appear to act as a limiting factor, followed by \$80 million for 2005, still substantially above the years prior to 2004, and then \$23 million in 2006.

Throughout 2007, the United States continued to raise transparency and other concerns, both in bilateral meetings and during the transitional review before the WTO's Committee on

Agriculture in October 2006. In 2008, the United States will continue to work to ensure that NDRC administers TRQs transparently and in a manner that is consistent with China's commitments and that does not impede market access or commercial decisions.

Sanitary and Phytosanitary Issues

In 2007, China's SPS measures posed increasingly serious problems for U.S. agricultural producers exporting to China. As in prior years, the United States repeatedly engaged China on a number of SPS issues, in high-level bilateral meetings and technical discussions as well as during meetings of the WTO's SPS Committee, including the transitional review held in October 2007. The United States also continued to provide extensive training to China's regulatory authorities and to urge them to adhere more consistently to China's transparency obligations under the SPS Agreement. While market access for U.S. soybeans and grain has been maintained, little progress was made in 2007 in addressing SPS barriers for raw meat, poultry and pork products, while market entry requirements for processed foods and horticultural products remain burdensome. In 2007, China's market continued to be closed to U.S. beef and beef products because of China's BSE-related ban, and China continued to maintain several state-level Avian Influenza (AI) bans. In many instances, progress was made difficult by China's inability to provide relevant risk assessments or the science-based rationale for maintaining its import restrictions against U.S.-origin products. For example, in 2007, China was unable to provide a science-based rationale for maintaining import restrictions on U.S. beef products and some U.S. poultry and pork products, as described below. In addition, China's regulatory authorities continued to issue significant new SPS measures without complying with the notice-and-comment requirements of the SPS Agreement. The United States will continue to press for resolution of these and other outstanding issues in 2008.

BSE-Related Bans on Beef and Low-Risk Bovine Products

In December 2003, China and other countries imposed a ban on imports of U.S. cattle, beef and processed beef products in response to a case of BSE found in the United States. Since that time, the United States has repeatedly provided China with extensive technical information on all aspects of its BSE-related surveillance and mitigation measures, internationally recognized by the Office International des Epizooties (OIE) as effective and appropriate, for both food safety and animal health. After four years, China still has not provided any scientific justification for continuing to maintain its ban.

At the April 2006 JCCT meeting, China agreed to conditionally reopen the Chinese market to U.S. beef, subject to the negotiation and finalization of a protocol by technical experts on an expedited basis. Jointly negotiated protocols, and accompanying export certificates, are normal measures necessary for the export of any livestock products from the United States to China or other trading partners. However, subsequent protocol negotiations made it clear that China was only contemplating a limited market opening, still without any science-based support. In July 2006, China's food safety regulators unilaterally announced a limited market opening, restricted to the entry of U.S. boneless beef thirty months of age or less, accompanied by 22 onerous entry conditions. Several of these conditions were not capable of being fulfilled, and others did not even relate to BSE.

In May 2007, the United States received a risk classification as a "controlled risk" country by the OIE, indicating that all U.S. beef and beef products are safe to trade, provided that certain risky materials are removed during processing. Later that month, while in Washington for the May 2007 SED meeting, Vice Premier Wu offered to open China's market to both boneless and bone-in beef, although still with the age restriction of 30 months or less. The United States rejected this offer because the applicable OIE classification has no age restrictions. Since then, U.S. and Chinese officials have met repeatedly, but to date China has not indicated any willingness to begin accepting U.S. beef and beef products into its market in a manner consistent with the OIE's classification. The United States will continue to press China to re-open its market in 2008.

At the same time that it banned U.S. cattle, beef and processed beef products, China also banned bovine-origin products (i.e., bovine semen, bovine embryos, and protein-free tallow) that are listed in OIE guidelines as safe to trade regardless of a country's BSE status. Additionally, China banned imports of U.S.-origin non-ruminant feeds and fats (such as pet food, rendered products and porcine proteins) even though these products were of non-bovine-origin and presented absolutely no BSE-related risk. After numerous bilateral meetings and technical discussions in 2004, including a visit to U.S. bovine facilities by Chinese food safety officials, China announced a lifting of its BSE-related ban for these "low-risk" products in late September 2004. However, China conditioned the lifting of the ban on the negotiation of protocol agreements setting technical and certification parameters for incoming low-risk products. In November 2004, U.S. and Chinese officials finalized and signed amended protocols that would enable the resumption of exports of U.S.-origin bovine semen and bovine embryos, contingent on facility-by-facility certification by China's regulatory authorities in accordance with the

original protocols that were signed more than 10 years prior. Additionally, U.S. and Chinese authorities signed a new protocol which authorized a resumption of exports of U.S.-origin non-ruminant feeds and fats. In July 2005, during the run-up to the JCCT meeting, China finally announced the resumption of trade in bovine semen and bovine embryos, following facility certifications completed in June 2005. However, it was not until early 2006 that imports of U.S.-origin bovine semen and bovine embryos actually resumed. Additionally, in June 2005, China agreed to accept a systems approach audit (as opposed to facility-by-facility certification) to approve U.S. facilities to export U.S.-origin non-ruminant feeds and fats (pet food, rendered products, porcine proteins, etc.) to China. The initial shipment of U.S.-origin non-ruminant pet food occurred in September 2005. By January 2006, trade in the full range U.S.-origin non-ruminant feed and fat products had also resumed, after negotiation and resolution of a series of onerous, detailed and unnecessary non-BSE related information requirements proposed by China that are not consistent with OIE guidelines and contrast sharply with U.S. requirements. To date, trade in protein-free tallow (a product listed by the OIE as safe to trade regardless of a country's BSE status) has still not resumed, as U.S. and Chinese officials continue to be unable to reach agreement on provisions of a protocol.

Pathogen Standards and Residue Standards for Raw Meat and Poultry Products

Since 2002, as previously reported, China has applied SPS-related requirements on imported raw meat and poultry that do not appear to be consistent with Codex Alimentarius (Codex) guidelines or current scientific testing practices. One requirement establishes a zero tolerance limit for the presence of Salmonella bacteria. Similar zero tolerance standards exist for Listeria and other pathogens. Meanwhile, the complete elimination of these enteropathogenic bacteria is generally considered unachievable without first subjecting raw meat and poultry to a process of irradiation. Moreover, China apparently does not apply this same standard to domestic raw poultry and meat, raising national treatment concerns.

In 2007, this issue took on added significance, as China de-listed several U.S. plants, hindering trade in pork and poultry. To date, 11 U.S. pork and 4 poultry plants have been de-listed by China for alleged violations of zero tolerance standards for pathogens or detection of certain chemical residues. Despite positive results from USDA Food Safety and Inspection Service investigations of the plants, and extensive follow-up efforts by U.S. regulatory officials, these plants have not been re-listed as approved to ship product to China. In 2008, the United States will continue to press China to re-list the plants.

Meanwhile, China continues to maintain maximum residue levels (MRLs) for certain heavy metals, veterinary drugs and other residues that are inconsistent with Codex and other international standards. China also enforces a "zero tolerance" for some residues, even where Codex has adopted guidelines that many of China's major trading partners have adopted. U.S. regulatory officials have encouraged their Chinese counterparts to adopt MRLs that are scientifically based, safe and minimally trade-disrupting. This effort will continue in 2008.

Avian Influenza

In February 2004, as previously reported, China imposed a nationwide ban on U.S. poultry in response to cases of low-pathogenic AI found in Delaware. Throughout 2004, the U.S. provided technical information to China on the U.S. AI situation, and in August a high-level Chinese delegation conducted a review of the status of AI eradication efforts in the United States. In December 2004, China lifted its nationwide ban on U.S. poultry, leaving in place a ban only for the states of Connecticut and Rhode Island.

In early 2005, following the announcement of low-pathogenic AI found in the state of New York, China did not impose a nationwide ban. Instead, demonstrating progress in following OIE guidelines, China imposed a ban limited to poultry from the state of New York.

In 2006, China imposed an import ban for poultry and poultry products originating from the state of Pennsylvania, based on incidents of low-pathogenic AI. China also suspended the importation of heat-treated and cooked poultry and poultry products at the same time, even though the OIE's AI chapter makes clear that products that have been heat-treated in a manner to inactivate the virus should not be subject to an AI-related import ban. In 2007, China also banned poultry and poultry products from West Virginia, Virginia and Nebraska because of low-pathogenic AI.

Following the eradication of AI in Connecticut, Rhode Island, New York, Pennsylvania, West Virginia, Virginia and Nebraska, the United States asked China to re-open trade in poultry and poultry products from these states, consistent with OIE guidelines. To date, however, China has not done so. The United States is continuing to raise this issue during the run-up to the JCCT meeting scheduled for December 2007 and will continue to pursue the re-opening of China's market in 2008 as necessary.

Transparency

As in the TBT context, some of China's SPS measures continue to enter into force without having first been notified to the SPS Committee, and without other WTO members having had the opportunity to comment on them, contrary to the requirements of the SPS Agreement. Many of these unnotified measures are of key concern to foreign traders. Indeed, over the past two years, the United States has identified 22 SPS measures implementing important new registration requirements, residue standards, inspection requirements and quarantine requirements – none of which China notified to the SPS Committee, even though these measures constrain U.S. exports of frozen meat, dairy products, grain, poultry, feed, horticultural products, a variety of processed products and alcoholic beverages.

In 2007, as in prior years, the United States urged China's regulatory authorities to improve their adherence to China's SPS Agreement transparency obligations. The United States also highlighted China's shortcomings during regular meetings and the annual transitional reviews before the SPS Committee. The United States will continue to seek improvements from China in this area in 2008.

Inspection-related Requirements

Through two 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 – AQSIQ requires importers to obtain a Quarantine Inspection Permit, or QIP, prior to signing purchase contracts for nearly all traded agricultural commodities. QIPs are one of the most important trade policy issues affecting the United States and China’s other agricultural trading partners.

AQSIQ sometimes slows down or even suspends issuance of QIPs at its discretion, without notifying traders in advance or explaining its reasons, resulting in significant commercial uncertainty. Because of the commercial necessity to contract for commodity shipments when prices are low, combined with the inherent delays in having QIPs issued, many cargoes of products such as soybeans, meat and poultry arrive in Chinese ports without QIPs, creating delays in discharge and resulting in demurrage bills for Chinese purchasers. In addition, traders report that shipment quantities are often closely scrutinized and are at risk for disapproval if considered too large.

Some improvements were made to the QIP system in 2004 following repeated engagement bilaterally and through interventions made by the United States and other WTO members during the transitional reviews before the SPS Committee and the Committee on Import Licensing in 2002 and 2003. In June 2004, fulfilling a Chinese commitment made in connection with the April 2004 JCCT meeting, AQSIQ issued Decree 73, the *Items on Handling the Review and Approval for Entry Animal and Plant Quarantine*, which extended the period of validity for QIPs from three months to six months. AQSIQ also began issuing QIPs more frequently within the established time lines. Nevertheless, a great deal of uncertainty remains even with the extended period of validity, because a QIP still locks purchasers into a very narrow period to purchase, transport and discharge cargoes or containers before the QIP’s expiration, and because AQSIQ continues to administer the QIP system in a seemingly arbitrary manner.

Traders continue to be hesitant to press AQSIQ for change because they would risk falling out of favor. Many traders would at least like AQSIQ to eliminate the quantity requirements that it unofficially places on QIPs. These quantity requirements have been used often by AQSIQ during peak harvest periods to limit the flow of commodity imports. In 2006, traders reported that MOFCOM not only limited QIP quantities, but also required some companies to use up the majority of a QIP before being issued another one and required other companies to use up their QIPs or risk being “de-listed.” Eliminating these requirements would make the QIP system more dependent on market forecast.

Little improvement in the QIP system has taken place over the last three years. AQSIQ officials continue to insist that the QIP system ensures that an adequate number of examiners are on duty at ports when shipments arrive to certify and inspect them for quality and quantity, while the United States and other WTO members argue that there does not appear to be any scientific basis for the QIP system and that it serves as an unjust and overly restrictive barrier to trade. The United States will continue to press China on this important issue in 2008.

Meanwhile, MOFCOM administers a separate import permit system for commodities such as poultry products. Through its issuance of Automatic Registration Forms (ARFs) to importers, MOFCOM allocates a volume amount to an importer for imports of particular commodities each year. In 2007, U.S. officials urged MOFCOM to eliminate ARFs or issue them in a more transparent, flexible manner so that trade is not disrupted.

Export Subsidies

Since shortly after China's accession to the WTO, U.S. industry has been concerned that China provides export subsidies on corn, despite China's WTO commitment to eliminate all export subsidies upon accession to the WTO. In past years, it appeared that significant quantities of corn had been exported from China, including corn from Chinese government stocks, at prices that may have been 15 to 20 percent below domestic prices in China. As a result, U.S. corn exporters were losing market share for corn in their traditional Asian markets, such as South Korea and Malaysia, while China was exporting record amounts of corn.

Since 2002, the United States has pressed its concerns about possible export subsidies on corn with China bilaterally, including in high-level meetings. The United States has also raised its concerns and has sought additional information about China's corn policies – including the use of potentially excessive VAT rebates – during meetings before the Committee on Agriculture, including the transitional reviews.

In 2004, trade analysts began to conclude that, because of several economic factors, primarily falling stock levels and burgeoning domestic demand, China was trending toward eventually becoming a net importer of corn. One result appears to be that China's exports are largely being made on a commercial basis, although concern remains regarding the operation of China's VAT rebate system for corn.

The United States will continue to investigate China's subsidization practices and VAT rebate system for the agricultural sector in 2008. The United States will make every effort to ensure that any use of export subsidies is eliminated.

Intellectual Property Rights

With its acceptance of the TRIPS Agreement, China took on obligations to adhere to generally accepted international 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 IPR enforcement in administrative and civil actions and, 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

favoured nation treatment to the nationals of other WTO members with regard to the protection and enforcement of intellectual property rights.

Since its accession to the WTO, China has overhauled its legal regime and put in place a comprehensive set of laws and regulations aimed at protecting the intellectual property rights of domestic and foreign entities in China. At the same time, some key improvements in China's legal framework are still needed, and China has continued to demonstrate little success in actually enforcing its laws and regulations in the face of the challenges created by widespread counterfeiting, piracy and other forms of infringement. As a result, in 2007, the United States' bilateral engagement with China continued to focus on obtaining improvements to multiple aspects of China's system of IPR protection and enforcement so that significant reductions in IPR infringement in China could be realized and sustained over time.

Several weaknesses in all aspects of China's enforcement system – criminal, civil and administrative – contribute to China's poor IPR enforcement record. For example, one major weakness is China's chronic underutilization of deterrent criminal remedies. In particular, legal measures in China that establish high thresholds for criminal investigation, prosecution and conviction preclude criminal remedies in many instances of commercial-scale counterfeiting and piracy, creating a "safe harbor" for infringers and raising concerns that China may not be complying with its obligations under the TRIPS Agreement. The United States is seeking to resolve this concern, along with concerns regarding border enforcement and the enforceability of copyrights during the period before works obtain censorship approval, in a WTO case that it filed in April 2007 that focuses on deficiencies in China's legal regime for protecting and enforcing copyrights and trademarks on a wide range of products.

An exacerbating factor is China's continued maintenance of import and distribution restrictions for certain types of legitimate copyright-intensive products, such as theatrical films, DVDs, music, books and journals, which inadvertently helps to ensure that infringing products continue to dominate those sectors within China. As discussed above in the sections on Trading Rights and Distribution Services, the United States is addressing these restrictions in another WTO case filed in April 2007.

China's leaders began to demonstrate a willingness to address U.S. concerns in October 2003, when a new IPR Leading Group was formed, signaling a more focused and sustained effort by China to tackle the IPR enforcement problem. Many officials in China, led by President Hu Jintao, Premier Wen Jiabao and Vice Premier Wu Yi, continued to give voice to China's commitment to protecting intellectual property rights in subsequent years and worked hard to make it a reality, as they allocated substantial resources to the effort and attempted to improve not only public awareness but also training and coordination among the numerous Chinese government entities involved in IPR enforcement while simultaneously fighting local protectionism and corruption. Sustained involvement by China's leaders is critical if China is to deliver on the IPR commitments that it made at the April 2004, July 2005 and April 2006 JCCT meetings, including China's core commitment to significantly reduce IPR infringement levels across the country.

As previously reported, building on earlier engagement with China, the United States conducted an out-of-cycle review under the Special 301 provisions of U.S. trade law in 2004 and 2005. This review involved a systematic evaluation of China's entire IPR enforcement regime and concluded in April 2005 with the Administration's elevation of China to the Special 301 "Priority Watch" list and the creation of a comprehensive strategy for addressing China's ineffective IPR enforcement regime, which included the possible use of WTO mechanisms, as appropriate.

Pursuing this new strategy at the July 2005 JCCT meeting, the United States sought and obtained China's agreement to take a series of specific actions designed to (1) increase prosecutions of IPR violators, (2) improve enforcement at the border, (3) counter piracy of movies, audio visual products and software, (4) address Internet-related piracy and (5) assist small and medium sized U.S. companies experiencing China-related IPR problems, among other things. To date, China has taken steps to fulfill many of these commitments. It adopted amended rules governing the transfer of administrative and customs cases to criminal authorities, and it took some steps to pursue administrative actions against end user software piracy. China posted an IPR Ombudsman to its Embassy in Washington, who has facilitated contacts between U.S. government officials and their counterparts in Beijing, and has been a source of information for U.S. businesses, including small and medium size companies. China has also sought to expand enforcement cooperation.

Meanwhile, in October 2005, the United States submitted a request to China under Article 63.3 of the TRIPS Agreement, as did both Japan and Switzerland, seeking more transparency on IPR infringement levels and enforcement activities in China, with the objective of obtaining a better basis for assessing the effectiveness of China's efforts to improve IPR enforcement since China's accession to the WTO. However, despite the United States' extensive efforts to follow up on its Article 63.3 request bilaterally, China provided only limited information in response, hampering the United States' ability to evaluate whether China is taking all necessary steps to address the rampant IPR infringement found throughout China.

In 2006, the United States again used the JCCT process, including the IPR Working Group created at the April 2004 JCCT meeting, to secure new IPR commitments and, in a few instances, specific actions to implement past commitments. During the run-up to the April 2006 JCCT meeting, China took enforcement actions against plants that produce pirated optical discs, and it also issued new rules that require computers to be pre installed with licensed operating system software. At the meeting itself, China further committed to ensure the legalization of software used in Chinese enterprises and to take up issues of government and enterprise software asset management in the JCCT IPR Working Group. China also agreed to work on cooperation to combat infringing goods displayed at trade fairs in China and to intensify efforts to eliminate infringing products at major consumer markets in China, such as the Silk Street Market in Beijing. The two sides further agreed that they would increase cooperation between their respective law enforcement authorities and customs authorities and that the United States would provide China with additional technical assistance to aid China in fully implementing the World Intellectual Property Organization (WIPO) Internet treaties, i.e., the WIPO Copyright Treaty and

the WIPO Performance and Phonograms Treaty. In addition, China reaffirmed its prior commitments to continue efforts to ensure use of legalized software at all levels of government and to adopt procedures to ensure that enterprises use legal software, beginning with state owned enterprises and other large enterprises.

Since the April 2006 JCCT meeting, China has made some progress in implementing its commitments, but it has been slower than in the past. One bright spot appears to be China's implementation of the new rules requiring computers to be pre installed with licensed operating system software, as U.S. industry continues to be pleased with the results of that effort.

In 2007, the United States continued to use bilateral discussions to encourage China to improve its IPR enforcement regime. Until April 2007, these discussions focused on concrete steps that China could take to improve its legal protections and enforcement efforts. It was when it was clear that these efforts at dialogue would yield no progress that the United States filed the two IPR-related WTO cases in April 2007. Later that month, USTR issued its Special 301 report, which continued to place China on the Priority Watch List and make China subject to Section 306 monitoring. USTR's report was informed by a special review conducted in 2006 and 2007 to examine the adequacy and effectiveness of IPR protection and enforcement at the provincial government level. As the special 301 report explains, the provincial review revealed strengths, weaknesses and inconsistencies in and among China's provinces. After the filing of the two WTO cases and the issuance of the Special 301 report, the United States continued to seek ways in which to work together with China to improve China's IPR enforcement regime. These efforts yielded some results, such as the signing of a Memorandum on Cooperation in IPR Enforcement between the two countries' customs authorities. However, China also decided in other ways to limit its cooperation because of dissatisfaction with the United States' decision to use the WTO dispute settlement mechanism, despite the fact that the issues in dispute involved narrowly drawn legal issues and had not been able to be resolved through dialogue.

Legal Framework

In most respects, China's framework of laws, regulations and implementing rules remains largely satisfactory. However, reforms are needed in a few key areas, such as further improvement of China's measures for copyright protection on the Internet following the notable achievement of China's accession to the WIPO Internet treaties. In particular, more work is needed at both the national level and the provincial level to meet the challenges of Internet piracy and fully implement the WIPO Internet treaties. Right holders have also pointed to a number of continuing deficiencies in China's criminal measures. Most notably, as discussed above, it appears that China needs to eliminate thresholds for criminal prosecution that provide a legal "safe harbor" for many commercial infringers if it is to bring its legal framework into compliance with its TRIPS Agreement obligations.

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*, followed by implementing rules. China also issued regulations and implementing rules covering specific subject areas, such as integrated circuits, computer software and pharmaceuticals. U.S. experts carefully reviewed these measures after their issuance and, together with other WTO members, participated in a comprehensive review of them as part of the first transitional review of China before the TRIPS Council in 2002.

Since 2003, China has periodically issued new IPR measures. The U.S. Government has reviewed these measures through bilateral discussions and subsequent TRIPS Council reviews. Encouragingly, China has also become more willing to circulate proposed measures for public comment and to discuss proposed measures with interested trading partners and stakeholders. For example, the United States and U.S. right holders provided written comments to China on several drafts of regulations for the protection of copyrights on information networks.

In 2007, China announced a new Action Plan for revising its legal regime in order to better protect intellectual property rights. Among other things, this Action Plan sets out China's intentions for revising various laws and other measures, including the *Patent Law*, the *Trademark Law* and related measures. These efforts are ongoing, and the United States has been assessing the potential ramifications of the contemplated revisions for U.S. right holders. The United States and U.S. industry groups have also submitted written comments, along with invitations to continue dialogue on these important pieces of legislation.

China has also been working on other proposed legal measures that could have significant implications for the intellectual property rights of foreign right holders. In particular, China issued an *Anti-Monopoly Law* in August 2007 and is considering rules relating to the treatment of IPR by standards setting organizations. The United States has been carefully monitoring these efforts and raised concerns with particular aspects of these proposals, both in bilateral meetings and at the WTO during the annual transitional reviews before the TRIPS Council and the TBT Committee.

The United States, meanwhile, has repeatedly urged China to pursue additional legislative and regulatory changes, using both bilateral meetings and the annual transitional reviews before the WTO's TRIPS Council. The focus of the United States' efforts is to persuade China to improve its legal regime in certain critical areas, such as criminal, civil and administrative IPR enforcement and legislative and regulatory reform. For example, obstacles that have been noted in the area of criminal enforcement include China's high criminal thresholds, the lack of criminal liability for certain acts of copyright infringement, the profit motive requirement in copyright cases, the requirement of identical trademarks in counterfeiting cases, and the absence of minimum, proportional sentences and clear standards for initiation of police investigations in cases where there is a reasonable suspicion of criminal activity. At the same time, the United States has also been pressing China to consider a variety of improvements to its administrative and civil enforcement regimes. While some of these issues do not raise specific WTO concerns, all of them will continue to detract from China's enforcement efforts until addressed.

In an Action Plan issued in April 2007, China undertook to “study and further improve” its December 2004 judicial interpretation on the handling of criminal IPR cases and to consider a variety of other steps that could potentially improve the legal framework for criminal, civil and administrative IPR enforcement. China also issued a new judicial interpretation that appeared to resolve one issue related to China’s problematic thresholds, namely, the problem that China’s *Criminal Law* provided for the prosecution of unauthorized reproduction of certain copyrighted works only when accompanied by unauthorized distribution. At the same time, however, Chinese government officials have given no indication whether the study and improvement foreseen in the 2007 Action Plan will lead to the reduction or elimination of China’s thresholds – a key concern in light of China’s obligations under Article 61 of the TRIPS Agreement. The United States included this issue in its April 2007 WTO case challenging deficiencies in China’s IPR enforcement regime.

The United States has also sought improvements in China’s copyright protection in the context of electronic information networks since the April 2004 JCCT meeting. China took an important step at the time of that meeting when the National Copyright Administration (NCA) issued the *Measures for Administrative Protection of Copyright on the Internet*. That measure requires Internet service providers to take remedial actions to delete contents that infringe on copyrights upon receipt of a complaint from the right holder, or face administrative penalties ranging from confiscation of illegal gains to fines of up to RMB 100,000 (\$13,500).

During the run-up to the July 2005 JCCT meeting, the United States also urged China to accede to the WIPO Internet treaties and to fully harmonize its regulations and implementing rules with them. Compliance with these treaties is not required under WTO rules, but they still reflect important international norms for providing copyright protection over the Internet. These treaties have been ratified by many developed and developing countries since they entered into force in 2002. In the case of China, this type of copyright protection is especially important in light of its rapidly increasing number of Internet users, many of whom have broadband access. At the July 2005 JCCT meeting, the United States obtained China’s commitment to submit the legislative package necessary for China’s accession to the WIPO Internet treaties to the National People’s Congress by June 2006. Although China’s fulfillment of this commitment has been delayed for technical reasons relating to coordination with Hong Kong and Macau, China did move forward with the harmonization of some of its regulations and implementing rules in 2005 and 2006. In May 2006, for example, the State Council adopted an important Internet-related measure, the *Regulations on the Protection of Copyright Over Information Networks*, which went into effect in July 2006. Overall, this measure represents a welcome step, demonstrating China’s determination to improve protection of electronic data while China continues its preparations for accession to the WIPO Internet treaties. This measure is not comprehensive, however. A number of gaps remain to be filled for China to meet the challenges of Internet piracy and fully implement the WIPO Internet treaties.

With respect to software piracy, China issued new rules during the run-up to the 2006 JCCT meeting that require computers to be pre installed with licensed operating system software and government agencies to purchase only computers satisfying this requirement. Combined with

ongoing implementation of previous JCCT commitments on software piracy, it is hoped that these rules will contribute to significant further reductions in industry losses due to software piracy. According to the U.S. software industry, China's software piracy rate has dropped ten percentage points in the last three years, and the legitimate software market grew to nearly \$1.2 billion in 2006 – an increase of over 350% since 2003. Achieving sustained reductions in end user software piracy, however, will require more enforcement by China's authorities, followed by high profile publicity of fines and other remedies imposed.

In the customs area, the United States is encouraged by the Customs Administration's increased efforts to provide effective enforcement against counterfeit and pirated goods destined for export and the Customs Administration's agreement in 2007 to cooperate with U.S. customs authorities to fight exports of counterfeit and pirated goods. Nevertheless, the United States remains concerned about various aspects of the *Regulations on the Customs Protection of Intellectual Property Rights*, issued by the State Council in December 2003, and the Customs Administration's May 2004 implementing rules, which were intended to improve border enforcement, make it easier for right holders to secure effective enforcement at the border and strengthen fines and punishments. Disposal of confiscated goods remains a problem under the implementing rules, which appear to mandate auction following removal of infringing features, rather than destruction of infringing goods not purchased by the right holder or used for public welfare. The United States raised this issue as well in its April 2007 WTO case challenging deficiencies in China's IPR enforcement regime.

The United States also remains concerned about a variety of weaknesses in China's legal framework that do not effectively deter, and may even encourage, certain types of infringing activity, such as the "squatting" of foreign company names, designs and trademarks, the theft of trade secrets, the registration of other companies' trademarks as design patents and vice versa, the use of falsified or misleading license documents or company documentation to create the appearance of legitimacy in counterfeiting operations, and false indications of geographic origin of products. In 2007, the United States continued to discuss these and other problems with China and seek solutions for them. In a positive development, SAIC announced in August 2007 that it was launching a 6-month campaign targeting the unauthorized use of well-known trademarks and company names in the enterprise registration process.

In the pharmaceuticals sector, the United States continues to have a range of concerns. The United States has urged China to provide greater protection against unfair commercial use of undisclosed test and other data submitted by foreign pharmaceuticals companies seeking marketing approval for their products. The United States has also encouraged China to undertake a more robust system of patent linkage and to consider the adoption of a system of patent term restoration. In addition, built-in delays in China's marketing approval system for pharmaceuticals continue to create incentives for counterfeiting, as does China's inadequate regulatory oversight of the production of active pharmaceutical ingredients by domestic chemical manufacturers. In 2007, as in prior years, the United States sought to address all of these issues as part of its broader effort to work with China to improve China's regulatory regime for the pharmaceuticals sector.

Enforcement

The TRIPS Agreement requires China to ensure that enforcement procedures are available so as to permit effective action against any act of infringement of intellectual property rights covered by the TRIPS Agreement, including expeditious remedies to prevent infringement and remedies that constitute a deterrent to further infringement. 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, effective IPR enforcement has not been achieved, and IPR infringement remains a serious problem throughout China. IPR enforcement is hampered by lack of coordination among Chinese government ministries and agencies, lack of training, resource constraints, lack of transparency in the enforcement process and its outcomes, and local protectionism and corruption.

Despite repeated anti piracy campaigns in China and an increasing number of civil IPR cases in Chinese courts, overall piracy and counterfeiting levels in China remained unacceptably high in 2007. IPR infringement continued to affect products, brands and technologies from a wide range of industries, including films, music and sound recordings, publishing, business and entertainment software, pharmaceuticals, chemicals, information technology, apparel, athletic footwear, textile fabrics and floor coverings, consumer goods, food and beverages, electrical equipment, automotive parts and industrial products, among many others.

U.S. industry estimates that levels of piracy in China across all lines of copyright business ranged between 85 and 93 percent based on data for 2006, which indicates little or no overall improvement over 2005. Trade in pirated optical discs continues to thrive, supplied by both licensed and unlicensed factories and by smugglers. Small retail shops continue to be the major commercial outlets for pirated movies and music (and a variety of counterfeit goods), and roaming vendors offering cheap pirated discs continue to be visible in major cities across China. Piracy of books and journals and end user piracy of business software also remain key concerns, although improvements have been seen in business software piracy rates, as discussed above. In addition, Internet piracy is increasing, as is piracy over enclosed networks such as universities. However, China's regulatory authorities did take initial steps to address text book piracy on university campuses in late 2006 and 2007. NCA also began to undertake campaigns to combat Internet piracy.

Although China made a commitment at the July 2005 JCCT meeting to take aggressive action against movie piracy, including enhanced enforcement for titles not yet authorized for distribution, right holders have monitored China's efforts and report little meaningful improvement in piracy of pre release titles in several major cities. For that reason, lack of copyright protection for works that have not yet been approved for release in China is one of the issues raised in the April 2007 WTO case challenging deficiencies in China's IPR enforcement regime.

China's widespread counterfeiting not only harms the business interests of foreign right holders, but also includes many products that pose a direct threat to the health and safety of consumers in

the United States, China and elsewhere, such as pharmaceuticals, food and beverages, batteries, auto parts, industrial equipment and toys, among many other products. At the same time, the harm from counterfeiting is not limited to right holders and consumers. China estimated its own annual tax losses due to counterfeiting at more than \$3.2 billion back in 2002, and this figure could only have grown in the ensuing years.

The United States places the highest priority on addressing the IPR protection and enforcement problems in China, and since 2004 it has devoted significant additional staff and resources, both in Washington and in Beijing, to address these problems. A domestic Chinese business constituency is also increasingly active in promoting IPR protection and enforcement. In fact, Chinese right holders own the vast majority of design patents, utility models, trademarks and plant varieties in China and have become the principal filers of invention patents. In addition, most of the IPR enforcement efforts in China are now undertaken at the behest of Chinese right holders seeking to protect their interests. Nevertheless, it is clear that there will continue to be a need for sustained efforts from the United States and other WTO members and their industries, along with the devotion of considerable resources and political will to IPR protection and enforcement by the Chinese government, if significant improvements are to be achieved.

As in prior years, the United States worked with central, provincial and local government officials in China in 2007 in a determined and sustained effort to improve China's IPR enforcement, with a particular emphasis on the need for dramatically increased utilization of criminal remedies as well as the need to improve the effectiveness of civil and administrative enforcement mechanisms. A variety of U.S. agencies held regular bilateral discussions with their Chinese counterparts and have conducted numerous technical assistance programs for central, provincial and local government officials on TRIPS Agreement rules, enforcement methods and rule of law issues. USTR also completed its special provincial government-level review in 2007, and the results revealed IPR enforcement strengths and weaknesses in key locations. In addition, the United States organized another annual roundtable meeting in China designed to bring together U.S. and Chinese government and industry officials. The United States also continued to urge China to use the IPR Working Group created at the April 2004 JCCT meeting and the JCCT process itself to press China for needed changes, although China demonstrated reluctance to pursue this avenue of cooperation after the United States filed two IPR-related WTO cases in April 2007.

The United States' efforts have also benefited from cooperation with other WTO members in seeking improvements in China's IPR enforcement, both on the ground in China and at the WTO during meetings of the TRIPS Council. For example, several WTO members have requested third-party status in one or both of the United States' April 2007 IPR-related WTO cases against China. Previously, the United States, Japan and Switzerland made coordinated requests under Article 63.3 of the TRIPS Agreement in order to obtain more information about IPR infringement levels and enforcement activities in China and provide a better basis for assessing the effectiveness of China's efforts to improve IPR enforcement since China's accession to the WTO. In addition, the United States and the EC have increased coordination and information sharing on a range of China IPR issues over the last year. China's membership in the Asia

Pacific Economic Cooperation Forum (APEC) also brings increased importance to APEC's work to develop regional IPR best practices.

The United States has also continued to pursue a comprehensive initiative to combat the enormous global trade in counterfeit and pirated goods, including exports of infringing goods from China to the United States and the rest of the world. That initiative, the Strategy Targeting Organized Piracy (STOP!), was announced in October 2004. It is a U.S. government wide effort to stop fakes at the U.S. border, to empower U.S. businesses to secure and enforce their intellectual property rights in overseas markets, to expose international counterfeiters and pirates, to keep global supply chains free of infringing goods, to dismantle criminal enterprises that steal U.S. intellectual property and to reach out to like minded U.S. trading partners in order to build an international coalition to stop counterfeiting and piracy worldwide. China's share of infringing goods seized at the U.S. border stood at 81 percent in mid-year 2007, according to data from U.S. customs authorities.

China is making genuine efforts to improve IPR enforcement. U.S. industry has confirmed that some of China's special campaigns, such as the "Mountain Eagle" campaign against trademark infringement crimes that ended in 2006, have in fact resulted in increased arrests and seizures of infringing materials, although the disposition of seized goods and the outcomes of criminal cases remain largely obscured by lack of transparency. The 2007 Action Plan announced that China will launch more special crackdown efforts with regard to various IPR infringement problems. The United States has urged China to use its implementation of such efforts as an opportunity to tackle emerging enforcement challenges, particularly the sale of pirated and counterfeit goods on the Internet. In addition, the United States has suggested that China use this opportunity to examine the potential benefits of specialized national IPR courts and prosecutors, providing faster trademark examination, and ensuring that the resources available to local administrative, police, and judicial authorities charged with protecting and enforcing intellectual property rights are adequate to the task. The United States will continue to pursue these efforts in 2008.

Nevertheless, despite its many positive efforts to improve IPR enforcement, China pursues other policies that continue to impede effective enforcement. These policies led the United States to resort to the WTO dispute settlement mechanism earlier this year, where it is seeking needed changes to China's legal framework that would facilitate the utilization of criminal remedies, improve border enforcement and provide copyright protection for works during the period when they are awaiting censorship approval. These changes should be an important objective for China, given the lack of deterrence clearly evident in China's current enforcement regime. At the same time, other changes are needed on the market access side. As discussed above, China maintains market access barriers, such as import and distribution restrictions, which discourage and delay the introduction of numerous types of legitimate foreign products into China's market. These barriers create additional incentives for infringement of copyrighted products like theatrical films, DVDs, music, books and journals and inevitably lead consumers to the black market, again compounding the severe problems already faced by China's enforcement authorities.

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 commitments 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 service sectors did not have an unqualified right to apply for a license to establish or otherwise provide services 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.

After six years of China’s membership in the WTO, challenges still remain in securing the benefits of many of China’s services commitments. Over the past year, China implemented relatively minor additional commitments required by December 11, 2006, in the areas such as wholesale and retail distribution services, insurance services and architectural and engineering services. Problems developed, however, with regard to the scheduled implementation of important commitments in the area of banking services, where China’s timely implementing regulations generated immediate concerns, and in the area of electronic payments services, where China had still made no attempt at implementation as of early December 2007. China also has not yet implemented further liberalization scheduled for the telecommunications sector by December 11, 2006.

In 2007, China also continued to maintain or erect high or cumbersome terms of entry in some sectors that prevent or discourage foreign suppliers from gaining market access. For example, excessive and often discriminatory capital requirements continued to restrict market entry for foreign suppliers in many sectors, such as insurance, banking, motor vehicle financing, securities, asset management, telecommunications and construction services, among others. In addition, in sectors such as banking, insurance and legal services, branching restrictions have been put into effect that call into question commitments made by China in its Services Schedule. In other sectors, particularly financial information services and construction services, problematic measures appear to be taking away previously acquired market access rights.

The *Administrative Licensing Law*, which took effect in July 2004, has increased transparency in the licensing process, while reducing procedural obstacles and strengthening the legal environment for domestic and foreign enterprises. As a result, the licensing process in many sectors continued to proceed in a workman-like fashion in 2007, although national treatment concerns remained, particularly in the banking and insurance sectors. In addition, in some sectors, such as insurance and telecommunications services, the licensing process was characterized by inordinate delays.

China is scheduled to implement the last of its services commitments by December 11, 2007. These commitments involve the areas of taxation services, management consulting services, mobile voice and data services, travel and tourism services, and rail transport services. The United States will monitor developments in these areas in 2008, while continuing its efforts to obtain China's full compliance with previously matured commitments.

Financial Services

Banking

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 domestic currency business, the experiment was limited to foreign customers in two cities.

In its WTO 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 domestic 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 was to be phased in. Within two years after accession, foreign banks were also to be able to conduct domestic currency business with Chinese enterprises, subject to certain geographic restrictions, which were to be lifted gradually over the following three years. Within five years after accession, foreign banks were to be able to conduct domestic currency business with Chinese individuals, and all geographic restrictions were to be lifted. Foreign banks were also to be permitted to provide financial leasing services at the same time that Chinese banks are permitted to do so.

Since its accession to the WTO, China has taken a number of steps to implement its banking services commitments. At times, however, China's implementation efforts have generated concerns, and there are some instances in which China still does not seem to have fully implemented particular commitments.

As previously reported, 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 2002. The PBOC also issued several other related measures. Although these measures appeared to keep pace with the WTO commitments that China had 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, which made it more difficult for foreign banks to establish and expand their market presence in China. Many of these requirements, moreover, did not apply equally to foreign and domestic banks. For example, a foreign bank branch licensed to conduct business in all currencies for both corporate and individual clients had to satisfy an operating capital requirement of RMB 500 million (\$67.5 million), while a domestic bank branch with the same business scope needed only RMB 300 million (\$40.5 million) in operating capital. In addition, the PBOC allowed foreign-funded banks to open only one branch every 12 months.

In several bilateral meetings following China's WTO accession, 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's Committee on Trade in Financial Services, including the transitional reviews held in 2002 and 2003. In December 2003 and July 2004, some progress took place, as the PBOC reduced working capital requirements for various categories of foreign banks. With the issuance of the *Implementing Rules for the Administrative Regulations on Foreign-Invested Financial Institutions* in July 2004, the China Banking Regulatory Commission (CBRC) also removed the restriction that had limited foreign-funded banks to opening only one new branch every 12 months. Nevertheless, the United States, along with Australia, Canada, the EC and Japan, continued to urge China to make its banking sector more accessible to foreign banks, as reflected in the annual transitional reviews before the Committee on Trade in Financial Services, including in 2007.

Meanwhile, China kept up with its commitments regarding the lifting of geographic restrictions on foreign banks conducting domestic currency business with foreign enterprises and individuals and Chinese enterprises. In December 2004, CBRC opened up five additional cities to foreign banks, including two cities (Xian and Shenyang) one year ahead of the commitment in China's Services Schedule. In December 2005, CBRC announced the opening of seven additional cities, five more than the two cities (Shantou and Ningbo) scheduled to be phased in by that time, bringing the total to 25 Chinese cities in which foreign banks were able to conduct business.

One area in which China has fallen behind in its WTO commitments involves the establishment of Chinese-foreign joint banks. In the Services Schedule accompanying its WTO accession agreement, China agreed that qualified foreign financial institutions would be permitted to establish Chinese-foreign joint banks immediately after China acceded, and it did not schedule any limitation on the percentage of foreign ownership in these banks. To date, however, China has limited the sale of equity stakes in existing state-owned banks to a single foreign investor to 20 percent, while the total equity share of all foreign investors is limited to 25 percent. The United States and other WTO members have urged China to relax these limitations during the annual transitional reviews before the Committee on Trade in Financial Services. In addition, the United States pressed China on this issue at the May 2007 SED meeting and the Joint Economic Committee meeting in September 2007, without achieving any progress. The United States is again raising this issue in connection with the SED meeting scheduled for December 2007.

Despite high capital requirements and other continuing impediments to entry into the domestic currency business, the business that foreign banks were most eager to pursue in China, participation of U.S. and other foreign banks in the domestic currency business has expanded tremendously. According to the PBOC and the CBRC, the domestic currency business of foreign banks grew rapidly in the first two years after China's WTO accession, albeit from a low base level, even though the foreign banks' clients were then limited to foreign-invested enterprises and foreign individuals. Following the PBOC's December 2003 announcement that foreign banks would be permitted to conduct domestic currency business with Chinese enterprises subject to geographic restrictions allowed by China's WTO commitments, the rate of growth in U.S. and other foreign banks' domestic currency business further accelerated. By the

end of 2006, when foreign banks were scheduled to begin engaging in domestic currency business with Chinese individuals, 260 foreign banks, including a number of U.S. banks, had branches or representative offices in China, although only large banks had sufficient resources to satisfy the entry requirements. In addition, the total assets of foreign banks in China had reportedly reached \$123 billion, representing just over 2 percent of the total banking assets in China. In some coastal cities, the percentage was higher.

The five-year phase-in period for banking services by foreign banks ended on December 11, 2006. By that time, China was supposed to have removed remaining geographic limitations and to have allowed foreign banks to conduct domestic currency business with Chinese individuals. These commitments have been anticipated for some time, as U.S. and other foreign banks should benefit tremendously from new business opportunities, and China should realize important benefits from having greater access to world-class banking services.

In November 2006, however, the State Council issued implementing regulations – the *Regulations for the Administration of Foreign-Funded Banks* – which generated some immediate concerns. For example, the regulations mandated that only foreign-funded banks that have had a representative office in China for two years and that have total assets exceeding \$10 billion can apply to incorporate in China. After incorporating, moreover, these banks only become eligible to offer full domestic currency services to Chinese individuals if they can demonstrate that they have operated in China for three years and have had two consecutive years of profits. The regulations also restricted the scope of activities that can be conducted by foreign banks seeking to operate in China through branches instead of through subsidiaries. In particular, the regulations restricted the domestic currency business of foreign bank branches. While foreign bank branches can continue to take deposits from and make loans to Chinese enterprises in domestic currency, they can only take domestic currency deposits of RMB 1 million (\$135,000) or more from Chinese individuals and cannot make any domestic currency loans to Chinese individuals. In addition, unlike foreign banks incorporated in China, foreign bank branches cannot issue domestic currency credit and debit cards to Chinese enterprises or Chinese individuals.

Other problems arose once the new regulations went into effect in December 2006. For example, Chinese regulators did not act on the applications of foreign banks incorporated in China to issue domestic currency credit and debit cards, or to trade or underwrite commercial paper or long-term listed domestic currency bonds.

In 2007, working closely with U.S. banks, the United States pressed China in an attempt to improve the access of U.S. banks to the domestic currency business. The United States principally used the May 2007 SED meeting, the U.S.-China Joint Economic Committee meeting in September 2007 and the SED meeting scheduled for December 2007 to seek these improvements. At the May 2007 SED meeting, China committed to act on the applications of foreign banks incorporated in China seeking to issue their own domestic currency credit and debit cards. Nevertheless, while the CBRC has since approved the banks' applications, the PBOC has so far withheld its approval, citing technical issues. The banks' continuing inability

to issue their own credit and debit cards has hindered the banks' ability to attract Chinese individuals as new customers.

At the SED meeting scheduled for December 2007 and, if necessary, in 2008, the United States will continue to press China to allow U.S. banks full access to the domestic currency business. The United States will make every effort to ensure that China fully implements its domestic currency business commitments and that U.S. banks realize the full benefits to which they are entitled.

Motor Vehicle Financing

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

As previously reported, 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. Despite extensive engagement by the United States and other WTO Members, it was not until October 2004, nearly three years after its accession to the WTO, that China finally implemented the measures necessary to allow foreign financial institutions to obtain licenses and begin offering auto loans.

Insurance

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

China also made additional significant commitments relating specifically to branching. China scheduled a commitment to allow non-life insurance 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.

As previously reported, 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, the capitalization requirements imposed by the regulations were significantly more exacting than those of other populous countries with no less an interest in preserving a healthy insurance market, and they limited the ability of foreign insurers to make necessary joint venture arrangements. The regulations also lacked adequate transparency, as they continued to permit considerable bureaucratic discretion and to offer limited predictability to foreign insurers seeking to operate in China's market. Meanwhile, notwithstanding several important commitments on branching, the regulations are vague on foreign insurers' branching rights, and CIRC has often been reluctant to provide clarifications.

In close consultation with U.S. insurers, the United States first 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, China issued draft implementing rules in August 2003. Although this draft demonstrated some progress with regard to capitalization requirements and transparency, more progress was needed. The United States also continued to press its concerns, particularly with regard to branching, in high-level meetings in September, October and November 2003, and at the transitional review before the Committee on Trade in Financial Services in December 2003. In May 2004, CIRC issued final implementing rules, the *Detailed Rules on the Regulations for the Administration of Foreign-Invested Insurance Companies*. These rules lowered capital requirements for national licenses from RMB 500 million (\$67.5 million) to RMB 200 million (\$27 million) and for branch offices from RMB 50 million (\$6.75 million) to RMB 20 million (\$2.7 million). These changes were welcomed by some U.S. insurers, but others still considered the capital requirements to be too high. The rules also streamlined licensing application procedures and shortened approval times, although some procedures remained unclear. Meanwhile, the rules did not adequately address branching rights, as many aspects of this area remained vague. The rules also did not address another issue that U.S. and other foreign insurers had begun to complain about – in practice, it appeared that

established Chinese insurers were being granted new branch approvals on a concurrent basis, meaning more than one branch at a time, while foreign insurers had only received approvals on a consecutive basis, meaning one branch at a time. In addition, while the rules provide some guidance regarding foreign non-life insurers wishing to apply for approval to convert from a branch to a subsidiary, CIRC has continued to have difficulty adhering to its own regulatory requirement that it act on applications within 60 days, as long delays are routine.

At the April 2004 JCCT meeting, the United States had sought and obtained a commitment from China to re-start the CIRC working group, so that U.S. regulators and insurers could discuss the range of insurance issues with CIRC officials. The United States attempted to schedule these discussions shortly after the May 2004 implementing rules were issued, but without success. Later in the year, the United States raised its concerns in the insurance area during the transitional review before the Committee on Trade in Financial Services, held in November 2004, with support from Canada and Japan. At about the same time, CIRC agreed to schedule the next working group meeting in early 2005. The CIRC working group meeting finally took place in April 2005. It provided a useful forum for U.S. and Chinese industry experts to join U.S. and Chinese government representatives in a discussion of a broad range of concerns. Not long thereafter, at the July 2005 JCCT meeting, China agreed to make CIRC available for another working group meeting by the end of 2005. That meeting took place in December 2005, and another meeting took place in November 2006. Through those meetings and additional bilateral engagement, the United States obtained assurances from CIRC that it was China's policy to grant foreign insurers new branch approvals on a concurrent basis, as has been done for domestic insurers, but in practice it has not been happening. The United States has also obtained useful clarifications regarding the status of China's draft Insurance Law. In addition, CIRC has provided useful information regarding the *Regulations on the Administration of the Reinsurance Business*, which were issued in late 2005 without prior notice or the opportunity for public comment. However, there continued to be uncertainty about these regulations, including with regard to the issue of whether they effectively require insurers in China to conclude contracts only with reinsurers invested in China, a requirement that would raise questions about China's compliance with its WTO commitments, which permit the insurers the flexibility to source reinsurance from cross-border suppliers.

In 2007, despite these ongoing problems, the operations of foreign insurers in China continued to grow, with all remaining geographic restrictions and business scope restrictions having been removed. As of July 2007, 45 foreign insurers were operating in China, including a large number of U.S. insurers. Foreign insurers had only a four percent share of the national market, but they continued to capture encouraging market shares in major coastal municipalities and were working to broaden their presence in China.

The United States used the SED meeting in May 2007 to try to make progress on some of the troublesome issues facing U.S. insurers. At that meeting, China committed to eliminate the backlog of U.S. non-life insurers' applications for conversion from a branch to a subsidiary by August 2007, and CIRC followed through on that commitment. However, China refused to address other issues raised by the United States. Because of the limited progress made at the

May 2007 SED meeting, the United States is also raising insurance issues during the run-up to the JCCT and SED meetings scheduled for December 2007, including the need for China to establish non-discriminatory procedures allowing U.S. companies to submit applications for internal branches on a concurrent or consecutive basis, at their choice, with timely action on those applications by China's regulatory authorities.

In 2008, as in prior years, the United States will continue to use both bilateral and multilateral engagement to address issues of concern to U.S. insurers. The United States is committed to seek market access for U.S. insurers on a transparent, fair and equitable basis.

Financial Information Services

In its WTO accession agreement, as noted above, China committed that, for the services included in its Services Schedule, the relevant regulatory authorities would be separate from, and not accountable to, any service suppliers they regulated, with two specified exceptions. One of the services included in China's Services Schedule – and not listed as an exception – is the “provision and transfer of financial information, and financial data processing and related software by suppliers of other financial services.”

Nevertheless, China has still not established an independent regulator in the financial information services sector. Xinhua, the Chinese state news agency, is both a major market competitor of, and the regulator of, foreign financial information service providers in China. As problems with Xinhua's regulation of this sector mounted following China's WTO accession, U.S. and other foreign financial information service providers began to call for the establishment of an independent regulator. The United States and the EC both raised concerns about this issue during the transitional review before the WTO's Committee on Trade in Financial Services, held in September 2005. The United States continued to press China on this issue bilaterally in 2006, as did the EC.

In September 2006, a major problem developed when Xinhua issued, without an opportunity for prior public comment, the *Administrative Measures on News and Information Release by Foreign News Agencies within China*. These rules abolished the *Measures for Administering the Release of Economic Information in China by Foreign News Agencies and Their Information Subsidiaries*, which had been issued in 1996. Among other things, under the 2006 rules, Xinhua now precludes foreign providers of financial information services from contracting directly with or providing financial information services directly to domestic Chinese clients. Instead, foreign financial information service providers must operate through a Xinhua-designated agent, and the only agent designated to date is a Xinhua affiliate. These new restrictions do not apply to domestic financial information service providers and, in addition, contrast with the rights previously enjoyed by foreign information service providers since the issuance of the 1996 rules, well before China's accession to the WTO in December 2001. The United States immediately raised strong concerns with the new rules during a series of bilateral meetings in Beijing, as did the EC, as a number of potential WTO concerns were implicated, including China's national treatment obligation, commitments that China made in its GATS Schedule and China's

commitment to establish an independent regulator. In response to these complaints, Premier Wen publicly promised that the new rules would not change how foreign financial information service providers did business in China. Shortly thereafter, Xinhua told foreign financial information service providers that the new rules would not be applied to them until after an implementing measure was issued. The United States reiterated its concerns about these rules during the transitional review before the WTO's Committee on Trade in Financial Services in November 2006. The United States also raised this issue on the margins of the December 2006 SED meeting.

In 2007, working closely with the U.S. and European industries and the EC, the United States established a regular dialogue with Xinhua on this issue, securing Xinhua's agreement to maintain the status quo until this issue can be resolved. The United States also raised this issue in connection with the May 2007 SED meeting and is currently pressing for a resolution of this issue during the run-up to the JCCT meeting scheduled for December 2007. The United States will take further actions in 2008, including the initiation of WTO dispute settlement, if appropriate, in an effort to ensure that U.S. suppliers are able to provide financial information services in China in a manner consistent with the commitment that China made in its Services Schedule.

Electronic Payments Processing

In the Services Schedule accompanying its Protocol of Accession, China committed to remove market access limitations and provide national treatment for foreign suppliers providing payment and money transmission services, including credit, charge, and debit cards, with this commitment becoming effective with regard to the domestic currency business of retail clients. China also committed to allow the provision and transfer of financial information, financial data processing and advisory, intermediation and other financial services auxiliary to payments and money transmission services. These electronic payments processing commitments were to be implemented by no later than December 11, 2006.

Under its existing rules, China restricts foreign credit card companies' access to its market. It only permits China Union Pay (CUP), an entity created by the PBOC and owned by participating Chinese banks, to provide electronic payments processing services for domestic currency credit card transactions. Foreign credit card companies can only provide these services for foreign currency transactions.

In the second half of 2006, a number of troubling proposals were attributed to CUP and apparently supported by the PBOC. The common theme of these proposals was that CUP would be designated as a monopoly provider of electronic payments processing services for Chinese consumers for RMB processing, and that no other providers would be able to enter this market. Through a series of bilateral meetings beginning in September 2006, the United States cautioned China that none of the proposals being attributed to CUP would satisfy the commitments that China had made to open up its market to foreign credit card companies. The United States reinforced this message during the transitional review before the Committee on Trade in

Financial Services, held in November 2006. The United States also raised this issue on the margins of the first SED meeting, held in December 2006, without achieving any resolution.

In 2007, the United States continued to press China to implement its electronic payments processing commitments. The United States raised this issue in connection with the May 2007 SED meeting and other bilateral meetings as well as at the WTO during the transitional review before the Committee for Trade in Financial Services, without making progress.

The United States is currently raising this issue during the run-up to the JCCT meeting scheduled for December 2007. The United States will continue to pursue this issue vigorously in 2008, if necessary, and will take further appropriate actions seeking to ensure that U.S. credit card companies enjoy the full benefits of the market-opening commitments that China made in its Services Schedule.

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 of any kind. 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 WTO 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 act as "foreign legal consultants" who advise clients on foreign legal matters and may 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.

As previously reported, the State Council issued the *Regulations on the Administration of Foreign Law Firm Representative Offices* in December 2001, and the Ministry of Justice issued implementing rules in July 2002. 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. Among other things, it appears that these measures create an economic needs test for foreign law firms that want to establish offices in China, which raises WTO concerns, given China's GATS commitments. In addition, the procedures for establishing a new office or an additional office are unnecessarily time-consuming. For example, a foreign law firm may not establish an additional representative office until its most recently established representative office has been in practice for three consecutive years. Furthermore, new foreign representatives must go through a lengthy approval process that can take more than

one year, during which time they must leave the country monthly to file for a renewal visa. These measures also seem to take an overly restrictive view of the types of legal services that foreign law firms may provide – which impedes their efforts to secure enforcement of China’s IPR laws and other legal rights accorded to foreign businesses by the terms of China’s WTO accession. In particular, foreign attorneys may not take China’s bar examination, and they may not hire registered members of the Chinese bar as attorneys, which prohibits them from providing advice on Chinese law to clients. In addition, foreign law firms are placed at a considerable disadvantage in relation to domestic law firms. The MOJ refuses to fully license Chinese attorneys that work in foreign law firms, but allows them to engage in the full range of practice areas in domestic law firms. Foreign law firms are also subject to taxes at both the firm and individual levels, while domestic law firms are only taxed as partnerships. Foreign law firms additionally are not permitted to repatriate profits earned because, as representative offices, they are not permitted to convert profits from domestic currency into foreign currency.

The United States has raised its concerns both bilaterally and at the WTO during the annual transitional reviews before the Council for Trade in Services, with support from the EC and Japan. To date, although a number of U.S. and other foreign law firms have been able to open a second office in China, little progress has been made on the problematic aspects of the new measures, particularly the economic needs test, the unreasonable restrictions on the types of legal services that can be provided and the unnecessary delays that must be endured when seeking to establish new offices. In 2007, these obstacles continue to prevent foreign law firms from participating fully in China’s legal market. The United States will continue to engage China in 2008 in an attempt to resolve these outstanding concerns.

Telecommunications

In the Services Schedule accompanying its WTO accession agreement, China committed 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 Reference Paper on regulatory principles. As a result, China became obligated to separate the regulatory and operating functions of MII (which had been both the telecommunications regulatory agency in China and the operator of China Telecom) upon its accession. 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 incumbent suppliers such as China Telecom, China Netcom and China Unicom.

Even though China has nominally kept to the agreed schedule for phasing in its WTO commitments, no meaningful market-opening progress took place in the telecommunications services sector through 2007. As discussed below, MII's imposition of excessive capital requirements and MII's reclassification of value-added services as basic services, together with MII's lengthy license application process, have continued to present formidable barriers to market entry for foreign enterprises. Indeed, as China nears the end of its sixth year of WTO membership, the United States is unaware of any domestic or foreign application for a license to provide basic services that has completed the MII licensing process. As a result, the number of suppliers of basic services appears to be frozen, limiting the opportunities for new joint ventures and reflecting a level of competition that is extraordinarily low given the size of China's market.

Central to the absence of meaningful progress in opening China's telecommunications sector is the reality that, six years after its accession to the WTO, China has not yet established a truly independent regulator. 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.

As previously reported, the State Council issued regulations on the administration of foreign-invested telecommunications enterprises in December 2001. These regulations implemented 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 established high capital requirements (particularly for basic services) that pose a significant barrier to entry for many potential foreign suppliers. Then, in April 2003, MII issued its Catalogue of Telecommunications Services, which reclassified several telecommunications services from the value-added category to the basic category, contrary to widely accepted international practice. MII also placed restrictions on what new services could be classified under the value-added category. These moves limited the ability of U.S. firms to access China's telecommunications market because, under China's Services Schedule, basic services were on a slower liberalization schedule than value-added services, and China subjects basic services to higher capitalization requirements. Indeed, China requires suppliers of basic services to satisfy an excessive registered capital requirement of RMB 2 billion (\$270 million). A review of capital requirements around the world shows essentially no capital requirements in many WTO member markets, including, for example, Argentina, Australia, Brazil, Chile, the member States of the European Union, Japan and the United States. Where capital-related requirements do exist, they typically only take the form of guarantees.

If China takes the initiative, its planned new *Telecommunications Law* could be a vehicle for addressing these existing market access barriers and other problematic aspects of China's current telecommunications regime. A draft of this long-awaited law began to circulate among Chinese ministries and agencies in 2004. However, to date, China has not made a draft available for public comment, despite repeated requests from the United States and other WTO members.

Over the years, the United States has raised its many concerns in the telecommunications area with China, using both bilateral engagement and WTO meetings, including the annual transitional reviews before the Council for Trade in Services, where it has received support from the EC and Japan. In 2005, the United States elevated its concerns to the level of the JCCT. At the July 2005 JCCT meeting, the United States was able to persuade China to commit its telecommunications regulator, MII, to a bilateral working group to discuss capitalization requirements, resale services and other issues agreed to by the two sides. The first meeting of this working group took place in January 2006. Subsequently, the United States focused on making progress on the issue of high capital requirements during the run-up to the April 2006 JCCT meeting. At that meeting, China specifically committed to make appropriate adjustments to its registered capital requirements for providers of basic services, and it was agreed by the two sides that a working group would meet to discuss China's implementation of this commitment. The United States subsequently discussed this commitment in the working group and in bilateral meetings with MII and MOFCOM, but one year later China still had taken no steps to fulfil this commitment. The United States then used the May 2007 SED meeting to urge China to implement this commitment, but continued to see no progress. The United States is currently pressing China to implement this commitment in advance of the JCCT meeting scheduled for December 2007.

In 2008, the United States will continue to press China to implement its commitment to adjust the capitalization requirements for providers of basic services, if necessary. The United States will also continue to engage China on the range of other issues that contribute to the absence of meaningful market-opening progress in China's telecommunications sector.

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.

As previously reported, 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 provide schedules for the opening up of construction services and related construction engineering design services to joint ventures with majority foreign ownership and wholly foreign-owned enterprises. The necessary implementing rules for Decree 113 were issued in April 2003, but Decree 114 implementing rules were delayed until early 2007.

Decreets 113 and 114 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. In addition, these decrees for the first time require foreign-invested enterprises to incorporate in China, and they impose high minimum registered capital requirements and technical personnel staff requirements that are difficult for many foreign-invested enterprises to satisfy. In consultation with U.S. industry, the United States, in a high-level intervention, pressed its concerns about Decreets 113 and 114 and sought a delay before the decrees' problematic requirements would become effective. While Decree 114 still had no implementation date because implementing rules had not been issued, the Ministry of Construction agreed to extend the Decree 113 implementation date from October 2003 until April 2004. The United States and U.S. industry used this extension to pursue these issues further with the Ministry of Construction and MOFCOM.

In April 2004, Decree 113 went into effect. However, in September 2004, the Ministry of Construction and MOFCOM issued Circular 159, which permitted foreign providers of construction services and related construction engineering design services to continue operating on a project by-project basis until July 2005, effectively extending the effective date of the incorporation-related requirements. Since the expiration of Circular 159 in July 2005, however, U.S. and other foreign companies have faced a great deal of uncertainty when contemplating participation in projects in China.

Implementing rules for Decree 114 were finally issued, and became effective, in January 2007. These implementing rules were generally positive, as they temporarily lifted foreign personnel residency and staffing requirements imposed by Decree 114, and recognized the foreign qualifications of technical experts when considering initial licensing. However, they also contained restrictions that may limit market access by U.S. and other foreign companies, as they, for example, only "temporarily" lifted foreign residency and personnel requirements, required two years of domestic experience before companies can apply for higher-level licenses and imposed more stringent initial qualification requirements for foreign companies than domestic companies in the area of design services.

Meanwhile, in November 2004, the Ministry of Construction issued a measure – the *Provisional Measures for Construction Project Management* – that restricts the provision of project management services. This measure, known as Decree 200, became effective in December 2004 and appears to preclude the same company from providing construction services and project management services on a single project. This aspect of Decree 200 raises concerns because U.S. companies often provide integrated construction services packages – combining management, design, and construction services – in project delivery systems in overseas markets. Decree 200 also imposes burdensome requirements by, for example, not allowing foreign companies to provide project management services without already holding a license in one of six categories, which include construction, design, costing, tendering, supervision and surveying. No implementing rules for Decree 200 have been issued to date.

In 2007, as in prior years, the United States engaged China, both bilaterally and at the annual transitional reviews before the Council on Trade in Services, in an effort to obtain improvements in Decrees 113 and 114 and related measures, including three new measures issued by the Ministry of Construction in June 2007. In addition, the United States and China held an initial useful exchange on international best practices in the construction sector. This exchange, which took place in June 2007, allowed U.S. Government officials and U.S. industry representatives to share ideas with Ministry of Construction officials, officials from other relevant ministries and agencies and representatives of China's construction industry about how China's regulatory regime could be improved to the benefit of both the United States and China. A second best practices exchange is tentatively scheduled for early 2008.

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, as previously reported, shortly after becoming a WTO member in December 2001, 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 authority, 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, in apparent contravention of China's horizontal "acquired rights" commitment (discussed above at the beginning of the Services section).

Following sustained engagement by the United States and other affected WTO members, particularly the EC and Japan, China revised these measures in September and October 2002 and implemented a more streamlined – but still unnecessarily burdensome – entrustment application process. While U.S.-invested express delivery companies were able to continue to operate without significant disruption and even to expand their operations in China, it was not until more than four years later, following the SED meeting in May 2007, that China agreed to require only a single entrustment certificate covering a foreign-invested express delivery company and all of its branches in China.

In 2003, as previously reported, China began selectively circulating draft amendments to its *Postal Law*, which generated immediate concerns. 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, again raising WTO concerns, given China's horizontal "acquired rights" commitment. Second, the draft amendments did not address the need for an independent

regulator. Third, the draft amendments appeared to create a new, more burdensome licensing process to replace the existing entrustment process, and they also seemed to require express couriers to pay four percent of their revenue from the delivery of letters into a fund for universal mail service in China.

In 2004, the United States made express delivery services one of its priority issues during the run-up to the April JCCT. The United States focused its engagement with China on the weight restriction, which would cut back on the scope of activities that foreign-invested express delivery companies had been licensed to provide prior to China's WTO accession. At the JCCT meeting, Vice Premier Wu committed that old problems, like the weight restriction, would not resurface as new problems. Nevertheless, in July 2004, the State Council circulated another set of draft amendments to the *Postal Law* that continued to include a weight restriction, now reduced from 500 grams to 350 grams, and did little to address other U.S. concerns.

Over the next two years, the United States continued to raise its concerns in bilateral meetings and during the annual transitional reviews before the WTO's Council for Trade in Services, with support from the EC, while China continued to work on further drafts of the *Postal Law*. In 2006, as reports of problematic provisions continued, the United States raised its concerns during the run-up to the April 2006 JCCT meeting. At that meeting, China reiterated its commitment that the regulatory environment for express delivery services by foreign companies would not be negatively impacted by the issuance of new rules, including the *Postal Law*. Later that year, however, China circulated an "eighth" draft of the *Postal Law* among some Chinese stakeholders, and this draft generated serious new concerns, as it reportedly would completely exclude foreign service providers from the domestic express delivery market in China.

The United States understands that China is now selectively circulating a "ninth" draft of the *Postal Law*. Like prior drafts, China has not circulated this draft for public comment. Nevertheless, this draft reportedly contains many provisions that cause serious concern for U.S. companies. In particular, it appears that foreign-invested express delivery companies would not be allowed to handle packages containing letters or other documents in the domestic express delivery market in China, as China Post would have a monopoly on documents weighing less than 150 grams, and only China Post and other domestic companies – but not foreign-invested companies – could deliver documents weighing 150 grams or more. In addition, it appears that this draft of the *Postal Law*, like prior drafts, continues to include an unspecified tax obligation on express delivery companies to help fund China Post's universal mail service obligation.

Meanwhile, in August 2006, the State Council reportedly finalized its Postal Reform Plan, which reportedly separates China's postal operations from the administrative function of regulating China's postal system, with the State Postal Administration (SPA) to serve as the regulator and a new state-owned enterprise – the China Post Group Corporation – to be set up to conduct postal business. In September 2006, SPA announced the establishment of 31 provincial-level Postal Management Bureaus to assist in the regulatory effort, while the China Post Group Corporation was established in December 2006. The United States remains disappointed that the State Council has not made public its Postal Reform Plan and that the September 2006 announcement

launching the provincial-level regulatory bureaus did not clarify certain of the outstanding issues, such as whether providers of express delivery services will be asked to pay into a fund to support universal mail service in China.

In 2007, the United States continued to work closely with U.S. express delivery companies in pressing China to increase transparency, both with regard to the draft *Postal Law* and the Postal Reform Plan, and to urge China to develop a sensible and WTO-consistent set of amendments to the *Postal Law*. The United States raised these concerns in connection with the SED meeting in May 2007, without making tangible progress, and is currently raising them again during the run-up to the JCCT meeting scheduled for December 2007.

Finally, in September 2007, a new issue arose when China issued express delivery “standards.” It is not yet clear whether these “standards” are mandatory, but they do contain many elements that appear to impose undue burdens on the operations of foreign-invested express delivery companies and may also result in the establishment of provincial-level regulatory bodies that could further hinder growth in the operations of foreign-invested express delivery companies’ operations in China. The United States is attempting to clarify how these “standards” will be implemented during the run-up to the JCCT meeting scheduled for December 2007.

Aviation Services

As previously reported, China took a significant step in July 2004 to increase market access for U.S. service providers of air transport services, an area that for the most part falls outside the scope of the GATS and is normally the subject of bilateral agreements. At that time, China signed a landmark bilateral aviation agreement with the United States that will more than double the number of U.S. airlines operating in China and that will increase by five times the number of flights providing passenger and cargo services between the two countries over the next six years. The agreement also allows each countries’ carriers to serve any city in the other country, provides for unlimited code-sharing between them, expands opportunities for charter operators, grants cargo carriers the right to provide door-to-door delivery services, and eliminates government regulation of pricing as of 2008. U.S. airlines and U.S. express delivery companies have since obtained additional routes and increased flight frequencies, as envisioned by the agreement.

Meanwhile, an important commitment enshrined in the July 2004 agreement calls for the commencement of negotiations toward further liberalization through a bilateral Open Skies Agreement. The first round of these negotiations took place in April 2006. The United States and China exchanged views and agreed to hold a second round of negotiations during the second half of 2006. However, China subsequently postponed the second round of negotiations, citing the designation of a Chinese company under Executive Order 13382, which addresses the proliferation of weapons of mass destruction.

Bilateral engagement with China resumed in 2007 following the SED meeting held in December 2006, as the United States and China set out to improve the existing bilateral aviation agreement.

Multiple rounds of negotiations took place between January and May 2007 and yielded an amended agreement, which should bring significant economic benefits to the U.S. aviation industry, passengers, shippers and local communities. The agreement allows for significantly expanded air service and should further facilitate trade, investment, tourism and cultural exchanges between the United States and China. Among other things, the agreement will add ten new daily passenger flights that U.S. carriers may operate to the Chinese gateway cities of Beijing, Shanghai and Guangzhou between 2008 and 2012, allow unlimited U.S. cargo flights to any point in China and an unlimited number of U.S. cargo carriers to serve the China market as of 2011, increase from six to nine the number of U.S. passenger carriers that may serve the China market by 2011, and expand opportunities for U.S. carriers to code-share on other U.S. carriers' flights to China. The agreement also commits the United States and China to launch Open Skies negotiations in 2010.

Maritime Services

As previously reported, even though China made no WTO commitments to open up its maritime services sector, it took a significant step in December 2003 to increase market access for U.S. service providers. The United States and China signed a far-reaching, five-year bilateral maritime agreement, which gives U.S.-registered companies the legal flexibility to perform an extensive range of additional shipping and logistics activities in China. U.S. shipping and container transport services companies, along with their subsidiaries, affiliates and joint ventures, are also able to establish branch offices in China without geographic limitation.

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, 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 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.

In a few sectors, China has actually gone beyond its commitments. For example, even though China had only committed to permit majority foreign-owned joint ventures in the convention services sector, MOFCOM opened this sector to wholly foreign-owned enterprises in February 2004. In addition, at the May 2007 SED meeting, China agreed to gradually expand the business scope of joint venture securities companies to allow them to engage in securities brokerages, proprietary trading and asset management.

In other sectors, however, China has been less willing to increase market access for foreign service providers, even when it would help to achieve other important objectives that China has set for itself, such as improved IPR enforcement. For example, China continues to interpret its audio-visual services commitments restrictively, despite the fact that this approach encourages

the illegal copying and sale of foreign films in China. In particular, China continues to treat its commitment to allow the importation of 20 foreign films for theatrical release on a revenue-sharing basis per year as a ceiling rather than a floor and further constrains the timely release of these films through distribution and marketing restrictions and lengthy film approval requirements. The United States has raised its concerns in this area with China at high levels since 2004, including through the July 2005 JCCT meeting and in extensive bilateral discussions leading up to the filing of WTO dispute settlement proceedings in April 2007 on IPR enforcement and on China's restrictions on the importation and distribution of copyright-intensive products such as theatrical films, DVDs, music, books and journals. However, little progress has been made to date.

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 fully 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

Official Journal

In its WTO accession agreement, China committed to establish or designate an official journal dedicated to the publication of all laws, regulations and other measures pertaining to or affecting trade in goods, services, TRIPS or the control of foreign exchange. China also committed to publish this journal on a regular basis and to make copies of all issues of this journal readily available to enterprises and individuals.

Following its accession to the WTO, China did not establish or designate an official journal. Rather, China relied on multiple channels, including ministry websites, newspapers and a variety of journals, to provide information on trade-related measures. In bilateral meetings and at the WTO, the United States urged China to adopt a single official journal, explaining that the establishment or designation of a single journal would greatly enhance the ability of WTO members to track the drafting, issuance and implementation of trade-related measures. The United States also noted that the use of a single journal to request comments on proposed trade-related measures, as envisioned in China's WTO accession agreement, would facilitate the timely notification of comment periods and submission of comments.

In early 2006, as previously reported, the United States elevated this issue to the level of the JCCT, pressing its concerns during the run-up to the JCCT's April 2006 meeting. In March 2006, the State Council issued a notice directing all central, provincial and local government entities to begin sending copies of all of their trade-related measures to MOFCOM for immediate publication in the *MOFCOM Gazette*. The United States has been monitoring the effectiveness

of this notice, both to assess whether all government entities regularly publish their trade-related measures in the *MOFCOM Gazette* and whether all types of measures are being published. So far, adherence to the State Council's notice continues to be far from complete.

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. 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.

The principal focus of China's first year of WTO membership was on its framework of laws and regulations governing trade in goods, trade in services, IPR and trade remedies. Most of this work took place at the central government level, with more than 2,500 trade-related laws and regulations reportedly being reviewed for WTO consistency. As a result of this initial review, China reportedly repealed more than 800 laws and regulations, while it issued almost 450 new or revised ones. In 2003, the central government continued this work, issuing more than 100 new or revised laws and regulations in an effort to meet China's WTO obligations. China's 31 provinces and autonomous regions and 49 major cities also reportedly made progress, as they repealed nearly 500 trade-related measures and amended almost 200 more.

Despite the tremendous amount of work that China put into overhauling its framework of trade-related laws and regulations in 2002 and 2003, China's ministries and agencies still had a poor record of providing an opportunity for public comment *before* new or modified laws and regulations were 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 as well as 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, only a small proportion of new or revised laws and regulations were issued after a period for public comment, and even in those cases the amount of time provided for public comment was generally too short.

In 2004, some improvements took place, particularly on the part of MOFCOM, which began following the rules set forth in its *Provisional Regulations on Administrative Transparency*, issued in November 2003. Those rules could potentially serve as a model for other ministries and agencies seeking to improve their transparency.

Nevertheless, basic compliance with China's notice-and-comment commitment continued to be uneven in the ensuing years, including 2007. In the area of intellectual property rights, for example, several ministries and agencies circulated proposed measures for public comment. The National People's Congress also circulated a proposed *Labor Contract Law* for public comment in March 2006. However, China did not provide for public comment on other major trade-related laws and regulations, such as the April 2005 *Measures on the Importation of Parts for Entire Automobiles*, which has since given rise to a WTO dispute brought by the United States, the EC and Canada, CIRC's December 2005 *Regulations on the Administration of the Reinsurance Business*, the August 2006 M&A regulations, Xinhua's September 2006 *Administrative Measures on News and Information Release by Foreign News Agencies within China*, or the October 2007 *Sectoral Guidelines Catalogue for Foreign Investment*. In addition, China did not seek public input on new rules on telecommunications value-added services issued by MII in July 2006, or new rules on qualification requirements for senior managers of insurance companies issued by CIRC in July 2006. The United States and other WTO members have also been seeking the opportunity to comment on a number of significant new measures, such as the draft *Postal Law* and the draft *Telecommunications Law*, so far without success.

In numerous bilateral meetings with the State Council, MOFCOM and other Chinese ministries since China's WTO accession, including high-level meetings such as JCCT meetings and SED meetings, the United States has emphasized the importance of China's adherence to the notice-and-comment commitment in China's accession agreement, both in terms of fairness to WTO members and the benefits that would accrue to China. Together with other WTO members, the United States has also raised this issue repeatedly during regular WTO meetings and as part of the annual transitional reviews conducted before various WTO councils and committees.

At the April 2006 JCCT meeting, which took place shortly after China finally adopted a single official journal, the United States put China on notice that the next step China needed to take was to use that journal to implement a mandatory notice-and-comment practice for all new or modified trade-related laws and regulations. Subsequently, at the SED meeting in December 2006, the United States and China agreed to make transparency, including notice-and-comment procedures and other rulemaking issues, a topic for discussion in future SED meetings. These discussions began at the May 2007 SED meeting and are scheduled to continue during the SED meeting scheduled for December 2007. At the same time, the United States has continued to provide technical assistance to facilitate Chinese government officials' understanding of the workings, and benefits, of an open and transparent rulemaking process. In July 2006, for example, the United States put on a seminar for Chinese government officials on the operations of the Federal Register. In addition, during 2007, the United States provided detailed information to Chinese government officials explaining how U.S. agencies examine voluminous public comments received during rulemaking proceedings and how U.S. agencies conduct cost-benefit analyses.

China's ministries and agencies continue to have a much better record when it comes to making new or revised laws and regulations available to the public after they have been finalized. 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.

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 previously reported, 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 created websites to provide answers to frequently asked questions as well as further guidance and information.

Uniform Application of Laws

In its WTO 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.

As previously reported, 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, although the actual workings of this mechanism remain unclear.

During 2007, as in prior years, 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

In its WTO accession agreement, 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 2007 continued to express serious concern about the independence of China's judiciary. In their experience and observation, Chinese judges continue to be influenced by political, government or business pressures, particularly outside of China's big cities.

Meanwhile, in 2007, the United States continued to monitor 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 in October 2002, have handled cases involving administrative agency decisions relating to international trade in goods or services or intellectual property rights. So far, however, there continues to be little data, as few foreign companies have had experience with these courts.

APPENDIX 1

List of Written Submissions Received in Response to Request for Public Comment by the Trade Policy Staff Committee on China WTO Compliance

1. U.S.-China Business Council
2. U.S. Chamber of Commerce
3. International Intellectual Property Alliance
4. Coalition of Service Industries
5. National Cotton Council
6. Norandal U.S.A., Inc.
7. U.S. Council for International Business
8. Society of Plastics
9. National Electrical Manufacturers Association
10. American Iron and Steel Institute
11. American Forest & Paper Association
12. Nucor Corporation and the Steel Manufacturers Association
13. Wal-Mart Stores, Inc.
14. American Dehydrated Onion and Garlic Association

APPENDIX 2

**List of Witnesses
Testifying at the Public Hearing
before the Trade Policy Staff Committee
on China WTO Compliance
Washington, D.C.
September 27, 2007**

1. Erin Ennis
Vice President
U.S.-China Business Council
2. Myron Brilliant
Vice President, East Asia
U.S. Chamber of Commerce
3. Eric H. Smith
President
International Intellectual Property Alliance
4. John Maguire
Senior Vice President
National Cotton Council of America
5. Alan Price
On Behalf of Nucor Corporation and
the Steel Manufacturers Association
6. Scott Croft
President
Norandal U.S.A., Inc