CHINA

TRADE SUMMARY

The U.S. goods trade deficit with China was $315.1 billion in 2012, up $19.6 billion from 2011. U.S. goods exports in 2012 were $110.6 billion, up 6.4 percent from the previous year. Corresponding U.S. imports from China were $425.6 billion, up 6.6 percent. China is currently the 3rd largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to China were $26.7 billion in 2011 (latest data available), and U.S. imports were $11.3 billion. Sales of services in China by majority U.S.-owned affiliates were $28.5 billion in 2010 (latest data available), while sales of services in the United States by majority China-owned firms were $966 million.

The stock of U.S. foreign direct investment (FDI) in China was $54.2 billion in 2011 (latest data available), down from $58.5 billion in 2010. U.S. FDI in China is primarily in the manufacturing sector.

IMPORT BARRIERS

Prior to its WTO accession in December 2001, China restricted imports through high tariffs and taxes, quotas, and other nontariff measures, as well as restrictions on trading rights, *i.e.*, the right to engage in importing and/or exporting goods. Beginning in 2002, its first year in the WTO, China significantly reduced tariff rates on many products, decreased the number of goods subject to import quotas, expanded the number of Chinese enterprises with trading rights and the products they could import, and increased the transparency of its licensing procedures. Subsequently, China has continued to make progress by implementing tariff reductions on schedule, phasing out import quotas, and expanding trading rights for foreign enterprises and individuals. Nevertheless, some serious problems remain, such as China's refusal to grant trading rights for certain industries that are listed in the following section.

Trading Rights

In its Protocol of Accession to the WTO, China committed to substantial liberalization in the area of trading rights. Although China did not fully adhere to the agreed phase-in schedule, it put in place a registration system implementing the required liberalization of trading rights for wholly Chinese-owned enterprises, Chinese-foreign joint ventures, wholly foreign-owned enterprises, and foreign individuals, including sole proprietorships. This liberalization is reflected in China's revised Foreign Trade Law, issued in April 2004. It provides for trading rights to be automatically available through a registration process, effective July 1, 2004. In June 2004, the Ministry of Commerce (MOFCOM) issued implementing rules establishing the procedures for registering as a foreign trade operator. U.S. companies have reported few problems with the trading rights registration process.

Consistent with the terms of China's Protocol of Accession to the WTO, the importation of some goods, such as petroleum and sugar, is still reserved for state trading enterprises. In addition, for goods still subject to tariff-rate quotas (TRQs), such as grains, cotton, vegetable oils and fertilizers, China reserves a portion of the in-quota imports for state trading enterprises, while it makes the remaining portion (ranging from 10 percent to 90 percent, depending on the commodity) available for importation through non-state traders. In some cases, the percentage available to non-state traders increases annually for a fixed number of years. (*For further information, please refer to the section below on Tariff-Rate Quotas.*)

China continued to restrict the importation and distribution of copyright-intensive products such as books, newspapers, journals, theatrical films, DVDs and music, in contravention of its trading rights and distribution services commitments, leading the United States to mount a successful WTO challenge to these policies. In order to comply with the WTO ruling, China agreed to remove these restrictions by March 2011. China subsequently issued several revised measures and repealed other measures relating to the restrictions on books, newspapers, journals, DVDs, and music. China did not issue any measures addressing theatrical films, but requested bilateral discussions. In February 2012, the two sides signed a Memorandum of Understanding (MOU) regarding the film-related aspects of the WTO ruling. The MOU provides for increased market access for imported films and better terms of compensation for foreign film producers. The MOU will be reviewed after five years in order to discuss issues of concern, including additional compensation for the U.S. side. (*For further information, please refer to the section below on Audiovisual and Related Services.*)

Import Substitution Policies

When it acceded to the WTO, China agreed to eliminate all subsidies prohibited under Article 3 of the WTO Agreement on Subsidies and Countervailing Measures (Subsidies Agreement), including all forms of subsidies contingent on the use of domestic over imported goods. In its Protocol of Accession to the WTO, China also committed that it would not condition import or investment approvals on whether there are competing domestic suppliers nor impose other performance requirements. In anticipation of this commitment, China enacted legal changes in 2000 and 2001 to eliminate local content requirements for foreign investments. Under the prevailing rules, however, investors are still "encouraged" to follow some of the formerly mandated practices. Instances in which the Chinese government has reportedly pursued import substitution or similar policies are described below.

Ministry of Industry and Information Technology Equipment Catalogue:

Following intensive dialogue, including under the U.S.-China Joint Commission on Commerce and Trade (JCCT) and the U.S.-China Strategic and Economic Dialogue (S&ED), regarding concerns about import substitution provisions, on November 14, 2011, China's Ministry of Industry and Information Technology (MIIT) published a revised draft *Guiding Catalogue of Indigenous Innovation in Major Technologies and Equipment* for public comment. On a positive note, the revision removed specific eligibility criteria contained in the 2009 *Catalogue Guiding Indigenous Innovation in Major Technology Equipment* relating to import substitution and to the generation of foreign exchange earnings through exports. In addition, the revised catalogue no longer provides that products will be eligible for government procurement preferences, nor does it any longer identify subsidies and other benefits for which listed products are eligible. However, the catalogue's revised product selection criteria are subjective and vague, and the government benefits to be accorded are not specifically enumerated. As a result, it is still possible that listed products could receive benefits that conflict with China's WTO obligations. The United States will continue to monitor China's practices in connection with use of the catalogue.

Automotive Policy:

U.S. automakers and parts manufacturers face significant challenges in China's automotive market, as China has implemented a series of policies with a discriminatory effect on foreign enterprises. In May 2004, China issued a new automobile industrial policy: the Policy on Development of the Automotive Industry, and subsequently issued implementing regulations that unfairly discriminated against imported automotive parts and discouraged automobile manufacturers in China from using imported automotive parts in the assembly of vehicles. In 2006, the United States, the EU, and Canada initiated dispute settlement proceedings against China at the WTO. The WTO ultimately ruled in favor of the United States. In September 2009, China repealed the challenged measures.

Additional problems emerged after China's economic policymakers began devoting substantial resources – and creating new policies – to assist Chinese automobile enterprises in developing cutting-edge New Energy Vehicle (NEV) technologies and building domestic brands that could succeed in global markets. China introduced regulations, issued by the National Development and Reform Commission (NDRC) in 2007 and by MIIT in 2009, requiring manufacturers of NEVs in China to "demonstrate mastery" over, and hold intellectual property rights in, core NEV technologies. Because China only allows foreign automobile manufacturers to operate in China through joint ventures with Chinese enterprises, and because none of these joint ventures can be majority foreign-owned, this raised serious concerns that these policies could compel the transfer of foreign automotive manufacturers' core NEV technologies to their Chinese domestic joint venture partners. There were also widespread reports that China would require all NEVs manufactured in China to be sold under Chinese, rather than foreign, brands.

China has also pursued policies similarly designed to promote the development of a Chinese NEV component industry at the expense of foreign enterprises. For example, in March 2011, the NDRC issued a draft *Catalogue Guiding Foreign Investment in Industry ("Foreign Investment Catalogue")* that proposed a new limitation on foreign ownership in NEV parts manufacturing facilities in China to no more than 50 percent. Previously, foreign automotive parts manufacturers could establish in China as wholly foreign-owned enterprises. Foreign enterprises also raised questions about whether new consumer subsidies and other incentive programs being introduced by the Chinese government would be made available to both domestic and imported NEVs, raising national treatment concerns.

In 2011, the United States repeatedly raised its concerns about China's NEV policies during the preparations for the November 2011 U.S.-China JCCT meeting. As a result of these efforts, at the JCCT meeting, China confirmed that it would not require foreign automobile manufacturers to transfer technology to Chinese enterprises or to establish Chinese brands in order to invest in China's market for NEVs. China also confirmed that foreign-invested enterprises would have equal access to subsidies and other preferential policies for NEVs and that these policies would conform to WTO rules. With regard to the new investment restrictions contained in the draft *Foreign Investment Catalogue*, China removed the 50 percent limit on foreign capital for almost all of the key components of NEVs in the final version, released in January 2012, but retained the restriction on NEV batteries. The retention of the limit is a significant limitation on foreign ownership in the NEV sector, as batteries are one of the critical components of most NEVs, and the United States continues to urge China to eliminate this restriction as well. The United States will continue to monitor China's evolving NEV policies and will continue to engage China on concerns in this important sector.

(For discussion of concerns regarding government procurement policies in the automotive sector, please refer to the section below on Indigenous Innovation, Technology Transfer and Strategic Emerging Industry Barriers.)

Steel:

China's 2005 *Steel and Iron Industry Development Policy* (Steel Policy) includes a host of objectives and guidelines that raise serious concerns. For example, the Steel Policy requires that foreign enterprises seeking to invest in Chinese iron and steel enterprises possess proprietary technology or intellectual property in the processing of steel. These provisions appear to remain in effect. Given that foreign investors are not allowed to have a controlling share in steel and iron enterprises in China, this requirement could be regarded as a *de facto* technology transfer requirement. The Steel Policy also appears to discriminate against foreign equipment and technology imports, encouraging the use of local content by calling for a variety of government financial supports for steel and iron projects using newly developed domestic equipment. Even more troubling, the policy calls for the use of domestically produced steel manufacturing equipment and domestic technologies whenever domestic suppliers exist –

raising serious concerns given China's commitment under its Protocol of Accession to the WTO not to condition importation on whether competing domestic suppliers exist.

China's steel production has grown rapidly and at a rate faster than the growth in its domestic steel consumption, causing China to become the global leader in steel exports starting in 2006. In bilateral and multilateral meetings, the United States has argued that China has acted to impose different levels of taxes on different exports of steel products and steelmaking inputs in a manner that appears to encourage the export of certain value-added steel products. In Fall 2008, in response to the financial downturn, China rapidly reduced or removed export duties on many, but not all, steel products to encourage exports during a period of steeply declining global demand. In a series of moves over several months, China eliminated export duties on additional semi-finished and finished steel products while it also reinstated or increased value-added tax (VAT) export rebates. As a result, Chinese steel production reached a record 567 million metric tons in 2009, a 14 percent increase over 2008. Later, in June 2010, the Ministry of Finance (MOF) and the State Administration of Taxation removed the 9 percent VAT export rebate on certain steel products, primarily intermediate hot-rolled products. Because the VAT export rebates on finished pipes, tubes and other tubular products remained in place, the differential VAT treatment between exports of hot-rolled products and tubular products actually increased, further incentivizing the production and export of tubular products.

In June 2010, the State Council published the *Opinions on Strengthening Energy Saving and Emission Reduction and Accelerating Structural Adjustment in the Iron and Steel Sector*. This measure reiterated existing steel policies, specifically identifying a number of well-known objectives for the sector, such as controlling steel industry growth, strengthening efforts to eliminate outdated capacity, promoting energy savings and emissions reduction, technical innovation, accelerating mergers, disciplining access to iron ore imports and promoting domestic iron ore mining, and encouraging domestic steel producers to explore mining and steel investments abroad.

In October 2011, MIIT published its *Twelfth Five-Year Development Plan for the Iron and Steel Industry*, covering the period of 2011 to 2015. The plan itself notes that China's steel production grew from 350 million MT in 2005 to 630 million MT in 2010. The plan places the Chinese government in the role of closely managing the development of the steel industry, and furthermore, specifies where to build, close, or relocate steelmaking capacity, how much to spend on research and development, and the types of products that should not be produced. The plan also emphasizes "self-sufficiency" in steel production and sets specific market share targets for domestic steel producers, implying that imports of certain steel products are too high and should be replaced by domestic production. This high degree of government direction and decision-making, including over areas such as the allocation of resources into and out of China's steel industry, raises concerns in light of China's WTO commitments. Meanwhile, the plan provides no indication that China plans to liberalize restrictions on foreign investment in the Chinese domestic sector, yet it sets out objectives for overseas investment by Chinese iron and steel producers. The plan also states that incentives will be provided to support investment in foreign iron ore mines and steel plants to create groups with "powerful international competitive strength."

China's steelmaking capacity was 424 million metric tons in 2005, and more than doubled by 2012, according to OECD estimates. China's steelmaking capacity has continued to grow and is expected to top 900 million metric tons by 2014. In September 2012, MIIT released the 2012 *Regulations and Conditions of Production and Operation of the Iron and Steel Industry*. The new regulations are formulated in line with *Several Opinions of the General Office of the State Council on Further Strengthening Energy Conservation and Emission Reduction and Speeding Up Restructuring in the Iron and Steel Industry* and the *Twelfth Five-Year Development Plan for the Iron and Steel Industry*. The new regulations seek to reduce excess inefficient capacity, increase value-added production, reduce energy consumption and pollution, and increase steel mills' social responsibility. However, in 2012, China approved the installation of significant new large-scale steel plants, and it is unclear whether the September 2012 measures will succeed in achieving their capacity rationalization, social and environmental objectives.

Semiconductors:

China's Twelfth Five-Year Plan calls for increased research and development in the Chinese semiconductor sector, replacing the emphasis in former five-year plans on production capacity. In spite of government investment in the semiconductor sector, this sector remains fairly weak in terms of innovation. The United States continues to monitor whether or not the new financial support China is making available to its domestic integrated circuit producers is consistent with the WTO Subsidies Agreement's disciplines. Chinese exports of counterfeit semiconductor products have also eroded the sales of legitimate semiconductor products and created security threats to recipients of these products.

Fertilizer:

China exempts all phosphate fertilizers except diammonium phosphate (DAP) from the VAT. DAP, a product that the United States exports to China, competes with other phosphate fertilizers produced in China, particularly monoammonium phosphate. Both the U.S. Government and U.S. producers have complained that China has employed its VAT policies to benefit domestic fertilizer production.

Telecommunications Equipment:

There have been continuing reports of MIIT adopting policies to discourage the use of imported components or equipment. For example, MIIT has reportedly still not rescinded an internal circular issued in 1998 instructing telecommunications companies to buy components and equipment from domestic sources.

The Twelfth Five-Year Plan, which began in 2011, anticipates investing up to RMB 600 billion in the telecommunications sector by 2015. This plan calls for explosive growth in broadband capacity. The United States and the private sector have criticized China in the past for heavily promoting, supporting, and favoring one technical standard over others in the telecommunications sphere. During the 2010 JCCT meeting, China committed to be "technologically neutral" for current and future services and technologies related to 3G networks and future networks based on new technologies, allowing operators to choose freely among those technologies. The Chinese government also committed not to provide any preferential treatment based on the standard or technology used by an operator.

Agricultural Support

At the end of 2011, China submitted notifications on its domestic support policies (for 2005 to 2008) to the WTO. China reported that the value of its agricultural subsidies, as measured by the Aggregate Measurement of Support (AMS), is below the WTO-compliant *de minimis* level of 8.5 percent of the value of agriculture production. However, there have been reports of additional subsidies to agriculture as part of China's recent agricultural reform policy.

While certain categories of agricultural support are permitted under the WTO, China has significantly increased its support to agriculture. China has a number of agricultural support programs including a direct payment program, minimum support prices for basic commodities, and significant input subsidies. China's classification of certain programs and the methodology China used to calculate certain measures of its support, particularly with its price support policies and direct payments, present potential concerns.

The United States will continue to monitor and evaluate the potential trade-distorting effects of China's new policies.

Tariffs and Other Import Charges

China maintains high duties on some products that compete with sensitive domestic industries. For example, the tariff on automobiles is 25 percent. Likewise, most video, digital video, and audio recorders and players still face duties of approximately 30 percent. Some agricultural items continue to face high tariffs and taxes; for instance, certain tree nut imports face duties of up to 25 percent. After several years of negotiation between the United States and China, China reduced in-shell almond tariffs from 24 percent to 10 percent effective January 1, 2013.

Tariff Classification

Chinese customs officers appear to have wide discretion in classifying goods, and U.S. companies have expressed concern that classifications sometimes appear to be arbitrary. The lack of uniformity makes it difficult to anticipate border charges.

Customs Valuation

China has not uniformly implemented the various customs valuation measures issued following its accession to the WTO. U.S. exporters continue to report that they encounter 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 still improperly use "reference pricing," often resulting in a higher dutiable value. Moreover, reference pricing appears to be on the rise in recent years. Products often subjected to reference pricing include information technology products and wood products.

In addition, some of China's customs officials reportedly do not apply 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 are a condition of sale for the goods being valued.

U.S. exporters have also continued to complain that some Chinese customs officials are assessing duties on digital products based on the imputed value of the content, such as the data recorded on a CD-ROM. China's own regulations require this assessment to be made on the basis of the value of the underlying carrier medium, meaning the CD-ROM itself.

China has indicated that it is working to establish more uniformity in its adherence to WTO customs valuation rules. The United States has assisted this effort by conducting technical assistance programs for Chinese government officials. In addition, the United States has raised its concerns about particular valuation problems during meetings of the WTO's Committee on Customs.

More generally, U.S. exporters still complain of 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 that they are not related to the cost of services rendered, as required by China's WTO obligations.

Border Trade

China's border trade policy also continues to generate most favored nation (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 WTO rules. 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.

Antidumping, Countervailing Duty and Safeguard Measures

Since acceding to the WTO, China has become a significant user of antidumping measures. As of December 2012, China had a total of 107 antidumping measures in place (some of which predate China's membership in the WTO) affecting imports from 17 countries and regions, and 12 antidumping investigations in progress. China's significant use of antidumping measures underscores the importance of China adhering to the transparency and procedural fairness requirements and substantive standards embodied in WTO rules.

MOFCOM's predecessor agencies, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) and the State Economic and Trade Commission (SETC), issued most of the rules and regulations that MOFCOM uses to conduct its antidumping investigations. While these measures generally represent good faith efforts to implement the relevant WTO commitments and to improve China's pre-WTO accession measures, they also contain vague language, have gaps in areas of practice, and allow inordinate discretion in their application. In July 2009, MOFCOM solicited public comment on draft revisions of its rules for new shipper reviews, antidumping duty refunds, and price undertakings. Once finalized, China is obligated to notify these revised rules to the WTO to allow an opportunity to review the rules for compliance with the WTO Antidumping Agreement and to seek any needed clarifications.

In 2012, the United States and other WTO members continued to express serious concerns about key lapses in transparency and procedural fairness in China's antidumping investigations. The principal areas of concern include MOFCOM's inadequate disclosure of key documents placed on the record by domestic Chinese producers; insufficiently detailed disclosures of the essential facts underlying MOFCOM decisions, such as the results of on-site verification, dumping margin calculations and evidence supporting injury and dumping conclusions; and failure to adequately address critical arguments or evidence put forward by interested parties.

The United States and other WTO members have also expressed serious concerns about China's evolving practice of launching antidumping and countervailing duty investigations that appear designed to discourage the United States or other trading partners from the legitimate exercise of their rights under WTO antidumping and countervailing duty rules and the trade remedy provisions of China's accession protocol. This type of retaliatory conduct is not typical of WTO members, and it may have its roots in China's Foreign Trade Law and antidumping and countervailing duty implementing regulations, which authorize "corresponding countermeasures" when China believes that a trading partner has discriminatorily imposed antidumping or countervailing duties against imports from China. Further, when China has pursued investigations under these circumstances, it appears that its regulatory authorities imposed duties regardless of the strength of the underlying legal and factual support.

As China's antidumping regime has matured, many of its antidumping orders have been in effect for five years, warranting sunset reviews, which MOFCOM calls "expiry reviews." As of December 2012, MOFCOM was conducting eight expiry reviews. While none of these reviews involves products from the United States, every expiry review involving U.S. products to date has resulted in the measure at issue being extended. Because of the problems that respondents have encountered in China's antidumping investigations, it is critical that China publish rules and procedures specifically governing the conduct of expiry reviews, as required by the WTO Antidumping Agreement. The United States has pressed China to issue regulations governing sunset reviews for more than two years and will continue to do so.

To date, it appears that only one interested party, a Russian exporter, has filed for judicial review of a Chinese antidumping proceeding. However, China has not released any information to the public about the case. As China continues to launch antidumping investigations and apply antidumping measures against imports, the opportunity for interested parties to seek judicial review will become more critical.

China initiated its first three countervailing duty investigations in 2009. Each of these investigations involved imports of products from the United States: grain-oriented electrical steel (GOES), chicken broiler products, and automobiles. These countervailing investigations demonstrated that, as in the antidumping area, China needs to improve its transparency and procedural fairness when conducting these investigations. The United States is concerned, for example, about how China applies the principle of "facts available" under WTO countervailing duty rules. In addition, as in the antidumping area, the United States has expressed serious concerns about China's pursuit of countervailing duty remedies that appear intended to discourage the United States and other trading partners from the legitimate exercise of their rights under WTO countervailing duty rules and the trade remedy provisions of China's accession protocol.

The United States is currently pursuing three WTO disputes against China in the areas of antidumping and countervailing duties. The disputes involve China's antidumping and countervailing duty measures on imports of GOES, chicken broiler products, and automobiles from the United States.

The United States initiated the GOES dispute in September 2010, arguing that China's regulatory authorities imposed the duties at issue without the necessary legal and factual support, and without observing certain transparency and procedural fairness requirements, in violation of various WTO rules. A WTO panel was established in March 2011, and eight other WTO members joined as third parties. Hearings took place in September and December 2011. The panel issued its report in June 2012, finding in favor of the United States on all significant claims. China appealed the panel's report in July 2012. The WTO's Appellate Body rejected China's appeal in October 2012. The United States has requested binding arbitration to set a reasonable period of time for China to comply with the GOES reports.

The United States initiated the chicken broiler products WTO dispute in September 2011. Once again, in the course of its antidumping and countervailing duty investigations, China's regulatory authorities appeared to have imposed the duties at issue without the necessary legal and factual support and without observing certain transparency and procedural fairness requirements, in violation of various WTO rules. Consultations were held in October 2011, and the United States requested the establishment of a panel in December 2011. A WTO panel was established in January 2012, and seven other WTO members joined as third parties. Hearings took place in September and December 2012, and the panel is scheduled to issue its report in 2013.

The United States initiated the automobiles WTO dispute in July 2012, raising claims similar to those put forward in the GOES and chicken broiler products disputes. A WTO panel was established in October 2012, and eight other WTO members have joined the dispute as third parties.

In July 2012, China initiated its fourth countervailing duty investigation against the United States. This investigation, along with a companion antidumping investigation, involves imports of solar-grade polysilicon – a major input into the production of solar panels. The investigations are currently ongoing.

Nontariff Barriers

Many U.S. industries continue to indicate that they face significant nontariff barriers to trade, which are discussed in more detail in various sections below. These barriers include, for example, regulations that set high thresholds for entry into services sectors such as banking, insurance and telecommunications; selective and unwarranted inspection requirements for agricultural imports; and the use of questionable sanitary and phytosanitary (SPS) and technical barriers to trade (TBT) measures. (*China's SPS and TBT measures are addressed in separate reports issued by USTR.*)

Beef

China continues to maintain market access barriers to U.S. beef and beef product exports that are inconsistent with international standards of the World Animal Health Organization (OIE). Reopening China's beef market consistent with science and international standards, as well as in a commercially viable manner, is an important priority. This issue is discussed in detail in USTR's annual Report on Sanitary and Phytosanitary Measures.

Remanufacturing

China currently prohibits the importation of remanufactured products, which it typically classifies as used goods. China also maintains a general import prohibition that prevents remanufacturing process inputs (cores) from being imported into China's customs territory other than to its special economic zones. This undermines the development of many sectors, such as mining, agriculture, healthcare, transport and communications. Businesses and consumers are unable to purchase high-quality, lower-cost remanufactured products produced outside of China. Certain capital equipment companies have found ways to participate in China's market through pilot programs and Memoranda of Understanding, but their activities remain severely restricted and prohibitions on the importation of remanufactured goods and cores remain a problem. To help address this issue, in 2011 and 2012, the Department of Commerce, USTR and China's Ministry of Industry and Information Technology co-chaired the U.S.-China Remanufacturing Dialogue. Relevant industry and government stakeholders from both countries participated. Through this dialogue and in other bilateral fora, such as the JCCT, the U.S. Government has pushed China to lift the ban on the importation of used goods with respect to remanufactured products and cores, and to expand upon the scope of remanufacturing activity that is allowed to be conducted in China.

Tariff-Rate Quotas

As part of its WTO accession commitments, China established large and increasing tariff-rate quotas (TRQs) for imports of wheat, corn, rice, cotton, wool, sugar, rapeseed oil, palm oil, soybean oil, and fertilizer, with most in-quota duties ranging from 1 percent to 15 percent. Under these TRQ systems, China places quantitative restrictions on the amount of these commodities that can enter at a low "in-quota" tariff rate, and any imports over that quantity are charged a prohibitively high duty. Each year, a portion of each TRQ is to be reserved for importation through non-state trading entities. China's Protocol of Accession to the WTO sets forth specific rules for administration of the TRQs, including increased transparency and reallocation of unused quotas to end users that have an interest in importing. China phased out the vegetable oil TRQs in 2006, but currently maintains TRQs for wheat, cotton, corn, rice, wool and sugar, as well as three chemical fertilizers, including DAP.

The administration of China's TRQ system has suffered from systemic problems since China's WTO accession, including insufficient transparency and administrative guidance affecting how the allocated quota is used. Although the United States has repeatedly engaged China bilaterally, as well as multilaterally at the WTO, concerns about inadequate transparency remain. U.S. fertilizer exports to China have declined throughout the post-WTO accession period, due in part to Chinese government policies, such as export duties and discriminatory internal taxes that promote the use of domestic fertilizer.

INTERNAL POLICIES

Non-discrimination

Multi-Level Protection Scheme:

Beginning in 2010 and continuing through 2012, the United States raised its concerns with China about framework regulations for information security in critical infrastructure known as the Multi-Level Protection Scheme (MLPS), first issued in June 2007 by the Ministry of Public Security (MPS) and MIIT. The MLPS regulations put in place guidelines to categorize information systems according to the extent of damage a breach in the system could pose to social order, public interest and national security.

Among other things, the MLPS regulations bar foreign products from information systems graded level 3 and above, because all products deployed must be developed by Chinese information security companies and must be based on Chinese intellectual property in their key components. Additional troubling product testing provisions for level 3 and above require companies to disclose product source code, encryption keys and other confidential business information. (*This topic is discussed in more detail in the USTR TBT Report.*)

To date, hundreds of requests for proposals (RFPs) incorporating MLPS requirements have come from government agencies, the financial sector, telecommunications companies, the power grid, educational institutions and hospitals in China. These RFPs cover a wide range of information security software and hardware, and many of them exclude the purchase of foreign products by incorporating level-3 requirements. If implementing rules for the MLPS regulations are issued and applied widely to commercial sector networks and information technology infrastructure, they could have a significant impact on sales by U.S. information security technology providers in China.

At the December 2012 JCCT meeting, China indicated that it would begin the process of revising the MLPS regulations. It also agreed that, during that process, it would enter into discussions with the United States regarding U.S. concerns.

Taxation

Value-Added Taxes (VAT):

China gains a significant amount of annual tax revenue from VAT. This revenue is shared between the central government (75 percent) and the local government (25 percent). In 2009, the central government implemented VAT reforms, changing the VAT from production-based to consumption-based. All enterprises and individuals engaged in the sale of goods, provision of processing, repairs and replacement services, and import of goods within China are required to pay the VAT, although there are a few exemptions.

China's State Council, in October 2011, announced a VAT reform program aimed at resolving double-taxation issues and providing support to the development of China's services sector by replacing the business tax with the VAT in certain industries, including transportation and some modern services. A business tax-to-VAT pilot program was first launched in Shanghai, and, in the fall of 2012, the State

Council expanded the pilot program. As of February 2013, a total of 12 provinces and municipalities are participating. The government plans to further expand the business tax-to-VAT program to other provinces in 2013 and may also increase the number of sectors.

Uneven application of the VAT continues in China. Importers from a wide range of sectors report that, because taxes on imported goods are reliably collected at the border, they are subject to the application of a VAT that their domestic competitors often fail to pay. In addition, China's selective exemption of certain fertilizer products from the VAT has operated to the disadvantage of imports from the United States.

China retains an active and constantly changing VAT rebate program for exports. The effect of many of China's VAT rebate adjustments, which are often used in conjunction with export duties, is to make larger quantities of primary and intermediate products in a particular sector available domestically at lower prices than the rest of the world, giving China's downstream producers of finished products using these inputs a competitive advantage over foreign downstream producers. China discourages the export of the relevant primary and intermediate products by reducing or eliminating VAT rebates and is believed to also impose export duties on select products, resulting in increased domestic supply and lower domestic prices. China's downstream producers, in turn, benefit from these lower input prices as well as larger VAT rebates on export of their finished products. In some situations, China has also used its border taxes to encourage the export of certain finished products over other finished products within a sector, especially the steel and aluminum sectors.

Business Tax on Foreign Services:

Effective January 1, 2009, China issued amendments to its business tax regulations that reinterpreted the scope of taxable services. Previously, taxes were imposed only on taxable services actually provided within China. Under the amendments, if services are provided to an enterprise, a non-business organization or an individual in China, the service provider is liable for business tax regardless of where the services are performed.

Consumption/Luxury Taxes:

A number of higher-end products currently face consumption or luxury taxes, including large displacement automobiles and SUVs, recreational vehicles, yachts, and wine. Reports suggest that additional consumption taxes are being considered, including for general aviation aircraft.

EXPORT REGULATION

Export Quotas, Duties and Licenses

Since its accession to the WTO, China has continued to impose restraints on exports of raw materials – including quotas, duties and related fees, licensing requirements and other restraints – as the Chinese government has continued to guide the development of downstream industries. These export restraints are widespread. For example, China maintains export quotas and sometimes export duties on antimony, bauxite, coke, fluorspar, indium, magnesium carbonate, molybdenum, rare earths, silicon, talc, tin, tungsten, yellow phosphorus and zinc, all of which are of key interest to U.S. producers of downstream products. These types of export restraints can significantly distort trade, and are normally barred by WTO rules. In case of China, the trade-distortive impact is exacerbated, because China is the world's leading producer of many of the raw material inputs at issue.

China's export restraints affect U.S. and other foreign producers of a wide range of downstream products, such as steel, chemicals, hybrid and electric cars, energy efficient light bulbs, wind turbines, hard-disc drives, magnets, lasers, ceramics, semiconductor chips, refrigerants, medical imagery, aircraft, refined petroleum products, fiber optic cables and catalytic converters, among many others. The export restraints can create serious disadvantages for these foreign producers by artificially increasing China's export prices for the raw material inputs, which also drives up world prices. At the same time, the export restraints can artificially lower China's domestic prices for the raw materials due to significant increases in domestic supply, enabling China's domestic producers of downstream products to produce lower-priced products, thereby creating significant advantages for China's domestic downstream producers. The export restraints can also create incentives for foreign downstream producers to move their operations, jobs and technologies to China.

Despite extensive U.S. engagement in this area starting shortly after China's WTO accession, China appears to have maintained its policies for these input materials. In fact, it appears that, over time, China has increased the artificial advantages afforded to its downstream producers by making the export quotas more restrictive and by imposing or increasing export duties on many of the raw material inputs at issue.

In June 2009, the United States and the EU initiated a WTO case challenging export quotas, export duties, and other restraints maintained by China on the export of several key raw material inputs for which China is a leading producer, including bauxite, coke, fluorspar, magnesium, manganese, silicon carbide, silicon metal, yellow phosphorus and zinc. A WTO panel was established to hear the case in December 2009, and 13 other WTO members joined the case as third parties. The panel issued its decision in July 2011, finding in favor of the United States and its co-complainants on all of the significant claims. China appealed the decision in August 2011. In a decision issued in January 2012, the WTO's Appellate Body upheld the panel's core findings that China's export quotas and export duties violate its WTO obligations. China subsequently agreed to come into compliance with the WTO's rulings by December 2012. China removed the export quotas and export duties at issue in December 2012, although it continued to impose an export licensing requirement on several of the products at issue in the case, which could act as an export restriction depending on how it is administered.

China's export restraints on rare earths, a collection of 17 different chemical elements used in a variety of green technology products, among other products, began to generate significant concern among China's trading partners in July 2010. At that time, even though China controls about 97 percent of the global rare earths market, China sharply reduced its export quotas on rare earth ores, concentrates, oxides, metals, chlorides, chlorinates, fluorides, carbonates and other compounds, causing world prices for some of the rare earths to rise dramatically higher than China's domestic prices, hindering efforts in other countries to develop expertise in the increasingly important downstream manufacturing of green technology products. In 2011, China expanded the scope of the products covered by the rare earths quota to include more downstream products, making the quota even more restrictive than it had been in 2010. In addition, according to several reports, China's customs authorities began rejecting rare earth exports that were not priced above certain minimum export prices. It appears that this practice disrupted the export quota process and contributed to rapidly increasing prices outside China.

In March 2012, the United States initiated a WTO case challenging China's export quotas, export duties, and other export restraints on rare earths, as well as tungsten and molybdenum. These raw materials are key inputs in a multitude of U.S.-made products and manufacturing sectors, including hybrid car batteries, wind turbines, energy-efficient lighting, steel, advanced electronics, automobiles, petroleum, and chemicals, among many others. Because China is a top global producer of these raw material inputs, its export restraints can artificially increase prices for the inputs outside of China while lowering prices in China. This price dynamic creates significant cost advantages for China's producers when competing against U.S. producers, both in China's market and in other markets around the world. It also contributes to creating substantial pressure on U.S. and other non-Chinese downstream producers to move their operations, jobs and technologies to China. The European Union and Japan joined in the case as co-complainants, and joint consultations took place in April 2012. A WTO panel was established to hear the case at the complaining parties' request in July 2012, and 18 other WTO members joined the case as third parties. Proceedings before the panel began in February 2013.

Export Subsidies

A general lack of transparency makes it difficult to identify and quantify possible export subsidies provided by the Chinese government. China's subsidy programs are often the result of internal administrative measures and are not publicized. U.S. industries have alleged that subsidization is a key reason that Chinese exports are undercutting prices in the United States and gaining market share. Of particular concern are China's practices in the steel, petrochemical, high technology, forestry and paper products, agricultural products, textiles, hardwood, plywood, machinery, aerospace, clean energy, and copper and other nonferrous metals industries.

China acceded to the WTO in December 2001, but did not submit the first of its annually required subsidies notifications to the WTO's Subsidies Committee until April 2006, nearly five years late. The notification was incomplete and failed to notify any subsidies provided by provincial and local governments or by state-owned banks as required. In addition, while China notified several subsidies that appeared to be prohibited under WTO rules, it did so without making any commitment to withdraw them. Following the submission of China's 2006 notification, the United States repeatedly raised concerns about the incomplete notification. During Subsidies Committee meetings in 2009 and 2010, China pledged to finalize a second subsidies notification. When China failed to submit the notification, the United States filed a counter notification under Article 25.10 of the Subsidies Agreement in October 2011. The United States identified 200 unreported subsidy programs in its counter notification, including many provided by provincial and local authorities and many which the United States has found countervailable in the course of its countervailing duty investigations. Following the United States' filing of the counter-notification, China submitted a new subsidies notification. However, the new notification was incomplete; it only covered the period of 2005 to 2008 and contained numerous overlapping programs. In October 2012, the United States submitted a written request for information from China under Article 25.8 of the Subsidies Agreement regarding numerous other central and sub-central government subsidies that China has not yet notified. Article 25.9 of the Subsidies Agreement requires that a response to an Article 25.8 request be provided "as quickly as possible and in a comprehensive manner." To date, China has not answered the questions in the United States' Article 25.8 request. The United States will continue to press China to answer these questions, to submit complete and current subsidies notifications on a regular basis, and to withdraw any subsidies that are prohibited by WTO rules.

The United States has pursued four WTO dispute settlement cases against China involving claims of prohibited subsidies. The first three cases led to favorable outcomes, as China modified or repealed the various challenged measures. The United States initiated its fourth case in September 2012 when it challenged numerous subsidies provided by the central government and various sub-central governments in China to automobile and automobile-parts enterprises located in regions in China known as "export bases." The challenged subsidies appear to be inconsistent with China's obligation under Article 3 of the Subsidies Agreement not to provide subsidies contingent upon export performance. In addition, it appeared that China failed to abide by various WTO transparency obligations requiring it to publish the measures at issue in an official journal, notify them to the WTO Committee on Subsidies and Countervailing Measures and make translations of them available in one or more WTO languages. Consultations with China took place at the WTO in November 2012.

INTELLECTUAL PROPERTY RIGHTS PROTECTION

China's persistent inadequacies in the protection and enforcement of intellectual property rights (IPR) continue to present barriers to U.S. exports and investment. China was listed again on the Priority Watch List in the 2012 Special 301 report. Key concerns include unacceptable levels of retail and wholesale counterfeiting; persistently high levels of book and journal piracy; end-user piracy of business software; lack of effective trade secret protection and enforcement; and copyright piracy over the Internet. The report describes these enforcement-related concerns and summarizes the legal difficulties rights holders face when attempting to assert their IPR rights in China. The lack of deterrent penalties and other policies, such as barriers to the market for legitimate products, contribute to the poor record on reducing IPR crime in China. The report also recognizes industry concerns about the possibility that laws or policies in a variety of fields might be used to unfairly favor domestic intellectual property (IP) over foreign IP, including procurement preferences for products with domestically developed IP and the treatment of IPR in setting standards.

Chinese markets were also prominent in USTR's Out-of-Cycle Review of Notorious Markets in 2011, as well as 2012, which identified physical and online markets that have significant levels of piracy and counterfeiting. Following the publication of the first online list, the Chinese website Baidu reached a precedent-setting licensing agreement with U.S. and international rights holders in the recording industry to curtail illegal music downloads. Another Chinese website, Taobao, has also launched new procedures to facilitate the removal of infringing material from its website.

With respect to copyright piracy and trademark counterfeiting, weaknesses in China's enforcement system – criminal, civil, and administrative – contribute to China's poor IPR enforcement record. There are also a number of other obstacles to effective enforcement. High value and volume thresholds must be met in order to initiate criminal prosecution of IPR infringement. U.S. trademark and copyright industries also report that administrative fines are too low, and imposed too infrequently, to be a deterrent. Consequently, infringers view administrative seizures and fines merely as a cost of doing business. Civil damages for infringement are likewise inadequate.

Foreign companies have also had trouble protecting and enforcing their trade secrets against misappropriation in China. The challenges these companies face in trying to protect their trade secrets in China are complex, ranging from the enforcement of trade-secret related agreements to difficulties in gathering evidence in trade secret cases, as well as the lack of a clear legal framework in China for handling trade secret problems. U.S. companies have found it difficult to obtain relief against those who have benefitted from trade secrets misappropriation, despite compelling evidence demonstrating the misappropriation.

U.S. companies also have concerns related to China's patent regime. The United States continues to encourage China to provide an effective system to expeditiously address patent issues in connection with applications to market pharmaceutical products. In addition, the United States continues to have concerns about the extent to which China provides effective protection against unfair commercial use, as well as unauthorized disclosure, of undisclosed test or other data generated to obtain marketing approval for pharmaceutical products.

An exacerbating factor contributing to China's poor IPR protection has been China's maintenance of restrictions on the right to import and distribute legitimate copyright-intensive products, such as theatrical films, DVDs, music, books, newspapers and journals. These restrictions impose burdens on legitimate, IPR-protected goods and delay their introduction into the market, creating advantages for infringing products and helping to ensure infringing products continue to dominate the Chinese domestic market.

As previously reported, after the United States brought a successful WTO case, China issued several measures, and repealed other measures, relating to its importation and distribution restrictions on imported books, newspapers, journals, DVDs and music. However, China did not issue any measures addressing theatrical films. In February 2012, after China had sought an alternative solution to its compliance with the films-related aspects of the WTO ruling, the United States and China reached an agreement providing for substantial increases in the number of foreign films imported and distributed in China each year, along with substantial additional revenue for foreign film producers.

The United States and China continued to engage in bilateral efforts to address a variety of IPR issues. Just prior to the November 2011 JCCT meeting, China committed to establish a State Council-level leadership structure, headed by a Vice Premier, to lead and coordinate IPR enforcement across China in order to enhance China's ability to crack down on IPR infringement, thereby making permanent the leadership structure under the special campaign. China also made significant commitments on software legalization at the 2011 JCCT meeting. China specifically committed to complete its software legalization efforts at the provincial government level by the middle of 2012 and at the local and municipal levels by the end of 2013. According to the General Administration for Press and Publications (GAPP) and the National Copyright Administration of China (NCAC), all government offices at the provincial level in China completed software legalization by June 30, 2012, but this assertion has not been independently verified, given the lack of published information by China's government related to software audits and inspection efforts.

In addition, China stated, at the 2011 JCCT meeting, that it would increase resources for audits and inspections of government agencies and would improve the efficiency and accuracy of the audits and inspections. To help achieve these goals, Chinese government agencies promised to further improve the management of their software assets, including by the use of technical means. China also pledged to publish the results of the audits to ensure that there is an accurate accounting of all types of software used by government agencies. Finally, China committed to further promote the use of licensed software by state owned enterprises, conduct additional enterprise software management projects, and publish progress reports on the projects.

In November 2011, at the 22nd JCCT meeting, MOFCOM, USTR, and USPTO signed the U.S.-China IPR Cooperation Framework Agreement 2012-2013. The United States and China are working together through the framework to more effectively promote the protection and enforcement of IPR. Finalization of the details of a 2013 work plan for the framework agreement is under discussion.

At the May 2012 U.S.-China Strategic & Economic Dialogue (S&ED), China reaffirmed its commitment made during Vice President Xi Jinping's February 2012 visit to the U.S. that technology transfer would not be a pre-condition for market access, and agreed to continue intensive, ongoing interagency discussions. China also committed to improve IPR-related laws and regulations, further strengthen measures for the pursuit of criminal liability for IPR infringement, and continue enforcement efforts in IPR border protection to reduce cross-border trade in IPR-infringing goods. Both sides also committed to fostering a market environment that leads to the increased sales of legitimate IP products and services. China also affirmed the importance of trade secret protection, and pledged to include this affirmation in its 2012 work plan for the State Council IPR leading group, which it did.

Major concerns related to potential IPR-related trade barriers since the 2012 NTE and Special 301 reports include the potential consequence of empowering provincial-level IP Offices to administratively enforce patent rights, investigate and sanction infringements, and determine and award compensatory damages as envisioned in the 4th amendments to China's Patent Law, since this could lead to inconsistent enforcement approaches. The United States has also expressed concerns regarding the potentially severe consequences for U.S. businesses conducting research and development in China of draft regulations issued by the State IP Office related to award and remuneration requirements for "service inventions" or IP developed in the course of an inventor's or creator's employment activities. The United States is following these developments with great attention, obtaining input from interested U.S. parties, submitting written comments when appropriate, and engaging with the relevant authorities to ensure that IP-related policy developments eliminate existing IPR related trade barriers for U.S. rights holders, without creating new problems.

SERVICES BARRIERS

China imposes restrictions in a number of services sectors that prevent or discourage foreign suppliers from gaining or further expanding market access. For example, in certain sectors, China either does not grant new licenses or maintains a licensing review process that is opaque or slow-moving. China also imposes foreign equity limitations or other discriminatory measures on foreign suppliers in certain industries. Excessive and sometimes discriminatory capital requirements continue to prove unduly burdensome for foreign enterprises in many sectors, including telecommunications and construction services.

Insurance Services

China continues to maintain market access barriers in the insurance sector. Foreign insurance companies saw very modest growth following China's WTO accession. China's formal and informal practices have combined to keep foreign market share very low. Foreign invested insurance companies' market share in the life insurance sector was less than four percent while only 1 percent for the non-life insurance sector (property and casualty). Foreign life insurance companies can only be established as joint ventures, with foreign equity capped at 50 percent. And China's market for political risk insurance is closed to foreign participation. In May 2012, China amended its regulations to open its mandatory third-party liability motor vehicle insurance market to foreign participation. The United States will seek to ensure that U.S. companies obtain maximum benefit from such liberalization.

U.S. companies established in China continue to have difficulty opening new internal branches to expand their operations. The China Insurance Regulatory Commission (CIRC) is not always consistent in meeting its own deadlines for reviewing and approving internal branch applications. U.S. companies also report difficulties in applying for and receiving multiple, concurrent approvals for new internal branches. In addition, the United States has urged China to ensure that China Post, which has been granted a license to supply insurance through its existing network of postal facilities, is not given competitive advantages in terms of regulatory requirements and distribution network for insurance products of other companies.

Private Pensions – Enterprise Annuities

China has not granted any new enterprise annuities services licenses (similar to the U.S. 401(k) system) in more than five years. Even under previous licensing windows, China licensed very few foreign operators, and only for limited elements of enterprise annuities services. If China were to re-open its licensing procedure, any license to manage enterprise annuities would need to be obtained from the Ministry of Human Resources and Social Security, which must include the China Banking Regulatory Commission (CBRC), the China Securities Regulatory Commission and CIRC in its decision-making process. This complex approval process could create barriers to market access. The United States will continue to urge China to re-open its licensing process and ensure that any such licensing procedures are transparent and do not discriminate against qualified suppliers.

Banking and Securities Services

Regulations mandate that only foreign-funded banks that have had a representative office in China for two years and that have total assets exceeding approximately $10 billion can apply to incorporate in China. After incorporating, 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. In addition, foreign banks in China are subject to rules mandating a 20 percent ownership limit on any single foreign investment in a Chinese bank, with total foreign ownership capped at 25 percent. While foreign banks' assets in China grew 24 percent in 2011, their share of total banking assets in China is still below 2 percent. Locally incorporated foreign banks operating in China face numerous administrative barriers to competing on equal terms with Chinese banks.

With respect to the securities sector, at the May 2012 S&ED, China committed to allow foreign investors to hold up to 49 percent equity stake in domestic securities joint ventures, up from a 33 percent limit. In addition, China agreed to shorten the period for securities joint ventures before they can apply to expand into brokerage, fund management, and trading activities from five years to two years. China also agreed to allow foreign investors to establish joint venture brokerages to trade commodity and financial futures and hold up to 49 percent of the equity in those joint ventures.

Electronic Payment Services

In the Services Schedule accompanying its Protocol of Accession to the WTO, 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 (RMB) 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 payment and related commitments were to be implemented by no later than December 11, 2006.

After the December 11, 2006 deadline passed without China taking any action, the United States pursued extensive bilateral engagement, which did not resolve U.S. concerns. The United States requested WTO consultations in September 2010 over China's various restrictions on foreign suppliers of electronic payment services. Consultations were held in October 2010, but failed to resolve the dispute. At the United States' request, a WTO panel was established to hear the case in March 2011, and six other WTO members joined the case as third parties. Hearings before the panel took place in October and December 2011, and the panel issued its decision in July 2012. The panel found the challenged restrictions to be inconsistent with China's commitments under the GATS. China decided not to appeal the panel's decision and subsequently agreed to come into compliance with the WTO's rulings by July 2013.

In 2010, the PBOC issued a set of rules requiring licenses for online payment transmission services, and began a process of accepting and processing applications for Payment Settlement Organization licenses. The rules stipulate that foreign-invested service suppliers will be governed by a separate set of rules to be issued by PBOC, and set a deadline of September 1, 2011 for existing suppliers to comply with the licensing requirement. As no rules for foreign-invested suppliers have been issued to date, service suppliers with foreign investment facing a possible shutdown of their businesses had to divest their foreign-owned stakes to obtain licenses by the September 1 deadline. In 2011, PBOC, which has yet to clarify how it will treat foreign-affiliated suppliers, issued 40 licenses in two tranches. To date, no foreign-affiliated suppliers have been licensed.

Foreign banks are interested in issuing credit and debit cards in China. In 2008, the first application to issue local currency credit and debit cards was approved for an offshore entity, although regulators have been slow in approving foreign banks' direct participation in this business. In August 2012, Citigroup became the first U.S.-based bank to issue its own credit card in China.

Retailing Services

The United States remained concerned that China treats domestic companies more favorably than foreign companies regarding zoning and urban development requirements, and imposes additional informal minimum capital requirements on foreign suppliers. In addition, China maintains the right to impose foreign equity approval restrictions on foreign chain stores operating more than 30 stores in China that seek to sell certain commodities.

Sales Away From a Fixed Location

In 2010, MOFCOM delegated authority for approving direct sales products to provincial authorities, a move that allowed localization of products and faster approvals. This is a welcome step, but a number of concerns remain, as China maintains unduly burdensome "service center" establishment requirements, caps and other restrictions on sales force compensation, and discriminatory qualification requirements affecting foreign direct sellers.

Express Delivery Services

The United States continues to monitor China's implementation of its 2009 Postal Law and related regulations, including a new permitting system introduced under the State Postal Bureau's (SPB's) September 2009 *Measures for the Management of Express Delivery Business Permits*. The United States remains concerned that China's regime does not treat foreign and domestic companies equally, despite China's WTO commitment to open the domestic express delivery services sector to foreign competition by 2005. To date, the SPB has severely delayed review and approval of its newly mandated domestic (point-to-point within China) express package delivery business permits for U.S. express delivery companies, significantly handicapping their ability to compete. The United States also is concerned that China may not provide adequate protection to the existing operations of U.S. companies as such new permits are issued. In contrast, the SPB has continued to quickly approve permit requests from Chinese domestic express delivery companies, allowing them broad access to the Chinese marketplace. The Postal Law also excludes foreign suppliers from the important document segment of China's domestic express delivery market. In addition, the United States is concerned that any additional Postal Law implementing regulations, including those related to the universal service fund requirement, may unfairly affect foreign companies.

In July 2010, the General Administration of Customs of China (GACC) eliminated the RMB 400 (approximately $64) *de minimis* exemption for advertising materials and samples imported to China. As a result, importers of these goods that had previously been exempted now are required to obtain a customs registration code. However, the process of obtaining such a code is cumbersome and limiting. Further, GACC practices relating to the classification of packages for tax purposes and GACC processes for the collection of duties run counter to international best practices, creating confusion for companies. These requirements add administrative and cost burdens to express delivery service providers and slow the shipping process.

On the related issue of air freight forwarding, wholly foreign-owned express delivery companies cannot qualify for an Air Transport Agency license, and therefore do not have the ability to directly load cargo on Chinese domestic or international flights, but instead must work through a Chinese agent.

Construction, Engineering, Architectural, and Contracting Services

The *Rules on Administration of Foreign-Invested Construction Enterprises* (known as Decree 113) and *Rules on the Administration of Foreign-Invested Construction Engineering and Design Enterprises* (known as Decree 114) impose more restrictive conditions on foreign firms than existed prior to China's WTO accession. These decrees require foreign-invested enterprises to incorporate in China, impose high minimum registered capital requirements, and burdensome personnel staff requirements. Decree 113 also limits the scope of projects (in terms of size and scale) open to participation by foreign-invested enterprises. Two Ministry of Construction circulars impose additional discriminatory restrictions. Circular 200 prohibits foreign companies from providing project management services unless they also have construction or design enterprise approvals. Under Circular 202, foreign construction engineering design companies do not have the right to apply for a comprehensive “Grade A” design license, as domestic companies do.

Logistics Services

The Ministry of Transport (MOT) has been slow to approve applications by foreign logistics firms, and is unwilling to issue nationwide trucking licenses, limiting the ability of foreign firms to build economies of scale. In addition, local regulations in almost all major Chinese cities restrict daytime access by trucks. China’s enforcement efforts are often targeted at foreign transport/logistics firms, while local firms are permitted to operate without being in full compliance.

China’s State Council supports the logistics industry as part of the Chinese government’s industry revitalization plans for 10 key industries. Foreign logistics firms with investments in China have raised concerns about inadequate transparency for implementing measures, equitable treatment, and efforts to strengthen industry standardization. Although modern logistics is listed in the encouraged investment category in the latest *Foreign Investment Catalogue*, China limits foreign participation in certain aspects of its domestic express delivery sector and includes certain freight rail transportation in the restricted category, both of which are inconsistent with further development of its logistics sector.

Aviation Services

The United States and China negotiated an amended bilateral air services agreement, which was signed in July 2007. Although China agreed to work with the United States towards the mutual goal of eliminating frequencies limitations on passenger and cargo flights, the Civil Aviation Authority of China (CAAC) has not engaged with the United States to schedule new rounds of negotiations since August 2011. Additionally, China’s unfavorable interpretation of cargo hub provisions in the agreement has resulted in U.S. cargo carriers experiencing difficulties in getting their operating schedules approved by the CAAC.

Telecommunications

Foreign participation in China’s telecommunications market, including both basic and value-added telecommunications services, remains very limited. China maintains foreign equity restrictions and a multitude of other barriers in the telecommunications sector, including investment approval procedures that are nontransparent and lengthy. Although China has the world’s largest fixed landline, mobile, and broadband markets measured by subscribership, the lack of opportunities for foreign service suppliers is striking. China’s regulator for the sector, MIIT, while nominally separate from current telecommunications operators, maintains extensive influence and control over their operations and the overall structure of the market. China’s foreign equity restrictions (a maximum of 49 percent foreign equity for basic telecommunications and 50 percent for value-added telecommunications) severely diminish commercial opportunities in the sector.

Not only was there no new market entry in the basic telecommunications sector over the past decade, but China also forced the consolidation of the sector in 2008, reducing the number of national operators from six to three—China Mobile, China Telecom, and China Unicom. China's policy is to permit only foreign joint ventures with existing, state-owned licensees. This policy has further reduced market access opportunities for U.S. suppliers and limited the potential for additional competition in the Chinese telecommunications market. Although not explicitly stated in rule or policy, China appears to apply an economic needs test to new entrants in this sector to avoid "unhealthy competition." China also shows reluctance to authorize new services or technologies which might compete with the revenue of incumbent operators, such as cable modem service, Voice over Internet Protocol (VoIP), or WiFi over a mobile handset. In September 2008, in response to a long-standing U.S. request, China slightly reduced basic telecommunications capitalization requirements to RMB 1 billion (approximately $160 million). This level is still excessively high and makes it commercially unattractive for most foreign operators to invest in the sector, particularly for leased line, resale, and corporate data services, which require no new building of facilities. Although China recently announced plans to open its market to resale of mobile services to private sector companies (that is, not just the three state-owned providers listed above), China's draft regulations suggest that foreign companies would not be allowed to participate in such liberalization, another source of great concern.

At the December 2010 JCCT meeting, China agreed to technology neutrality for 3G networks and future networks based on new technologies, such as 4G, allowing operators to choose freely among those technologies without the Chinese government providing any preferential treatment based on the standard or technology used by an operator. The United States will continue to monitor this situation closely.

Regarding value-added telecommunications, although there are over 20,000 licensed domestic telecommunications value-added suppliers in China, as of December 2009, MIIT has issued only 19 value-added licenses to foreign companies, including five U.S.-affiliated companies. One difficulty foreign companies face in obtaining a license is the lack of clarity regarding which services a foreign-affiliated firm is permitted to offer. In addition, MIIT seems to classify certain value-added corporate data services (IP-VPN) as value-added when offered domestically, but as basic (and thus capped at lower foreign equity levels and subject to higher capitalization requirements) when offered internationally. MIIT has provided no justification for this practice. China agreed at the 2011 JCCT meeting to publish in draft and allow public comment on the revision to its value-added telecommunications services catalogue.

Regarding satellite services, such as video transport services for Chinese broadcasters or cable companies, foreign satellite operators remain severely hampered by Chinese policies that prohibit foreign satellite operators from obtaining licenses to operate these services in China. China's rules only allow foreign operators to use a licensed Chinese satellite operator to provide these services. The policies make it difficult for foreign operators to develop their own customer base in China, as Chinese satellite operators essentially have a right of first refusal with regard to potential customers.

China made a draft of its Telecommunications Law available for review and comment on an unofficial basis in the fall of 2009. This draft contains troubling elements, including provisions that would codify China's foreign equity limitations for the sector, complicating ongoing efforts in the WTO and other fora to encourage China to liberalize this sector, and other issues of concern to industry. China has been working on the draft law for over 10 years. MIIT still lacks a specific authorizing statute for its powers.

In addition, the opening of broadband spectrum access for wireless Internet access has been highly limited in China. Bureaucratic disagreements between MIIT and the State Administration of Radio, Television, and Film seem to be a key factor in broadband's paralysis. MIIT's 2012 announcement that a portion of 5 GHz bandwidth will be allocated for commercial use is a positive step, but overall broadband access remains highly restricted.

Online Services

China operates the world's most restrictive and comprehensive Internet filtering regime, which affects a broad range of commercial activity conducted via the Internet. Chinese authorities closely monitor and routinely filter Internet traffic entering China, focusing primarily on the content they deem objectionable on political, social, or religious grounds, but often arbitrarily blocking access to other content that is not clearly offensive or objectionable. Since the 2008 Olympics, a concerted effort to reassert control appears to have been instituted, through what the Open Net Initiative termed "Control 2.0" and an effort to "set the agenda for coverage, rather than suppress it." At the time of the 2012 18th National People's Congress, China experienced one of the most restrictive periods of Internet access in recent history. Specific foreign websites were completely blocked, while overall access was extremely limited, and Virtual Private Networks (VPNs), on which many foreign firms rely to conduct their online functions, were largely blocked.

Changes to Internet filtering can occur without warning or public explanation. While the filtering ostensibly is to address public interest concerns enumerated in law, Chinese government authorities rarely issue lists of banned search terms or banned sites, with little justification or means of appeal, putting Internet-enabled services in a precarious position, caught between complying with the law and implementing apparently arbitrary restrictions.

China's Internet regulation regime is exceedingly complex and nontransparent. Internet content restrictions for Internet Content Providers, electronic commerce sites and application service providers located in China are governed by a number of measures, not all of which are public. Since 2000, these measures have increased, with as many as 12 government entities wielding authority over Internet access and content. Some of these measures restrict who may report news and place limits on what exactly may constitute news. In addition to interfering with news reporting in the traditional sense, these measures may also provide a basis for Chinese authorities to interfere with the normal business reporting operations of non-news organizations, such as multinational corporations, if they use the Internet to keep clients, members, their headquarters, and other interested parties informed about events in China.

This complex regulatory regime governing online services has resulted in several high-profile cases which have affected foreign firms' delivery of online services, such as search engine and web domain registration. Uncertainty also continues regarding a number of other online service areas, such as mapping and other online content distribution methods.

In 2011, in an effort to streamline the bureaucratic regulatory process governing the Internet, China established the State Internet Information Office (SIIO). Its officers are drawn from the agencies mentioned above that have authority over Internet content and access. Given U.S. concerns that China's arbitrary blocking of commercial websites undercut U.S. WTO services trade rights, USTR posed a series of questions to China regarding China's plans to regulate the Internet, including with reference to SIIO's publication of a White Paper on that issue. The United States met with China in April 2012 to seek more detail regarding an initial response that China had provided in 2011. The United States continues its outreach to China to discuss these issues in more detail and to ensure more transparency and predictability in such regulations.

Audiovisual and Related Services

Importation and distribution of books, newspapers, journals, sound recordings, videos, films, and television programs remain highly restricted. Inconsistent and subjective application of censorship regulations further impedes market growth for foreign providers. China's large black market for foreign DVDs and other home entertainment video products continues to grow because market access restrictions create a demand for pirated goods in the absence of legitimately licensed home or theatrical entertainment.

At both the central and regional levels, interconnected agencies under the State Administration for Radio, Film and Television (SARFT) dictate the terms under which films can be produced and distributed. SARFT permits only one film importer and two film distributors (which are both components of the same monopoly managed by SARFT) to operate in China. For theatrical releases, the monopoly dictates the number of films that will be imported, when the films will be released in China's market, and the compensation paid to foreign film producers. In addition, the Chinese government sets strict guidelines with respect to the public screening of foreign films. Under Article 44 of the *Regulations for the Administration of Films,* issued by the State Council in 2001, the total annual screening time for foreign films must not exceed one-third of the total screening time of all films (domestic and foreign).

Television quotas are also highly restrictive. The *Administrative Measures on the Import and Broadcast of Extraterritorial Television Programs*, effective October 23, 2004, restrict foreign television drama and film programming to no more than 25 percent of total airtime, and other foreign programming to no more than 15 percent of total air time. Foreign programming, including animated programs, is banned between 7:00 P.M. and 10:00 P.M. on terrestrial stations. SARFT's *Interim Regulation on Digital Cable TV Pay Channels* (November 14, 2003) restricts foreign programming to a maximum of 30 percent of total airtime on pay television channels.

Major concerns for imported films include censorship reviews by Chinese authorities, which can delay the arrival of imported foreign films on Chinese movie screens. In addition, the Chinese government has historically decreed "black-out periods" during which no new revenue-sharing foreign films may be released, in order to prevent competition with Chinese films being released during the same period. Banning the release of new foreign titles or removing popular foreign films during peak seasons not only hurts theatrical revenues but also contributes to increased piracy, as pirates meet immediate consumer demand for foreign titles by offering illegal downloads through the Internet, on pirate optical discs and pirate video-on-demand channels.

China also continues to require that film prints be made in local laboratories for most theatrical distribution, and for all home video distribution. Local printing and duplication requirements reduce rights holders' ability to control the quality of a film copy and may result in increased costs.

For sound recordings, China limits market access opportunities for imported sound recordings in a manner similar to the limitations imposed on films for theatrical release or home viewing. The Ministry of Culture's *Opinion on the Development and Regulation of Network Music* bans foreign ownership of firms supplying digital music services, requiring that entities engaging in the online distribution of sound recordings in China be wholly Chinese-owned entities. This regulation was amplified in rules established jointly by MIIT and SARFT, explicitly restricting audio and video distribution services (including over electronic networks such as the Internet) to state-owned entities.

As discussed above in the section on Trading Rights, the United States initiated a WTO dispute settlement case against China in April 2007 challenging the importation and distribution restrictions applicable to certain copyright-intensive products, including books, newspapers, journals, theatrical films, videos and sound recordings, and associated services. The WTO panel that heard the case issued its decision in August 2009, ruling in favor of the United States on all significant issues. China appealed the panel's decision in September 2009. The WTO's Appellate Body rejected China's appeal on all counts in December 2009. China agreed to comply with these rulings by March 2011. China subsequently issued several revised measures, and repealed other measures, relating to its distribution of restrictions on imported books, newspapers, journals, DVDs, and music. However, China did not issue any measures addressing theatrical films. In February 2012, after China had sought an alternative solution to its compliance with the films-related aspects of the WTO ruling, the two sides entered into an MOU that provides for increased market access for imported films and better terms of compensation for foreign film producers. The MOU will be reviewed after five years.

Investment in China's audiovisual sector is highly restricted. For television production, joint ventures or cooperative firms must have a minimum capital requirement of RMB 2 million (approximately $275,000), foreign capital is capped at 49 percent, and two-thirds of the programs of a joint venture or cooperative firm must have Chinese themes.

In August 2005, the State Council issued a directive stating that private capital cannot be used to establish or operate a news agency, newspaper, publishing house, radio station, or television station. The directive also stated that radio and television signal broadcasting and relay stations, satellite networks and backbone networks are closed to private capital.

Travel and Tourism Services

Group Travel

In December 2007, the United States and China signed an MOU to facilitate Chinese group leisure travel to the United States and the marketing in China of U.S. destinations or businesses. The first group of Chinese leisure travelers visited the United States under the MOU in June 2008. In November 2009, the United States and China agreed to implement the second phase of the MOU to include an additional 12 jurisdictions, bringing the total to 21. As part of the December 2010 JCCT meeting, the United States and China agreed to implement the third phase of the MOU, opening the market to three additional provinces in China. During the 2011 JCCT meeting, China and the United States agreed to expand the MOU, opening the market for the sale of packaged travel to three additional provinces, and bringing the total number of province-level administrative districts covered by the MOU to 27 out of a total of 31. The United States will continue to press China to broaden the scope of access to include the remaining provinces.

In order to obtain a 10-year license, foreign travel and tourism firms in China must register with the China National Travel Administration (CNTA) and deliver a required feasibility study to CNTA/Ministry of Commerce, as well as an annual report on future investment and possible sectoral expansion. China continues to apply an annual sales requirement on foreign travel agencies, although there are no such requirements for domestic agencies.

Computer Reservation Systems/Global Distribution Systems

China requires all Chinese travel agents and airlines to connect into China's nationally owned and operated computer reservation system/global distribution system when booking airline tickets for domestic flights and outbound international flights as well as hotel, car, or other travel service bookings. Foreign global distribution systems have been excluded from providing their services to Chinese travel agents and Chinese airlines in China, the world's second-largest domestic air travel market and a rapidly growing international market. In October 2012, the CAAC published long-awaited regulations for the global distribution services market. However, these provisional rules have limited application and the new do not seem to liberalize access to China's domestic air market in any commercially meaningful way. China also has not yet explained how it intends to implement the new measures.

Education and Training Services

The Ministry of Education (MOE) restricts participation by foreign educators and trainers. China permits only nonprofit educational activities that do not compete with the MOE-supervised nine years of compulsory education, thereby inhibiting much-needed foreign investment in the education sector. China also bans foreign companies and organizations from offering educational services via satellite networks. Foreign universities may set up nonprofit operations, but must have a Chinese university host and partner to ensure that programs bar subversive content and that imported informational material is adapted to suit local conditions.

Legal Services

Foreign law firms face numerous restrictions on the scope and structure of their activities in China, as well as other barriers affecting market access. Current Chinese laws and regulations prohibit foreign firms from practicing Chinese law, and Chinese lawyers must temporarily forfeit their license to practice law while working for a foreign law firm. As a result, foreign firms are unable to hire Chinese-qualified lawyers to practice Chinese law as employees of their firms, or otherwise provide advice on Chinese law to clients. China also maintains restrictions on cooperation with Chinese law firms (including investment and profit-sharing restrictions) that further limit market opportunities. Foreign law firms are concerned that they are not being allowed, in some cases, to attend, along with their clients, certain regulatory proceedings administered by Chinese government agencies, including MOFCOM mergers and acquisitions reviews. Typically foreign law firms would provide consultancy and legal advisory services to clients as part of such reviews.

China also maintains regulatory requirements for foreign representative legal offices that are not applied to Chinese law firms, as set forth in the December 2001 Regulations on the Administration of Foreign Firm Representative Offices and July 2002 implementing rules. The measures appear to create an economic needs test for foreign law firms seeking to establish representative offices in China. In addition, a foreign law firm may not establish an additional representative office until its most recently established office has been in practice for three consecutive years. China also requires that representatives of foreign law firms must have practiced for no less than two years outside of China as a member of a bar or law society of a WTO Member. Foreign lawyers seeking to provide legal services in China must undergo a lengthy approval process that can take more than one year, during which they must leave the country periodically to renew their visas.

Substantial differences in official tax policies applied to the representative offices of foreign law firms in comparison with taxes applied to Chinese law firms, coupled with inconsistent tax enforcement policies, represent an additional significant hurdle to supplying legal services in China.

INVESTMENT BARRIERS

The volume of foreign direct investment (FDI) in China rose by 8.1 percent in 2011 to $124 billion, but was only $91.7 billion as of the end of October 2012, a year-on-year decline of 3.45 percent. China is the world's second-largest destination for FDI, after the United States. However, investors in China continue to voice concerns about the lack of transparency, inconsistent enforcement of laws and regulations, weak IPR protection, corruption, and an unreliable legal system that fails to enforce contracts and judgments.

Although China's leadership has repeatedly affirmed its commitment to further open China to foreign investment, including during the May 2012 S&ED, in practice, China has not followed through on this promise, except in limited instances. China also pursues other actions that discriminate against or otherwise disadvantage foreign investors. For example, China's investment restrictions are often accompanied by other problematic industrial policies, such as the increased use of subsidies and the development of China-specific standards. Many of these developments appear to represent protectionist tools created by industrial planners to shield inefficient or monopolistic enterprises, particularly those in which the Chinese government has an ownership interest, from competition.

The United States has continued to raise its concerns about China's investment restrictions on multiple occasions in bilateral fora, such as the JCCT, the S&ED, and the Investment Forum, as well as in WTO meetings. The United States and China are also engaged in bilateral investment treaty (BIT) negotiations launched in 2008. At the 2012 S&ED, the United States and China agreed to intensify BIT negotiations. To date, the two sides have held eight negotiating rounds, including meetings in October and December 2012.

Investment Requirements

Upon accession to the WTO, China assumed the obligations of the Agreement on Trade Related Investment Measures (TRIMS Agreement), which prohibits trade-related investment measures that violate GATT Article III obligations to treat imports no less favorably than domestic products and GATT Article XI obligations not to impose quantitative restrictions on imports. In its Protocol of Accession to the WTO, 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 other requirements such as technology transfer and offsets.

Although China has revised many of its laws and regulations to conform to its WTO investment commitments, some of these measures continue to raise WTO concerns, including those that require parties to conduct certain amounts of research and development in China, or to register their intellectual property in China or license it to Chinese entities, frequently state-owned enterprises, as well as those that "encourage" technology transfers to China, without formally requiring them. The United States remains concerned that these measures and activities of Chinese agencies, when reviewing investment applications, are resulting in U.S. companies either directly, or indirectly through negotiations with Chinese state-owned enterprises, being required to transfer technology on terms that are not consonant with commercial business dealings, particularly given the high degree of discretion Chinese agencies wield 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, even in the absence of applicable language in a law, regulation or agency rule, 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.

Investment Guidelines

Foreign Investment Catalogue:

China's foreign investment objectives are defined in part through its *Foreign Investment Catalogue*, which is revised every few years. China's latest revised *Foreign Investment Catalogue* went into effect on January 30, 2012. The *Foreign Investment Catalogue* employs vague language and lacks transparency. For example, sections of the *Foreign Investment Catalogue* appear to be inconsistent with foreign investment regulations and policies issued by ministries and/or local governments. In addition, the *Foreign Investment Catalogue* includes several key sectors, such as telecommunications, certain insurance services, legal services, and logistics, in its "restricted" category. The United States has provided formal comments to China on the Catalogue, noting that it fails to make substantial progress in opening China's markets to greater foreign investment and, in some cases, imposes new limitations in sectors that had previously been more open. Regulators are reportedly in the process of revising the *Foreign Investment Catalogue* for the undeveloped central and western regions in order to guide more investment to those regions. In any case, China has the ability to liberalize its investment regime even without a formal amendment of the Catalogue.

For discussion of concerns regarding the Foreign Investment Catalogue in the automotive sector, see the sections titled: Import Barriers, Import Substitution Policies, and Automotive Policy.

Administrative Measures to Restrict Investment

In August 2012, the NDRC published *Draft Administrative Measures for the Examination and Approval of Foreign Investment Projects* for public comment. The United States is very concerned that the foreign investment approval process contemplated in the draft (and to a large extent, already in place) creates significant uncertainty for foreign investors and lacks transparency, and could be used to block market access, even in sectors China deems to be "permitted" or "encouraged" for foreign investment. China also would maintain vague approval conditions relating to assessing "the public interest," and to overall national economic and social development planning, that only apply to foreign investors.

In December 2006, the State-owned Assets Supervision and Administration Commission (SASAC) issued the *Guiding Opinion Concerning the Advancement of Adjustments of State Capital and the Restructuring of State-Owned Enterprises*. Statements accompanying the release of this measure identified an expansive list of sectors deemed critical to the national economy. This measure explained that "pillar" and "backbone" industries, such as automotive, chemical, construction, electronic information, equipment manufacturing, iron and steel, nonferrous metals, science and technology, and survey and design, must remain under relatively strong state control. Reportedly, SASAC officials also identified a separate set of seven strategic sectors in which state capital must play a leading role, including aviation, coal, defense, electric power and grid, oil and petrochemicals, shipping, and telecommunications. SASAC committed to restrict foreign participation in these sectors by preventing further foreign investment in state-owned enterprises operating in these sectors.

In October 2008, the National People's Congress issued the *Enterprise State-Owned Assets Law*. Among other provisions, Article 57 of the law states that, where state-owned assets are transferred to a foreign investor, the transfer must not harm the national security or public interests of China. It remains unclear how SASAC implements these policies in practice or, in the context of the *Enterprise State-Owned Assets Law*, how it interprets the "national security" and "public interests" of China. In August 2010, the State Council issued the *Opinions on Promoting Enterprise Merger and Restructuring*, which promotes consolidation of enterprises in six industries, most of which are dominated by state-owned enterprises, including the automobile, steel, cement, aluminum, rare earths, and machinery manufacturing industries.

China also continued to employ various sector-specific measures designed to impose new requirements on foreign investors. For example, in January 2010, China imposed a new restriction on foreign investment in the offshore wind power market. At that time, China's National Energy Administration (NEA) and the State Oceanic Administration (SOA) jointly issued the *Interim Measures for Offshore Wind Power Development and Construction*, stipulating that offshore wind farm investment projects in China must be undertaken by either a Chinese enterprise or a Chinese majority-controlled enterprise with foreign ownership of no greater than 49 percent. Measures affecting foreign investment in the automotive and steel sectors are discussed above in the section on Import Substitution Policies.

In June 2009, revisions to the *Provisions on the Mergers and Acquisitions of Domestic Enterprises by Foreign Investors*, originally issued in 2006, were promulgated by MOFCOM and five other government agencies. Under the 2006 measure, foreign mergers and acquisitions of domestic enterprises that would result in "actual control" of a domestic enterprise in a "key industry" with "potential impact on national economic security" or that would give control of a famous Chinese trademark or traditional Chinese brand to a foreign investor required approval at the central government level by MOFCOM. The 2006 measure also placed MOFCOM in the role of determining if the domestic acquisition target has been appropriately valued. The 2009 revisions neither removed nor provided greater clarity with respect to terms such as "national economic security" and "critical industries," and also retained the provision permitting denial of a foreign investor's acquisition if a famous trademark or a traditional Chinese brand is being acquired. Changes in these areas would have provided useful clarity for foreign investors, and the continued lack of precision raises concerns that administrative ambiguity will continue to provide a basis for uneven administration and for differential treatment of Chinese and foreign investors.

In February 2011, China released the *State Council Notice Regarding the Establishment of a Security Review Mechanism for Foreign Investors Acquiring Domestic Enterprises*. The notice established an interagency Joint Conference, led by NDRC and MOFCOM, with the authority to block foreign mergers and acquisitions of domestic firms that it believes may have an impact on national security. The Joint Conference is instructed to consider the impact of a proposed transaction on national defense, economic stability, social stability, and the research and development capabilities of key national security technologies. MOFCOM issued implementing rules for the system in August 2011. The United States has voiced its strong concerns about the broad scope and opaque structure of the review mechanism. The concerns center on China's application of the broad scope of review the system allows, the determination of "actual control" under the system, the criteria for determining risks to national security, the relationship between these review process and other existing reviews of foreign investment, and the ability of non-government entities to call for reviews of transactions in which they are not directly involved. China committed at the May 2012 S&ED to focus its security reviews solely on national security concerns and to adhere to specific timelines and review standards.

Other Investment Issues

Private Equity and Venture Capital:

Foreign private equity and venture capital investments are subject to a variety of regulatory limitations in China. Restrictions on foreign exchange conversion, for instance, are still a major hurdle for private equity funds investing in China. China's Qualified Foreign Limited Partnerships (QFLP) pilot program, launched initially in Shanghai, followed by Beijing and Tianjin, has made establishing an RMB fund somewhat easier for qualified foreign firms by eliminating the requirement for State Administration of Foreign Exchange (SAFE) approval of every foreign exchange transaction. Under the QFLP program, qualified foreign private equity firms can launch RMB-denominated funds using overseas capital up to a quota permitted by the license granted to that firm. However, QFLPs must still work with MOFCOM for approval of investment plans, acquisitions, and capital contribution transactions. In addition, the quota limits will likely restrict participation by some of the largest foreign private equity firms, and China's continued concerns about "hot money" inflows may limit the pace of continued reform and opening in this sector. In general, China still lacks a uniform set of national rules for foreign private equity investment. In addition, it is still unclear how SAFE will allocate quotas to foreign private equity firms.

Holding Companies:

Foreign-invested holding companies in China are at least 25 percent, and usually 100 percent, owned by foreign investors to manage their investments and provide services to their subsidiaries in China. Holding companies are barred from engaging in manufacturing or other types of production, but may engage in trading, distribution, and research and development. Because holding companies are subject to an approximately $30 million minimum registered capital investment requirement, and must already have at least one subsidiary in China, only large multinationals with ambitious expansion plans in China tend to be interested in establishing them. Some restrictions on services provided by holding companies and on holding companies' financial operations remain in place, in addition to constraints on the ability to balance foreign exchange internally. Profit and loss consolidation within holding companies also remains prohibited. In addition, rules promulgated in August 2011 require that all dividends, interest, liquidation proceeds, and other income received by holding companies be treated as an increase to registered capital before it can be reinvested in projects in China. This requirement appears inconsistent with government policy to encourage the establishment of holding companies, as it is likely to force foreign-invested holding companies to make capital-inefficient reinvestments of income, delaying or reducing their ability to declare and repatriate dividends to their shareholders.

Securities Investments:

China continues to open its domestic securities markets to foreign investors. Through the Qualified Foreign Institutional Investor (QFII) program, foreign institutional investors may apply for QFII licenses, which permit limited access to Chinese financial markets, subject to a quota. Chinese authorities enacted reforms to expand the investment scope and lower the minimum qualification requirements of QFIIs, including granting QFIIs access for the first time to China's interbank bond market. In 2012, China granted $15.8 billion in QFII quota and approved 72 new QFII licenses. As of February 2013, China has granted a total of $40 billion to over 177 foreign entities since the program was launched in 2002.

Access to Capital Markets;

Foreign-invested firms in China are limited in their ability to raise capital domestically. China's controls on capital flows and differences between its accounting standards and those of other countries remain the main obstacles in developing the so-called "panda bond market," where foreign entities issue RMB-denominated debt in China. Meanwhile, the market for RMB-denominated debt issued in Hong Kong ("dim sum" bonds) was opened to foreign companies in 2010, and after tremendous initial growth, it has seen a slowdown in issuance. In late 2012, China appears to have yet again put on hold plans to create an "international board" of the Shanghai Stock Exchange where foreign companies could list. Allowing foreign firms greater access and freedom to trade in these assets would add substantial expertise, liquidity and competition to the Chinese market.

Some loosening of capital controls was announced in late 2012. Starting in mid-December 2012, foreign investors will not need regulatory approval to open bank accounts, remit profits, and transfer money between different domestic accounts, according to recent public comments from SAFE. Limits on the number of foreign-currency accounts and the amount of money that can be transferred will also be loosened. In total, SAFE will cancel 35 rules on regulatory approval and simplify 14 others. These moves are expected to encourage long-term capital inflows. Nevertheless, foreign exchange transactions on China's capital account are still tightly regulated. To date, foreign firms remain generally satisfied with their ability to repatriate profits. With respect to capital inflows, several foreign firms continue to note difficulties in obtaining government approval to bring in foreign capital to expand their businesses.

GOVERNMENT PROCUREMENT

According to the Ministry of Finance (MOF), China's government procurement for 2011 was approximately $180 billion, using MOF's narrow definition of government procurement spending. This figure represents approximately 11 percent of total fiscal spending, an increase of more than 30 percent over the 2010 published figure.

Accession to the WTO Agreement on Government Procurement

China is not a signatory to the WTO Agreement on Government Procurement (GPA). In accordance with China's Protocol of Accession to the WTO, it became an observer to the WTO Committee on Government Procurement in 2002. China also committed, in its Protocol of Accession, to initiate negotiations for accession to the GPA "as soon as possible." China initiated GPA accession by submitting its application for accession and initial offer of coverage in December 2007.

The United States and other GPA Parties noted that significant improvements would be needed in China's initial market access offer to bring China's coverage to a level commensurate to other Parties. In accordance with its commitment at the May 2010 S&ED meeting, China submitted its first revised GPA accession offer in July 2010. While the revised offer reflected some improvement over China's initial offer, the United States and other GPA Parties noted a number of changes necessary to bring China's coverage to a level comparable to that of the other GPA Parties. The Parties particularly emphasized the need to include sub-central entities and certain state-owned enterprises that engage in government activities in its subsequent offer.

At the December 2010 JCCT meeting, China committed to accelerate its accession to the GPA and to submit a robust revised offer in 2011. In addition, during Chinese President Hu's state visit in January 2011, China agreed that its revised offer would include sub-central entities. On November 30, 2011, China submitted its second revised offer, which included several sub-central entities. Although the revised offer was an improvement over the previous offer, it still did not provide terms comparable to the extensive procurement that the United States and other Parties cover under the GPA. Specifically, the offer lacked coverage of state-owned enterprises engaged in procurements for government purposes, included insufficient coverage of sub-central entities and services, maintained excessively high thresholds, and proposed overly broad exclusions to coverage.

At the May 2012 S&ED meeting, China committed to submit "a new comprehensive revised offer that responds to the requests of the GPA parties before the [GPA] committee's final meeting in 2012." China subsequently submitted its third revised offer in November 2012. This revised offer still falls well short of the coverage provided by the United States and other GPA parties, as China responded to few requests made by GPA parties. The United States, the EU, and other GPA parties described the revised offer as highly disappointing, both in terms of scope and coverage, and pushed China to submit a revised offer commensurate to other Parties by July 2013. At the December 2012 JCCT meeting, China agreed to engage seriously with the United States on outstanding core issues relating to the scope of projects that qualify as government procurement and situations where state-owned enterprises in China engage in government procurement activities.

Government Procurement Regime

In January 2003, China issued a *Government Procurement Law* (GPL), which generally reflects GPA obligations and incorporates provisions from the *United Nations Model Law on Procurement of Goods*. However, the GPL does not cover all Chinese procurement, as noted below. Further, it directs central and sub-central government entities to give priority to "local" goods and services, with limited exceptions.

In 2010, China circulated two draft measures intended to implement its *Government Procurement Law*. The first draft measure, the *Regulations to Implement the Government Procurement Law*, was issued by MOF in January 2010. The United States submitted comments on the draft measures, in which, among other things, it expressed concern that the draft measure did not provide a GPA-consistent regime. The United States also expressed concern that the draft measure did not provide more specificity about the conduct of government procurement. The second draft measure, the *Administrative Measures for Government Procurement of Domestic Products*, was issued for public comment in May 2010 by MOF, MOFCOM, NDRC and the General Administration of Customs. In accordance with China's October 2009 JCCT commitment, this draft measure set out requirements for products to qualify as "domestic products," ensuring that products produced in China by foreign-invested enterprises receive the same treatment as products produced by any other firm in China, including wholly-Chinese owned enterprises. The United States submitted comments on this draft measure in June 2010, in which it expressed concerns about the lack of details regarding how the draft measure would be implemented. As of January 2013, neither of the draft regulations had been issued in final form.

The GPL generally does not cover tendering and bidding for large-scale public works and government infrastructure projects. Those projects are subject to a different regulatory regime, established by *China's Tendering and Bidding Law* (TBL), which entered into force in January 2000. While official figures for procurement covered under the TBL are not available, analysts estimate that this procurement may exceed $200 billion. In September 2009, the State Council finally circulated NDRC's draft implementing regulations for the TBL for public comment. In October 2009, the United States submitted written comments on these draft regulations in which it emphasized, among other things, the need for greater clarification of the relationship between the TBL and the GPL, and the need to define "domestic products." At the end of December 2011, the State Council issued the final implementing rules for the TBL. The new rules entered into effect on February 1, 2012.

INDIGENOUS INNOVATION, TECHNOLOGY TRANSFER AND STRATEGIC EMERGING INDUSTRY BARRIERS

In November 2009, MOST, NDRC and MOF issued the *Circular on Launching the 2009 National Indigenous Innovation Product Accreditation Work*, requiring companies to file applications for their products to be considered for accreditation as "indigenous innovation products." This measure provided for preferential treatment in government procurement to any products granted this accreditation, which was based on criteria such as the ownership or development of a product's intellectual property in China. Subsequently, the United States and U.S. industry, along with the governments and industries of many of China's other trading partners, expressed serious concerns to China about this measure. In April 2010, MOST, NDRC, and MOF issued a draft measure for public comment, the *Circular on Launching 2010 National Innovation Product Accreditation Work*. The draft measure would have amended certain of the product accreditation criteria set forth in the November 2009 measure, but would have left other problematic criteria intact. At the May 2010 S&ED, China agreed that its innovation policies would be consistent with a number of innovation principles and agreed to begin intensive multi-agency discussions of innovation policies in the U.S.-China Innovation Dialogue.

At the December 2010 JCCT meeting, China took additional important steps to address U.S. concerns about its indigenous innovation policies. China agreed not to maintain any measures that provide government procurement preferences for goods or services based on the location where the intellectual property is owned or was developed. China also agreed to take into account U.S. views on its *Draft Regulations Implementing the Government Procurement Law*, which provide for government procurement preferences for indigenous innovation products. During Chinese President Hu Jintao's January 2011 state visit, China further committed to delink its innovation policies from the provision of government procurement preferences. To implement President Hu's commitment, at the May 2011 S&ED, China agreed to eliminate all of its government procurement product accreditation catalogues and revise the *Draft Regulations Implementing the Government Procurement Law* to eliminate the provision requiring government procurement preferences for indigenous innovation products. On June 23, 2011, MOF issued a circular effectively canceling the implementation of the *Measures on Budget Administration for Government Procurement of Indigenous Innovation Products*, the *MOF Circular on Issuing 'Measures on Assessment for Government Procurement of Indigenous Innovation Products'*, and the *MOF Circular on Issuing 'Measures on Contract Administration for Government Procurement of Indigenous Innovation Products'*. During the 2011 JCCT meeting, China announced that the State Council had issued a measure requiring provincial, municipal, and autonomous regional governments to eliminate any catalogues or other measures linking innovation policies to government procurement preferences.

In 2012, the United States continued to call attention to the trade and investment-restrictive aspects of China's indigenous innovation and technology and intellectual property localization policies. Increasingly, U.S. companies are describing business situations they confront in which the Chinese government or government-affiliated entities are signaling or requiring that technology and intellectual property be shared with Chinese parties in conjunction with the approval of investments, as well as the grant of licenses, permits and other approvals. During the February 2012 visit of Vice President Xi Jinping, the United States urged China not to press U.S. companies to involuntarily transfer intellectual property and technology to Chinese entities. China agreed that technology transfer and technological cooperation shall be decided by businesses independently and will not be used by the Chinese government as a pre-condition for market access. At the May 2012 S&ED, China agreed to engage in intensive, on-going discussion on these matters. China also agreed to treat and protect IPR owned or developed in other countries the same as IPR owned or developed in China.

The United States also used the 2012 JCCT process to raise concerns with China about its innovation and technology and intellectual property localization policies. As a general matter, China agreed that it will correct any departmental or local measures that are inconsistent with its above-referenced commitment that businesses alone shall be involved in decisions relating to technology transfer and technology cooperation. The United States also raised concerns about a number of Chinese measures that may require U.S. firms to transfer technology to China. For example, the United States expressed concern about China's draft 2012 catalogue of vehicles eligible for purchase for official use and its applicable vehicle selection rules. They contain a number of problematic eligibility criteria, including a requirement that automobile manufacturers invest at least 3 percent of operating revenue on research and development in China and hold the right to modify, improve or transfer relevant intellectual property. Given that foreign automobile manufacturers must establish joint ventures with Chinese partners, and are not permitted to have controlling shares, in order to operate in China, these provisions could require foreign automobile manufacturers to conduct or transfer research and development activities to China and share the resulting technology with their Chinese partners. These provisions also appear to require foreign automobile manufacturers to transfer the rights to existing core intellectual property to their Chinese partners. The United States views such criteria as very troubling, given China's commitments not to link innovation policies to government procurement preferences, and not to condition government procurement preferences on where intellectual property is owned or developed. During the December 2012 JCCT meeting, China committed to delay issuance of a final catalogue and to engage with the United States on these concerns.

At the 2012 JCCT, the United States also raised concerns about China's *High and New Technology Enterprise Certification Administration Measures.* These measures provide a reduced tax rate for enterprises only if they register their intellectual property in their major products in China or have an exclusive intellectual property license.

Strategic Emerging Industries Policies

In 2010, China unveiled a new high-level government plan to rapidly spur innovation in seven high-tech sectors. The *Decision of the State Council on Accelerating the Cultivation and Development of Strategic Emerging Industries* established an early, broad framework for "developing and cultivating" innovation in energy conservation, environmental protection, new generation information technology, biology, high-end equipment manufacturing, new energy, new materials, and new energy-powered vehicles. During a May 30, 2012, meeting of the State Council, Premier Wen Jiabao offered additional clarity on the scope and goals for each strategic emerging industry (SEI) sector and emphasized both the importance of "indigenous innovation" and international exchanges between Chinese and foreign enterprises.

The release of China's national SEI policies coincided with China's 12th Five-Year Plan process that requires central government ministries and subcentral government offices to draft strategies and goals in a wide variety of areas. *The National 12th Five-Year Plan for the Development of Strategic Emerging Industries* defines SEI sectors, set priorities, and recommended future policy support. Consistent with Premier Wen's statement, the 12th Five Year Plan also advocates pursuing "indigenous innovation" policies while "deepening international cooperation", in part, by affirming that SEI development policies "are equally applicable to qualified foreign-funded enterprises."

In the second half of 2012, China issued three catalogues on SEI development. In July 2012, MIIT distributed to subcentral Industry and Information Technology departments documents cataloguing the development priorities for key technologies and products considered to be SEIs. The *Notification of the Ministry of Industry and Information Technology on Printing and Issuing Development Priorities of Key Generic Technologies and Key Products in Strategic Emerging Industries* identifies specific sub-sectors, technologies, and specific products in each SEI sector. It also identifies major research and development units and major companies, as well as government policies and funds designed to spur development in each category. Only a small number of companies listed have any foreign investment, as the list heavily favors Chinese-invested firms, particularly state-owned enterprises and national champions.

In September 2012, the NDRC released a draft *Guiding Catalogue of Key Products and Services of the Strategic and Newly Emerging Industries* (NDRC Draft SEI Catalogue). This catalogue lists specific sub-sectors, technologies, and products that should be considered as SEIs, but omits specific details about how the catalogue should be used. In November 2012, MIIT issued the *Solicitation of Public Opinions on the Classification Catalogue of Strategic Emerging Industries* (MIIT SEI Classification Catalogue), which also defined the scope of SEIs for each sub-sector and created a unique numerical identification system. In the preamble to the catalogue, MIIT explains that this document will be used to statistically track the development of China's SEI industries, and suggests that it should be used by other Chinese government departments to "issue targeted supporting fiscal and taxation policies".

The U.S. Government has voiced strong concerns over the direction of some of China's SEI policy development, particularly regarding those measures which indicate discrimination against U.S. firms or their products, would allow excessive government involvement in determining market winners and losers, or could lead to injurious subsidized imports. This engagement has led to Chinese commitments at the 2011 and 2012 JCCT meetings. Specifically, China committed in 2011 to provide a "fair and level playing field for all companies, including U.S. companies" in the development of China's SEIs. In 2012, China went further by committing to provide foreign enterprises with fair and equitable participation in the development of SEIs, and announcing that policies supporting SEI development would be equally applicable to qualified domestic and foreign enterprises. The U.S. Government is closely following the development of China's SEI and 12th Five Year Plans and policies throughout China and will continue to raise concerns over measures that appear to run counter to China's multilateral or bilateral commitments.

ELECTRONIC COMMERCE

China has experienced dramatic growth in Internet usage. According to the China Internet Network Information Center (CNNIC), the number of Internet users in China reached approximately 538 million as of June 2012, representing an Internet penetration rate of 39.9 percent. The majority of these people access the Internet through non-computer means, *i.e.*, cell phones and tablets. The number of households with broadband access is currently 170 million, an increase of 20 million from 2011. Mobile devices have become the most commonly used form of access to the Internet in China, with 388 million people using mobile devices in 2012, an increase of 32.7 million from 2011. The increase in the percentage of Internet users that access the Internet via mobile devices increased from 69.3 percent in 2011 to 72.2 percent in 2012.

China is experiencing a rapid development in online businesses such as search engines, network education, online advertisements, audio-video service, paid electronic mail, short message, online job searches, Internet consulting, electronic trading, and online gaming. In June 2012, CNNIC reported that the number of Chinese online retailers had reached 24,620, an increase of over 20 percent from 2011. The size of China's online retail market is estimated at $82 billion, an increase of 46.6 percent from 2011. Chinese firms dominate the electronic commerce market within China, with tmall.com holding a 47.6 percent market share in business-to-customer retail and taobao.com holding a 94.5 percent market share in customer-to-customer retail.

The Chinese government recognizes the potential of electronic commerce to promote exports and increase competitiveness, and has made some progress toward establishing a viable commercial environment. However, several Chinese ministries have jurisdiction over electronic commerce and impose a range of burdensome restrictions on Internet use (*e.g.*, registration requirements for web pages and arbitrary and nontransparent content controls), stifling the free flow of information and the consumer privacy needed for electronic commerce to flourish. Encryption is also regulated, as discussed more fully above (in the "Online Services" section), and the frequent blocking of websites (including those of a commercial nature) inhibits the predictability and reliability of using electronic networks as a medium of commerce.

A number of technical problems also inhibit the growth of electronic commerce in China. Rates charged by government-approved Internet service providers (ISPs) make Internet access expensive for most Chinese citizens. Slow connection speeds are another problem, although this is changing quickly as broadband connections become more widely available. At the same time, Internet penetration is still relatively low in China, and the urban penetration rate is six times higher than the rural penetration rate, so there is still significant room for growth.

Other impediments to businesses and consumers conducting online transactions in China include the paucity of credit card payment systems (exacerbated by a current monopoly provider of RMB-denominated services), consumer reluctance to trust online merchants, lack of secure online payment systems, and inefficient delivery systems. China has also yet to develop a legal framework conducive to the rapid growth of electronic commerce. Laws recognizing the validity of "electronic contracting" tools and stressing the importance of online privacy and security have been proposed but not yet issued. Despite these obstacles, however, a large and growing percentage of Chinese Internet users reportedly have made online purchases. The number of electronic bank and online payment users grew 14.8 percent and 12.3 percent respectively in the first half of 2012. By the end of June 2012, such users numbered 191 million and 187 million, respectively.

The number of electronic commerce retail sites grew in 2012. Many are taking on the above-mentioned challenges themselves or finding ways around them. For example, the large platforms have invested in fulfillment centers and logistics services to reduce delivery inconsistencies. Cash on delivery is still a preferred method of payment, and mobile credit card swiping machines are being deployed for "swipe on delivery" options. In addition, consumers are becoming more trusting of online payment systems like Alipay, a Paypal clone owned by Alibaba. Recently, there has been an increase in sites that require companies to have a registered retail business in China in order to post their products online. This has helped create online "safe havens" that are trusted among shoppers. Alibaba has also launched an anti-counterfeiting campaign to combat recent negative publicity on their C2C platform, Taobao.

For foreign electronic commerce companies, ISP licensing agreements also form a barrier to entry. According to Chinese regulations, foreign firms must partner with Chinese companies to obtain an ISP license and operate in the Chinese market.

In general, electronic commerce does not have a clear legal framework in China. Cross-border data flows and data sovereignty are areas of particular concern. Given the partnership requirements for obtaining ISP licenses, data that foreign firms collect about customers, including spending trends and personal data such as credit card information, is not clearly controlled by the foreign firm. This increases the risk for foreign firms to operate electronic commerce services in China.

ANTICOMPETITIVE PRACTICES

Competition Policy Laws and Regulations

China has many laws and regulations that concentrate production in certain sectors into monopolies, near-monopolies or authorized oligopolies. These measures are concentrated in capital intensive sectors, like electricity and transportation, or in industries such as fixed-line telephony and postal services, in which this approach may be used to ensure national coverage. Examples of such laws and regulations include the *Law on Electricity* (1996), *Civil Aviation Law* (1995), *Regulations on Telecommunication* (2000), *Postal Law* (1986), *Railroad Law* (1991) and *Commercial Bank Law* (amended in 2003), among others. The enforcement of these laws and regulations is uneven because of the inherent difficulty in coordinating their implementation nationwide, as well as inconsistent local and provincial enforcement which may be exacerbated by local protectionism. More troubling are efforts by government authorities at all levels in China to restrict competition to specific firms, often state-owned enterprises, through various forms of regulation. Official statements frequently suggest that these efforts are tied primarily to employment concerns. However, the ultimate beneficiaries of the resulting measures are often unclear. In addition, local governments frequently enact rules that restrict interprovincial trade. Since the central government has difficulty enforcing its own industrial policy measures at the local level, these local government rules continue to restrict market access for certain imported products, raise production costs, and limit market opportunities for foreign invested enterprises.

The *Anti-monopoly Law* took effect in August 2008 and established an anti-monopoly commission with oversight and coordinating responsibilities. Several Chinese ministries and agencies are members of this body. Three agencies share enforcement responsibilities: MOFCOM reviews mergers; NDRC reviews monopoly activities, abuse of dominance, and abuse of administrative power involving pricing; and SAIC reviews these same types of activities when they are not price-related.

After the *Anti-monopoly Law* was issued, MOFCOM, SAIC, NDRC and other Chinese government ministries and agencies began to formulate implementing regulations, departmental rules and other measures. Generally, these ministries and agencies have been willing to seek public comment on their proposed measures. The United States has urged China to implement the *Anti-monopoly Law* in a manner consistent with global best practices and with a focus on consumer welfare and the protection of the competitive process. The United States has underscored the importance of avoiding consideration of industrial policy or other non-competition objectives. The United States has also urged China to ensure that 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.

It remains unclear how China will implement the *Anti-monopoly Law* with respect to state-owned enterprises and government monopolies in industries deemed nationally important. Although an ambiguous provision of the *Anti-monopoly Law* suggests such enterprises may be subject to a different standard, the three *Anti-monopoly Law* enforcement agencies have publicly stated that the law applies to state-owned enterprises, and have pursued enforcement actions against them. In addition, because trade associations in China frequently appear to have strong government ties, the United States has encouraged the Chinese agencies charged with enforcing the *Anti-monopoly Law* to work with Chinese regulatory agencies with sectoral responsibilities to encourage trade associations to comply with the *Anti-monopoly Law*. Furthermore, the inclusion of provisions on the abuse of administrative power in the *Anti-monopoly Law*, which also appear in NDRC's and SAIC's implementing regulations, could be important instruments for promoting the establishment and maintenance of increasingly competitive markets in China.

Since the *Anti-monopoly Law* went into effect, MOFCOM's oversight of mergers has yielded the most enforcement activity, largely due to the requirement to pre-notify merger transactions. Under the *Anti-monopoly Law*, through late 2012 China has "unconditionally" approved 458 merger cases and "conditionally" approved 15 through late 2012. Twelve of 15 cases approved with conditions have involved offshore transactions between foreign parties, rather than transactions between Chinese enterprises. The other three transactions involved foreign companies merging with Chinese enterprises. MOFCOM blocked one acquisition, in which a foreign company tried to acquire a well-known Chinese enterprise. As a step to improve the transparency of enforcement, MOFCOM issued a notice in November 2012 disclosing information about the 458 merger cases it has unconditionally approved under the *Anti-monopoly Law*. MOFCOM has committed to disclosing information on a quarterly basis going forward.

OTHER BARRIERS

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 agreed to publish the journal regularly and to make copies of all issues of the journal readily available to enterprises and individuals. Following its accession to the WTO, however, 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. Following sustained U.S. engagement, the State Council issued a notice in March 2006 directing all central, provincial, and local government entities to begin sending copies of all trade-related measures to MOFCOM for immediate publication in the MOFCOM Gazette. Adherence to the State Council's notice appeared to be far from complete. Following additional U.S. expressions of concern, at the December 2007 SED meeting, China reconfirmed its WTO commitment to publish all final trade-related measures in a designated official journal before implementation. As a result of US efforts, it appears that most government entities now regularly publish their trade-related measures in this journal, although it is still not clear whether all types of trade-related measures are being published.

Public Comment:

In its WTO accession agreement, China committed to provide a reasonable period for public comment on new or modified trade-related laws, regulations and other measures before implementing them, except in certain enumerated instances. However, China has been slow to implement this commitment. Following sustained U.S. engagement, the NPC's Standing Committee instituted notice-and-comment procedures for draft laws in April 2008. Two months later, in June 2008, China agreed to publish in advance for public comment, subject to specified exceptions, all trade- and economic-related administrative regulations and departmental rules proposed for adoption and provide a public comment period of not less than 30 days from the date of publication. China further agreed to publish such measures for comment in a single location: the Chinese Government Legislative Information Website of the State Council Legislative Affairs Office (SCLAO). Since then, although the NPC has been regularly publishing draft laws for public comment and the State Council has also been regularly publishing draft regulations for public comment, China has had more difficulty implementing the agreement to publish trade- and economic-related administrative regulations. Since June 2008, China has increased the number of proposed departmental rules published for public comment on the State Council's website, but a significant number are still issued without first having been published for public comment on the State Council's website. While some ministries publish departmental rules on their own websites, they often allow less than 30 days for public comment, making it difficult for interested parties to submit timely and complete comments.

In October 2010, the State Council issued the *Opinions on Strengthening the Building of a Government Ruling by Law*, which directs ministries and agencies at the central and provincial levels of government to solicit public comment when developing new rules and regulatory documents that directly affect citizens' legal rights and obligations, subject to certain exceptions primarily related to the protection of state secrets. However, this measure does not require government agencies to publish their measures in advance for public comment for at least a 30 day public comment period on the Chinese Government Legislative Information Website.

At the May 2011 S&ED meeting, China committed to issue a measure in 2011 implementing the requirement to publish all proposed trade- and economic-related administrative regulations and departmental rules on the State Council's website for comment. In advance of the May 2012 S&ED meetings, SCLAO issued two measures that appear to require all central government agencies to observe China's S&ED commitments. Since the issuance of those two SCLAO measures, the proportion of administrative regulations and departmental rules published on the Chinese Government Legislative Information Website or individual agency websites for at least a 30-day public comment period has increased. However, a significant portion of administrative regulations and departmental rules are still not published in accordance with China's S&ED commitments. In addition, it appears that Chinese agencies are not frequently soliciting public comment on draft regulatory documents that directly implicate citizens' rights and obligations.

Legal Framework

Laws and Regulations:

Laws and regulations in China often contain provisions that lack sufficient precision. While this approach allows the Chinese authorities to apply laws and regulations flexibly, it also results in inconsistency and confusion in application. Companies often have difficulty determining whether their activities contravene a particular law or regulation.

Regulations are also promulgated by a host of different entities at the central, provincial, and local levels, and it is not unusual for the resulting regulations to be at odds with one another. Even though finalized regulations are now routinely published in China, they often leave room for discretionary application and inconsistencies. Indeed, government bureaucracies have sometimes been accused of selectively applying regulations. China has many strict rules that are often ignored in practice until a person or entity falls out of official favor. Governmental authorities can wield their discretionary power on foreign or disfavored investors or make special demands on them simply by threatening to crack down. In addition, confidential accounts from foreign enterprises indicate that Chinese government officials, acting without fear of legal challenge, at times require foreign enterprises to transfer technology if they want to secure investments approvals, even though Chinese law does not – and cannot under China's WTO commitments – require technology transfer.

This lack of a clear and consistent framework of laws and regulations creates barriers and uncertainty. A clear and consistent legal framework, coupled with adequate prior notice of proposed changes to laws and regulations and an opportunity to comment on those changes and consistent adherence to and enforcement of those laws and regulations, would greatly enhance business conditions, promote non-discrimination between foreign and domestic firms, and reduce opportunities for corruption.

The U.S. Government has provided technical assistance, at the central, provincial, and local levels of government in China, in an effort to promote improvements in China's legislative and regulatory drafting processes. In its Protocol of Accession to the WTO, China committed to establish tribunals for the review of all administrative actions relating to the implementation of trade-related laws, regulations, judicial decisions, and administrative rulings. 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. To date, little information is publicly available regarding the frequency or outcomes of reviews before these tribunals.

China also committed, at all levels of government, to apply, implement, and administer all of 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 connection with this commitment, China established an internal review mechanism, now overseen by MOFCOM's Department of WTO Affairs, to handle cases of non-uniform application of laws. The actual workings of this mechanism remain unclear, however.

Administrative Licensing:

In July 2004, China's Administrative Licensing Law entered into effect. This law is designed to increase transparency in the licensing process by establishing procedures relating to administrative licensing applications, examinations, approvals and public hearings, including applicable timeframes. Since entering into effect, this law has increased transparency in the licensing process, while reducing procedural obstacles and strengthening the legal environment for domestic and foreign enterprises. China has also continued to reform its administrative licensing system. For example, China has established administrative licensing centers to facilitate the issuance of licenses, and many licensing authorities are increasingly using the Internet to allow persons to apply for administrative licenses and track the progress of their applications online. Since 2001, the State Council has released six decisions to eliminate or amend various administrative licensing requirements, including a September 2012 State Council decision, which calls for the standardization of the administrative examination and approval process. In addition, under the auspices of the JCCT, the United States and China have agreed to work together in order to facilitate commercial activity impacted by administrative licensing.

Nevertheless, significant problems remain with administrative licensing in China. U.S. industry reports that, in practice, many Chinese government bodies at the central, provincial and municipal levels do not comply with this law. U.S. industry also reports that vague criteria and possibilities for delay in the licensing process provide licensing officials with tremendous discretion, thereby creating opportunities for corruption, and sometimes lead to foreign enterprises and products being treated less favorably than their domestic counterparts. For example, in the foreign investment context, in addition to restrictions formally imposed via China's foreign investment catalogue, industry contends that China can impose additional constraints on investment through its foreign investment approval processes, where Chinese government officials can use vaguely defined powers on an ad hoc basis to delay or restrict market entry. In addition, according to confidential reports from foreign enterprises, Chinese government officials may use informal means to require a foreign enterprise to conduct research and development in China, transfer technology, satisfy performance requirements relating to exportation or the use of local content, or make valuable, deal-specific commercial concessions if it wants its investment approved.

Commercial Dispute Resolution:

Both foreign and domestic companies often avoid seeking resolution of commercial disputes through the Chinese courts, due to deep skepticism about the independence and professionalism of China's court system and the enforceability of court judgments and awards. There is a widespread perception that judges, particularly outside big cities, are subject to influence by local political or business pressures. Many judges are not trained in the law or lack higher education, although this problem decreases at the higher levels of the judiciary.

At the same time, the Chinese government is moving to establish consistent and reliable mechanisms for dispute resolution through the adoption of improved codes of ethics for judges and lawyers and increased emphasis on the consistent and predictable application of laws. For example, Supreme Court rules provide that foreign or Chinese enterprises and individuals may bring cases in the designated courts, raising challenges under the Administrative Litigation Law to decisions made by China's administrative agencies relating to international trade matters. The rules also state that when there is more than one reasonable interpretation of a law or regulation, the courts should choose an interpretation that is consistent with the provisions of international agreements to which China has committed, such as the WTO rules.

Despite initial enthusiasm, there is increasing skepticism of the China International Economic and Trade Arbitration Commission (CIETAC) as a forum for the arbitration of trade disputes. Some foreign firms have obtained satisfactory rulings from CIETAC, but other firms and legal professionals have raised concerns about restrictions on the selection of arbitrators and inadequacies in procedural rules necessary to ensure thorough, orderly and fair management of cases.

Finally, in cases where the judiciary or arbitration panels have issued judgments in favor of foreign-invested enterprises, enforcement of the judgments has often been difficult. Officials responsible for enforcement are often beholden to local interests and unwilling to enforce court judgments against locally powerful companies or individuals.

Labor Issues:

In recent years, China has sought to expand the scope of its national labor laws and regulations. Three important labor laws are: the *Labor Contract Law (LCL)*, which clarifies the rights and obligations of workers and employers to promote better labor relations; the *Labor Dispute Mediation and Arbitration Law*, which improves and streamlines the labor dispute resolution process; and the *Employment Promotion Law*, which aims to stimulate employment opportunities. In 2012, the Standing Committee of the National People's Congress published draft amendments to the *Labor Contract Law* focusing on the Law's labor dispatch-related provisions.

On December 28, 2012, the Standing Committee of the National People's Congress approved amendments to the *LCL*. The amended *LCL* will go into effect on July 1, 2013. The amendments add significant requirements that are designed to discourage the use of temporary/dispatched workers who by law should, but in practice often do not, receive the same treatment as direct-hire employees. Until July 1, 2013, enterprises will be allowed to continue to use temporary/dispatched workers already under contract prior to passage of the amendment. However, all enterprises, including foreign- invested enterprises, must adjust their employment practices by July 1, 2013, or they will be subject to penalties from RMB 5,000 to RMB 10,000 (approximately $800 to $1600) for each temporary/dispatched worker employed in violation of the amended *LCL*. Under Chinese law, representative offices established by foreign enterprises are not considered independent legal entities and are exempt from those particular amendments. As representative offices are not allowed to hire Chinese employees directly, they must continue to hire workers through qualified labor agencies as defined in the amendments. This is likely to become more expensive, as provisions in the amended LCL increase the registered capital and other requirements for companies to register as qualified labor agencies.

China does not adhere to certain internationally recognized labor standards, including the freedom of association and the right to bargain collectively. Chinese law provides for the right to associate and form a union, but does not allow workers to form or join an independent union of their own choosing. Unions must affiliate with the official All-China Federation of Trade Unions (ACFTU), which is under the direction of the Communist Party of China. Once a union chapter is established, the enterprise is required to pay fees to the ACFTU, often through the local tax bureau, equaling 2 percent of total payroll, regardless of the number of union members in the enterprise. The workers at these enterprises are required to accept the ACFTU as their representative; they cannot instead select another union or decide not to have any union representation.

In addition, China does not effectively enforce its labor laws and regulations concerning issues such as minimum wages, hours of work, occupational safety and health, bans on child labor, forced prison labor, and participation in social insurance programs. Many foreign invested companies have expressed concern about their domestic competitors' lack of compliance with labor and social welfare laws due to lax enforcement, which allows the domestic firms to avoid the costs associated with compliance.

Skilled workers are in relatively short supply. Restrictions on labor mobility continue to distort labor costs. China is gradually easing restrictions under the country's household registration system, which has traditionally limited the movement of workers within the country, in part due to the recognition that labor mobility is essential to the continued growth of the economy.

Corruption:

China's entry into the WTO, which mandated a significant reduction in tariffs and non-tariff barriers, was expected to reduce incentives for smuggling-related corruption. While WTO membership has increased China's exposure to international best practices and resulted in some overall improvements in transparency, corruption remains prevalent. Chinese officials admit that corruption is one of the most serious problems the country faces and have stated that corruption poses a threat to the survival of the Communist Party and the state. China's leadership has called for an acceleration of the country's anticorruption drive, with a focus on closer monitoring of provincial-level officials. According to official sources, the Communist Party of China's anticorruption agencies have punished more than 660,000 officials found guilty of disciplinary violations over the past five years.

As required by the United Nations Convention Against Corruption, which China ratified in 2006, the National People's Congress amended China's criminal law to criminalize the payment of bribes to officials of foreign governments and international public organizations on February 25, 2011. The amendment took effect on May 1, 2011. Although criminalizing foreign bribery represents an important milestone in fighting international corruption, China has provided little information about how the law will be interpreted and enforced. Accordingly, the United States will continue to monitor China's anticorruption efforts and encourage China to vigorously enforce its anti-bribery laws. In addition, the United States will continue to encourage China to join the OECD Working Group on Bribery and seek accession to the Anti-Bribery Convention.

While the central government in recent years has pledged to begin awarding contracts solely on the basis of commercial criteria, it is unclear how quickly, and to what extent, the Chinese government will be able to follow through on this commitment. U.S. suppliers complain that the widespread existence of unfair bidding practices in China puts them at a competitive disadvantage. Corruption nevertheless undermines the long-term competitiveness of both foreign and domestic entities in the Chinese market.

Land Issues:

China's constitution specifies that all land is owned in common by all the people. In practice, agricultural collectives, under the control of local Communist Party chairmen, distribute collectively-owned agricultural land to rural residents in the form of 30-year renewable contracts, while provincial and municipal governments distribute state-owned urban land for residential and industrial use under a greater diversity of terms depending on the type of land, its intended use, and the status of the land-use rights "purchaser." Governments and collectives can transfer or lease land-use rights to enterprises in return for the payment of fees, or other forms of compensation, such as profit-sharing. However, the law does not currently define standards for compensation when eminent domain supersedes land-use rights. This situation creates considerable uncertainty when foreign investors are ordered to vacate premises in the public interest. Moreover, the absence of public hearings on planned public projects can give affected parties, including foreign investors, little advance warning. The government is aware of this problem, however, and is revising the *Land Administrative Law* to correct it, but it remains unclear how extensive or effective the revision will be.

A major problem for foreign investors is the array of regulations that govern their ability to acquire land-use rights, which are limited to 50 years for both industrial and commercial purposes in the case of foreign investors. Local implementation of these regulations may vary from central government standards, and prohibited practices may be tolerated in one area while the regulations are enforced in another. Most wholly-owned foreign enterprises seek land-use rights to state-owned urban land as the most reliable protection for their operations. Chinese-foreign joint ventures usually attempt to acquire land-use rights through lease or contribution arrangements with local partners.

China's National People's Congress passed a *Property Rights Law* on March 16, 2007, which grants equal legal status to private, state, and collectively-owned property, while explicitly affirming the dominant role of public property in the economy. In addition, this law covers the "means of production," such as factories, but agricultural land remains a collective possession distributed in the form of 30-year contracts. It is unclear at this time how the law will be implemented, particularly in light of the ongoing revision of the *Land Administration Law*.

Given the scarcity of land resources in China, the price of land-use rights and land allocation are important considerations from both a market access and competition standpoint and from the perspective of their effect on production and trade. It is therefore of some concern to the United States that the Chinese government continues to exercise a strong hand in land-use markets in China, with the objective, in part, to ensure that land use-rights are allocated in accordance with a compulsory national land-use plan aimed at boosting grain production, and state industrial development policies aimed at sustaining urbanization and growth.