2005 REPORT TO CONGRESS ON CHINA'S WTO COMPLIANCE

United States Trade Representative

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FOREWORD

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

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

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

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

To aid in its preparation of this report, USTR also published a notice in the Federal Register on August 3, 2005, asking for written comments and testimony from the public and scheduling a public hearing before the TPSC, which took place on September 14, 2005. A list of the written submissions received from interested parties is set forth in Appendix 1, and the persons who testified before the TPSC are identified in Appendix 2.

EXECUTIVE SUMMARY

With regard to WTO compliance, for the last four years, China has taken important steps in implementing the numerous commitments that it undertook upon its WTO accession on December 11, 2001. With most of China's key commitments scheduled to be phased in fully by December 11, 2004, this past year provided a first critical glimpse at what to expect of China as a WTO member with its full range of commitments in place. At this point, however, China's implementation work is still incomplete. While China has made important progress in implementing specific commitments and in adhering to the ongoing obligations of a WTO member, there are still serious problems in some important areas, especially in the enforcement of intellectual property rights (IPR).

Many of the shortfalls in China's WTO compliance efforts seem to stem from China's incomplete transition from being a state-planned economy. As several U.S. trade associations highlighted in their written comments and testimony before USTR and the other agencies that comprise the Trade Policy Staff Committee, China has not yet fully embraced the key WTO principles of market access, non-discrimination and national treatment, nor has China fully institutionalized market mechanisms and made its trade regime predictable and transparent. While China has made some important progress, it continued to use an array of industrial policy tools in 2005 to promote or protect favored sectors and industries, and these tools at times collide with China's WTO obligations. The problems that result continue to foster a view of China in some quarters as an unfair and protectionist trader rather than an open and non-discriminatory economy that is one of the major engines of growth in the world.

When the United States and other WTO members concluded 15 years of negotiations with China over the specific terms of China's entry into the WTO at the end of 2001, China had agreed to extensive, far-reaching and often complex commitments to change its trade regime, at all levels of government. China had committed to implement a set of sweeping reforms that required it to lower trade barriers in virtually every sector of the economy, provide national treatment and improved market access to goods and services imported from the United States and other WTO members, and protect intellectual property rights. China had also agreed to special rules regarding subsidies and the operation of state-owned enterprises, in light of the state's large role in China's economy. The United States and other WTO members envisioned that faithful WTO implementation by China would reduce the ability of non-market forces, including government policies and directives from government officials, to intervene in the market to direct or restrain trade flows. Eventually, it was expected that China's economy would operate on market principles, like its trading partners' economies.

As previously reported, the first year of China's WTO membership – 2002 – saw significant but uneven progress, as China took steps to repeal, revise or enact more than one thousand laws, regulations and other measures, in an effort to bring its trading system into compliance with WTO standards. By 2003, however, China's WTO implementation efforts had lost a significant amount of momentum, and we identified numerous specific WTO-related problems. As those problems mounted in 2003, the Administration responded by stepping up its efforts to engage China's senior leaders, culminating in December 2003, when President Bush and Premier Wen committed to upgrade the level of discussions and undertake an intensive program of bilateral interaction – with a view to resolving problems in the U.S.-China trade relationship and facilitating increased U.S. exports to China. This new approach began to take shape with the high-level Joint Commission on Commerce and Trade (JCCT) meeting in April 2004. At that meeting, the two sides resolved no fewer than seven potential disputes over China's WTO compliance. Three months later, the United States and China were also able to mutually resolve the first-ever dispute settlement case brought against China at the WTO, in which the United States, with support from four other WTO members, had challenged discriminatory value-added tax (VAT) policies that favored Chinese-produced semiconductors over imported semiconductors.

By the end of last year, expectations for significant WTO implementation progress by China were high, given the success of the April 2004 JCCT meeting and promises by China's senior leaders that China would fully and in a timely manner adhere to the scheduled phase-in of key commitments on trading rights and distribution services by December 11, 2004. However, in 2005, old problems like ineffective IPR enforcement persisted and new problems in areas like distribution services began to emerge. The Administration utilized high-level engagement, expert-to-expert discussions and WTO mechanisms to address these problems, and in particular, initiated a comprehensive new strategy (outlined below) for obtaining improvements in China's IPR enforcement. Many of these efforts culminated in a meeting of the JCCT in July 2005, co-chaired by Vice Premier Wu Yi on the Chinese side and Secretary of Commerce Gutierrez and United States Trade Representative Portman on the U.S. side. That meeting achieved measured progress on a range of concerns, but it fell short of realizing the many win-win outcomes of the April 2004 JCCT meeting.

As 2005 was drawing to an end, many U.S. companies described achievement of the full market access and predictability and transparency in trade envisioned by China's WTO accession agreement as "essential." These companies saw Chinese governmental efforts to manage trade as the root cause of many of the problems they faced. As one trade association expressed it, "we hope that China, under the auspices of its WTO obligations, continues its progress towards removing the state from the Chinese economy. . . . [W]e believe the Chinese government must recognize that the market, left to its own devices, is the most effective vehicle for Chinese economic growth." Another trade association emphasized that "without concrete, sustained, and visible progress, China's political challenge in the United States will become more serious."

The areas of particular concern to the United States and U.S. industry, and most in need of improved WTO compliance efforts, are summarized below.

Intellectual Property Rights

China has undertaken substantial efforts to implement its commitment to overhaul its legal regime to ensure the protection of intellectual property rights in accordance with the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement). While the United States continues to work with China in some problem areas, China has done a relatively good job of overhauling its legal regime. However, China has been much less successful in enforcing its laws and regulations and ensuring the effective IPR enforcement required by the TRIPS Agreement. With most in U.S. industry reporting no significant reduction in IPR infringement levels in 2005, IPR enforcement remains problematic. Counterfeiting and piracy in China remain at epidemic levels and cause serious economic harm to U.S. businesses in virtually every sector of the economy.

The Administration places the highest priority on improving IPR enforcement in China. Building on its engagement with China at the April 2004 JCCT meeting, the United States took several aggressive steps in 2005 in an effort to obtain meaningful progress. First, the United States conducted an out-of-cycle review under the Special 301 provisions of U.S. trade law, which involved a systematic evaluation of China's entire IPR enforcement regime, supported by submissions from U.S. manufacturers and businesses to document IPR infringement to the extent possible. At the conclusion of this review in April 2005, the Administration elevated China to the Special 301 "Priority Watch" list and set forth a comprehensive strategy for addressing China's ineffective IPR enforcement regime, which included the possible use of WTO mechanisms, as appropriate. The United States immediately began to pursue this strategy during the run-up to the July 2005 JCCT meeting, as the United States sought to strengthen the commitments that China had made at the April 2004 JCCT meeting and to obtain China's commitment for greater involvement of its police authorities in IPR enforcement matters. China subsequently agreed to take a series of specific actions designed to increase criminal prosecutions of IPR violators, improve enforcement at the border, counter piracy of movies, audio-visual products and software, address Internet-related piracy and assist small- and medium-sized U.S. companies experiencing China-related IPR problems, among other things. Because lack of transparency on IPR infringement levels and enforcement activities in China has hampered the United States' ability to assess the effectiveness of China's efforts to improve IPR enforcement since the April 2004 JCCT meeting, the United States also submitted a request to China under Article 63.3 of the TRIPS Agreement in October 2005. The United States' request, made in conjunction with similar requests by Japan and Switzerland, seeks detailed information from China on its IPR enforcement efforts over the last four years. China's response to these requests, anticipated in early 2006, will help the United States further evaluate whether China is taking all necessary steps to address the rampant IPR infringement found throughout China.

The United States is committed to working constructively with China to significantly reduce IPR infringement levels in China and continues to devote extra staff and resources, both in Washington and in Beijing, to address the many aspects of this problem. At the same time, the United States remains prepared to take whatever action is necessary and appropriate to ensure that China develops and implements an effective system of IPR enforcement, as required by the TRIPS Agreement.

Trading Rights and Distribution Services

China was scheduled to phase in two key WTO commitments by December 11, 2004. These commitments called for full liberalization of trading rights – the right to import and export – and distribution services, including wholesaling services, commission agents' services, retail services and franchising services, as well as related services. As had been agreed at the JCCT meeting in April 2004, China implemented its trading rights commitments nearly six months ahead of schedule, permitting companies and individuals to import and export goods in China directly without having to use a middleman. However, delay and confusion characterized China's efforts to implement its distribution services commitments, substantially hindering the ability of U.S. and other foreign companies to begin engaging freely in the distribution of goods in China. It took several months and repeated U.S. engagement for China to address many of the problems that arose in this critical area, and some problems still remain. In addition, China only issued the regulations implementing its commitment to open its market for sales away from a fixed location, also known as "direct selling", in September 2005, and these regulations contain several problematic provisions that the United States has urged China to reconsider. The Administration will continue to pursue these important issues in 2006 to ensure that China fully meets its commitments.

Industrial Policies

Since acceding to the WTO, China has increasingly resorted to industrial policies that limit market access by non-Chinese origin goods or bring substantial government resources to support increased exports. The objective of these policies seems to be to support the development of Chinese industries that are higher up the economic value chain than the industries that make up China's current labor-intensive base, or simply to protect less competitive domestic industries.

In 2005, examples of these industrial policies are readily evident. They include the issuance of regulations on auto parts tariffs that serve to prolong prohibited local content requirements for motor vehicles, the telecommunications regulator's interference in commercial negotiations over royalty payments to intellectual property rights holders in the area of 3G standards, the pursuit of unique national standards in many areas of high technology that could lead to the extraction of technology or intellectual property from foreign rights-holders, draft government procurement regulations mandating purchases of Chinese-produced software, a new steel industrial policy that calls for the state's management of nearly every major aspect of China's steel industry, continuing export restrictions on coke, and excessive government subsidization benefitting a range of domestic industries in China. Some of these policies appear to conflict with China's WTO commitments in the areas of market access, national treatment and technology transfer, among others.

The United States and China made important progress in resolving U.S. concerns regarding the draft software procurement regulations at the July 2005 JCCT meeting. However, serious disagreements over a number of the other industrial policies remain, particularly regarding China's regulations on auto parts tariffs and China's export restrictions on coke. The United States will continue to press China on these issues and will take further appropriate actions seeking elimination of these policies.

Services

Overall, the United States continued to enjoy a substantial surplus in trade in services with China in 2005, and the market for U.S. service providers in China remains promising. However, in some sectors, the expectations of the United States and other WTO members when agreeing to China's commitments to increase market access and remove restrictions have not been fully realized. Chinese regulatory authorities continue to frustrate efforts of U.S. providers of insurance, telecommunications, construction and engineering and other services to achieve their full market potential in China through the use of an opaque regulatory process, overly burdensome licensing and operating requirements, and other means. In 2005, China did follow through on commitments made at the April 2004 and July 2005 JCCT meetings by resuming a dialogue on insurance issues, and China also was moving forward with a promised dialogue on telecommunications issues.

Agriculture

U.S. agricultural exports to China in 2004 totaled $5.5 billion, and so far 2005 has also been a very successful year, with China becoming the United States' fourth largest agricultural export market. U.S. exports of agricultural commodities, particularly cotton and wheat, have increased dramatically in recent years, and U.S. exports of soybeans continued to perform strongly – on target in 2005 to well exceed $2 billion for the third year in a row, with China remaining the leading export destination for U.S. soybeans.

While U.S. exports of agricultural commodities largely fulfill the potential envisoned by U.S. negotiators during the years leading up to China's WTO accession, China's WTO implementation in the agricultural sector is beset by uncertainty, largely because of selective intervention in the market by China's regulatory authorities. As in past years, capricious practices by Chinese customs and quarantine officials can delay or halt shipments of agricultural products into China, while sanitary and phytosanitary standards with questionable scientific bases and a generally opaque regulatory regime frequently bedevil traders in agricultural commodities, who require as much predictability and transparency as possible in order to preserve margins and reduce the already substantial risks involved in commodities trade. As a result, trade with China in the agricultural sector remains among the least transparent and predictable of the world's major markets. In 2006, the United States will continue to pursue vigorous bilateral engagement with China in order to obtain progress on its outstanding concerns, particularly with regard to China's continuing ban on the importation of U.S. beef products.

Transparency

One of the fundamental principles of the WTO Agreement, reinforced throughout China's WTO accession agreement, is transparency. Adherence to this principle permits markets to function effectively and reduces opportunities for officials to engage in trade-distorting practices behind closed doors. While China's transparency commitments in many ways require a profound historical shift, China has made important strides to improve transparency across a wide range of national and provincial authorities. China's Ministry of Commerce (MOFCOM) remains most notable for its impressive moves toward adopting WTO transparency norms. However, many other ministries and agencies continue to resist the changes called for by China's WTO obligations. As a result, many of China's regulatory regimes continue to suffer from systemic opacity, frustrating efforts of foreign – and domestic – businesses to achieve the potential benefits of China's WTO accession.

Conclusion

In 2006, the Administration will continue its relentless efforts to ensure China's full compliance with its WTO commitments, with particular emphasis on reducing IPR infringement levels in China, and on pressing China to make greater efforts to institutionalize market mechanisms and make its trade regime more predictable and transparent. Throughout this process, the Administration remains committed to working constructively with China to ensure that all of the benefits of China's WTO membership are fully realized by U.S. workers, businesses, farmers, service providers and consumers and that problems in our trade relationship are appropriately resolved. When this cooperative process is not successful, however, the Administration will not hesitate to employ the full range of dispute settlement and other tools available as a result of China's accession to the WTO. At the same time, the Administration will continue to strictly enforce its trade laws to ensure that U.S. interests are not harmed by unfair trade practices.

BACKGROUND

China's WTO Accession Negotiations

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

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

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

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

Overview of China's WTO Commitments

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

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

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

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

STATUS OF CHINA'S WTO COMPLIANCE EFFORTS

Trading Rights and Distribution Services

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

China's commitments on trading rights and distribution services are critically important. They offer the potential to enormously expand the scope of business opportunities available to a wide range of U.S. and other foreign industries doing business, or seeking to do business, in China. These commitments were scheduled to be fully phased in (subject to a few product exceptions) by December 11, 2004, when existing restrictions on companies already invested in China were to be removed, and U.S. companies were to be fully able to import and sell goods in China or export goods from China. It is envisioned that these changes will enhance the efficiency with which a wide range of U.S. companies can distribute and provide related logistics services for imported or domestically produced goods in China, while also enabling U.S. companies to integrate their China operations more easily with their global networks.

As explained below, China is currently in basic compliance with its trading rights commitments, as it has made trading rights automatically available to all Chinese enterprises and individuals, Chinese-foreign joint ventures, wholly foreign-owned enterprises and foreign individuals. One problem area, however, involves the importation of books, newspapers and magazines, which China still reserves for state trading. Meanwhile, China has made slower progress in implementing its distribution services commitments, as delays in implementation and confusion over eligibility characterized much of 2005. In addition, China is still implementing rules that should have been in place one year ago, such as in the area of sales away from a fixed location.

Trading Rights

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

In its accession agreement, responding to concerns raised by members of the WTO working party on China's accession, China committed to substantial liberalization in the area of trading rights. China agreed to eliminate its system of examination and approval of trading rights and make full trading rights automatically available for all Chinese enterprises, Chinese-foreign joint ventures, wholly foreign-owned enterprises and foreign individuals, including sole proprietorships, within three years of its accession, or by December 11, 2004, the same deadline for China to eliminate most restrictions in the area of distribution services. The only exceptions applied to products listed in an annex to China's accession agreement, such as grains, cotton and tobacco, for which China reserved the right to engage in state trading. China also agreed to take a number of liberalization steps during the years prior to its adoption of an automatic trading rights system, including trading rights for Chinese enterprises immediately upon China's accession, followed by trading rights for joint ventures with minority foreign ownership within one year after China's accession and trading rights for joint ventures with majority foreign ownership within two years after China's accession.

As previously reported, during the phase-in period, China fully implemented its commitments relating to Chinese enterprises, but fell behind in implementing the commitments for foreign-invested enterprises. China did not make full trading rights available to all joint ventures with minority foreign ownership (as was required by December 11, 2002), nor did China subsequently make full trading rights available to all joint ventures with majority foreign ownership (as was required by December 11, 2003). Instead, well into 2004, China continued to limit the availability of trading rights by imposing conditions on the eligibility of these enterprises, including requirements related to minimum registered capital, import levels, export levels and prior experience. It was only in mid-2004 that China finally began to take steps to implement its commitments more fully.

As China fell behind in phasing in its trading rights commitments, the United States raised its concerns with China's restrictive treatment of foreign-invested enterprises in bilateral meetings throughout 2003, beginning with a U.S.-China meeting at the Deputy United States Trade Representative-Vice Minister level (known as the Trade Dialogue) held in Beijing in February and including a series of high-level meetings later in the year and a second Trade Dialogue meeting in November. The United States urged China to take immediate steps to bring its regulations into compliance with its trading rights commitments. The United States and several other WTO members also raised these same concerns during the transitional reviews held by the WTO's Market Access Committee and Council for Trade in Goods in October and November 2003. As 2004 approached, the United States also pressed China on the importance of issuing, in a timely manner, final laws and regulations creating an automatic trading rights system for all Chinese enterprises, Chinese-foreign joint ventures, wholly foreign-owned enterprises and foreign individuals, including sole proprietorships, as required by December 11, 2004. The United States made trading rights one of its priority issues during the run-up to the April 2004 JCCT meeting.

In April 2004, prior to the JCCT meeting, the National People's Congress issued a revised *Foreign Trade Law*. It provided for trading rights to be automatically available through a registration process for all domestic and foreign entities and individuals, effective July 1, 2004, almost six months ahead of the scheduled full liberalization required by China's accession agreement. In June 2004, MOFCOM issued implementing rules setting out the procedures for registering as a foreign trade operator in time for the new registration process to be operational on the July 1 effective date.

U.S. companies report few problems with the new trading rights registration process. For many U.S. companies, however, having the right to trade – and, in particular, the right to import – is only meaningful when coupled with the right to distribute goods within China, an area in which China's implementation progress has been slower.

Meanwhile, China has not yet implemented its trading rights commitments insofar as they relate to the importation of books, newspapers and magazines. Under the terms of China's accession agreement, China's trading rights commitments apply fully to books, newspapers and magazines, as they are not among the products for which China reserved the right to engage in state trading As a result, trading rights for books, newspapers and magazines should have been automatically available to all Chinese enterprises, Chinese-foreign joint ventures, wholly foreign-owned enterprises and foreign individuals as of December 11, 2004. Nevertheless, China continues to wholly reserve the right to import books, newspapers and magazines to state trading enterprises. Working with U.S. industry, the United States raised its concerns regarding this matter during the transitional reviews before the Committee on Market Access in October 2005 and before the Council for Trade in Goods in November 2005. China maintains that it can continue to limit the right to import books, newspapers and magazines to state trading enterprises based on the general exception for the protection of the public morals in Article XX of GATT 1994. The United States will continue to press China on this issue in 2006.

China has also not yet implemented its trading rights commitments insofar as they relate to the importation of pharmaceuticals. Even though China's accession agreement creates no exception for pharmaceuticals, and trading rights should have been automatically available to foreign pharmaceutical companies as of December 11, 2004, China still requires foreign pharmaceutical companies to hire Chinese importers to bring their finished products into the country (and it also requires them to sell their finished products through Chinese wholesalers). This is one of a number of problems faced by foreign pharmaceutical companies seeking to operate in China, and the United States continues to engage the Chinese regulatory authorities in an effort to promote comprehensive reform of China's healthcare system and to reduce the unnecessary – and, in some cases, apparently WTO-inconsistent – trade barriers that they face.

Distribution Services

Prior to its WTO accession, China generally did not permit foreign enterprises to distribute products in China, i.e., to provide wholesaling, commission agents', retailing or franchising services or to provide related services, such as repair and maintenance services. These services were largely reserved to Chinese enterprises, although some foreign-invested enterprises were allowed to engage in distribution services within China under certain circumstances. For example, joint ventures had the right to supply wholesaling and retailing services for the goods they manufacture in China since the issuance of the *Regulations for the Implementation of the Law on Chinese-Foreign Equity Joint Ventures* by MOFCOM's predecessor, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), in December 1987. Similarly, wholly foreign-owned enterprises had this same right under the *Detailed Rules for the Implementation of the Law on Wholly Foreign-Owned Enterprises*, issued by MOFTEC in April 2001.

In its accession agreement, China committed to eliminate national treatment and market access restrictions on foreign enterprises providing these services through a local presence within three years of China's accession (or by December 11, 2004), subject to limited product exceptions. In the meantime, China agreed to progressively liberalize its treatment of wholesaling services, commission agents' services and direct retailing services (except for sales away from a fixed location), as described below.

China's implementation efforts in this area were initially problematic. Immediately upon its WTO accession, China fell behind in its implementation of the required progressive liberalization, as foreign enterprises continued to face a variety of restrictions. It was not until mid-2004, following U.S. engagement during the run-up to the April 2004 JCCT meeting, that China began to take steps to liberalize. At that time, MOFCOM issued regulations eliminating national treatment and market access restrictions on joint ventures providing wholesaling services, commission agents' services, direct retailing services (other than sales away from a fixed location) and franchising services. These regulations also established a timetable for extending this liberalization to wholly foreign-owned enterprises on December 11, 2004.

Although MOFCOM was slow to implement these regulations, and it still has not implemented them fully, it has taken a number of steps recently to improve its implementation and make its distribution licensing and approval process more workable. Meanwhile, MOFCOM's nine-month delay in issuing regulations on sales away from a fixed location, or direct selling, postponed the start-up of direct selling activities by foreign enterprises. A similar delay affected the wholesaling and retailing of pharmaceuticals. These delays have been disappointing, given the fundamentally important nature of China's distribution services commitments and the repeated assurances by senior-level Chinese government officials that China would implement these commitments on time.

In 2006, the United States will closely monitor how MOFCOM and relevant provincial and local authorities exercise their approval authority. In particular, the United States will work to ensure that the approval systems operate expeditiously, in a non-discriminatory manner and without creating any new trade barriers.

The United States will also continue to work closely with U.S. companies as they seek to provide the range of distribution services in China. Inevitably, U.S. and other foreign companies will face challenges, particularly with regard to the creation of nationwide distribution networks in China.

Currently, distribution networks remain highly fragmented in China, as there are no Chinese distribution companies with nationwide networks and no Chinese distribution company holds a market share greater than two percent, due largely to infrastructure limitations and restrictive provincial and local requirements. Nevertheless, the central government has a strong interest in developing nationwide distribution networks, because they will foster economic and employment growth and help revitalize rural areas in China.

The United States will also work to ensure that U.S. distribution companies do not face unwarranted barriers to the expansion of their activities in China. For example, the United States will continue to monitor how MOFCOM and relevant provincial and local authorities apply a provision in the new distribution services regulations requiring wholesaling and retailing enterprises to comply with municipal commercial development rules and will work to ensure that any requirements are applied on a national treatment basis. This provision, which does not appear to apply to domestic enterprises, would seem to reinforce the *Notice on Strengthening the Planning Work for Urban Commercial Networks*, issued by MOFTEC in January 2003. That notice had reiterated the requirement in an earlier measure that wholesaling joint ventures comply with the commercial development plans of the cities in which they are located. It also provided that cities that have not yet formulated urban commercial network plans cannot submit wholesaling joint venture applications for approval.

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

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

China fell behind in implementing its commitments regarding wholesaling services and commission agents' services insofar as they relate to foreign-invested enterprises seeking to distribute goods made by other enterprises in China or imported goods. China was required to begin phasing in these commitments for joint ventures with minority foreign ownership on December 11, 2002. The phase-in was scheduled to extend to joint ventures with majority foreign ownership by December 11, 2003. Through the end of 2003 and well into 2004, however, China continued to limit wholesaling services and commission agents' services largely to joint ventures with minority foreign ownership, and it subjected these enterprises to a number of stringent qualification requirements and other restrictions. The principal governing measure, issued in June 1999 by MOFTEC and the State Economic and Trade Commission (known as the SETC, it was subsequently merged into MOFCOM during the mid-2003 government restructuring), was the *Procedures for Pilot Projects for Commercial Enterprises with Foreign Investment*. One other measure, the January 2003 *Provisional Rules for the Establishment of Chinese-Foreign Equity Joint Venture Foreign Trade Companies* (discussed above in the Trading Rights section), extended the right to engage in wholesaling services to certain foreign-invested trading enterprises. Specifically, minority foreign-owned and (beginning December 11, 2003) majority foreign-owned joint ventures that qualify for trading rights under this measure's stringent requirements regarding trade volumes, registered capital and prior experience were permitted to engage in wholesaling services for the goods that they import.

In 2003, the United States pressed its concerns with China's then-existing wholesale regulations at the Trade Dialogue meetings held in Beijing in February and November as well as in several other bilateral meetings during the course of the year. The United States urged China to take immediate steps to bring its regulations into compliance with its phase-in commitments. The United States raised these same concerns during the transitional review held by the WTO's Council for Trade in Services in December 2003. The United States subsequently made distribution services – including wholesale services – one of its priority issues during the run-up to the April 2004 JCCT meeting, as it urged China to circulate and allow ample time for public comment on draft regulations implementing China's commitment to full liberalization in the important area of wholesale services, scheduled to be phased in on December 11, 2004.

In April 2004, following wide circulation of a draft, MOFCOM issued the *Measures on the Management of Foreign Investment in the Commercial Sector*, which superseded the June 1999 *Procedures for Pilot Projects for Commercial Enterprises with Foreign Investment*. These regulations belatedly lifted market access and national treatment restrictions on joint ventures engaging in wholesale services effective June 1, 2004. They also extended this liberalization to wholly foreign-owned enterprises and removed product exceptions for books, newspapers, magazines, pharmaceutical products, pesticides and mulching films (but not for chemical fertilizers, processed oil, crude oil, salt and tobacco) as of the scheduled phase-in date of December 11, 2004. The regulations require enterprises to obtain central or provincial-level MOFCOM approval before providing these services. In addition, they appear to set relatively low qualifying requirements. For example, according to one provision, enterprises must only satisfy the relatively modest capital requirements of the *Company Law* rather than the high capital requirements found in many other services sectors.

While these regulations were welcome, MOFCOM was very slow to implement them, and it still has not implemented them fully. Initially, MOFCOM did not issue any guidance regarding how its approval system would operate, and the application process remained opaque. In most instances, the application process turned into a protracted negotiation, as the central and local approving authorities were still in the process of determining the appropriate procedures and documentation requirements. When approvals were issued, moreover, the central and local approving authorities imposed a variety of restrictions, such as limits on the scope of products that could be distributed and limits on the specific services that could be supplied. Registered capital requirements have also varied.

In addition, through the first six months of 2005, the Chinese authorities rarely issued approvals for existing enterprises seeking to expand their business scope to include wholesale distribution, in part because the Chinese authorities were sorting our historical tax treatment and Free Trade Zone (FTZ) issues. The Chinese authorities did issue some approvals for the establishment of new wholesale distribution enterprises, but this route did not make business sense for many enterprises already established in China.

By June 2005, the Chinese authorities had begun to make progress in resolving many of the problems that had plagued the application and approval process, including how it would handle the tax and FTZ issues that had stalled many enterprises' applications. During the run-up to the July 2005 JCCT meeting, as the United States made full implementation of China's wholesale (and retail) distribution services commitments an issue of high priority, the Chinese authorities reduced much of the backlog of distribution license applications. In addition, in July 2005, MOFCOM and the General Administration of Customs (Customs Administration) issued the *Circular on Issues Concerning the Trade Administration of Bonded Zones and Bonded Logistics Parks*, which clarified the handling of applications from enterprises located in FTZs. At the July 2005 JCCT meeting, China committed to improve the transparency of the application and approval process. Consistent with this commitment, in September 2005, MOFCOM issued the *Application and Approval Guidelines for Foreign Investments*, which clarify many aspects of the application and approval process. Since then, some improvements have taken place in the application and approval process, although U.S. industry continues to have concerns with regard to continuing product and services restrictions. U.S. industry is also concerned about the uncertainty created by the provision in the April 2004 regulations that allows the local approving authorities to withhold wholesale (and retail) distribution license approvals when, as is the case in most cities, urban commercial network plans have not yet been formulated. This provision could operate as a *de facto* restriction on the operations of foreign wholesalers (and retailers). The United States will continue to monitor developments relating to U.S. industry's licensing concerns in 2006 in an effort to ensure that China fully implements its important wholesaling services commitments.

One area of wholesaling services that requires clarification from the Chinese authorities involves the distribution of books, newspapers and magazines. While the April 2004 regulations purport to allow foreign enterprises to obtain the right to distribute books, newspapers and magazines in China, other measures appear to restrict this right. For example, the *Administrative Measures on* *the Subscription of Imported Publications*, issued by the General Administration of Press and Publications in September 2004, appear to restrict the distribution of imported publications by subscription to state trading enterprises. Working with U.S. industry, the United States has sought to clarify the rights of foreign enterprises in discussions with China, including at the transitional reviews before the Council for Trade in Services in September 2005 and the Council for Trade in Goods in November 2005. While China has confirmed that foreign enterprises are now permitted to distribute books, newspapers and magazines in China, it has not provided a justification for the measure that restricts the distribution of imported publications by subscription to state trading enterprises. The United States will continue to press China on this issue in 2006.

China began to implement several measures governing the distribution of automobiles by foreign enterprises in 2005, including the *Implementing Rules for the Administration of Brand-Specific Automobile Dealerships,* jointly issued by MOFCOM, the National Development and Reform Commission (NDRC) and the State Administration for Industry and Commerce (SAIC) in February 2005. While U.S. industry generally welcomes these measures, they do contain some restrictions on foreign enterprises that are not being applied to domestic enterprises. The United States will closely monitor how MOFCOM and SAIC apply these measures in 2006.

China has delayed the implementation of its distribution services commitments with regard to pharmaceuticals, despite the fact that the exception for pharmaceuticals contained in China's accession agreement expired as of December 11, 2004. Although the April 2004 regulations indicated that separate regulations would be issued for the pharmaceuticals sector, China has not issued any further regulations and has continued to require foreign pharmaceutical companies to sell their finished products through Chinese wholesalers (after hiring Chinese importers to bring their finished products into the country). China reportedly decided in the last half of 2005 to begin accepting applications from foreign pharmaceutical companies for wholesale (and retail) licenses under the April 2004 regulations and the State Food and Drug Administration's *Rules on the Management of Drug Business Licenses*. The United States will monitor developments in this area closely in 2006 to ensure that U.S. pharmaceutical companies can begin to realize the benefits of China's distribution services commitments.

<u>Retailing Services</u>

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

China fell behind in implementing its retailing services commitments for joint ventures. China was required to begin phasing in these commitments for joint ventures with minority foreign ownership upon its accession, subject to geographic restrictions, quantitative restrictions and exceptions for a handful of listed goods. The phase-in was scheduled to extend to joint ventures with majority foreign ownership by December 11, 2003. Through the end of 2003 and into 2004, however, China continued to place severe restrictions on the supply of these services. Although China authorized retailing services to be supplied through joint ventures with minority foreign ownership and, in certain circumstances, joint ventures with majority foreign ownership, it maintained requirements that were burdensome and trade-restrictive. For example, onerous threshold requirements (relating to minimum wholesale volume, minimum imports and exports, minimum assets, minimum registered capital and prior experience) significantly reduced the number of enterprises that could qualify for the right to supply retailing services. The principal governing measure was the June 1999 *Procedures for Pilot Projects for Commercial Enterprises with Foreign Investment*.

In April 2004, following repeated bilateral and multilateral U.S. engagement as described above in the Wholesaling Services and Commission Agents' Services section, MOFCOM issued the *Measures on the Management of Foreign Investment in the Commercial Sector*, which superseded the June 1999 *Procedures for Pilot Projects for Commercial Enterprises with Foreign Investment*. These regulations belatedly lifted market access and national treatment restrictions on joint ventures engaging in retail services effective June 1, 2004, except for allowed geographic and quantitative restrictions and product exceptions for pharmaceuticals, pesticides, mulching films and processed oil. The regulations also extended this liberalization to wholly foreign-owned enterprises and removed all remaining geographic and quantitative restrictions as of the scheduled phase-in date of December 11, 2004. As in the wholesale area, the regulations require enterprises to obtain central or provincial-level MOFCOM approval before providing these services, and they appear to set relatively low qualifying requirements, including relatively modest capital requirements, although in practice foreign (but not domestic) retailers reportedly must meet higher capital requirements.

Many of the same problems that plagued the application and approval process in the wholesale area in 2005 also arose in the area of retailing services, and the United States repeatedly pressed China to speed up and improve the implementation of its commitments, just as it did in the wholesale area. While the improvements that took place in the application and approval process in the run-up to and after the July 2005 JCCT meeting are encouraging, U.S. industry continues to have concerns, particularly with regard to the provision in the April 2004 regulations allowing the local approving authorities to withhold retail distribution license approvals when, as is the case in most cities, urban commercial network plans have not yet been formulated. The United States will continue to monitor developments closely in 2006 in an effort to ensure that China fully implements its important retail services commitments.

Meanwhile, it appears that China may not be fully implementing its commitment to allow foreign enterprises to sell gasoline at the retail level. As explained above, China's retail services commitments initially did not apply to processed oil, as it was one of the excepted goods under China's Services Schedule. However, that exception expired on December 11, 2004, and by that time China committed to permit wholly foreign-owned enterprises to operate gas stations. Instead, according to some recent reports, China is now claiming that gas stations fall under the chain store provision in its Services Schedule, which applies to "those chain stores which sell products of different types and brands from multiple suppliers with more than 30 outlets" and permits only joint ventures with minority foreign ownership. The United States is currently working with U.S. industry to clarify this situation and will engage the Chinese government as necessary in 2006 to ensure that U.S. industry realizes the benefits to which it is entitled.

Franchising Services

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

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

The United States has expressed strong concern about these rules and urged China to reconsider them. MOFCOM has since indicated that it is considering revisions to the rules, and it is working with U.S. industry to better understand their concerns. The United States will monitor developments in this area closely in 2006.

<u>Sales away from a fixed location</u>

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

In its WTO accession agreement, China committed to lift market access and national treatment restrictions in the area of sales away from a fixed location, or direct selling, by December 11, 2004. China did not agree to any liberalization before that date.

As early as 2002, MOFCOM and SAIC began drafting measures to implement China's direct selling commitment. Despite U.S. requests and the December 11, 2004 deadline for China to implement its direct selling commitment, the Chinese authorities did not make any drafts of these measures publicly available, instead only providing unofficial drafts to select direct selling enterprises. The Chinese authorities subsequently issued final versions of these measures – the *Measures for the Administration of Direct Selling* and the *Regulations on the Administration of Anti-Pyramid Sales Scams* – in September 2005, nine months late.

The final versions of the direct selling measures made some improvements to provisions apparently included in the earlier drafts. Nevertheless, these measures still contain several problematic provisions. For example, one provision would outlaw practices allowed in every country in which the U.S. industry operates – reportedly 170 countries in all – by refusing to allow direct selling enterprises to pay compensation based on team sales, where upstream personnel are compensated based on downstream sales. The United States has pointed out that China could revise this provision to permit team-based compensation while still addressing its legitimate concerns about pyramid schemes. Other problematic provisions include a three-year experience requirement that only applies to foreign enterprises, not domestic ones, restrictions on the cross-border supply of direct selling services and high capital requirements that may limit smaller direct sellers' access to the market.

The United States has urged the Chinese authorities to reconsider the problematic provisions in the direct selling measures, both bilaterally and during the transitional review before the Council for Trade in Services, held in September 2005. MOFCOM has since offered to meet with U.S. and other foreign industry representatives to hear their concerns. This meeting is expected to take place in January 2006. The United States will work closely with U.S. companies in urging China to revise its direct selling measures to facilitate legitimate commerce and to comply with its WTO commitments.

Import Regulation

Tariffs

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

As in prior years, China implemented its scheduled tariff reductions for 2005 on schedule. These tariff changes further increased market access for U.S. exporters in a range of industries, as China continued the process of reducing tariffs on goods of greatest importance to U.S. industry from a base average of 25 percent (in 1997) to 7 percent over a period of five years, running from January 1, 2002, while it made similar reductions throughout the agricultural sector (see the Agriculture section below). The reductions made on January 1, 2005, involved a range of sectors, including motor vehicles and motor vehicle parts, office machinery, large appliances, furniture and chemicals, and contributed to another significant increase in U.S. exports, which rose approximately 17 percent from January through September 2005, when compared to the same time period in 2004.

In one of its more significant tariff initiatives, China continued its participation in the Information Technology Agreement (ITA), which requires the elimination of tariffs on computers, semiconductors and other information technology products. China began reducing and eliminating these tariffs in 2002 and continued to do so in the ensuing years, achieving the elimination of all ITA tariffs on January 1, 2005, as the tariffs dropped to zero from a pre-WTO accession average of 13.3 percent. U.S. exports of ITA goods continued to perform well in 2005, as they were projected to exceed $5 billion by the end of the year, although they did decrease by 12 percent from January through September 2005, when compared to the same time period in 2004.

China also continued its timely implementation of another significant tariff initiative, the WTO's Chemical Tariff Harmonization Agreement, in 2005. U.S. chemical exports covered by this agreement increased by 36 percent from January through September 2005 and were projected to reach $5.8 billion by the end of the year, well above 2004's healthy total of $4.7 billion.

Customs and Trade Administration

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

Customs Valuation

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

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

Nevertheless, China has not uniformly implemented these various measures. U.S. exporters continue to report that they are encountering valuation problems at many ports. For example, even though the 2002 regulations and 2003 implementing rules provide that imported goods normally should be valued on the basis of their transaction price, meaning the price the importer actually paid, nearly four years later, many Chinese customs officials are still improperly using "reference pricing," which usually results in a higher dutiable value. In addition, some of China's customs officials are reportedly not applying the provisions in the 2002 regulations and 2003 implementing rules 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 China's 2003 implementing rules expressly direct them to add those fees only if they are import-related and a condition of sale for the goods being valued.

Beginning in 2004, U.S. exporters also complained about the Customs Administration's handling of imports of digital media that contain instructions for the subsequent production of multiple copies of products such as DVDs. The Customs Administration has been inappropriately assessing duties based on the estimated value of the yet-to-be-produced copies. The United States has urged China to re-examine its current practices.

When the United States first presented its concerns about the customs valuation problems being encountered by foreign companies, China indicated that it was working to establish more uniformity in its adherence to WTO customs valuation rules. Since then, the United States has sought to assist in this effort in part by conducting technical assistance programs for Chinese government officials on WTO compliance in the customs area. In addition, in 2005, as in prior years, the United States raised its concerns about these customs valuation problems during meetings of the WTO Committee on Customs Valuation, including the transitional review held in October 2005. The United States focused particularly on the continuing practice of using "reference pricing" and the inconsistent valuation of software royalties and license fees. It appears that China continues to make efforts to eliminate the practice of using "reference pricing," although this practice can still be found at many ports. In addition, while some improvement appears to have taken place with regard to the valuation of royalties and license fees since the issuance of the *Rules on the Determination of Customs Value of Royalties and License Fees Related to Imported Goods* in 2003, these implementing rules have not led to uniform, WTO-consistent implementation by China's customs officials in this area.

<u>Rules of Origin</u>

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

In March 2001, the State Administration of Quality Supervision and Inspection and Quarantine (AQSIQ) issued regulations and implementing rules intended to bring the rules of origin used by China to check marking requirements into compliance with the Agreement on Rules of Origin. U.S. exporters have not raised concerns with China's implementation of these regulations.

In September 2004, nearly three years after China acceded to the WTO, the State Council finally issued the more important regulations intended to bring China's rules of origin into conformity with WTO rules for import and export purposes, without first circulating a draft for public comment. These regulations took effect on January 1, 2005, although necessary implementing rules are still being drafted. The United States has urged China to notify the regulations that have been issued and proposed implementing rules so that WTO members could review them and raise concerns or seek any needed clarifications from China. However, to date, China has not done so.

Import Licensing

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

Shortly after China acceded to the WTO, MOFTEC issued regulations revising China's automatic import licensing regime, and it later supplemented these regulations with implementing rules. MOFTEC also issued regulations revising China's non-automatic licensing regime. Following their issuance, the United States raised various concerns with MOFCOM regarding the regulations on automatic and non-automatic licensing in an effort to promote clarity and to ensure that the licensing procedures do not have trade-distorting or restrictive effects. Together with other WTO members, including the EC and Japan, the United States also presented detailed comments on various aspects of these regulations at meetings of the WTO's Import Licensing Committee, including the transitional reviews, in 2002, 2003 and 2004.

In May 2005, after Chinese steel producers negotiated contracts with major foreign iron ore suppliers, the Chinese government began imposing new import licensing procedures for iron ore without prior WTO notification. Even though the WTO's Import Licensing Agreement calls for import licensing procedures that do not have a restrictive effect on trade, China reportedly restricted licenses to 48 traders and 70 steel producers and has not made public a list of the qualified enterprises or the qualifying criteria used. The United States and Australia sought to clarify the operation of the import licensing procedures applicable to iron ore during the transitional reviews before the Committee on Import Licensing in October 2005 and the Council for Trade in Goods in November 2005. While China maintained that the Chinese government did not impose any qualifying criteria, it did acknowledge that two organizations affiliated with the Chinese government, the China Steel Industry Association and the Commercial Chamber for Metals, Minerals and Chemicals Importers and Exporters, had been discussing a set of rules regarding qualifying criteria such as production capacity and trade performance. In 2006, the United States will continue to monitor this situation, which could set a troubling precedent for the handling of imports of other raw materials.

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

Non-tariff Measures

In its accession agreement, China agreed that it would eliminate numerous trade-distortive non-tariff measures (NTMs), which included import quotas, licenses and tendering requirements covering hundreds of products. Most of these NTMs, including, for example, the NTMs covering chemicals, agricultural equipment, medical and scientific equipment and civil aircraft, had to be eliminated by the time that China acceded to the WTO. China committed to phase out other NTMs, listed in an annex to the accession agreement, over a transition period ending on January 1, 2005. These other NTMs included import quotas on industrial goods such as air conditioners, sound and video recording apparatus, color TVs, cameras, watches, crane lorries and chassis, and motorcycles as well as licensing and tendering requirements, which applied to a few types of industrial goods, such as machine tools and aerials.

As has been previously reported, China's import quota system was beset with problems. The State Council was late in issuing necessary regulations, and the authorities charged with implementing this system – MOFTEC for some products and SETC for others – were late in allocating quotas. Because of a lack of transparency, it was also difficult to assess whether the quotas were allocated in accordance with the agreed rules. Some of the more difficult problems were encountered with the auto import quota system, resulting at times in significant disruption of wholesale and retail operations for imported autos.

While these problems prevented the United States and other WTO members from realizing the full contemplated benefits of these import quotas, China did fully adhere to the agreed schedule for the elimination of all of its import quotas as well as all of its other NTMs, the last of which China eliminated on January 1, 2005. In some cases, China even eliminated its NTMs ahead of schedule, as it did with the import quotas on crane lorries and chassis, and motorcycles.

Tariff-rate Quotas on Industrial Products

In its WTO accession agreement, China agreed to implement a system of tariff-rate quotas (TRQs) designed to provide significant market access for three industrial products, including fertilizer, a major U.S. export. Under this type of TRQ system, a set quantity of imports is allowed at a low tariff rate, while imports above that level are subject to a higher tariff rate. In addition, the quantity of imports allowed at the low tariff rate increases annually by an agreed amount. China's accession agreement specifies detailed rules, requiring China to operate its fertilizer TRQ system in a transparent manner and dictating precisely how and when China is obligated to accept quota applications, allocate quotas and reallocate unused quotas.

As has been previously reported, SETC was slow to implement its TRQ system in 2002, and a lack of transparency made it difficult to assess whether the quota allocations followed the rules set out in China's goods schedule. U.S. exporters also complained of administrative guidance discouraging some TRQ holders from freely utilizing their quotas. In July 2002, following repeated bilateral engagement, the United States requested formal consultations with China under the headnotes in China's goods schedule. During the ensuing consultations, which took place in September 2002 in Geneva, China was forthcoming in its responses and provided the United States with a better understanding of the challenges facing it, but the United States and China were unable to agree on concrete steps to remedy the situation.

In 2003, as the United States continued to engage China, SETC issued the quota allocations on time and apparently in the correct amount, representing a substantial improvement over 2002. However, U.S. companies continued to complain about administrative guidance discouraging TRQ holders from freely utilizing their quotas. According to reports from these companies, administrative guidance may have been used to limit imports of the principal U.S. fertilizer product, diammonium phosphate (DAP), to less than 60 percent of the quota allocations actually issued by SETC. U.S. fertilizer exports to China were down by 32 percent in 2003, totaling $459 million as compared to $676 million in 2002.

Even after SETC was merged into MOFCOM as part of the mid-2003 government restructuring, the systemic problems did not go away in 2004. Despite continued U.S. engagement, principally through the transitional review before the WTO's Committee on Market Access, China's fertilizer TRQ system was still operating with insufficient transparency, and administrative guidance still seemed to be affecting how allocated quota was used. Meanwhile, U.S. fertilizer exports to China were down 33 percent in 2004, totaling $306 million, due in part to the continuing problems with MOFCOM's administration of the fertilizer TRQ system and in part to increasing subsidization – and resulting overcapacity – of China's domestic fertilizer industry.

In 2005, MOFCOM's administration of the fertilizer TRQ system had not noticeably improved, and the United States again focused on how this system was being administered in connection with the transitional review before the Committee on Market Access, held in October 2005. At the same time, U.S. fertilizer exports to China remained essentially stable, as the figures for

January through September 2005 showed a slight decrease, totaling $210 million as compared to $215 million during the same period in 2004. The United States will continue to monitor developments closely in 2006 and work to ensure that China fully complies with its commitments and administers its TRQ system in a transparent and fair manner.

Other Import Regulation

Antidumping

In its WTO accession agreement, China committed to revising its regulations and procedures for antidumping (AD) proceedings by the time of its accession, in order to make them consistent with the WTO Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (AD Agreement). That agreement sets forth detailed rules prescribing the manner and basis on which a WTO member may take action to offset the injurious dumping of products imported from another WTO member. China also agreed to provide for judicial review of determinations made in its AD investigations and reviews.

Since its accession to the WTO, China has become a leading user of AD measures, with a total of 69 AD measures covering 19 countries currently in place and 38 new AD investigations in progress. According to U.S. AD experts, the greatest shortcomings to date in China's AD practice continue to relate to transparency and fair procedures. The United States has been pressing China to clarify and address these concerns both bilaterally and multilaterally.

Four years after its WTO accession, much of China's legal framework for its AD regime appears to be in place, although there are still some key pieces of legislation that China has not notified to the WTO. Shortly before China's accession to the WTO, the State Council issued new AD regulations, which became effective in January 2002. These regulations replaced those that had governed China's AD regime since its beginning in 1997. In early 2002, MOFTEC, which at that time was charged with making determinations of dumping under the new regulations, issued several sets of rules covering initiation of investigations, questionnaires, sampling, verifications, information disclosure, access to non-confidential information, price undertakings, hearings, interim reviews, refunds and new shipper reviews. SETC, which at that time was charged with making determinations of injury, issued rules covering industry injury investigations and public hearings in January 2003. These regulations were updated and notified to the WTO following the consolidation of the AD functions of MOFTEC and SETC into the newly-formed MOFCOM in March 2003. A revised version of China's governing statute, the *Foreign Trade Law*, which included expanded trade remedy language and was also eventually notified to the WTO, came into force in July 2004.

Within MOFCOM, the Bureau of Fair Trade for Imports and Exports (BOFT) is charged with making dumping determinations and MOFCOM's Bureau of Industry Injury Investigation (IBII) is charged with making injury determinations. The State Council Tariff Commission continues to make the final decision on imposing, revoking or retaining AD duties, based on recommendations provided by the two MOFCOM bureaus, although its authority vis-à-vis MOFCOM is not clearly defined in the revisions to the regulations and implementing rules issued subsequent to the reorganization.

In practice, China's handling of AD investigations has not fully observed the fundamental requirements of transparency and fair procedures embodied in the AD Agreement. There continue to be a growing number of reports from U.S. respondents and respondents from other WTO members, complaining about the lack of detailed information made available to parties and the lack of disclosure of the facts that form the basis for decisions made by the administering authorities. As reported in previous years, BOFT makes documents from AD investigations reasonably available on demand. However, IBII continues to have a spotty record of making available to respondents materials generated and submitted during the course of its injury investigations, a situation that it has not improved. Compounding this problem is the highly limited disclosure to interested parties by China's AD authorities of the essential facts underlying the decisions and calculations in both dumping and injury investigations. This dearth of disclosure impairs the ability of U.S. companies to mount an effective defense in Chinese AD investigations. Like last year, many respondents have criticized China's AD authorities for not providing appropriate opportunities for business to comment on and provide input into the government's deliberative process, the lack of domestic producer information or untimely access to such information, and the opaque nature of decision making in injury investigations, including demonstrating the causal link between injury and dumping. Indeed, in the many AD investigations conducted by MOFCOM since China's WTO accession, IBII has not once found that U.S. exports were not causing injury to China's domestic industry, despite compelling arguments raised by U.S. respondents. Now that China is completing investigations and collecting antidumping duties, these problems are having a real impact on U.S. exporters.

At the WTO, in addition to addressing problems with China's AD practice in regular AD Committee meetings, the United States continues to vigorously make use of the annual transitional reviews to clarify issues and voice concerns regarding China's AD practices. During the most recent transitional review before the AD Committee, held in October 2005, the United States and other WTO members, including the EC and Japan, again raised concerns with China regarding transparency and fair procedures. The United States will continue to use the AD Committee to press China to address these problems.

The United States also continues to pursue these matters bilaterally. In April 2004, the United States and China agreed to establish the Trade Remedies Working Group at the JCCT meeting. This working group has given U.S. AD experts a dedicated forum to engage Chinese administrators and decision-makers directly and in detail regarding the problems facing U.S. exporters subject to Chinese AD actions. U.S. AD experts also continue to have frequent formal and informal information exchanges with China's AD authorities, which helps to promote greater transparency and accountability in China's AD regime.

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

With China now having completed several AD investigations undertaken since its accession to the WTO, the opportunity for parties to seek judicial review has become more important. In August 2002, the Supreme People's Court issued *Rules Regarding Supreme People's Court Hearings on Judicial Review of International Trade Disputes*, which provide guidance concerning judicial review of administrative agency decisions affecting international trade, including those in the AD area (and in the countervailing duties, or CVD, area). In September of the same year, the Supreme People's Court issued *Provisions of the Supreme People's Court on Certain Issues Concerning the Applicability of Laws in the Hearing and Handling of Antidumping Administrative Cases*. None of these rules has been formally submitted to the WTO, so there has been no opportunity for effective multilateral review of China's judicial review procedures. In addition, to the United States' knowledge, no interested party has yet sought judicial review of a MOFCOM AD determination.

<u>Countervailing Duties</u>

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

Shortly before China's accession, the State Council issued new CVD regulations, which came into force on January 1, 2002. Later, MOFTEC, which at that time was charged with making determinations of subsidization under China's CVD regime, issued several sets of ministerial rules on initiation of investigations, questionnaires, verifications and hearings. The SETC, which at that time was charged with making determinations of injury in China's CVD proceedings, issued implementing rules covering industry injury investigations and public hearings in January 2003. In March 2003, a general reorganization of the State Council ministries and commissions consolidated the subsidization and injury investigation functions of MOFTEC and SETC into MOFCOM. Updated regulations were later notified to the WTO, as was the revised *Foreign Trade Law*, as discussed above in the Antidumping section.

As in the AD area, China continues in its efforts to conform its CVD regulations and procedural rules to the provisions and requirements of the Subsidies Agreement and the commitments in its

WTO accession agreement. China's regulations and procedural rules generally track those found in the Subsidies Agreement, although there are certain areas where key provisions are omitted or are vaguely worded. During the transitional reviews conducted in the WTO Subsidies Committee in 2003, 2004 and 2005, the United States and other WTO members sought to clarify a variety of issues concerning China's legislative and regulatory framework, as they have pressed China for greater transparency. The United States will continue to seek needed clarifications through the Subsidies Committee and bilateral contacts in 2006, including the Trade Remedies Working Group established at the April 2004 JCCT meeting.

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

Safeguards

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

Shortly before China's WTO accession, as previously reported, the State Council issued the *Regulations on Safeguards*, which became effective on January 1, 2002. Under these regulations, MOFTEC became responsible for determining whether the volume of imports of a given product has increased and (together with SETC) whether there is a causal link between any such imports and injury to the domestic industry. Shortly thereafter, MOFTEC issued two sets of provisional procedural rules, one covering initiations and the other hearings. SETC, the agency that was charged with determining injury to the domestic industry, then issued the *Rules on Investigations and Determinations of Industry Injury for Safeguards* and the *Rules on Public Hearings with regard to Investigations of Injury to Industry* in early 2003. In 2003, a general reorganization of the State Council ministries and commissions consolidated the safeguard functions of MOFTEC and SETC into MOFCOM and, in 2004, the State Council issued revised *Regulations on Safeguards* and MOFCOM issued revised implementing rules to reflect this change.

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

To date, China has conducted only one safeguard proceeding. In May 2002, MOFTEC initiated an investigation addressing imports of certain steel products from various countries, including the United States. China imposed provisional measures in the form of tariff-rate quotas on nine categories of products the day after initiation, and six months later it rendered a final determination maintaining these measures in place. Although U.S. companies exported little of the subject merchandise to China, there were complaints that China's process for allocating quotas under the safeguard measures was unclear, making it difficult for them to determine the quota available and obtain a fair share. MOFCOM terminated the safeguard measures in December 2003.

Export Regulation

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

Nevertheless, since its accession to the WTO, China has continued to impose restrictions on exports of a few raw materials and intermediate products. In an attempt to justify these restrictions, MOFCOM has often cited Article XX(g) of GATT 1994, which permits a WTO member to impose measures relating to the conservation of exhaustible natural resources, provided that such measures are made effective in conjunction with restrictions on domestic production or consumption, and provided they are not applied in a manner that would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on international trade.

In 2004, China's longstanding export restrictions on blast furnace coke, a key steel input, began to have a significant, adverse effect on U.S. integrated steel producers and their customers. China was (and is) the world's largest producer of coke as well as the world's most significant exporter of coke, supplying more than one-half of the world's traded coke. Even though its total production was projected to (and did) rise to nearly 210 metric tons (MT) in 2004, China initially imposed an export quota of 8.3 million MT, down from the 2003 level of 14.3 million MT. In the first six months of 2004, China's export quota, combined with the illegal sale of export quota certificates, caused the export price for Chinese coke to rise to the vicinity of $500 per MT, more than three times the price in 2003. This price rise triggered a similar rise in world coke prices, while Chinese domestic prices ranged between $150 and $200 per MT.

The United States began to raise its concerns with China's coke export restrictions during high-level meetings in Washington in April 2004. The United States urged China to put the practice of using export restrictions behind it, not just for coke but also for other products. The United States also began to coordinate with other concerned WTO members, particularly the EC and Japan, which had become active in addressing this issue. In late July 2004, following sustained engagement by the United States, which included both high-level contacts and a series of meetings with MOFCOM officials in Beijing, China raised the 2004 quota allotment to 12.3 million MT, and it indicated that it would eventually be raising the quota to the 2003 level of 14.3 MT. Shortly thereafter, MOFCOM also issued an urgent notice reiterating that the sale of export licenses was illegal, calling for investigations into this practice by provincial MOFCOM authorities, and demanding reports by August 15. In the ensuing months, with the increased supply of Chinese coke and the crackdown on the sale of export licenses, the export prices for Chinese coke declined significantly, nearly reaching $200 per MT. U.S. industry was also able to obtain a substantially larger quantity of Chinese coke in 2004 than it had in 2003.

In September and November 2004, the United States continued to press China for complete elimination of the annual export quota on coke. Along with other WTO members, including the EC and Japan, the United States raised its concerns at the WTO during the transitional reviews before the Committee on Market Access and the Council for Trade in Goods as well as during side meetings. The United States also reiterated its concerns in bilateral meetings in Beijing in November 2004.

The United States continued to pursue this issue in 2005, both bilaterally and at the WTO. In May 2005, consistent with earlier indications from China, an NDRC official stated publicly that China would eliminate the coke export quota system as of January 1, 2006. However, to date, China has not issued a measure that formally eliminates this system. In addition, at the transitional review before the Council for Trade in Goods, held in November 2005, China stated that it had not yet made any decision on the elimination of the export quotas on coke. The United States will closely monitor developments in this area in 2006 and will take whatever action is necessary to bring about the elimination of the export quotas on coke.

Fluorspar is another example of a raw material subject to export restrictions. China imposes quotas and license fees on fluorspar exports, apparently with the objective of supporting China's domestic users of fluorspar, which face no comparable restrictions. Since shortly after China's WTO accession, the United States has raised its concerns about these restrictions bilaterally with China. The United States has also worked with other WTO members with an interest in this issue, including Japan, and it raised this issue during the transitional reviews before the Committee on Market Access and the Council for Trade in Goods in 2002, 2003, 2004 and 2005. To date, however, China has refused to modify its practices in this area. The United

States will continue to urge China to lift these and other export restrictions on raw materials in 2006.

Internal Policies Affecting Trade

Non-discrimination

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

The MFN rule (set forth in Article I of GATT 1994) attempts to put the goods of all of an importing WTO member's trading partners on equal terms with one another by requiring the same treatment to be applied to goods of any origin. It generally provides that if a WTO member grants another country's goods a benefit or advantage, it must immediately and unconditionally grant the same treatment to imported goods from all WTO members. This rule applies to customs duties and charges of any kind connected with importing and exporting. It also applies to internal taxes and charges, among other internal measures.

The national treatment rule (set forth in Article III of GATT 1994) complements the MFN rule. It attempts to put the goods of an importing WTO member's trading partners on equal terms with the importing member's own goods by requiring, among other things, that a WTO member accord no less favorable treatment to imported goods than it does for like domestic goods. Generally, once imported goods have passed across the national border and import duties have been paid, the importing WTO member may not subject those goods to internal taxes or charges in excess of those applied to domestic goods. Similarly, with regard to measures affecting the internal sale, purchase, transportation, distribution or use of goods, the importing WTO member may not treat imported goods less favorably than domestic goods.

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

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

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

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

However, China still does not appear to observe MFN and national treatment requirements in all areas. For example, several U.S. industries reported that China continued to apply the value-added tax in a manner that unfairly discriminates between imported and domestic goods, both through official measures and on an *ad hoc* basis, as discussed below in the Taxation section. It also appears that China has applied sanitary and phytosanitary measures in a discriminatory manner continually since it acceded to the WTO, as discussed below in the Agriculture section. In addition, China's new industrial policies on automobiles and steel appear to discriminate against foreign producers as well as imported goods, as discussed above in the Tariffs section and below in the Investment section.

The United States continued to address these and other MFN and national treatment issues with China in 2005, both bilaterally and in WTO meetings, such as the transitional reviews before the Committee on Market Access, the Committee on Trade-Related Investment Measures (TRIMS Committee), the Committee on Sanitary and Phytosanitary Measures (SPS Committee), the Council for Trade in Goods, the Committee on Trade in Financial Services and the Council for Trade in Services. The United States will continue to pursue these issues vigorously in 2006.

Taxation

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

<u>VAT Policies</u>

Since China's WTO accession, certain aspects of China's VAT system have raised serious national treatment concerns. One of these issues – the discriminatory rates being applied to imports versus domestically produced semiconductors – has now been resolved, although other issues remain.

As previously reported, China began to encourage the development of China's domestic integrated circuit (IC) industry through the announcement of discriminatory VAT policies beginning shortly before its WTO accession, although they did not become operational until 2004. Pursuant to a series of measures, China provided for the rebate of a substantial portion of the 17 percent VAT paid by domestic manufacturers on their locally produced ICs. A similar VAT rebate was available to imported ICs, but only if they had been designed in China. China charged the full 17 percent VAT on all other imported ICs.

Following extensive bilateral engagement from February 2003 to March 2004, it became clear that further talks would not convince China to eliminate its differential tax treatment of imported ICs. With U.S. exports of ICs to China totaling approximately $2 billion in 2003 and growing, and with China's policies encouraging the shifting of investment in IC manufacturing to China, the United States took appropriate action at the WTO. The United States initiated dispute settlement in March 2004 by requesting formal consultations with China. In the ensuing consultations, which took place in April 2004 in Geneva, with third party participation by Japan, the EC and Mexico, the United States laid out its claims under Article III of GATT 1994, which sets forth the WTO's national treatment principle. Shortly thereafter, China signaled its willingness to discuss a possible resolution of this matter. A series of bilateral meetings subsequently took place in Washington and Beijing, and in July 2004 a settlement was reached. China agreed to immediately cease adding Chinese IC manufacturers to the list of entities eligible for the VAT rebate and to issue the necessary regulations to eliminate the VAT rebate entirely by November 1, 2004, to be effective no later than April 1, 2005. China also agreed to repeal the relevant implementing rules that had made VAT rebates available for ICs designed in China but manufactured abroad by September 1, 2004, to be effective no later than October 1, 2004.

China followed through on each of these agreed steps in a timely manner, and the two sides notified the WTO in October 2005 that their dispute had been satisfactorily resolved. Nevertheless, the United States continues to monitor closely new financial support that China is making available to its domestic producers for consistency with the WTO Subsidies Agreement's disciplines.

China has also used VAT policies to benefit domestic fertilizer production. In July 2001, the Ministry of Finance (MOF) and the State Administration of Taxation issued a circular exempting all phosphate fertilizers except DAP from a 13 percent VAT. DAP, a product that the United States exports to China, competes with similar phosphate fertilizers produced in China, particularly monoammonium phosphate. The circular also allowed a partial VAT rebate for domestic producers of urea, a nitrogen fertilizer, through the end of 2002. The United States raised this issue bilaterally with China soon after it acceded to the WTO, and in many subsequent bilateral meetings, including the Trade Dialogue meetings held in February and November 2003, among other high-level meetings. The United States also raised this issue at the WTO, both in regular meetings of the Committee on Market Access and during the transitional reviews held in 2002, 2003, 2004 and 2005. So far, however, China has refused to make any changes, although it did allow the special tax treatment for domestic urea to expire at the end of 2002. The United States will continue to press its concerns regarding this issue in 2006.

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

Finally, China's border trade policy continues to generate MFN and other concerns. China provides preferential import duty and VAT treatment to certain products, often from Russia, apparently even when those products are not confined to frontier traffic as envisioned by Article XXIV of GATT 1994. In June 2003, China began to address these concerns when it eliminated preferential treatment for boric acid and 19 other products. However, several other products continue to benefit from preferential treatment. During the transitional reviews before the WTO's Council for Trade in Goods, the United States has continued to urge China to eliminate the preferential treatment for these remaining products.

Consumption Taxes

National treatment concerns also continue to surround China's consumption tax regulations, which first went into effect in 1993 and apply to a range of consumer products, including spirits and alcoholic beverages, tobacco, cosmetics and skin and hair care preparations, jewelry, fireworks, rubber, motorcycles and automobiles. Under these regulations, China uses different tax bases to compute consumption taxes for domestic and imported products, with the apparent result that the effective consumption tax rate for imported products is substantially higher than for domestic products. Since China's accession, the United States has raised this issue with China, both bilaterally and during the transitional reviews conducted by the WTO Committee on Market Access and the Council for Trade in Goods in 2002, 2003, 2004 and 2005. However, China has so far not revised these regulations. The United States will continue to insist on the revision of these regulations in 2006.

Subsidies

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

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

After four years of WTO membership, China had yet to fulfill a key requirement of the Subsidies Agreement, which is to notify certain information about its subsidies to the WTO (on an annual basis). Timely and informative notifications are vital to satisfying the rights of other WTO members to know and understand the range and operation of a member's subsidies and to be assured that the member is not maintaining any prohibited subsidies. Although China submitted a subsidies notification in an annex to its accession agreement, that notification only contained information through 1998 or 1999, and China acknowledged that it was far from comprehensive.

The United States has raised China's failure to make a subsidies notification in every transitional review before the WTO's Subsidies Committee, including the one held in October 2005, during which the United States and other WTO members, including the EC, Japan, Mexico and Canada, again urged China to submit a full and updated notification as soon as possible. During the transitional review before the Council for Trade in Goods in November 2004, however, China did commit to submit its long-overdue subsidies notification within the next year. China reiterated this commitment at the July 2005 JCCT meeting and at the October 2005 transitional review before the Subsidies Committee, where it clarified that it would submit the notification by the end of 2005. As of early December 2005, China had not yet submitted its notification.

During this year's transitional review before the Subsidies Committee, the United States also continued to raise questions about potentially prohibited subsidies maintained by China, including tax incentives and preferential bank financing provided to producers of agricultural and industrial goods that are contingent upon export or the use of domestic over imported goods. In addition, the United States sought more information about subsidies offered under industrial policies designed to revitalize China's northeast region. Canada and Mexico also joined the United States in seeking clarifications about China's new steel industrial policy, issued by NDRC in July 2005. The stated goal for China's steel policy is to encourage restructuring of the domestic industry, which is now the world's largest industry, accounting for 30 percent of global steel production. However, this policy includes several troubling aspects, including provisions that encourage the use of Chinese (rather than imported) equipment and technology and provisions that call for a variety of government financial support for China's steel mills.

As previously reported, in October 2004, the United States submitted a request under Article 25.8 of the Subsidies Agreement for China to provide detailed information regarding several programs and practices that appeared to constitute subsidies. The request identified programs and practices providing benefits to agricultural products, forest and paper products, textiles and various high technology products, among others, and included some programs and practices that appeared to constitute prohibited subsidies within the meaning of Article 3 of the Subsidies Agreement. China has not yet provided any responses to this request, even though Article 25.9 of the Subsidies Agreement directs that WTO members shall respond to this type of request "as quickly as possible and in a comprehensive manner."

Once China submits its subsidies notification and its responses to the Article 25.8 request, the United States will carefully analyze them, both for accuracy and completeness, and participate in multilateral reviews of them before the Subsidies Committee. The United States will also continue to pursue its own investigation and analysis of Chinese subsidy programs and practices and pursue bilateral engagement, as necessary, including through upcoming meetings of the Structural Issues Working Group, which was created at the April 2004 JCCT meeting.

Price Controls

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

In 2005, China continued to maintain price controls on several products and services covering both state-owned enterprises and private enterprises. Published through the China Economic Herald and the NDRC's website, these price controls may be in the form of either absolute mandated prices or specific pricing policy guidelines as directed by the government and include items such as pharmaceuticals, natural gas, transportation (including freight transportation), and tobacco and certain other agricultural products.

During the transitional review before the Subsidies Committee in October 2005, as in prior years, the United States sought updated information from China on its use of price controls and future plans, focusing on pricing for raw materials and inputs such as coal, steel and copper scrap, and water. The United States will continue to monitor China's progress in eliminating price controls in 2006.

Standards, Technical Regulations and Conformity Assessment Procedures

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

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

In addition, in the Services Schedule accompanying its WTO accession agreement, China committed to permit foreign service suppliers that have been engaged in inspection services in their home countries for more than three years to establish minority foreign-owned joint venture technical testing, analysis and freight inspection companies upon China's accession to the WTO, with majority foreign ownership no later than two years after accession and wholly foreign-owned subsidiaries four years after accession. China further agreed that qualifying joint venture and wholly foreign-owned enterprises would be eligible for accreditation in China and accorded national treatment.

Restructuring of Regulators

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

China also began to take steps in 2001 to address problems associated with its multiplicity of conformity assessment bodies, whose task it is to determine if standards and technical regulations are being observed. AQSIQ was established as a new ministry-level agency in April 2001. It is the result of a merger of the State Administration for Quality and Technical Supervision and the State Administration for Entry-Exit Inspection and Quarantine. China's officials explained that this merger was designed to eliminate discriminatory treatment of imports and requirements for multiple testing simply because a product was imported rather than domestically produced. China also formed the quasi-independent National Certification and Accreditation Administration, which is attached to AQSIQ and is charged with the task of unifying the country's conformity assessment regime.

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

Transparency

In the area of transparency, AQSIQ's TBT inquiry point, established shortly after China acceded to the WTO, has continued to be helpful to U.S. companies as they try to navigate China's system of standards, technical regulations and conformity assessment procedures. In addition, China's designated notification authority, MOFCOM, has been notifying proposed technical regulations and conformity assessment procedures to WTO members, as required by the TBT

Agreement. Indeed, in 2005, MOFCOM submitted more than four times as many notifications as in 2004. As in prior years, however, almost all of the notified measures have emanated from AQSIQ or SAC and have not included measures from other agencies that appear to require notification. Two years ago, in part to address this problem, China had reportedly formed a new inter-agency committee, with representatives from approximately 20 ministries and agencies and chaired by AQSIQ, to achieve better coordination on TBT (and sanitary and phytosanitary) matters, but little progress appears to have been made in this area.

Meanwhile, as the United States has highlighted during the annual transitional review before the TBT Committee, the comment periods established by China for the TBT measures actually notified continued to be unacceptably brief in some cases. In other cases, some U.S. companies reported that even when sufficient time was provided, written comments submitted by U.S. and other foreign interested parties seemed to be wholly disregarded. In still other cases, insufficient time was provided for Chinese regulatory authorities to consider interested parties' comments before a regulation was adopted.

<u>Standards and Technical Regulations</u>

Shortly after its accession to the WTO, China began the task of bringing its standards regime more in line with international practice. One of its first steps was AQSIQ's issuance of rules designed to facilitate China's adoption of international standards. China subsequently embarked on the task of reviewing all of China's existing 21,000 technical regulations to determine their continuing relevance and consistency with international standards. During the transitional review before the TBT Committee in November 2005, China reported that as of October 2005 it had nullified 1,416 national standards as a result of this review.

One trade association with broad representation asserts that "China is making steady progress through a thoughtful approach to reforming its standardization system." In its view, over the last year, "China has strengthened its links with those working on standards in other countries and moved its standards regime into closer conformity with international practice." For example, the Chinese standards organization for audio and video coding completed its work with foreign standards policy experts to develop detailed organizational rules and intellectual property policies, based on many of the core principles of international standards-setting organizations. The organization adopted these rules and policies in December 2004. Although areas for improvement remain, U.S. industry is hopeful that other Chinese standards organizations will consider adopting similar rules and policies.

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

Despite these positive developments, concern has grown over the past few years as China is actively pursuing the development of unique requirements, despite the existence of well-established international standards. As the same trade association explains, "[w]hile China deserves recognition for its standardization system reforms, the U.S. business community remains concerned by the continuing focus on developing unique indigenous standards as a way of protecting domestic companies from competing foreign standards and technologies." Indeed, China has already adopted a unique standard for enhanced versatile discs, and it is trying to develop unique standards and technical regulations in a number of other sectors, including, for example, autos, telecommunications equipment, Internet protocols, wireless local area networks, radio frequency identification tag technology, audio and video coding, whiskey and other distilled spirits, and fertilizer. This strategy has the potential to create significant barriers to entry into its markets, as the cost of compliance will be high for foreign companies. At the same time, China will also be placing its own companies at a disadvantage in its export markets, where international standards prevail.

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

The United States also elevated another standards issue to the JCCT level in 2004. The U.S. telecommunications industry was very concerned about increasing interference from Chinese regulators, both with regard to the selection of 3G telecommunications standards and in the negotiation of contracts between foreign telecommunications service providers and their Chinese counterparts. The United States urged China to take a market-based and technology neutral approach to the development of next generation wireless standards for computers and mobile telephones. At the April 2004 JCCT meeting, China announced that it would support technology neutrality with regard to the adoption of 3G telecommunications standards and that telecommunications service providers in China would be allowed to make their own choices about which standard to adopt, depending on their individual needs. China also announced that Chinese regulators would not be involved in negotiating royalty payment terms with relevant intellectual property rights holders. However, by the end of 2004, it had become evident that there was still pressure from within the Chinese government to ensure a place for China's home-grown 3G telecommunications standard. In 2005, China's regulators continued to take steps to promote that standard, and it also became evident that they had not ceased their attempts to influence negotiations on royalty payments. The United States will carefully monitor developments in this area in 2006 and re-engage China as necessary to ensure that China's regulators adhere to China's JCCT commitments.

As previously reported, near the end of 2003, AQSIQ issued a notice announcing the creation of a new requirement that exporters of recycled scrap to China must register with AQSIQ by July 1, 2004. U.S. exporters, which account for nearly $2 billion of recycled scrap exports to China annually, became concerned because several of the procedures and substantive requirements established by AQSIQ in a May 2004 notice lacked clarity. During ensuing discussions with U.S. government and private sector representatives, AQSIQ provided needed clarifications and subsequently showed some flexibility by agreeing to extend the deadline for filing an application to August 1, 2004. AQSIQ also indicated that exporters that filed incomplete applications would have until September 30, 2004 to correct their applications. However, the United States was still concerned because it appeared that existing shippers, or new shippers, that missed the August 1, 2004 application deadline would be precluded by AQSIQ from applying for registration until some indefinite time in the future. While the United States recognized that AQSIQ may have a legitimate basis for insisting that the exporters complete the registration process and obtain a registration number before exporting to China, it did not agree that AQSIQ had a legitimate basis for effectively barring their registration by not allowing them to apply after a certain date. Following further bilateral engagement, AQSIQ announced in October 2004 that it would delay implementation of the new registration requirement from November 1, 2004 until January 1, 2005. By the end of 2004, 87 percent of applicants, including hundreds of U.S. exporters, had reportedly become registered suppliers of recycled scrap. AQSIQ also indicated that it would institute a rolling application process. In mid-2005, the United States followed up on this issue at a meeting of the WTO's Committee on Import Licensing, when it sought to determine when AQSIQ would formally re-open the application process. AQSIQ re-opened the application process in August 2005.

Finally, late last year, new concerns arose following SAC's issuance of a draft measure – the *Provisions for Patent Issues Relating to National Standards* – and public statements by key Chinese government officials that appeared to call for compulsory licensing of patented technologies that are used for national standards in China. Standards organizations normally require enterprises that contribute patented technology to a standard to license their patents on "reasonable and non-discriminatory" terms, which entitles them to set reasonable limits on the use of their technology and to receive reasonable compensation. Although the initial draft of this measure did not expressly call for compulsory licensing and subsequent drafts have not been released for public comment, recent public statements by key Chinese government officials have generated U.S. industry concern that the final version of the measure may require foreign enterprises to share their patented technologies on a royalty-free basis in exchange for the opportunity to participate in developing standards, which is the approach that has been followed by some Chinese standards organizations on an *ad hoc* basis. The United States has urged China to circulate an updated draft for public comment and will closely monitor developments in this area in 2006.

Conformity Assessment Procedures

As previously reported, AQSIQ's regulations establishing a new Compulsory Product Certification System, issued in December 2001, took full effect on August 1, 2003. Under this system, there is now one safety mark, called the "China Compulsory Certification" or "CCC" mark, issued to both Chinese and foreign products. Under the old system, domestic products were only required to obtain the "Great Wall" mark, while imported products needed both the "Great Wall" mark and the "CCIB" mark. In 2005, as in prior years, U.S. companies continued to complain that the regulations lack clarity regarding the products that require a CCC mark. They also have reported that China is applying the CCC mark requirements inconsistently and that many domestic products required by AQSIQ's regulations to have the CCC mark are still being sold without the mark. In addition, despite the changes made by the regulations, U.S. companies in some sectors continued to complain in 2005 about duplication in certification requirements, particularly for radio and telecommunications equipment, medical equipment and automobiles.

Meanwhile, to date, China has granted well over one hundred Chinese enterprises accreditation to test and certify for purposes of the CCC mark. Despite China's commitment that qualifying minority foreign-owned (upon China's accession to the WTO) and majority foreign-owned (two years later) joint venture conformity assessment bodies would be eligible for accreditation and would be accorded national treatment, China so far has not granted accreditation to any foreign-invested conformity assessment bodies. As a result, exporters to China are often required to submit their products to Chinese laboratories for tests that have already been performed abroad, resulting in greater expense and a longer time to market.

In 2005, as in prior years, the United States raised its concerns in this area with China bilaterally and during meetings of the WTO's TBT Committee, including the transitional review held in November 2005, where it received support from the EC and Japan. The United States will continue to be in close contact with the relevant Chinese authorities in these areas in 2006.

Other Internal Policies

State-Owned and State-Invested Enterprises

While many provisions in China's WTO accession agreement indirectly discipline the activities of state-owned and state-invested enterprises, China also agreed to some specific disciplines. In particular, it agreed that laws, regulations and other measures relating to the purchase of goods or services for commercial sale by state-owned and state-invested enterprises, or relating to the production of goods or supply of services for commercial sale or for non-governmental purposes by state-owned and state-invested enterprises, would be subject to WTO rules. China also affirmatively agreed that state-owned and state-invested enterprises would have to make purchases and sales based solely on commercial considerations, such as price, quality, marketability and availability, and that the government would not influence the commercial decisions of state-owned and state-invested enterprises. Since China's accession to the WTO, U.S. officials have not heard many complaints from U.S. companies regarding WTO compliance problems in this area, although a lack of available information continues to make it a difficult area to assess. In 2005, however, some U.S. companies began to raise questions about the role of China's government in the investment decisions of state-owned enterprises, particularly in the oil and gas sector.

State Trading Enterprises

In its WTO accession agreement, China agreed to disciplines on the importing and exporting activities of state trading enterprises. China committed to provide full information on the pricing mechanisms of state trading enterprises and to ensure that their import purchasing procedures are transparent and fully in compliance with WTO rules. China also agreed that state trading enterprises would limit the mark-up on goods that they import in order to avoid trade distortions. Since China's WTO accession, the United States and other WTO members have sought information from China on the pricing and purchasing practices of state trading enterprises, principally through the transitional reviews at the WTO. So far, however, China has only provided general information, which does not allow a meaningful assessment of China's compliance efforts.

Government Procurement

The WTO Agreement on Government Procurement (GPA) is a plurilateral agreement and currently covers the United States and 37 other WTO members that have decided to join it. The GPA applies to the procurement of goods and services by central and sub-central government entities listed by each Party, subject to thresholds and certain exceptions. It requires GPA Parties to provide MFN and national treatment to the goods, services and suppliers of other GPA Parties and to apply detailed procedures designed to ensure fairness and predictability in the procurement process.

At present, China is not a party to the GPA. It committed to become an observer to the GPA upon its WTO accession, and in February 2002 it became an observer to the WTO Committee on Government Procurement. China also committed, in its WTO accession agreement, to initiate negotiations for accession to the GPA "as soon as possible," but it has not yet done so. In late 2003, MOF established a working group to study the possibility of initiating negotiations for accession to the GPA. In response to questions from the United States, the EC and Japan during the transitional review before the Council for Trade in Goods in November 2004, China stated that the working group was still studying the issue. In 2005, the United States placed more focus on this issue in a series of bilateral meetings leading up to the July 2005 JCCT meeting. At that meeting, China agreed to commence "technical discussions" with the United States and other WTO members in preparation for the initiation of negotiations to join the GPA. The first round of technical discussions between China and the United States are scheduled to take place in February 2006. The United States is also supplementing these discussions by pursuing capacity building designed to further educate Chinese policy makers about the GPA and government procurement issues generally.

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

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

China began the process of drafting regulations implementing the *Government Procurement Law* soon after its issuance. MOF circulated a draft of these regulations – the *Measures on the Administration of Bidding for Government-Procured Goods and Services* – for public comment in December 2002. The United States submitted written comments and then followed up on them during bilateral meetings with MOF officials. The final version of the regulations, issued in August 2004, set out detailed procedures for the solicitation, submission and evaluation of bids for government procurement contracts relating to goods ands services and help to clarify the scope and coverage of the *Government Procurement Law*. MOF also issued several sets of implementing rules, including measures relating to the announcement of government procurements and the handling of complaints by government procurement suppliers.

Meanwhile, beginning in 2003, U.S. companies expressed concerns about implementing rules on government software procurement being drafted by MOF. At a time when China's already large software market was projected to grow by more than 50 percent annually, the initial draft of these rules reportedly contained guidelines mandating that central and local governments – the largest purchasers of software in China – purchase only software developed in China to the extent possible. Later that year, the United States organized an industry roundtable to inform the relevant Chinese ministries of the views and concerns of interested U.S. trade associations. U.S. industry officials explained that the creation of a domestic software industry cut off from global standards would lead to inefficiencies and would limit, rather than promote, the development of China's software industry. At the roundtable, Chinese government officials responded that they were considering a definition for "domestic products" that would include products of foreign companies with established roots in China.

In October 2004, MOF issued a notice seeking input from foreign enterprises regarding the software procurement rules being drafted. Although no actual draft of those rules was included, it appeared that MOF was taking a very restrictive approach in defining "domestic products." Working closely with U.S. industry, the United States submitted written comments to MOF in November 2004. The United States strongly reiterated its concerns with China during bilateral meetings in Beijing and Geneva later that month.

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

To date, other than the software procurement issue, U.S. suppliers have not raised concerns with the U.S. Government about the operation of China's government procurement system, although U.S. and other foreign suppliers have limited opportunities for participation in procurement bidding. The United States will continue to monitor the treatment accorded to U.S. suppliers under the *Government Procurement Law* in 2006 and will continue to urge China to apply its new regulations and implementing rules in a transparent, non-discriminatory manner.

Investment

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

Beginning before its accession to the WTO, China revised its laws and regulations on foreign-invested enterprises to eliminate WTO-inconsistent requirements relating to export performance, local content and foreign exchange balancing as well as technology transfer. However, some of the revised laws and regulations continue to "encourage" technology transfer, without formally requiring it. U.S. companies remain concerned that this "encouragement" in practice can amount to a "requirement" in many cases, particularly in light of the high degree of discretion provided to Chinese government officials when reviewing investment applications. Similarly, some laws and regulations "encourage" exportation or the use of local content. Moreover, according to U.S. companies, some Chinese government officials in 2005 – even in the absence of encouraging language in a law or regulation – still consider factors such as export performance and local content when deciding whether to approve an investment or to recommend approval of a loan from a Chinese policy bank, which is often essential to the success of an investment project. The United States and other WTO members, including the EC and Japan, raised concerns in this area during the transitional reviews conducted by the TRIMS Committee in 2002, 2003, 2004 and 2005. The United States will continue to follow this situation closely in 2006.

In a separate commitment, as previously reported, China agreed to revise its Industrial Policy for the Automotive Sector to make it compatible with WTO rules and principles by the time of its accession. However, China missed this deadline, and U.S. industry reported that some local officials were continuing to enforce the WTO-incompatible provisions of the policy. In mid-2003, China began circulating a draft of a new automobile industrial policy for review by select domestic enterprises, and some of these enterprises forwarded the draft to their foreign joint venture partners. It was the United States' understanding that this draft, among other things, discouraged the importation of auto parts, sought to restrict imports of complete knocked-down auto kits, and set targets encouraging the use of domestic technology. China was also reportedly considering a requirement that separate distribution channels be used for domestic and imported autos.

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

The United States continued to press China bilaterally on this issue in 2004. In May 2004, China issued the final version of its new automobile industrial policy. This policy had been revised to eliminate any requirement that separate distribution channels be used for domestic and imported autos, although it continued to include provisions discouraging the importation of auto parts and encouraging the use of domestic technology. This policy also required new automobile and automobile engine plants to include substantial investment in research and development facilities, even though China expressly committed in its WTO accession agreement not to condition the right of investment on the conduct of research and development. The United States, the EC and Japan raised concerns and sought clarifications about various aspects of this policy during the transitional reviews before the Committee on Market Access, the TRIMS Committee and the Council for Trade in Goods in September, October and November 2004.

In 2005, China began to issue measures implementing the new automobile industrial policy. One measure that has generated strong criticism from the United States, the EC and Japan is the *Measures on the Importation of Parts for Entire Automobiles*, which was issued by the NDRC in February 2005 and became effective in April 2005.

These new auto parts rules require manufacturers in China to register the parts they use in the assembly of new automobiles to determine whether the parts that have been imported can be deemed to have formed the features of an entire automobile once the parts have been assembled within China. If the number or value of imported parts exceeds specified thresholds, China's General Administration of Customs will apply the tariff rate assessed a complete automobile on each of the various imported parts rather than the tariff rate applicable to an individual part. China's bound and applied tariff rates for complete automobiles are significantly higher than the tariff rates for imported auto parts. Consequently, application of these rules appears to result in the imposition of a tariff on auto parts in excess of the bound rate.

The *Measures on Importation of Parts for Entire Automobiles* also specify certain key parts and assemblies that must be manufactured locally in China. If they are instead imported, they will face the higher tariff rate assessed a complete automobile. This aspect of the new rules therefore appears to improperly condition tariff treatment on local content, contrary to Article III of GATT 1994 and the commitment in China's accession agreement to eliminate all local content requirements relating to importation.

The United States raised its concerns with the *Measures on Importation of Parts for Entire Automobiles* throughout 2005. Even though China has been slow to implement these rules, the uncertainty that they create distorts the auto parts trade. At the July 2005 JCCT, China agreed to review these rules in light of the United States' concerns. The United States subsequently raised its concerns multilaterally through the transitional review before the WTO Committee on Market Access, held in October 2005, as did the EC and Japan. In November 2005, the United States again pressed China for action during high-level meetings in Beijing, but China indicated that it was still reviewing the rules. The United States will continue to press China on these issues and will take further appropriate actions seeking elimination of China's discriminatory tariff treatment.

China issued another major industrial policy – the Steel and Iron Industry Development Policy – in July 2005. Although many aspects of this new policy have not yet been implemented, it still includes a host of objectives and guidelines that raise serious concerns.

This policy restricts foreign investment in a number of ways. For example, it requires that foreign investors possess proprietary technology or intellectual property in the processing of steel. Given that foreign investors are not allowed to have a controlling share in steel and iron enterprises in China, this requirement would seem to constitute a *de facto* technology transfer requirement, in conflict with the commitment in China's accession agreement not to condition investment on the transfer of technology.

This policy also appears to discriminate against foreign equipment and technology imports. Like other measures, this policy encourages the use of local content by calling for a variety of government financial support for steel and iron projects utilizing newly developed domestic equipment. Even more troubling, however, it calls for the use of domestically produced steel-manufacturing equipment and domestic technologies whenever domestic suppliers exist, apparently in contravention of the commitment in China's accession agreement not to condition the right of investment or importation on whether competing domestic suppliers exist.

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

To date, the United States has raised its various concerns with China's new steel policy principally through the transitional reviews before the Committee on Import Licensing, the TRIMS Committee and the Subsidies Committee, held in September and October 2005. Other WTO members, including Canada, Mexico, the EC and Japan, have also expressed their similar concerns. The United States will continue to closely scrutinize the steel policy and its implementation in 2006, particularly in light of the sharp increase in steel exports from China in 2005 and predictions that Chinese steel production will far exceed demand in 2006.

Meanwhile, in January 2005, the State Council issued a revised *Sectoral Guidelines Catalogue for Foreign Investment*. Like the prior version of this catalogue, issued in March 2002, the revised catalogue continued to reflect China's decision to adhere to its commitment to open up certain sectors to foreign investment, including travel agencies, human resources companies, cinemas, railway cargo and publications distribution (see the Services section below), with one exception. China continued to place the importation of books, magazines and newspapers in the "prohibited" category, despite having committed in its WTO accession agreement to make the right to import these products available to all enterprises, including Chinese-foreign joint ventures and foreign enterprises (and foreign individuals), by December 11, 2004 (as discussed above in the Trading Rights section). In addition, while China also continued to allow foreign investment in a number of sectors not covered by its WTO accession agreement, one notable exception to this progress is the area of production and development of genetically modified plant seeds, which China still places in the "prohibited" category.

Agriculture

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

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

TRQ administrator, the SDPC (and later the NDRC), and to require it to operate with transparency and according to precise procedures for accepting quota applications, allocating quotas and reallocating unused quotas.

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

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

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

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

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

Overall, very limited progress was achieved in 2005 in resolving contentious issues, as China's compliance efforts in the agriculture sector continued to reflect the government's extensive intervention in the market. While tariff reductions have certainly encouraged U.S. exports to China, which continued to reach record highs, the increases have largely been the result of greater demand. At the same time, a variety of non-tariff barriers continue to impede agricultural trade with China. In prior years, the United States and China have been able to resolve some of these issues through protracted negotiations, but this year those efforts were less successful.

On the positive side, U.S. agricultural products continued to experience strong sales to China. China is now the United States' fourth largest agricultural export market, as U.S. exports to China totaled $3.4 billion from January through September 2005, a small decrease (7 percent) over the same period in 2004, another very successful year. In fact, in 2004, U.S. exports exceeded $5.5 billion, more than twice the level in 2002 and more than five times the level in 1999. In addition, during the run-up to the April 2004 JCCT meeting, China addressed one of the most troublesome problems of 2002 and 2003 – the requirements of China's biotechnology regulations – by issuing final safety certificates for U.S. soybeans and several other products in early 2004. Meanwhile, China lifted a ban on some of the United States' non-risk bovine products imposed by China following the discovery of bovine spongiform encephalopathy (BSE) in a cow imported into the United States from Canada in December 2003, although trade in these products had not resumed as of early December 2005. China also began to follow Organization for Animal Health (OIE) guidelines in dealing with U.S. poultry exports from states in which outbreaks of Avian Influenza (AI) had been reported.

Nevertheless, serious problems continued to be encountered on many fronts. The key problems involved the non-transparent application of sanitary and phytosanitary measures, many of which appeared to lack scientific bases and impeded market access for many U.S. agricultural products, as well as unnecessary and seemingly arbitrary import inspection-related requirements. In addition, China's administration of TRQs on bulk agricultural commodities was still not functioning entirely as envisioned in China's WTO accession agreement, as it continued to be impaired by inadequate transparency.

In 2006, as in prior years, the United States will continue to pursue vigorous bilateral engagement with China in order to obtain progress on its outstanding concerns. As part of this effort, the United States will continue to use the high-level U.S.-China agricultural working group, created at the April 2004 JCCT meeting, as a vehicle to address each side's concerns in the agriculture area.

Tariffs

China implemented the required tariff changes on agricultural goods for 2005 on schedule on January 1, 2005, just as it did for industrial goods. These changes increased market access for many U.S. agricultural exporters, as China continued the scheduled reduction of tariffs on agricultural goods. As previously reported, tariffs of greatest importance to U.S. farmers and ranchers are being lowered from a 1997 average of 31 percent to 14 percent, in almost all cases over a period of five years running from January 1, 2002, or by January 1, 2006.

The tariff reductions made by China, coupled with increased demand, contributed to a marked increase in certain U.S. exports to China. Exports of some bulk agricultural commodities have increased dramatically in recent years, particularly cotton and wheat (see Tariff-rate Quotas on Bulk Agricultural Commodities section below), while exports of soybeans continued to perform strongly (see China's Biotechnology Regulations section below). Exports of forest products such as lumber performed strongly, increasing by 26 percent for the first nine months of 2005, with a projected year-end total of $477 million. Fish and seafood exports, after having increased from $119 million in 2001 to $135 million in 2002, and then to $176 million in 2003 and $258 million in 2004, rose by another 41 percent in the first nine months of 2005 and were projected to reach $363 million by the end of the year. Meanwhile, exports of consumer-oriented agricultural products increased by 4 percent from January through September 2005, when compared to the same period in 2004, yet were still projected to exceed $500 million by the end of they year.

However, the full market access potential of China's tariff cuts in 2005 was not realized for some products. As discussed below, a variety of non-tariff barriers continue to impede market access for U.S. agricultural exports to China.

China's Biotechnology Regulations

As previously reported, one of the most contentious agriculture issues that arose during China's first year of WTO membership involved new rules implementing June 2001 regulations relating to biotechnology safety, testing and labeling. The implementing rules, issued by China's Ministry of Agriculture (MOA) shortly before China's WTO accession, did not provide adequate time for scientific assessment and the issuance of formal safety certificates for biotechnology products. As the March 2002 effective date for these implementing rules approached, trade in biotechnology products began to be disrupted. The U.S. products most affected were soybeans, which had seen exports to China grow to more than $1 billion in 2001, while corn and other products, such as consumer products made from biotech commodities, remained at risk. Following concerted, high-level pressure from the United States, China agreed to a temporary solution in March 2002, which provided for a nine-month delay, effected through the issuance of temporary safety certificates, good though December 20, 2002. When it became apparent that this extension would not be sufficient, further high-level engagement produced another agreed extension until September 2003 and later an extension until April 2004. China finally issued a formal safety certificate for a U.S. biotechnology soybean variety known as Roundup Ready soybeans in February 2004. In addition, by the time of the April 2004 JCCT meeting, China had also issued formal safety certificates for six corn events, seven canola events and two cotton events. China issued a formal safety certificate for another corn event a few months later, leaving only one corn event still awaiting formal approval. China issued a formal safety certificate for this last corn event at the time of the July 2005 JCCT meeting.

With some stability added to the China soybean market through the extensions in 2003 and the issuance of the formal safety certificate for Roundup Ready soybeans in February 2004, U.S. exports of soybeans performed strongly. In 2003, U.S. soybean exports reached a record level of $2.9 billion, representing an increase of 190 percent over 2002. In 2004, U.S. soybean exports declined to $2.3 billion, although this figure was still twice the level of any year prior to 2003. In the first nine months of 2005, U.S. soybean exports totaled $1.2 billion, an increase of 28 percent over the same period in 2004, and China remained the leading export destination for U.S. soybeans.

Meanwhile, other U.S. concerns with China's biotechnology regulations and implementing rules remain. For example, China requires a product to be approved in the United States before it can be submitted in China for approval, and China allows only two new product applications each year. Both of these practices present significant and unnecessary delays for bringing U.S. goods into the China market. China's lack of clarity on the requirements applicable to products stacked with multiple traits is a cause for additional concern, as are China's sometimes duplicative and unprecedented testing requirements. A high level U.S.-China biotechnology working group that was formed in July 2002 is discussing these and other issues. In addition, a newly created sub-group of experts focuses on specific, technical issues. Together, these two groups have made substantial progress, and they will continue to work through the range of issues in 2006.

Tariff-rate Quotas on Bulk Agricultural Commodities

Another issue of particular concern involves China's commitments relating to TRQs on bulk agricultural commodities, which include several commodities of particular importance to U.S. farmers, such as wheat, corn, cotton and vegetable oils. Since SDPC (and later NDRC) began implementing these commitments following China's accession, a series of problems have undermined the market access envisioned by WTO members. Although progress has been made on some of these issues, NDRC's lack of transparency continues to create significant concern.

As previously reported, in 2002, the first year of this TRQ system, it appeared that SDPC had decided to allocate TRQs in a manner that would protect domestic farm interests and maintain the monopoly enjoyed by state trading enterprises. SDPC operated with only limited transparency, refusing to provide specific details on the amounts and the recipients of the allocations. At the same time, SDPC reserved a significant portion of the TRQs for the processing and re-export trade, despite China's commitment to provide market access and national treatment for imported products. SDPC also allocated a portion of the TRQs for some commodities in smaller than commercially viable quantities, and it employed burdensome licensing requirements. As these problems became apparent, the United States repeatedly engaged China bilaterally, at all levels of government, and it also raised its concerns at the WTO during meetings of the Committee on Agriculture. In July 2002, the United States requested formal consultations with China under the headnotes contained in China's WTO goods schedule, which took place in September 2002 in Geneva.

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

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

While these systemic changes were taking place, exports of some bulk agricultural commodities from the United States continued to show substantial increases, largely due to market conditions. In particular, despite some continuing problems with NDRC's handling of the cotton TRQs, U.S. cotton exports totaled a record $1.4 billion in 2004. In addition, U.S. wheat exports totaled $495 million in 2004, as the TRQ allocations for wheat did not appear to act as a limiting factor.

Throughout 2005, the United States continued to raise transparency and other concerns, both in bilateral meetings and during the transitional review before the WTO's Committee on Agriculture in September 2005. In 2006, the United States will continue to work to ensure that NDRC administers TRQs in a manner that is consistent with China's commitments, transparent and in a manner that does not impede market access or commercial decisions.

Sanitary and Phytosanitary Issues

In 2005, as in prior years, the United States repeatedly engaged China on a number of SPS issues, both in bilateral meetings, including high-level meetings, and during meetings of the WTO's SPS Committee, including the transitional review held in October 2005. The United States also provided technical assistance to China's regulatory authorities. As discussed below, however, little progress has been achieved to date, except in the case of the AI bans and, to a limited extent, the BSE-related ban on low-risk bovine products. The United States will continue to press for resolution of outstanding issues in 2006.

<u>BSE-Related Bans on Beef and Low-Risk Bovine Products</u>

In December 2003, China and other countries imposed a ban on U.S. cattle, beef and processed beef products in response to a case of BSE found in the United States. Since that time, the United States has repeatedly provided China with extensive technical information on all aspects of its BSE-related surveillance and mitigation measures, internationally recognized by the OIE as effective and appropriate, for both food safety and animal health. After two years, China still has not provided any scientific justification for continuing to maintain its ban, nor has it identified all of the regulatory steps that the United States needs to pursue to have the ban lifted. At the July 2005 JCCT meeting, China did finally agree to send a technical team to the United States to gather information on the United States' surveillance and mitigation measures and to follow a transparent, science-based process leading to the eventual lifting of the ban. The technical team's visit took place in late October 2005, but no further progress was evident as of early December 2005.

At the same time that it banned U.S. cattle, beef and processed beef products, China also banned low-risk bovine products, i.e., bovine semen and embryos, protein-free tallow and non-ruminant feeds and fats, even though they should be deemed tradable based on OIE guidelines regardless of a country's BSE status. After numerous bilateral meetings and technical discussions in 2004, including a visit to U.S. bovine facilities by Chinese food safety officials, China announced a lifting of its BSE-related ban for low-risk bovine products in late September 2004. However, China conditioned the lifting of the ban on the negotiation of protocol agreements setting technical and certification parameters for incoming low-risk bovine products. In November 2004, U.S. and Chinese officials finalized and signed protocols that would enable the resumption of exports of U.S.-origin bovine semen and embryos, contingent on facility certification by China's regulatory authorities, as well as a resumption of exports of U.S.-origin non-ruminant feeds and fats. In July 2005, during the run-up to the JCCT meeting, China finally announced the resumption of trade in bovine semen and embryos, following facility certifications made earlier in the year. However, by early December 2005, trade in U.S.-origin non-ruminant feeds and fats had still not resumed, as China's regulatory authorities were insisting on a series of onerous, detailed and unnecessary information requirements that are not consistent with OIE guidelines and contrast sharply with U.S. requirements. Trade in protein-free tallow had also not resumed, as U.S. and Chinese officials continue to be unable to reach agreement on provisions of a protocol.

Since the July 2005 JCCT, the United States has continued to press China for movement forward on the beef ban and for the immediate lifting of the de facto ban on low-risk bovine products, both during the transitional review before the SPS Committee, held in October 2005, and through subsequent technical meetings in Beijing. In early November 2005, the United States also raised its concerns during high-level meetings in Beijing, as did President Bush during his summit with China's President Hu in late November. The United States will continue to press China until its BSE-related bans are lifted.

Avian Influenza

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

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

As part of its ongoing dialogue with China's AQSIQ on avian influenza, the United States has presented epidemiological information in support of its request for China to lift the current import bans on poultry products from Connecticut, Rhode Island and New York.

Wheat

As previously reported, the 1999 U.S.-China Agricultural Cooperation Agreement established an agreed level of TCK fungus tolerance in U.S. wheat, and China no longer routinely blocks U.S. wheat exports from the Pacific Northwest on the basis of the TCK fungus. Nevertheless, China has imposed a maximum residue level (MRL) for selenium that is below the international standard and threatens all U.S. wheat exports to China. In addition, China has imposed an MRL for vomitoxin in wheat in the absence of any international standard. Although these measures are problematic, U.S. exports of wheat to China remained strong in 2005 (see Tariff-rate Quotas on Bulk Agricultural Commodities section above), as China does not appear to be enforcing them.

In high-level meetings in July 2005, China suggested that the two sides re-visit their agreement on TCK fungus tolerance. The United States did not agree to do so.

Zero Pathogen Standards

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

U.S. regulators are working proactively with China's regulators by providing training in the United States on topics such as pathogen reduction, with the goal of bringing China's regulatory system into line with most other WTO members' regulatory systems. As of early December 2005, China's regulators were in the process of drafting new pathogen standards.

Food Additive Standards

Another problematic area involves China's overly restrictive food additive standards. China continues to block many U.S. processed food products from entering the Chinese market by banning certain food additives that are widely used in other countries and have been approved by the World Health Organization. The most recent example is China's proposed *Hygienic Standard for Uses of Food Additives*, notified to the WTO in July 2005 so that WTO members could comment on it. This proposed technical regulation is 237 pages long and covers dozens of residues and additives for nearly 1,000 commodities. In some cases, it employs domestic nomenclature rather than internationally recognized technical terms, making it difficult to assess the impact that it would have on specific products. The United States recently submitted detailed comments on the proposed technical regulation and asked China to delay adoption of it until a thorough review could take place.

Fire Blight

China currently imposes quarantine restrictions on all but two varieties of U.S. apples and all U.S. plum varieties as well as other U.S. stone fruit, allegedly due to phytosanitary concerns regarding fire blight. However, the recent WTO Appellate Body report in *Japan - Measures Affecting the Importation of Apples* (*Japan-Apples*) has already determined that these concerns are unwarranted for imports of mature symptomless fruit. The United States urged China to allow U.S. exports of mature symptomless fruit, consistent with *Japan-Apples*, in a regular meeting of the SPS Committee in June 2005 and during the transitional review held in October 2005. To date, China has responded by insisting that it is still studying the issue. The United States will continue to press China on this issue until it modifies its overly broad restrictions on U.S. apples and stone fruit.

Inspection-related Requirements

Through two measures – the *Administrative Measures for the Entry-Exit Inspection and Quarantine for Grains and Feed Stuff*, which became effective on March 1, 2002, and the *Administrative Measures for Entry Animal and Plant Quarantine*, which became effective September 1, 2002 – AQSIQ requires importers to obtain a Quarantine Inspection Permit (QIP) prior to signing purchase contracts for nearly all traded agricultural commodities. QIPs are one of the most important trade policy issues affecting the United States and China's other agricultural trading partners.

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

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

Meanwhile, traders are hesitant to press AQSIQ for change because they would risk falling out of favor. Many traders would at least like AQSIQ to eliminate the quantity requirements that it unofficially places on QIPs. These quantity requirements have been used often by AQSIQ during peak harvest periods to limit the flow of commodity imports. Eliminating this requirement would make the QIP system more dependent on market forecast.

In 2005, little improvement in the QIP system took place. AQSIQ officials continue to insist that the QIP system ensures that an adequate number of examiners are on duty at ports when shipments arrive to certify and inspect them for quality and quantity, while the United States and other WTO members argue that there does not appear to be any scientific basis for the QIP system and that it serves as an unjust and overly restrictive barrier to trade. The United States will continue to press China on this important issue in 2006.

Export Subsidies

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

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

In 2004, trade analysts began to conclude that, because of several economic factors, including changes in the relationship between domestic prices and world prices, China is trending toward eventually becoming a net importer of corn. One result appeared to have been that China's exports were largely made on a commercial basis in 2004 and 2005, although concern remains regarding the operation of China's VAT rebate system for corn.

The United States will continue to investigate China's subsidies practices in the agriculture area in 2006 and will make every effort to ensure that any use of export subsidies is eliminated.

Intellectual Property Rights

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

Overall, China's efforts to bring its framework of laws, regulations and implementing rules into compliance with the TRIPS Agreement have been largely satisfactory, although some improvements, particularly in rapidly emerging areas such as Internet copyright protection, are still needed. Enforcement of these measures, however, remained largely ineffective in 2005, giving rise to increasingly strong concerns among U.S. industry. As one trade association representing the information technology sector explained, "[d]espite the Chinese government's serious effort to begin addressing the piracy of intellectual property, the protection of [intellectual property] remains our industry's chief concern in 2005. Indeed, the appropriation of intellectual property in China has occurred on such a massive scale that it has impacted international prices, disrupted supply chains, changed business models, and probably permanently altered the balance between tangible and intangible values contained within commercial products. U.S. companies have had their [intellectual property] appropriated within China even without engaging with China through exports or investment, and many U.S. companies, particularly in the media and entertainment, see their copied products migrate into mainland markets even while the legitimate product remains barred by regulation."

China's leaders began to demonstrate a willingness to address the United States' concerns in October 2003, when a new IPR Leading Group was formed, signaling a more focused and sustained effort by China to tackle the IPR enforcement problem. Shortly after the formation of this group, Vice Premier Wu, the group's Chair, acknowledged the problems that exist and the challenges facing China as it seeks to develop IPR protection in China, while emphasizing that the Chinese government is determined to make improvements. More recently, reflecting the high priority that the United States has placed on this issue, China's President Hu Jintao reaffirmed China's determination when he stated, during a summit meeting with President Bush in New York in September 2005, that China would "step up its efforts to protect intellectual properties . . . of all international intellectual property rights owners, including the United States." This welcome assurance from President Hu reflects added top-level support for the work of the IPR Leading Group. Sustained involvement by China's leaders is critical if China is to deliver on the commitments that it made at the April 2004 and July 2005 JCCT meetings, including China's core commitment to significantly reduce IPR infringement levels across the country.

As previously reported, the United States made IPR enforcement its highest priority during the run-up to the April 2004 JCCT meeting, as it strongly urged China in a series of high-level meetings in Washington and Beijing to take immediate action to put it on the path toward compliance with its critical TRIPS Agreement obligation to make available effective enforcement mechanisms. When the JCCT convened, China announced a comprehensive action plan on IPR enforcement, which included five major commitments, although China's efforts to implement these commitments were mixed.

First, and most importantly, China agreed that it would significantly reduce IPR infringement levels. Nevertheless, IPR infringement in China remains rampant, and IPR infringement levels reported by U.S. industry have not improved. Second, China committed that it would take steps by the end of 2004 to increase penalties for IPR violations by subjecting a greater range of violations to criminal investigation, applying criminal sanctions to the import, export, storage and distribution of pirated and counterfeit products and applying criminal sanctions to on-line piracy. China did take some steps to increase penalties for IPR violations, as China's Supreme People's Court and Supreme People's Procuratorate issued a judicial interpretation in December 2004 redefining the criteria for commencing criminal prosecutions and reaching criminal convictions. Nevertheless, while this judicial interpretation has generated improvements, it did not address deficiencies in China's criminal law still in need of correction. Third, China committed to crack down on IPR violators by conducting nation-wide enforcement actions and increasing customs enforcement actions. Vice Premier Wu launched this crack down at the time of the Xiamen China International Fair for Investment and Trade in August 2004. However, a lack of transparency hinders an assessment of the disposition of any ensuing enforcement and customs actions. Official Chinese statistics are expected in early 2006. Fourth, China committed to improve protection of on-line works by ratifying and implementing the World Intellectual Property Organization (WIPO) Internet-related treaties as soon as possible, and by extending an existing ban on the use of pirated software in government offices. Although China has not yet ratified the WIPO Internet-related treaties, the Chinese government did extend its ban on the use of pirated software in government offices. Fifth, China committed to launch a national IPR education campaign. China followed through on this commitment by launching a national public awareness campaign to educate the Chinese public on IPR protection, which included radio and televison programs, newspaper inserts, awards and national and local level training programs. The campaign also included the introduction of a television program, "Intellectual Fortune," which is broadcasted in 20 provinces nationwide, the publication of an English language insert in the China Daily English-language newspaper on intellectual property, and radio broadcast programs, among other targeted efforts. The long-term impact of these efforts is currently unclear.

At the April 2004 JCCT, China also agreed to establish an IPR working group that would function under the auspices of the JCCT to consult and cooperate with the United States on the full range of IPR issues described in China's action plan. Two working group meetings have since been held. Both of these meetings have proven effective at bringing the full-range of U.S. and Chinese government IPR experts together to begin addressing problems prevalent in the bilateral trade relationship.

In early 2005, the United States conducted an out-of-cycle review under the Special 301 provisions of U.S. trade law. This review involved a systematic evaluation of China's entire IPR enforcement regime, supported by submissions from U.S. manufacturers and businesses to document IPR infringement to the extent possible. The review's findings confirmed that China had not resolved critical deficiencies in its IPR enforcement regime, as IPR infringement remained at epidemic levels. In the results of this review, the United States elevated China to the Special 301 "Priority Watch" list and set forth a comprehensive strategy for addressing China's ineffective IPR enforcement regime, which included the possible use of WTO mechanisms, as appropriate.

The United States immediately began to pursue this strategy during the run-up to the July 2005 JCCT meeting, as the United States sought to strengthen the commitments that China had made at the April 2004 JCCT meeting and to obtain China's commitment for greater involvement of its police authorities in IPR enforcement matters. China subsequently agreed to (1) increase criminal prosecutions for IPR violations in absolute numbers and also relative to the total number of IPR administrative enforcement cases, (2) reduce exports of infringing goods by issuing regulations to ensure the timely transfer of cases for criminal investigation, (3) improve national police coordination by establishing a coordinating group in the Ministry of Public Security responsible for overall research, planning and coordination of all IPR criminal enforcement to ensure a focused and coordinated nationwide enforcement effort, (4) enhance cooperation on law enforcement matters with the United States by immediately establishing a bilateral IPR law enforcement working group focusing on the reduction of cross-border infringement activities,
(5) expand an ongoing initiative to aggressively counter piracy of movies and audio-visual products, (6) complete its program ensuring that only licensed software is use by all central, provincial and local government offices by the end of 2005 and extend this program to enterprises in 2006, (7) fight software end-user piracy by declaring that it is considered to constitute "harm to the public interest" and therefore is subject to administrative penalties

nationwide, (8) establish an IPR ombudsman in the Chinese embassy in Washington to assist U.S. companies, particularly small- and medium-sized companies, experiencing IPR problems, (9) develop measures to rid trade fairs of fake goods, (10) join the WIPO Internet-related treaties in 2006, and (11) clarify the December 2004 Judicial Interpretation to make clear that its criminal thresholds apply to sound recordings and that exporters are subject to independent criminal liability.

To date, China has already taken several steps to implement these commitments. Nevertheless, the overall results of China's efforts remain unclear, largely because of transparency problems associated with IPR enforcement activities in China. For example, China will not make public enforcement decisions made by administrative authorities. China has issued statistics that appear to show some increase in enforcement activities, but there is no evidence of any corresponding reduction in IPR infringement levels.

In October 2005, the United States submitted a request to China under Article 63.3 of the TRIPS Agreement The United States' request seeks detailed information from China on its IPR enforcement efforts over the last four years, as do similar requests submitted simultaneously by Japan and Switzerland. China's response to these requests, anticipated in early 2006, will be a key test of whether it is serious about resolving the rampant IPR infringement found throughout China. The United States remains prepared to take whatever action is necessary and appropriate to ensure that China develops and implements an effective system of IPR enforcement, as required by the TRIPS Agreement.

Legal Framework

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

As previously reported, U.S. experts carefully reviewed China's new IPR laws, regulations and implementing rules and, together with other WTO members, participated in a comprehensive review of them as part of the first transitional review of China before the TRIPS Council in 2002. In 2003, China issued several new measures in the patent, trademark and copyright areas, which were reviewed during the transitional review before the TRIPS Council in November 2003. While this process identified various areas where China could make improvements, and the United States and U.S. industry continue to press China to do so, overall the legal changes made by China through 2003 were major improvements that moved China generally in line with international norms in most key substantive areas.

In the trademark area, some progress was made in 2004 on the recognition of foreign well-known marks, more than a year after the issuance of implementing rules on well-known marks, as a handful of foreign marks have been recognized as well-known. In addition, in June 2005, the Trademark Administration circulated draft amendments to its *Regulations on the Timely Transfer of Suspected Criminal Cases in the Enforcement of Administrative Law*, which are designed provide guidance to regional industrial and commercial administrations in facilitating effective trademark enforcement and protection.

With regard to copyright protection over information networks, in November 2004, the National Copyright Administration of China and the Ministry of Information Industry (MII) jointly organized a hearing on draft implementing rules known as the *Draft Measures for Administrative Protection of Copyright on the Internet*. The Chinese authorities issued these rules in final form in April 2005. The rules require Internet service providers to take remedial actions to delete contents that infringe on copyrights upon receipt of a complaint from the right holder, or face administrative penalties ranging from confiscation of illegal gains to fines of up to RMB 100,000 ($12,000). In September 2005, China circulated a more important Internet-related measure for public comment, the draft *Regulations on the Protection of Copyright Over Information Networks*. This development is welcomed by the United States as a concrete step in line with China's April 2004 JCCT commitments to improve protection of electronic data while China continues its preparations for accession to the WIPO Internet-related treaties. U.S. industry subsequently submitted written comments on the draft regulations, and China invited the United States to assist in organizing a meeting with U.S. and other foreign rights holders to discuss the draft regulations. The final version of the regulations is expected to be issued in 2006.

Although China is not obligated under WTO rules to accede to the WIPO Internet-related treaties, the United States considers these treaties to reflect international norms for providing copyright protection over the Internet. These treaties entered into force in 2002 and have been ratified by many developed and developing countries. While China's existing regulations and implementing rules do address certain copyright issues related to the Internet, and China is in the process of drafting further revisions, the United States has urged China for some time to accede to the WIPO Internet-related treaties and fully harmonize its regulations and implementing rules with them. These steps are especially important in light of the rapidly increasing number of Internet users in China, most of whom have broadband access. At the April 2004 JCCT meeting, China agreed to ratify and implement the WIPO Internet-related treaties as soon as possible. At the July 2005 JCCT meeting, the United States obtained China's commitment to submit the legislative package necessary for China's accession to the WIPO Internet-related treaties to the National People's Congress by June 2006.

MOF and other relevant agencies are currently drafting regulations that require central government ministries and agencies to use only legitimate software products and that encourage these ministries and agencies to add funds to their budgets to cover legitimate software purchases. These draft regulations directly address China's April 2004 and July 2005 JCCT commitments to extend an existing ban on the use of pirated software in central, provincial and local government agencies. They reportedly will be ready for circulation for public comment before the end of 2005.

In furtherance of China's April 2004 JCCT commitment to increase border measures protecting against the import and export of infringing products and to make it easier for rights-holders to secure effective enforcement at the border, the Customs Administration issued the *Regulations on Customs Protection of Intellectual Property Rights*, which went into effect in March 2004. The Customs Administration subsequently issued implementing rules for these regulations, effective July 2004. These regulations and implementing rules addressed the duties of the Customs Administration and improved guidance on the implementation of the customs IPR recordal mechanism. In other areas, however, the regulations and implementing rules lacked clarity or could have benefitted from further changes, such as with regard to the storage and disposition of infringing goods and the transferral of cases for possible criminal prosecution. Meanwhile, in September 2004, the Customs Administration issued new regulations on administrative penalties in the customs context, the *Implementing Regulations for the Imposition of Administrative Penalties by the General Administration of Customs*, effective November 2004. In an apparent improvement over the prior regulations, these new regulations do not impose a "knowledge" requirement before penalties can be imposed. However, the new regulations provide for fines not to exceed 30 percent of the value of the goods confiscated, or RMB 50,000 ($6,000), whichever is lower. In contrast, the prior regulations allowed for fines up to the full value of the goods confiscated. The fines allowed under the new regulations are also lower than those imposed by other Chinese agencies focusing on domestic IPR infringement. At present, the effectiveness of these various regulations and implementing rules remains in doubt, as exports of counterfeit and pirated goods from China are increasing, facilitated by trading rights liberalization and the rapid growth of Internet usage and e-commerce.

The United States has urged China to pursue additional legislative changes to improve the legal framework supporting enforcement, particularly in the area of criminal enforcement. For example, the criminal enforcement legal framework could be improved through the removal of various evidentiary thresholds, the "for profit" requirement in the copyright area, the "identical trademark" requirement and the distinction between individual and enterprise liability. In addition, by not making retail sales of counterfeit and pirated goods subject to criminal penalties, and instead only making them subject to China's largely ineffective administrative enforcement system, China's legal framework has created a "safe harbor" for retailers that operates to deprive the criminal enforcement authorities of needed information regarding the sources of counterfeit and pirated goods.

The United States also remains concerned about weaknesses in China's legal framework that encourage or support counterfeiting and piracy. Some of these weaknesses have facilitated the establishment of Chinese companies under the false appearances of foreign companies, the squatting of foreign company names, designs and trademarks, and the theft of trade secrets. In addition, restrictions on market access for legitimate movies, music, software and books and built-in delays in the marketing approval system for pharmaceuticals have created incentives for counterfeiting and piracy that are difficult to address through the existing legal framework.

Enforcement

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

In 2002, shortly after China acceded to the WTO, one trade association explained that "[e]ffective enforcement against [IPR] infringement in China is universally recognized as the chief concern of [IPR] rights-holders, as piracy rates in China in all areas, including copyright, trademark and patents, continue to be excessively high." This statement was consistent with figures released by the State Council's Development Research Center in July 2003, which showed that the market value of counterfeit and pirated goods in China was between $19 billion and $24 billion in 2001, translating into enormous losses for IPR rights-holders.

In 2005, nearly four years after China's accession to the WTO, U.S. rights-holders uniformly report that IPR infringement in China remains rampant. Indeed, some trade associations report that the situation confronting U.S. rights-holders in 2005 remains unchanged from 2004. Other trade associations report that the situation has actually worsened. U.S. rights-holders uniformly urge the Chinese government to accelerate its reforms in order to significantly reduce IPR infringement levels.

IPR infringement in China in 2005 continued to affect products, brands and technologies from a wide range of industries, including films, music, publishing, software, pharmaceuticals, chemicals, information technology, consumer goods, industrial goods, food products, medical devices, electrical equipment, automotive parts and clothing, among many others. This situation not only has had an enormous economic impact, but also presents a direct challenge to China's ability to regulate many products that have health and safety implications for China's population and, as an increasing amount of counterfeit and pirated products are being exported from China, for others around the world.

The United States places the highest priority on addressing IPR enforcement problems in China, and since 2004 it has devoted additional staff and resources, both in Washington and in Beijing, to address these problems. While a domestic Chinese business constituency is increasingly active in promoting IPR enforcement, it is clear that there will continue to be a need for sustained efforts from the United States and other WTO members, along with the devotion of considerable resources and political will to IPR enforcement by the Chinese government, if significant improvements are to be achieved on this front.

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

In addition, the United States has worked to block counterfeit and pirated goods at the U.S. border. Since 2000, seizures of counterfeit and pirated goods at U.S. land borders and seaports are up 125 percent. The number of U.S. International Trade Commission proceedings instituted to enforce intellectual property rights and to prevent imports of infringing goods from China and other countries is up more than 80 percent over the last five years, when compared to the previous five years. Morever, in October 2004, the United States announced the most comprehensive initiative ever advanced to combat the enormous global trade in counterfeit and pirated goods. That initiative, the Strategy Targeting Organized Piracy (STOP!), is a U.S. government-wide effort to empower U.S. businesses to secure and enforce their intellectual property rights in overseas markets, to stop fakes at the U.S. borders, to expose international counterfeiters and pirates, to keep global supply chains free of infringing goods, to dismantle criminal enterprises that steal U.S. intellectual property and to reach out to like-minded U.S. trading partners in order to build an international coalition to stop counterfeiting and piracy worldwide.

Below, the three different mechanisms for IPR enforcement created by China's IPR laws and regulations – enforcement by administrative authorities, criminal prosecutions and civil actions for monetary damages – are examined. As the United States and other WTO members have been urging, China needs to take immediate steps to improve each of these enforcement mechanisms, particularly criminal enforcement, in line with the minimum standards for IPR enforcement established by the TRIPS Agreement.

Administrative Enforcement

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

Although the central government continues to promote periodic anti-counterfeiting and anti-piracy campaigns, and these campaigns in the short term result in high numbers of seizures of infringing materials, they are largely ineffective. For one thing, the cases subsequently brought by the administrative authorities usually result in low fines. When the administrative authorities decide on fines, the fine amounts are kept artificially low because many administrative authorities do not treat the infringing goods as having the value of the genuine articles, but rather establish value based on the price charged for the counterfeit or pirated goods. In addition, evidence showing that a person was caught warehousing infringing goods is not sufficient to prove an intent to sell them, and as a result the administrative authorities will not even include those goods in the value of the infringing goods when determining the fine amounts.

The lack of deterrence from the fines is compounded by the fact that the administrative authorities rarely forward an administrative case on to the Ministry of Public Security for criminal investigation, even for commercial-scale counterfeiting or piracy. Statistics provided by China confirm this fact. In 2004, according to these statistics, only 96 out of 51,851 administrative trademark cases (approximately 0.2%) and 101 out of 9,691 administrative copyright cases (approximately 1.0%) were transferred for criminal prosecution. These statistics showed no improvement over 2001, when the corresponding statistics similarly indicated very low transfer rates of 0.2% for administrative trademark cases and 1.5% for administrative copyright cases. As a result, the infringers continue to consider the seizures and fines simply to be a cost of doing business, and they are usually able to resume their operations without much difficulty.

At the 2005 JCCT meeting, as discussed above, China committed to increase the number of criminal IPR prosecutions relative to the number of administrative IPR cases. Since then, China has prepared and made available for public comment draft rules to facilitate the transfer of administrative cases for criminal enforcement. The United States has submitted written comments on these draft rules, which are expected to be finalized by the end of 2005. China is working separately on draft rules for the transfer of customs cases for criminal enforcement.

Meanwhile, China's administrative enforcement efforts have also failed to put an end to open and notorious IPR infringement at trade fairs, retail markets and wholesale markets throughout China. The United States has urged China to step up efforts at retail markets such as the "Silk Street" market in Beijing and wholesale markets such as Xiangyang in Shanghai, Yiwu in Yiwu City, and Lowu in Shenzhen. At major trade fairs, exhibitors displaying infringing goods in the past have escaped with only non-deterrent administrative penalties. China pledged to address the trade fair problem as part of its July 2005 JCCT commitments, and it is expected to issue final measures designed to improve administrative IPR enforcement at trade fairs, including provisions enhancing on-site complaint centers at major fairs, by the end of 2005.

The Customs Administration developed an action plan in mid-2004 calling for increased enforcement over exports of infringing goods, in conformity with China's April 2004 JCCT commitments. Currently, China's share of U.S. seizures of exports of counterfeit and pirated goods remain very high, although mid-year 2005 U.S. Customs and Border Patrol seizure data did show a modest decrease in seizures of infringing imports from China as compared with the same period in 2004, both in terms of aggregate value and percentage of total seizures.

Criminal Enforcement

In the view of the United States and U.S. industry, the most critical steps for China to take in improving its IPR enforcement are in the criminal area. Effective criminal enforcement is a core WTO obligation, and it offers the deterrence needed for China to begin to handle the rampant IPR infringement hurting both foreign and domestic enterprises. For this reason, the United States sought and obtained at the April 2004 and July 2005 JCCT meetings commitments by China to apply criminal sanctions to a wider range of IPR-infringing activities, to increase the penalties for IPR violations, to increase the number of criminal prosecutions for IPR violations, to reduce exports of infringing goods through the timely transfer of cases for criminal investigation, to improve national police coordination, and to ensure that its criminal thresholds apply to sound recordings and that exporters are subject to independent criminal liability.

At present, although the number of criminal prosecutions has increased, criminal prosecutions remain relatively low in relation to administrative cases, and they have not created an adequate deterrent for IPR infringers. U.S. companies also continue to complain that, in most regions of China, the police are either not interested in pursuing counterfeiting and piracy cases or simply lack the resources and training required to investigate these types of cases effectively. Moreover, even when IPR violations are referred for criminal enforcement, the actual prosecution of IPR crimes frequently requires coordination among a relatively large number of agencies at the national and local levels. Coordination remains problematic, however, with different agencies using different standards to determine whether criminal conduct exists and some agencies apparently unwilling or unable to work together.

Civil Enforcement

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

Services

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

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

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

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

As the fourth year of China’s WTO membership nears its completion, challenges remain in securing the benefits of many of these commitments. According to a trade association with broad representation among U.S. service suppliers, “China’s compliance with its [WTO] commitments remains a significant problem almost 4 years after accession. U.S. companies still face complex barriers, including many that were due to be dismantled in whole or in part pursuant to China’s WTO commitments.” Another trade association explained, “In many instances, PRC regulators are using a two-pronged approach to implement China’s services commitments. . . . China often enacts basic laws that ‘allow’ or ‘permit’ new investment in previously restricted sectors as required by WTO commitments, but sets the bar for entry prohibitively high. American investors in China’s service sectors say these restrictions and the lack of transparency in the regulatory system prevent complete market openings.”

As in prior years, while China continued to keep pace nominally with the openings required by its WTO accession agreement, it continued to maintain or erect terms of entry in some sectors that were so high or cumbersome as to prevent or discourage foreign suppliers from gaining market access. For example, excessive and often discriminatory capital requirements continued to restrict market entry for foreign suppliers in many sectors, such as insurance, banking, securities, asset management, freight forwarding, telecommunications and non-bank motor vehicle financing, among others. In addition, in sectors such as insurance and legal services, branching restrictions have been put into effect that call into question commitments made by China in its Services Schedule. In other sectors, particularly construction services, problematic measures appear to be taking away previously acquired market access rights.

Progress was made on some fronts in 2005. For example, China took steps to open up health, group and pension/annuity insurance markets to foreign participation as it had committed to do, and it lifted geographic restrictions in the banking sector on or ahead of schedule.

Meanwhile, the licensing process in many sectors continued to proceed in a workman-like fashion, although national treatment concerns remained, particularly in the banking and insurance sectors. The *Administrative Licensing Law*, which took effect in July 2004, has also increased transparency in the licensing process, while reducing procedural obstacles and strengthening the legal environment for domestic and foreign enterprises.

Financial Services

<u>Banking</u>

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

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

As previously reported, shortly after China's accession to the WTO, the People's Bank of China (PBOC) issued regulations governing foreign-funded banks, along with implementing rules, which became effective February 1, 2002. The PBOC also issued several other related measures. Although these measures kept pace with the WTO commitments that China made, it became clear that the PBOC had decided to exercise extreme caution in opening up the banking sector. In particular, it imposed working capital requirements and other prudential rules that far exceeded international norms, both for the foreign banks' headquarters and branches, making it more difficult for foreign banks to establish and expand their market presence in China. Many of these requirements, moreover, do not apply equally to foreign and domestic banks. For example, a foreign bank branch licensed to conduct business in all currencies for both corporate and individual clients must satisfy an operating capital requirement of RMB 500 million ($60 million), while a domestic bank branch with the same business scope needs only RMB 300 million ($36 million) in operating capital. In addition, the PBOC allowed foreign-funded banks to open only one branch every 12 months.

In several bilateral meetings following China's WTO accession, the United States urged the PBOC to reconsider its prudential requirements and to bring them in line with international norms. Together with other WTO members, the United States also raised these same concerns during meetings of the WTO's Committee on Trade in Financial Services, including the transitional reviews held in 2002 and 2003. In December 2003 and July 2004, some progress took place, as the PBOC reduced working capital requirements for various categories of foreign banks. With the issuance of the *Implementing Rules for the Administrative Regulations on Foreign-Invested Financial Institutions* in July 2004, the China Banking Regulatory Commission (CBRC) also removed the restriction that had limited foreign-funded banks to opening only one new branch every 12 months. Nevertheless, the United States, along with Australia, Canada, the EC and Japan, continued to urge China to make its banking sector more accessible to foreign banks, as reflected in the transitional review before the Committee on Trade in Financial Services, held in 2004 and 2005.

Meanwhile, China kept up with its commitment regarding the lifting of geographic restrictions on domestic currency business. In December 2004, CBRC opened up five additional cities to foreign banks seeking to conduct domestic currency business, including two cities (Xian and Shenyang) one year ahead of the commitment in China's Services Schedule. In early December 2005, CBRC announced the opening of seven more cities, which is five more than the two cities (Shantou and Ningbo) scheduled to be phased in by December 11, 2005. As a result, foreign banks are now able to conduct domestic currency business in 25 Chinese cities.

By October 2005, despite high capital requirements and other impediments, 173 foreign banks, including a number of U.S. banks, had branches or representative offices in China, although only major banks have been large enough to satisfy the application requirements. In addition, the business that foreign banks were most eager to pursue in China – domestic currency business – had expanded tremendously, although China's regulatory authorities continued to shield domestic banks from foreign competition in some areas, such as by limiting product innovation by foreign banks. According to the PBOC and CBRC, the domestic currency business of U.S. and other foreign banks grew rapidly in the first two years after China's WTO accession, even though the banks' clients were then limited to foreign-invested enterprises and foreign individuals. Following the PBOC's December 2003 announcement that foreign banks would be permitted to conduct domestic currency business with Chinese enterprises subject to previously permitted geographic restrictions, as required by China's WTO commitments, the growth in U.S. and other foreign banks' domestic currency business accelerated. By October 2005, the total assets of foreign banks in China reportedly had reached $84.5 billion, representing approximately 2 percent of the total banking assets in China. In some coastal cities, the amount was higher. For example, in Shanghai, foreign banks' assets reportedly represented 12.4 percent of total banking assets.

One area in which China has fallen behind in its WTO commitments involves the establishment of Chinese-foreign joint banks. In the Services Schedule accompanying its WTO accession agreement, China agreed that qualified foreign financial institutions would be permitted to establish Chinese-foreign joint banks immediately after China acceded, and it did not schedule any limitation on the percentage of foreign ownership in these banks. To date, however, China has limited the equity share of a single foreign investor in a Chinese-foreign joint bank to 20 percent, while the total equity share of all foreign investors is limited to 25 percent. The United States and other WTO members have urged China to relax these limitations during the transitional reviews before the Committee on Trade in Financial Services, including in 2005.

China has committed to remove all ownership limitations in the banking sector by December 2006, when the five-year phase-in period for banking services by foreign banks ends. The United States will closely monitor how China implements this commitment.

Insurance

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

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

China also made additional significant commitments relating specifically to branching. China scheduled a commitment to allow non-life insurance firms to establish as a branch in China upon accession and to permit internal branching in accordance with the lifting of China's geographic restrictions. China further agreed that foreign insurers already established in China that were seeking authorization to establish branches or sub-branches would not have to satisfy the requirements applicable to foreign insurers seeking a license to enter China's market.

As previously reported, CIRC issued several new insurance regulations shortly after acceding to the WTO, including ones directed at the regulation of foreign insurance companies. These regulations implemented many of China's commitments, but they also created problems in three critical areas – capitalization requirements, transparency and branching. In particular, the capitalization requirements imposed by the regulations were significantly more exacting than those of other populous countries with no less an interest in preserving a healthy insurance market, and they limited the ability of foreign insurers to make necessary joint venture arrangements. The regulations also lacked adequate transparency, as they continued to permit considerable bureaucratic discretion and to offer limited predictability to foreign insurers seeking to operate in China's market. Meanwhile, notwithstanding several important commitments on branching, the regulations are vague on foreign insurers' branching rights, and CIRC has often been reluctant to provide clarifications.

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

Following further bilateral meetings in 2003, including the February 2003 Trade Dialogue in Beijing, China issued draft implementing rules in August 2003. Although these draft rules demonstrated some progress with regard to capitalization requirements and transparency, the United States made clear in written comments that more progress was needed. The United States also continued to press its concerns, particularly with regard to branching, in high-level meetings in Beijing in September and October 2003, during the November 2003 Trade Dialogue meetings, and at the transitional review before the Committee on Trade in Financial Services in December 2003.

In May 2004, CIRC issued final implementing rules, the *Detailed Rules on the Regulations for the Administration of Foreign-Invested Insurance Companies*. These new rules lowered capital requirements for national licenses from RMB 500 million ($60 million) to RMB 200 million ($24 million) and for branch offices from RMB 50 million ($6 million) to RMB 20 million ($2.4 million). These changes were welcomed by some U.S. insurers, but others still considered the capital requirements to be too high. The new rules also streamlined licensing application procedures and shortened approval times, although some procedures remained unclear. Meanwhile, the new rules did not adequately address branching rights, as many aspects of this area remained vague.

At this time, U.S. and other foreign insurers also began to complain about another issue, not addressed by the new rules issued in May 2004. In practice, it appeared that established Chinese insurers were being granted new branch approvals on a concurrent basis, meaning more than one branch at a time. In contrast, foreign insurers so far have only received approvals on a consecutive basis, meaning one branch at a time.

At the April 2004 JCCT meeting, the United States had sought and obtained a commitment from China to re-start the CIRC working group, so that U.S. regulators and insurers could discuss the range of insurance issues with CIRC officials. The United States attempted to schedule these discussions shortly after the May 2004 implementing rules were issued, but without success. Later in the year, the United States raised its concerns in the insurance area during the transitional review before the Committee on Trade in Financial Services, held in November 2004, with support from Canada and Japan. At about the same time, CIRC agreed to schedule the next working group meeting in early 2005. The CIRC working group meeting finally took place in April 2005. It provided a useful forum for U.S. and Chinese industry experts to join U.S. and Chinese government representatives in a discussion of a broad range of concerns. Not long thereafter, at the July 2005 JCCT meeting, China agreed to make CIRC available for another working group meeting by the end of 2005. That meeting is currently scheduled to take place in December 2005.

Meanwhile, by the end of 2004, CIRC had lifted all geographic restrictions applicable to foreign life insurers on or ahead of schedule. In 2002, CIRC approved life insurance operations for U.S. insurers in Beijing, Suzhou and Tianjin, two years before China had committed to do so in its Services Schedule. In 2003, CIRC approved life insurance operations for a U.S. insurer in Chongqing nearly one year ahead of schedule. In December 2004, CIRC took the final step of removing all remaining geographic restrictions, as it had committed to do.

In 2005, with all geographic restrictions removed and most business scope restrictions lifted, the operations of foreign insurers in China continued to grow. Currently, 37 foreign insurers operate in China, including a large number of U.S. insurers. While foreign insurers had only a three percent share of the national market in 2005, they continued to capture encouraging market shares in major coastal municipalities and were looking to broaden their presence in China. However, as one trade association explained, "[a]chieving broad national access will require that issues related to branching – the greatest concern for foreign insurers in China – be adequately addressed and resolved."

In 2006, as in prior years, the United States will continue to use CIRC working group meetings and the transitional reviews before the Committee on Trade in Financial Services to address and resolve issues of concern to U.S. insurers, especially in the area of branching. The United States is committed to seek market access for U.S. insurers on a fair and equitable basis.

Motor Vehicle Financing

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

Despite these commitments, China did not open up this sector to foreign financial institutions upon its accession, leaving China's commercial banks as the only financial institutions able to offer auto loans. It was not until the end of its second year of WTO membership that China finally issued the measures necessary to allow foreign financial institutions to apply for licenses to offer auto loans. As previously reported, the Chinese regulator, CBRC, issued the long-awaited regulations permitting foreign financial institutions to offer auto loans in October 2003. One month later, CBRC issued implementing rules setting forth the procedures for foreign financial institutions to apply for licenses to begin operations. Although the regulations reduced the capital requirements from the levels set in earlier circulated drafts, they still remain relatively high, as the minimum registered capital is RMB 300 million ($36 million), and the minimum paid-in capital is RMB 500 million ($60 million).

During the November 2003 Trade Dialogue meetings, the United States urged CBRC to reconsider the high capital requirements and also emphasized the importance of quick action by CBRC on license applications, as U.S. companies were beginning to take steps to obtain licenses to begin operations. In addition, the United States began to work closely with the U.S. companies to ensure that CBRC acted promptly on their applications. In January 2004, CBRC granted licenses for one U.S. auto company and two other foreign auto companies to set up non-bank motor vehicle financing institutions. CBRC granted licenses for other foreign auto companies later in the year as well. In subsequent bilateral meetings and during the transitional review before the Committee on Trade in Financial Services, the United States, with support from Australia, Canada, the EC and Japan, continued to urge China to increase market access in this sector, particularly for small and medium-sized enterprises, by lowering the capital requirements established by CBRC's regulations.

In August 2004, the PBOC and CBRC jointly issued the *Administrative Rules on Auto Financing*, which became effective in October 2004. These rules set forth administrative requirements and risk management rules for extending auto loans in China. With these rules in place, the licensed companies could actually begin operations.

In 2005, the United States worked closely with U.S. companies to ensure that they were able to operate in the manner envisioned by China's WTO commitments. The United States will continue to monitor developments in this area in 2006.

Financial Information Services

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

Nevertheless, China has still not established an independent regulator in the financial information services sector. Xinhua, the Chinese state news agency, is both a major market competitor of, and the regulator of, foreign financial information service providers in China.

As problems with Xinhua's regulation of this sector mounted in 2005, U.S. and other foreign financial information service providers began to call for the establishment of an independent regulator. The United States and the EC both raised concerns about this issue during the transitional review before the WTO's Committee on Trade in Services, held in September 2005. The United States, in coordination with the EC, will continue to press China on this issue in 2006.

Legal Services

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

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

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

As previously reported, in consultation with U.S. law firms, the United States carefully reviewed the new regulations and implementing rules and expressed its concerns in written comments. The United States held a series of subsequent bilateral meetings with China's Ministry of Justice and MOFTEC and later MOFCOM. In addition, together with the EC and other WTO members, the United States continued to present its concerns to China in connection with the annual transitional reviews before the Council for Trade in Services.

To date, although a number of U.S. and other foreign law firms have been able to open a second office in China, little progress has been made on the problematic aspects of the new measures, particularly the economic needs test, the unreasonable restrictions on the types of legal services that can be provided and the unnecessary delays that must be endured when seeking to establish new offices. These obstacles continue to prevent foreign law firms from participating fully in China's legal market. The United States will continue to engage China in 2006 in an attempt to resolve these outstanding concerns.

Telecommunications

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

Importantly, China also accepted key principles from the WTO Reference Paper on regulatory principles. As a result, China became obligated to separate the regulatory and operating functions of MII (which had been both the telecommunications regulatory agency in China and the operator of China Telecom) upon its accession. China also became obligated to adopt procompetitive regulatory principles, such as cost-based pricing and the right of interconnection, which are necessary for foreign-invested joint ventures to compete with incumbent suppliers such as China Telecom, China Netcom and China Unicom.

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

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

Another problem area developed in April 2003, when MII issued its Catalogue of Telecommunications Services. MII reclassified several telecommunications services from the value-added category to the basic category, without notice or a public comment period and contrary to widely accepted international practice. MII also placed restrictions on what new services could be classified under the value-added category. These moves have limited the ability of U.S. firms to access China's telecommunications market because, under China's Services Schedule, basic services are on a slower liberalization schedule, and MII subjects them to higher capitalization requirements. Indeed, MII requires suppliers of basic services to satisfy an excessive registered capital requirement of RMB 2 billion ($241 million). A review of capital requirements around the world shows essentially no capital requirements in many WTO member markets, including, for example, Argentina, Australia, Brazil, Chile, the member States of the European Union, Japan and the United States. Where capital-related requirements do exist, they typically take the form of guarantees. For example, Korea requires a $2.5 million bank guarantee or performance bond, while India requires a bank guarantee ranging from $5 million to $80 million, depending on geographic scope.

Meanwhile, MII continues to process applications very slowly for the few foreign-invested telecommunications enterprises that have attempted to satisfy MII's licensing requirements. As China nears the end of its fourth year of WTO membership, the United States is aware of only one application for a license to provide value-added services that has completed the MII licensing process. That license was awarded to a Chinese-Korean joint venture earlier this year.

Overall, no meaningful progress took place in 2005 in the telecommunications services sector. Even though China has nominally kept to the agreed schedule for phasing in its WTO commitments, MII's imposition of excessive capital requirements and MII's reclassification of value-added services as basic services, together with MII's lengthy license application process, have continued to present formidable barriers to market entry for foreign enterprises.

A draft of the long-awaited *Telecommunications Law* began to circulate among Chinese ministries and agencies in 2004. If China takes the initiative, this law could be a vehicle for addressing existing market access barriers and other problematic aspects of China's current telecommunications regime. The United States and other WTO members have repeatedly urged China to circulate the draft law for public comment, although to date China has not done so.

The United States has raised its many concerns in this area with China, using both bilateral meetings, including the Trade Dialogues in February and November 2003, and the transitional reviews before the Council for Trade in Services in 2002, 2003 and 2004, where it has received support from the EC and Japan. In 2005, in addition to raising its concerns again during the transitional review before the Council for Trade in Services, the United States also sought progress through the July 2005 JCCT meeting. At that meeting, the United States was able to persuade China to commit its telecommunications regulator, MII, to a bilateral working group to discuss capitalization requirements, resale services and other issues agreed to by the two sides. The first meeting of this working group is scheduled to take place in January 2006.

Construction and Related Engineering Services

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

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

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

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

Throughout 2004 and 2005, the United States engaged both the Ministry of Construction and MOFCOM in an effort to obtain improvements in Decree 113. The United States also sought the opportunity to comment on a draft of the implementing rules for Decree 114, which has still not yet been circulated. The United States will continue to press its concerns in 2006.

Meanwhile, in November 2004, the Ministry of Construction issued a measure – the *Provisional Measures for Construction Project Management* – that restricts the provision of project management services. This measure, known as Decree 200, became effective in December 2004 and appears to preclude the same company from providing construction services and project management services on a single project. This aspect of Decree 200 raises concerns because U.S. companies often provide integrated construction services packages – combining management, design, and construction services – in project delivery systems in overseas markets. No implementing rules for Decree 200 have been issued to date.

Express Delivery Services

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

Nevertheless, shortly after becoming a WTO member, China issued two problematic measures. These measures required Chinese and foreign-invested international express delivery companies, including those that were already licensed by MOFTEC to provide international express delivery services (except for the delivery of private letters), to apply for and obtain so-called "entrustment" authority from China's postal authorities, China Post, their direct competitor, if they wanted to continue to provide express delivery services. The measures also placed new weight and rate restrictions on the letters that the companies could handle, assuming that they could obtain entrustment authority, in apparent contravention of China's horizontal "acquired rights" commitment (discussed at the beginning of the Services section). Working closely with U.S. express delivery companies and other affected WTO members, particularly the EC and Japan, the United States led a sustained effort that eventually convinced China to revise these measures. In September 2002, China issued a new measure, which eliminated the weight and rate restrictions and eased burdensome aspects of the entrustment application process. In bilateral meetings, China also provided assurances that the regulatory and operational functions of China Post would be split up and that MOFTEC would seek to ensure that China Post did not abuse its regulatory authority. Subsequently, in October 2002, China issued another measure streamlining the entrustment application process even further and effectively eliminated China Post's ability to exercise its discretionary authority to reject entrustment applications from foreign-invested express delivery companies already licensed by MOFTEC. The measure also provided that these companies do not have to apply for separate entrustment certificates for existing or new branches.

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

In July 2003, China began circulating draft amendments to its postal services law, which generated two immediate concerns among U.S. companies. In the ensuing months, in response to numerous interventions by the United States and other WTO members, China issued a series of revisions to these draft amendments. Despite these revisions, the last version of the draft amendments circulated in 2003 was still problematic on several fronts. First, the draft amendments purported to give China Post a monopoly over the delivery of letters under 500 grams, which would have constituted a new restriction on the scope of activities of existing foreign-invested express delivery companies, contrary to China's horizontal "acquired rights" commitment. Second, the draft amendments did not address the need for an independent regulator. Third, the draft amendments appeared to create a new, more burdensome licensing process to replace the existing entrustment process, and they also seemed to require express couriers to pay four percent of their revenue from the delivery of letters into a universal service fund.

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

In bilateral meetings and during the transitional reviews before the WTO's Council for Trade in Services in 2004 and 2005, the United States continued to raise its concerns with the draft amendments to the postal services law, with support from the EC. The United States will continue to work closely with U.S. express delivery companies in 2006 in urging China to issue a sensible and WTO-consistent set of amendments.

Aviation Services

As previously reported, even though China made no WTO commitments to open up its aviation services sector, it took a significant step in July 2004 to increase market access for U.S. service providers. China signed a landmark aviation agreement with the United States that will more than double the number of U.S. airlines operating in China and that will increase by five times the number of flights providing passenger and cargo services between the two countries over the next six years. The agreement also allows each countries' carriers to serve any city in the other country, provides for unlimited code-sharing between them, expands opportunities for charter operators, grants cargo carriers the right to provide door-to-door delivery services, and eliminates government regulation of pricing as of 2008. U.S. airlines and U.S. express delivery companies have since obtained additional routes and increased flight frequencies, as envisioned by the agreement.

Maritime Services

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

Other Services

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

In some sectors, China has actually gone beyond its commitments. For example, even though China had only committed to permit majority foreign-owned joint ventures in the convention services sector, MOFCOM opened this sector to wholly foreign-owned enterprises in February 2004.

In other sectors, however, such as audio-visual services, China has been less willing to increase market access for foreign service providers. Despite the fact that its restrictive approach encourages the illegal copying and sale of foreign films in China, China continues to treat its commitment to allow the importation of 20 foreign films per year for theatrical release on a revenue-sharing basis as a ceiling rather than a floor and further constrains the timely release of these films through distribution and marketing restrictions and lengthy film approval requirements. The United States raised these concerns with China at high levels in 2004 and again in 2005, including through the July 2005 JCCT meeting, in an attempt to obtain better, and more useful, market access for U.S. service providers. These efforts generated some progress in 2004 when MOFCOM approved a U.S.-invested film distribution joint venture and took steps to shorten the time required to bring films to market. However, no further progress has been made since then.

Legal Framework

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

Transparency

Public Comment

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

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

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

In 2004, some improvements took place, particularly on the part of MOFCOM, which began following the rules set forth in its *Provisional Regulations on Administrative Transparency*, issued in November 2003. Those rules could potentially serve as a model for other ministries and agencies seeking to improve their transparency. Nevertheless, basic compliance with China's notice-and-comment commitment continued to be uneven, both in 2004 and 2005. For example, China did not provide for public comment on major trade-related laws and regulations, such as the April 2005 *Measures on the Importation of Parts for Entire Automobiles.* In the area of intellectual property rights, however, a number of ministries and agencies circulated proposed measures for public comment in 2005.

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

In numerous bilateral meetings with the State Council, MOFCOM and other Chinese ministries since China's WTO accession, including high-level meetings, the United States has emphasized the importance of China's adherence to the notice-and-comment commitment in China's accession agreement, both in terms of fairness to WTO members and the benefits that would accrue to China. In addition, the United States continues to provide technical assistance to facilitate Chinese ministries' understanding of the workings, and benefits, of an open and transparent rulemaking process. Together with other WTO members, the United States also raised this issue during regular WTO meetings and as part of the transitional reviews conducted in 2002, 2003, 2004 and 2005 before various WTO councils and committees. The United States will continue to work to secure China's full compliance with this fundamental commitment in 2006.

Official Journal

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

China has yet to either establish or designate an official journal for this purpose. Rather, China currently relies on multiple channels, including ministry websites, newspapers and a variety of journals, to provide information on trade-related measures. The establishment or designation of a single journal would greatly enhance the ability of WTO members to track the drafting, issuance and implementation of trade-related measures. Furthermore, the use of a single journal to request comments on proposed trade-related measures, as envisioned in China's WTO accession agreement, would facilitate the timely notification of comment periods and submission of comments.

The United States pressed its concerns in this area most recently during the transitional review before the Council for Trade in Goods, held in November 2005. China responded that MOFCOM was working toward the goal of a single official journal, while China also intended to maintain many of the existing channels to achieve optimal transparency. The United States will continue to work with China and other interested WTO members in 2006 to secure China's full compliance with this commitment.

Enquiry Points

Another important transparency commitment requires China to establish enquiry points, where any WTO member or foreign company or individual may obtain information. As previously reported, China complied with this obligation by establishing a WTO Enquiry and Notification Center, now operated by MOFCOM's Department of WTO Affairs, in January 2002. Other ministries and agencies have also established formal or informal, subject-specific enquiry points.

Since the creation of these various enquiry points, U.S. companies have generally found these various enquiry points to be responsive and helpful, and they have generally received timely replies. In addition, some ministries and agencies have created websites to provide answers to frequently asked questions as well as further guidance and information.

Uniform Application of Laws

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

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

In 2002, China also established an internal review mechanism, now overseen by MOFCOM's Department of WTO Affairs, to handle cases of non-uniform application of laws. The actual workings of this mechanism still remain unclear in 2005, however.

During 2005, as in prior years, some problems with uniformity persisted. These problems are discussed above in the sections on Customs and Trade Administration, Taxation, Investment and Intellectual Property Rights.

Judicial Review

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

Beginning before China's accession to the WTO, China had taken steps to improve the quality of its judges. For example, in 1999, the Supreme People's Court began requiring judges to be appointed based on merit and educational background and experience, rather than through politics or favoritism. However, existing judges, many of whom have had no legal training, were grandfathered in. In part because of this situation, many U.S. companies in 2005 continued to express serious concern about the independence of China's judiciary. In their experience and observation, Chinese judges are often influenced by political, government or business pressures, particularly outside of China's big cities.

Meanwhile, in 2005, the United States continued to monitor how the courts designated by the Supreme People's Court's *Rules on Certain Issues Related to Hearings of International Trade Administrative Cases*, which went into effect in October 2002, have handled cases involving administrative agency decisions relating to international trade in goods or services or intellectual property rights. So far, however, there continues to be little data, as few foreign companies have had experience with these courts.

APPENDIX 1

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

1. National Electrical Manufacturers Association
2. U.S. Council for International Business
3. United States Information Technology Office
4. Information Technology Association of America
5. American Iron and Steel Institute
6. Wal-Mart
7. American Apparel & Footwear Association
8. American Forest & Paper Association
9. American Chemistry Council
10. American Dehydrated Onion and Garlic Association
11. U.S. Wheat Associates
12. U.S. Grains Council
13. Dewey Ballantine
14. Stewart and Stewart
15. Northern Mariana Islands
16. Distilled Spirits Council of the United States
17. National Association of Manufacturers
18. Society of Plastics
19. The Free Jude Shao Campaign

APPENDIX 2

List of Witnesses
Testifying at the Public Hearing
before the Trade Policy Staff Committee
on China WTO Compliance
Washington, D.C.
September 14, 2005

1. John Frisbie
   President
   U.S.-China Business Council

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

3. Jeff Bernstein
   Chairman
   American Chamber of Commerce-Shanghai
   on behalf of American Chamber of Commerce-China
   and American Chamber of Commerce-Shanghai

4. Robert Vastine
   President
   Coalition of Service Industries

5. Bill Primosch
   Senior Director, International Business Policy
   National Association of Manufacturers

6. Eric H. Smith
   President
   International Intellectual Property Alliance

7. Joe Damond
   Deputy Vice President, International Division
   Pharmaceutical Research and Manufacturers of America