PEOPLE'S REPUBLIC OF CHINA

The 1998 U.S. trade deficit with China reached $56.9 billion, an increase in the deficit of $7.2 billion from 1997. U.S. exports to China in 1998 totaled $14.3 billion, representing an increase of more than 11 percent from the previous year, making China the 12th largest U.S. export market. U.S. imports increased by $8.6 billion to $71.2 billion in 1998. In 1997, U.S. foreign direct investment (FDI) in China was $5 billion, primarily concentrated in the manufacturing, energy, and financial sectors. U.S. actual and contractual foreign direct investment in China for 1998 stood at USD 3.2 billion and USD 5.1 billion respectively, matching 1997 levels. U.S. FDI in China again has been concentrated largely in the manufacturing and petroleum sectors.

IMPORT POLICIES

China restricts imports through a variety of means, including high tariffs and taxes, non-tariff measures, limitations on which enterprises can import, and other barriers. For example: China has used prohibitively high tariffs -- which in late 1998 still reached over 100 percent on some motor vehicles -- in combination with other import restrictions and foreign exchange controls to protect its domestic industry and restrict imports. These high nominal tariff rates -- to which China adds applicable value-added taxes and, on some goods, consumption taxes -- contribute to inefficiencies in China's economy and pose a major barrier to U.S. commercial opportunities.

While China has generally met the requirements of the 1992 market access memorandum of understanding (MOU) to remove various explicit nontariff barriers, such as quotas and licensing requirements, China still maintains a large number of nontariff administrative controls to implement its trade and industrial policies.

Tariffs and Taxes

Until the mid-1990s, China's tariffs were often high enough to preclude most imports. In 1996, China lowered its average import tariff from 42.1 percent to 23 percent, and on October 1, 1997, further lowered the average import tariff to 17 percent. On January 6, 1999, the Minister of Finance announced that there would be further tariff cuts for 1,014 products in the forestry, textile and toy sectors retroactively effective January 1. Despite these reductions, U.S. industry continues to express concern that tariff rates for sectors in which China is seeking to build its international competitiveness, such as chemicals and motor vehicles, remain extremely high. In the 1996 and 1997 tariff reductions, the largest cuts were reserved for products that are imported in small volumes.

According to China Customs trade data, China's total imports in 1997 decreased 1.23 percent, while imports from the United States increased 4.35 percent. For 1998, total imports dropped to USD 144.4 billion, while imports from the United States as measured by China Customs increased 1.5 percent for the same period.

In addition to high tariff rates, unpredictable application of those rates creates difficulties for companies trying to export to, or import into, the Chinese market. Tariffs may vary for the same product, depending on whether the product is eligible for an exemption from the published NTR tariff. Tariffs may also vary depending on the geographical point of entry. Also, local tariffs may be applied to imports even after the importer paid the national tariff at the port.

High-technology items whose purchase is incorporated into state plans, for instance, have been imported at tariff rates significantly lower than the published NTR rate. China implemented a new import tariff-exemption plan for some goods under revised investment guidelines on January 1, 1998. The Plan is designed to increase investment in high-tech manufacturing by domestic and foreign firms.

China's Customs General Administration (Customs) has also granted preferential tariff rates through special exemptions or more informal means. For example, in notices issued on July 10, 1997, China Customs granted 20 percent import duty rates to two Chinese automobile manufacturers for their imports of certain automobile parts. The Notices cited domestic content exceeding 80 percent in sedans manufactured by the two automobile manufacturers as the basis for granting preferential import duties on parts imported by the two manufacturers. China's 1998 import tariff schedule shows automotive part duties ranging as high as 50 percent on parts from MFN trading partners.

U.S. and other foreign businesses selling goods into China also complain about the lack of uniformity in customs valuation practices. Different ports of entry may charge significantly different duty rates on the same products. Because there is flexibility at the local level in deciding whether to charge the official rate, actual customs duties, like many taxes, are often the result of negotiation between business persons and Chinese Customs officers. Allegations of corruption often result. In August 1998, Customs launched an ambitious program to standardize regulatory enforcement as part of an anti-smuggling campaign. Early reports indicate that the program has reduced the flexibility of local customs offices to 'negotiate' duties but it is too early to measure the permanent effects of the program on customs enforcement.

China has taken steps to reduce tariffs pursuant to its bilateral commitments and to support its WTO accession bid. Many tariff reductions are still under negotiation in the context of WTO discussions with 36 trading partners. U.S. and Chinese negotiators continue to discuss the specific rates to be applied to the many items of export interest to U.S. companies.

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

As a means of stimulating the flagging export sector, the state administration of taxation raised VAT rebates three times in 1998. From January 1, rebate rates on textile exports were increased two percentage points to eleven percent. In June, rebate rates for exports of ships, steel, cement and coal were also raised to eleven percent. In August, rebate rates for exports of telecommunications, power generating, agricultural and engineering machinery, automobile parts, bicycles, timepieces, shoes ceramics and lighting equipment were increased from nine to eleven percent, retroactive to July 1. The effectiveness of the rebate program has been offset by operational inefficiencies. Exporters complain that it takes several months to obtain the rebates and amounts are often miscalculated.

On October 1, 1997, China introduced a sliding duty on newsprint for which the United States has been an important supplier. The sliding duty is sensitive to import prices, and as import prices drop, the duty payable increases to as high as 45 percent for newsprint from NTR trading partners. China's previous ad valorem duty rate on newsprint was 15 percent in 1996. It has been the practice for Chinese buyers to purchase large quantities of newsprint on the international spot market when prices are low. Following a petition filed by domestic newsprint producers, however, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), working with the State Economic and Trade Commission (SETC), decided to implement the sliding duty. In addition, in late 1997, China launched an antidumping investigation against Canadian, Korean and U.S. newsprint producers. On July 10, 1998, MOFTEC announced a preliminary determination that newsprint from the three countries had been dumped in China at margins of up to 78.93 percent below domestic prices. On an interim basis, importers of newsprint from the three countries must post cash guarantees equal in value to the margin assessed against it. A final determination on the case is expected to be announced early in 1999.

Nontariff Measures

Nontariff barriers to trade are administered at national and subnational levels by the SETC, the State Planning Commission (SPC), and MOFTEC. China's traditional nontariff barriers include import and export licenses, import quotas, and other import controls. The levels of specific nontariff barriers are the result of complex negotiations between the central government and various ministries, state- owned corporations and trading companies.

Central government agencies determine the levels of import quotas through data collection and negotiating sessions. Officials at central and local levels evaluate the need for -- or quantitative restrictions on -- particular products for individual projects. Once "demand" is determined, central government agencies allocate quotas that are eventually distributed nationwide to end-users and administered by local branches of the central government agencies concerned. China provides little transparency regarding the quantity or value of products to be imported under a quota.

MOFTEC uses import licenses to exercise an additional, nation-wide system of control over some imports. Many products are subject both to quotas and also to import licensing requirements. For these products, after permission has been granted by other designated agencies for importation, MOFTEC must decide whether to issue a license. MOFTEC officials claim that import licenses are issued automatically once other agencies have approved an import.

China has removed over 1,000 quotas and licenses on a wide range of key U.S. exports such as telecommunications digital switching equipment, computers, many agricultural products, and medical equipment. Despite the removal of these quotas and license requirements, required under the 1992 MOU, there are indications that China is erecting new barriers to restrict imports. During 1998, China drafted new pharmaceutical price control regulations which will restrict profit margins on sales of many pharmaceuticals, issued a requirement that new power plants of less than 600mw use no foreign equipment (though government authorities have insisted that this decision originated with the power companies themselves), imposed a ban on the import of diesel and gasoline, and initiated a "buy local" campaign intended to diminish reliance on imports of telecommunications equipment and components. In addition, restrictive trading rights have affected crude oil imports, even though quotas have been removed.

China announced in early 1996 that, effective April 1, 1996, tariff-rate quotas (TRQs) would apply to imports of wheat, corn, rice, soybeans, and vegetable oils. By late 1998, China had still not announced TRQ administration rules or quota volumes, perhaps because this issue is being negotiated as part of its WTO accession. Out-of-quota tariff rates are as high as 121.6 percent. A lack of clarity and information complicates trade in these goods.

On January 1, 1999, China Customs announced that the number of products requiring export licenses had been cut from 707 to 395, a 44 percent reduction. Products still requiring licenses included mostly raw materials, lethal chemicals and food products. Some manufactured goods -- certain kinds of textiles, electric fans, computers, black and white televisions and bicycles -- are also included.

Transparency

The 1992 bilateral market access MOU laid the foundation for China to improve significantly the transparency of its trade regime, including the publication of a central repository for all central government trade regulations and publication in the provinces of all trade and investment-related trade regulations. The MOFTEC gazette was established to carry official texts of all trade-related laws and regulations at the national level. The gazette has contributed significantly towards transparency, but it is sometimes incomplete and not always timely. Moreover, it does not feature laws and regulations from other agencies which can have a significant impact on U.S. firms.

In addition, the Chinese Government has established several web sites (among which www.cei.gov.cn and www.moftec.com.cn are the most significant) in Chinese and English which carry government news and the texts of newly promulgated laws and regulations.

The opaque nature of customs and other government procedures, however, still compromises the important steps taken towards improving transparency in the import approval process, especially for industrial goods.

Trading Rights and Other Restrictions

China restricts the types and numbers of entities that have the legal right to engage in international trade. Only those firms with import trading rights may bring goods into China. In addition, some goods that are of great commercial value to both China and its trading partners, such as grains, cotton, vegetable oils, petroleum and certain related products are imported principally through state trading enterprises.

In some cases, specific bureaus or ministries impose informal market access barriers for imports that fall under their jurisdiction. Some agencies require that only a certain group of companies be allowed to import; end users are sometimes required to obtain purchase certificates before they can receive permission to import.

As a result, China's real demand for these types of imported products greatly exceeds the supply available through the official system. For example, U.S. industry estimates that, prior to the summer 1998 customs crackdown, only five percent or less of imported distilled spirits entered the Chinese market through official channels. Thus a large quasi-illegal "grey market" for products such as spirits, consumer electronics, computer equipment, cigarettes and automobiles grew up around the official system. The growth of the grey market resulted in revenue losses for China due to corruption and smuggling.

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

Import Substitution Policies

Import substitution has been a longstanding Chinese trade policy. Nonetheless, in the 1992 MOU, China stated that it had eliminated all import substitution regulations, guidance, and policies, and that it would not subject any products to import substitution measures in the future. This constituted a commitment, for example, that a Chinese Government agency would no longer deny permission to import a foreign product because a domestic alternative exists.

Despite this commitment, in late 1998 the Ministry of Information Industries (MII) issued a circular instructing telecom companies to buy components and equipment from domestic sources. Also in 1998, the Chinese Government announced that power generation facilities of 600 mw or smaller could not use imported equipment. Another example was China's 1994 automotive industrial policy that included import substitution requirements. This policy, designed to foster development of a modern automobile industry in China, explicitly called for production of domestic automobiles and automobile parts as substitutes for imports, and establishes local content requirements, which would force the use of domestic products, whether comparable or not in quality or price. China's industrial ministries can have considerable impact on U.S. firms through import substitution policies.

In December 1998, the state council released new pharmaceutical pricing regulations, effective January 1, 1999. The regulations discriminate against imported products. Price formulas vary based on whether domestic substitutes exist and receipt of certain benefits (such as exceptions from limits on profits) has been conditioned upon whether a product replaces an import.

The United States is consulting with China bilaterally and in the context of its WTO accession negotiations on the elimination of these policies and ensuring that future policies do not contain such provisions.

STANDARDS, TESTING, LABELING AND CERTIFICATION

China maintains statutory inspection requirements (conformity assessment procedures) on about 780 imported goods, and an even greater number of items are subject to statutory inspection requirements upon export from China. In addition to these conformity assessment inspections, China also imposes safety licensing requirements on certain products. On January 1, 1999, China imposed mandatory safety inspections for imports of electronic products, including personal computers, monitors, printers, switches, television sets and stereo equipment. This measure further stipulates that as of January 1, 2000, these same products will require an import commodity safety license.

In the context of China's WTO accession negotiations, China has identified over one hundred tariff-line items that are subject to safety licensing requirements. Major problems with China's standards system include the lack of transparency, difficulty in determining the appropriate standards, use of different standards on imports from different countries and different standards from domestic goods, and adoption of unique standards that differ from international standards for no identifiable reason.

China passed the "import and export commodity inspection law" establishing a separate regime for safety inspections of imported goods on February 2, 1989. The first catalog of nine commodities covered by the law was announced on August 1, 1989, with compliance required as of may 1, 1990. A second catalog of commodities covered by the law was announced on August 1, 1995, and contained a list of 38 categories of equipment, the first 20 of which became subject to safety inspection and certification on October 1, 1996. The last 18 of these equipment categories became subject to safety inspection and certification as of October 1, 1997.

As noted, U.S. and other foreign traders often encounter difficulty in learning which Chinese standards apply to their goods. Officials of the state administration entry-exit inspection and quarantine (now under the jurisdiction of the Customs Administration) have said that for some goods for which China has not yet developed its own standards, the standards of the country of origin will apply. Therefore, a particular good from the United States may have to meet a different standard at the Chinese point of entry than does the same good taken from the European Union.

For manufactured goods, China requires that a quality license be issued before the goods can be imported into China. With a few exceptions, China does not accept U.S. certification of product quality or manufacturing procedures. Obtaining quality licenses to export to China can be time-consuming and expensive. While the inspection and licensing requirements vary according to commodity, U.S. industry considers most to be burdensome and contrary to the principles of the WTO Agreement on Technical Barriers to Trade.

The 1992 market access MOU requires that China apply the same standards and testing requirements to nonagricultural products, whether foreign or domestic. The United States and other foreign suppliers have complained, however, that the safety and inspection procedures applied to foreign products are more rigorous than those applied to similar domestically-produced products. Foreign suppliers have also had difficulty in learning exactly how and by whom inspections are conducted. For some types of product inspections, China does not use the same inspection agency for domestic and imported goods.

China's phystosanitary and veterinary import quarantine standards are often overly strict, unevenly applied, and not backed up by modern laboratory techniques. An example was China's use of past Mediterranean fruit fly occurences in certain areas as a reason to ban the entry of citrus fruit from all parts of the United States. The Chinese Government also continues to require foreign pesticide producers to submit to costly testing and registration procedures, but does not apply these requirements to domestic producers. U.S. companies report that complying with these regulations costs more than USD 5 million per agriculture chemical.

China committed in the 1992 Market Access MOU to base its agricultural import standards on "sound science." since 1992, China has made some progress on agricultural sanitary and phytosanitary issues, signing bilateral protocols for several agricultural items, including live horses (September 1994); apples from Washington, Oregon and Idaho (April 1995); ostriches, bovine embryos, swine, and cattle (June 1995); cherries from Washington (March 1996) and grapes from California (may 1997). However, China's sanitary and phytosanitary measures still prohibit imports of U.S. citrus, plums, and pacific northwest wheat.

In early 1997, China announced a one-year trial period for imports of meat for the retail market. Under this scheme, China allows meat imports into the general market from selected plants in three countries (Australia, Canada and the United States) during an indefinite 'trial' period which began on June 1, 1997. Only five U.S. plants were approved to export a total of 26,800 MT of beef, pork, turkey and poultry. As of January 1999, no meat had been imported under this project. With a tariff of 45 percent and a VAT of 13 percent, informal importing channels are preferred. Access for meat and poultry from other plants are limited to use in hotels, restaurants and food processing facilities in China. In addition, pork imports face restrictive import licensing requirements: licenses are only issued by the State Administration for Entry-exit Administration and Quarantine (SIQ) in Beijing. The industry estimates that up t USD 400 million worth of U.S. chicken parts made their way to China through Hong Kong in both 1997 and 1998; total U.S. beef, pork and poultry direct exports in China amounted to just over USD 60 million.

GOVERNMENT PROCUREMENT

China's government purchasing actions and decisions are subject to China's general laws, regulations and directives. Despite its commitment under the 1992 Market Access MOU to publish all laws and regulations affecting imports and exports, China has not yet published any laws or regulations regarding its government procurement practices. Although one government entity, the national tendering center for machinery and electrical appliances, published a tendering guide, procurement procedures are unclear and lack transparency.

The State Development and Planning Commission (SDPC) began drafting a national procurement law for China in 1997. The draft law was forwarded to the State Council in late December 1998 and approval is expected in March 1999. Once promulgated, the law will include ten regulations on procurement of goods and services, especially in construction and for the military; scientific research projects; charges for bidding agencies; qualifications for bidding agencies; disputes in procurement procedures; and the establishment and discipline of bid evaluation committees.

Like many countries with developing procurement markets, two types of procurement exist in China:

-- procurement funded by the world bank or other international organizations and

-- procurement funded by the Chinese Government.

For projects using foreign loans provided by international organizations such as the World Bank, a loan condition requires that tendering procedures comply with standards set by the subsidiaries of state-owned trading companies or the state council's national tendering center for machinery and electrical equipment. The Chinese Government seldom uses the same transparent and competitive bidding procedures in procurement it funds. In fact, most of these procurements allow for preferential treatment of domestic suppliers' goods and services. Even when procurements are open to foreign bidders, such suppliers may be discouraged from bidding by the uncertainty of obtaining foreign exchange. Moreover, the Chinese Government routinely seeks to obtain offsets from foreign bidders in the form of local content requirements, technology transfers, investment requirements, counter-trade or other concessions, not required of Chinese firms. In fact, bidding documents, including those for internationally-funded procurement, often express a "preference" for offsets.

The problem of official corruption remains widespread as the government continues to call for improved self-discipline and anticorruption efforts at all levels. (Premier Zhu Rongji, in particular, has held the senior leadership charge against corrupt practices.) For procurement contracts decided according to competitive procedures, there is little direct evidence that corrupt practices have influenced awards or result in failure to enforce competitive measures. However, competitive procedures are not followed for the bulk of procurement in China. U.S. suppliers complain that bribery and corruption in China puts them at a competitive disadvantage. While this dilemma is less severe in sectors where the united states holds clear technological preeminence or cost advantages, it does undermine the long-term competitiveness of U.S. suppliers in the Chinese market.

The growth of the Chinese economy, the proportion of the economy still managed by the State, and the demand for the type of high technology goods and services that the United States provides all suggest that government procurement contracts would offer significant commercial opportunities if current restrictions and non-transparent practices were removed. Sectors of highest demand include infrastructure development (especially energy, petrochemicals, transportation and environmental protection), telecommunications and value-added services, machinery, electrical equipment and precision instruments, and certain agricultural and forest products.

EXPORT SUBSIDIES

The Chinese Government claims that direct financial subsidies on all exports including agricultural goods ended on January 1, 1991. While this may be true for direct budgetary outlays, China continues to use a variety of measures to support and promote exports. For example, Chinese exporters allegedly benefit from preferential loan policies (e.g., access to funds on non-commercial terms), preferential tax policies (e.g. reduced income taxes), and preferential energy and raw material supply policies (e.g., access to freight services and input supplies on non-commercial terms).

In December 1998, the People's Insurance Company of China (PICC) announced that it would raise the ceiling on export insurance for many countries that import Chinese commodities. MOFTEC is discussing a proposal to contribute export funds to PICC to cover part of the program, enabling the PICC to slash its fees. In addition, the export and import bank of China in late December contracted to provide the Shanghai Machinery Export and Import Co. Ltd. With export credits worth USD 180.72 million over three years. The contract will give strong support to China's exports of machinery and electronic products.

The government also generates exports by imposing export requirements on Chinese foreign trade corporations (FTCs) and foreign-invested enterprises. These requirements tend to make FTCs over export, resulting in systematic financial losses. These losses are often covered by state commercial bank loans; the chronic nature of these losses strongly suggests that much of the lending is not on strictly commercial terms. State companies are also subject to constraints that make them export in volumes not consistent with their import costs or other commercial considerations.

China is attempting to bring a greater degree of uniformity in the type and amount of taxes and duties imposed on enterprises in China, domestic and foreign- funded alike. As a result, preferential tax and duty policies that benefit exporters in special economic zones and coastal cities are being revised. It remains to be seen, however, whether uniformity will be achieved, particularly with respect to income and other direct taxes imposed on exporters.

China's recent corn exports (over 4 million metric tons in 1998) demonstrate clearly the continued willingness of parts of the Chinese Government to export. Most of China's 1998 corn exports were sold at prices USD 25 to USD 45 per metric ton below domestic wholesale corn prices. In the context of negotiations on its accession to the WTO, however, China has agreed not to use export subsidies for agricultural products. Reaching an understanding on what practices constitute subsidization is key to the value of this commitment

LACK OF INTELLECTUAL PROPERTY PROTECTION

Based on the 1995 and 1996 bilateral IPR agreements and extensive follow-up work with Chinese officials, China now has a functioning system to protect intellectual property rights (IPR). Enforcement of intellectual property rights has become part of China's nationwide anti-crime campaign; the Chinese police and court system have become actively involved in combating IPR piracy. According to Chinese Government statistics, China seized some 35 million illegal audio-visual products from 1994 to year-end 1998. It has shut down or fined 74 assembly operations for pirated VCDS and seized over 20 million smuggled VCDs during the same period.

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

Training on IPR enforcement has been a key part of building the necessary infrastructure for continuing enforcement efforts. More than 3,000 judges in China have received training on IPR laws and the subject is now taught at several major universities, including Beijing University, Harbin Engineering University and Shanghai's Fudan University. U.S. Government agencies and industry groups have provided specialized IPR training and technical assistance to Chinese Government personnel pursuant to the 1995 agreement.

The PRC Government reorganization in March 1998 abolished the State Science and Technology Commission's IPR Working Group Executive Conference, the U.S. Government's main counterpart in U.S.-China IPR negotiations. The State Intellectual Property Office (SIPO) was established on April 1, 1998 to coordinate IPR protection efforts and to take over the functions of the executive conference. MOFTEC remains a key interlocutor on the trade-related aspects of IPR.

Although China has revised its laws to provide criminal penalties for IPR violations, the U.S. remains concerned that penalties imposed by PRC courts do not act as a deterrent. Industry sources point out that unauthorized optical disks are still widely sold in China and urge better IPR enforcement at a retail level.

End-user piracy of computer software, especially the sensitive issue of piracy within PRC Government ministries, costs U.S. companies millions of dollars each year. The lack of agents in China authorized to accept trademark applications from foreign companies makes it difficult for foreigners to register trademarks. Regulations on the use of copyright agents by foreign companies have not yet been finalized; this effectively inhibits foreign companies from using agents to license copyrights. The lack of clear procedures to protect well-known trademarks makes it extremely difficult to oppose or cancel well-known marks registered by another party.

U.S. industry estimates of intellectual property losses in China due to counterfeiting, piracy, and exports to third countries have exceeded USD 2 billion. Some U.S. companies estimate losses from counterfeiting account for 15 to 20 percent of total sales in China. One U.S. consumer products company estimates that it loses USD 150 million annually due to counterfeiting, a growing problem, in China. The destructive effect of counterfeiting has discouraged additional direct foreign investment and threatened the long-term viability of some U.S. business operations in China. The inferior quality of counterfeit products also creates serious health and safety risks for consumers.

SERVICES BARRIERS

Restrictive investment laws, lack of transparency in administrative procedures and arbitrary application of regulations and laws severely limit U.S. service exports and investment in China, especially in the financial services, telecommunications, audiovisual, distribution, professional services and travel and tourism sectors.

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

Hiring issues are also complicated. Although many U.S. companies, such as those involved in joint-ventures, are allowed to hire and fire based on demand and performance and can pay wages according to market rates, the representative offices of U.S. service suppliers are still required to hire, recruit or register all local staff through state labor service companies which collect large monthly fees for each employee hired. In some services sectors, particularly professional services, there are strict limits on the hiring of Chinese professionals. Expatriate staff are also subject to strict limitations on their activities.

In line with its efforts to join the WTO, China has begun to allow greater foreign participation in a few services industries on a 'trial' basis. For example, the state council has followed up on plans announced in January 1996 to allow foreign banks in Shanghai's Pudong area to conduct local currency transactions on a restricted trial basis. To date, nine foreign banks have obtained permission to conduct local currency business in Pudong.

U.S. and other foreign financial institutions, however, still need approval -- granted on a discretionary, case-by-case basis -- for new representative offices and branches. By the end of 1998, China approved a total of 151 bank branches, seven joint-venture banks, and five wholly foreign-owned banking firms in 19 cities. The scope of activities for these banks and branches is limited almost exclusively to business denominated in foreign currencies, essentially carving out the entire domestic market and leaving only international trade- related business for foreign financial institutions. Steps by the PRC to crack down on unauthorized foreign exchange transactions in late 1998 have resulted in disruption of the operations of foreign banks and importers in China. Evidence of unauthorized capital outflows prompted the government to tighten documentation requirements, causing payment delays and increased transaction costs.

With respect to insurance services, China passed a new insurance law in 1993 and is taking steps to reform the domestic industry. In 1998, the Chinese Government created the Chinese Insurance Regulatory Commission (CIRC) to help facilitate the development of the industry in China. At present foreign insurers are, with one exception, only permitted to operate in Shanghai. Despite this restriction, by the end of 1998 over 100 foreign firms, including 23 from the U.S., had applied for permission to open branch offices in Shanghai. To date, only two U.S. firms have been allowed to operate in China. The licenses granted to foreign companies restrict each company to a narrow range of operations. Permission to compete directly with the state-run insurance company, the people's insurance company, or with other quasi-private Chinese companies such as Ping an or China Pacific, has not been granted.

In telecommunications services, U.S. companies continue to face investment barriers. Current regulations governing providers of basic and value-added telecommunications services limit the management or ownership of these types of services to domestic companies. Disturbingly, in August of 1998, the Ministry of Information Industries (MII) moved to restrict the nature and scope of foreign participation in China's telecom services market. Officials called for an end to the Chinese-Chinese-Foreign (CCF) joint venture formula that had been the only apparently legally acceptable means (though not officially sanctioned by regulation) of foreign participation in China's telecom services market. A final decision on how to deal with existing operations is still pending. Currently China Unicom has more than 40 joint venture arrangements with foreign companies. Uncertainty surrounding the future of these arrangements has effectively halted foreign investment in telecom services.

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

Audiovisual services is another sensitive area where participation by foreign firms is highly restricted, in part because of Chinese concerns about politically sensitive materials entering China. The websites of foreign news organizations are routinely blocked and news service providers remain wary that new restrictions could be imposed on their activities. Distribution of sound recordings, videos, movies, book and magazines is highly restricted. Inconsistent and subjective application of censorship regulations act as a further impediment to foreign participation in the market.

In 1998, U.S. companies involved in direct sales had their operations temporarily shut down as a result of a Chinese Government crack down on pyramid schemes. After the issue was raised by the United States, the companies were allowed to reopen but under restrictions that effectively change their business to traditional retailing. Here, as elsewhere in the retailing sector, geographic and quantitative limits on the number of services suppliers prevent firms from competing effectively against local retailers. Restrictions on the ability of foreign firms to set product prices, quantity, import composition, and quality undercut any competitive advantages foreign firms might bring to the market. Foreign retailers are also only allowed to sell the products of their parent company and cannot engage in the sale of domestic goods.

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

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

China has permitted the establishment of foreign law firms in designated cities on a case-by-case basis only. As of February 1998, China had licensed 93 foreign law firms, of which almost 30 were U.S. firms, in 15 cities. China limits a firm's practice to a single city and foreign attorneys are not permitted to employ Chinese lawyers or establish partnerships or form other types of associations with Chinese lawyers or law firms.

Accounting services are almost as restricted. In accounting, China limits the scope of activities for representative offices to consultancy. In addition, China is imposing forced localization. For example, foreign partners in accounting firms must gradually reduce their equity share to 33 percent by 2001.

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

INVESTMENT BARRIERS

Although official Chinese policy views foreign investment as critical to the country's economic development plans, the Chinese Government continues to maintain barriers and controls on foreign investment, channeling it toward areas that support Chinese Government development policies. China encourages foreign investment in priority infrastructure sectors such as energy production, communications, agriculture, forestry, environmental protection and transportation, and restricts or prohibits it in sectors where China's planners have not determined that China has a specific need or where China wants to protect a domestic industry.

China issued new foreign investment guidelines, effective January 1, 1998, and provided a revised list of sectors, in which foreign investment is encouraged, restricted or prohibited. According to the investment guidelines, the Chinese Government still prohibits foreign investment for projects with objectives not in line with the State Plan. In addition, there are many areas in which foreign investment is technically allowed but severely restricted. Restricted categories generally reflect:

-- the protection of domestic industries, such as the services sector, in which China fears its domestic market would quickly be dominated by foreign firms;

-- the goal of limiting luxuries or requiring large imports of components or raw materials; and

-- the avoidance of redundancy (i.e. excess capacity).

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

Examples of investment restrictions are abundant. For example, China bans investment in the management and operation of basic telecommunications, all aspects of value-added telecommunications as well as in the news media, broadcast and television sectors -- citing "national security interest." In addition, China severely restricts investment in the rest of the services sector, including distribution, trade, construction, tourism and travel services, shipping, advertising, insurance and education. Foreign firms are forced into joint venture arrangements in which they are often required to sell down to minority positions over a specified time period. Finally, China hinders foreign investment and distorts trade by insisting on fulfillment of contract-specific local content and mandatory transfer requirements if companies are to import under anything other than prohibitive tariff rates.

Once in the market, foreign ventures face numerous problems because of the uncertain investment climate created by policy vacillations and the uneven implementation of laws and regulations. China has taken steps to address investors' complaints regarding the inadequacies of protection for foreign investment, such as amending its joint venture law to prohibit the expropriation or nationalization of joint ventures without cause and compensation. While this action is a step in the right direction, the law continues to fall short of international standards sought by the United States. Other legislative actions have promised greater autonomy and incentives for foreign- invested ventures, but these laws have been haphazardly enforced, if at all.

In addition, the designation of key state enterprises in many industries as the exclusive basis for the development of critical technologies limits the choice of joint venture partners. Designated partners are frequently unattractive for various business reasons such as lack of experience, inappropriate staffing levels, and outdated equipment.

While foreign-invested enterprises may have a significantly greater degree of managerial autonomy, Chinese enterprises enjoy certain advantages because they are fully integrated into the national economic system. Unlike many U.S. companies in China, Chinese companies have free access to the Chinese domestic market.

For many companies, the highly personalized nature of business in China and the limited number of suppliers and customers often make arbitration or other legal remedies impractical. Even when they have strong cases, foreign investors often decide against using arbitration or other legal means to resolve problems out of concern of permanently alienating critical business associates or government authorities. The lack of recourse to an impartial legal system that is not susceptible to government pressure further undermines investor confidence.

In December 1992, the United States reestablished the Joint Commission on Commerce and Trade (JCCT) as a ministerial-level forum for discussion of investor and business concerns, among other things. The JCCT met most recently in December 1998 with working group sessions on trade and investment in a number of sectors. These working groups have established and continue to coordinate a range of cooperative exchanges on trade and investment issues, providing a forum to discuss specific investor and business problems.

ANTICOMPETITIVE PRACTICES

Anticompetitive practices in China come in the form of industrial conglomerates created to improve the profitability of state-owned enterprises. In some cases, the government has provided subsidies and other public benefits to such conglomerates. Some are even authorized to fix prices, allocate contracts and, in other ways, restrict competition among domestic suppliers. Such monopolistic or monopsonisitic practices may restrict market access for imported products, raise production costs, and restrict market opportunities for foreign-invested enterprises in China.

ELECTRONIC COMMERCE

At present sales and contracts executed through electronic commerce are not regulated under Chinese law. While officials in related Chinese organizations are aware of the potential of e-commerce to promote exports and increase the international competitiveness of Chinese firms they favor increased regulation of the medium. This is partially due to the insufficiency of China's information infrastructure, and in part to the Chinese Government's desire to control and monitor information exchanges between its citizens and those of other countries. The lack of a comprehensive legal framework for e-commerce and problems with security pose a significant challenge to the development of e-commerce in China.

In 1996, the Chinese Government established the China international electronic commerce center (CIECC). A division of MOFTEC, CIECC provides various e-commerce services to Chinese enterprises and institutions in order promote foreign trade. However, due to an underdeveloped Internet infrastructure, a low subscriber base, and difficulties with credit and credit cards, the more rigid Electronic Data Interchange

(EDI) based electronic commerce remains the dominant format in China. EDI essentially functions like a club, with member firms paying fees to use the standardized forms and dedicated networks that manage e-commerce transactions. It is much easier to control than its Internet counterparts.

In mid-1998, MOFTEC officials reported that guidelines for e-commerce in China are under development; little information is available about their proposed content. Key issues to be resolved include security for electronic payment systems, liability and user authentication.

OTHER BARRIERS

Legal framework: the lack of a clear consistent framework of laws and regulations is also a major barrier to U.S. firms. Although China is moving toward a commercial rule of law, many gaps exist. Even where laws and regulations have been published, they are often unclear and leave too much room for discretion -- either through honest misunderstanding or corrupt implementation -- or for being ignored outright. U.S. firms have found it difficult to collect awards made by Chinese courts against powerful Chinese companies. Local courts and officials have also taken illegal actions against U.S. firms and the injured parties have found it difficult, if not impossible, to obtain redress from the Chinese courts.