
2009 Report to Congress On China's WTO Compliance



**United States Trade Representative
December 2009**

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October 29, 2009

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July 28, 2009

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ABBREVIATIONS

ACFTU	All China Federation of Trade Unions
APEC	Asia-Pacific Economic Cooperation
AQSIQ	State Administration of Quality Supervision, Inspection and Quarantine
BOFT	Bureau of Fair Trade for Imports and Exports
CBRC	China Banking Regulatory Commission
CIRC	China Insurance Regulatory Commission
CNCA	National Certification and Accreditation Administration
Codex	Codex Alimentarius
CUP	China Union Pay
GAPP	General Administration of Press and Publication
IBII	Bureau of Industry Injury Investigation
ISO	International Organization for Standardization
JCCT	U.S.-China Joint Commission on Commerce and Trade
MII	Ministry of Information Industry
MIIT	Ministry of Industry and Information Technology
MOA	Ministry of Agriculture
MOC	Ministry of Construction
MOF	Ministry of Finance
MOFCOM	Ministry of Commerce
MOFTEC	Ministry of Foreign Trade and Economic Cooperation
MOH	Ministry of Health
MPS	Ministry of Public Security
NCA	National Copyright Administration
NDRC	National Development and Reform Commission
NPC	National People's Congress
OIE	World Organization for Animal Health
PBOC	People's Bank of China
SAC	Standardization Administration of China
SAIC	State Administration for Industry and Commerce
SARFT	State Administration of Radio, Film and Television
SASAC	State-owned Assets Supervision and Administration Commission
SAT	State Administration of Taxation
SDPC	State Development and Planning Commission
SED	U.S.-China Strategic Economic Dialogue
S&ED	U.S.-China Strategic and Economic Dialogue
SFDA	State Food and Drug Administration
SPB	State Postal Bureau
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

FOREWORD

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

Like the prior reports, this report is structured as an examination of the nine broad categories of WTO commitments undertaken by China. Throughout the report, USTR has attempted to provide as complete a picture of China's WTO compliance as possible, subject to the inherent constraints presented by the sheer volume and complexity of the required changes to China's trade regime and transparency obstacles. The report identifies areas where progress has been achieved and underscores areas of concern, as appropriate, with regard to the commitments that became effective upon China's accession to the WTO as well as those commitments scheduled to be phased in over time.

The focus of the report's analysis continues to be on trade concerns raised by U.S. stakeholders that, in the view of the U.S. Government, merit attention within the WTO context. The report does not provide an exhaustive analysis of the many areas in which China's WTO compliance efforts may have or may 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 assessing its efforts to comply with its WTO commitments. This TPSC subcommittee is composed of experts from USTR, the Departments of Commerce, State, Agriculture and Treasury, and the U.S. Patent and Trademark Office, among other agencies. It works closely with State Department economic officers, Foreign Commercial Service officers and Market Access and Compliance officers from the Commerce Department, Foreign Agricultural Service officers and Customs attaches at the U.S. Embassy and Consulates General in China, who are active in gathering and analyzing information, maintaining regular contacts with U.S. industries operating in China and maintaining a regular dialogue with Chinese government officials at key ministries and agencies. The subcommittee meets in order to evaluate, coordinate and prioritize the monitoring activities being undertaken and to review the steps that China has taken to implement its commitments.

To aid in its preparation of this report, USTR also published a notice in the Federal Register on August 31, 2009, asking for written comments and testimony from the public and scheduling a public hearing before the TPSC, which took place on October 2, 2009. 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

China acceded to the World Trade Organization eight years ago on December 11, 2001. The terms of its accession called for China to implement numerous specific commitments over time. All of China's key commitments should have been phased in by December 11, 2006, three years ago. Consequently, China is no longer a new WTO member, and the United States and other WTO members have been holding China fully accountable as a mature member of the international trading system, placing a strong emphasis on China's adherence to WTO rules.

2009 DEVELOPMENTS

Looking back on 2009, the new Administration worked to increase the benefits the United States derives from trade and economic ties with China by focusing on outcome-oriented dialogue at all levels of engagement, while also taking concrete steps to enforce China's adherence to its international trade obligations. Within this framework, the United States' intensive dialogue with China during the past year generated positive outcomes on a number of contentious issues. At the same time, the United States aggressively pursued WTO dispute settlement on issues left unresolved by dialogue, filing one new case, generating a favorable settlement in another case and obtaining favorable WTO panel decisions in two other cases.

On the bilateral front, the United States and China pursued a robust set of formal and informal meetings and dialogues over the last year, including numerous working groups and high-level meetings under the auspices of the newly created U.S.-China Strategic and Economic Dialogue (S&ED) and the U.S.-China Joint Commission on Commerce and Trade (JCCT). The United States and China held their first S&ED meeting in July 2009 and the 20th meeting of the JCCT in October 2009. A Presidential summit followed in November 2009. The United States used all of these avenues to establish a foundation for the new Administration's engagement of China's leadership on trade and economic matters and to

seek resolutions to a number of pressing trade issues.

Bilateral engagement produced concrete results in a number of important areas in 2009. The two sides were able to resolve significant trade irritants, while also achieving incremental but important progress in other areas and agreeing to pursue dialogue in still other areas where more detailed discussions were needed to lay the foundation for possible resolutions. For example, China made the following commitments, among others:

- China pledged to lift unscientific bans on imports of U.S. pork and pork products and live swine.
- China agreed to remove local content requirements on wind turbines.
- China confirmed that rules on information security certification that would have potentially barred several types of U.S. products from China's market only apply to products procured by Chinese government agencies and not to products purchased by state-owned enterprises or other sectors of China's economy.
- China committed to strengthened enforcement against Internet infringers, pirated academic and medical journals, bulk chemicals used as active pharmaceutical ingredients and counterfeit pharmaceuticals. China further committed to address U.S. concerns regarding a Ministry of Culture measure relating to online music distribution.
- China resumed issuing licenses for qualified direct selling services companies.
- China confirmed that products produced in China by foreign-invested enterprises would be treated as domestic products for government procurement purposes, and it also agreed to submit a revised offer to the WTO as early as possible in 2010 in connection with its

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commitment to accede to the Government Procurement Agreement as soon as possible.

At the same time, the two sides agreed to begin or continue discussions in a number of other important areas, including, for example, industrial policies, intellectual property rights, agriculture, standards and conformity assessment procedures, clean energy, health care reform and transparency. The two sides also continued to pursue bilateral investment treaty negotiations in 2009.

On the enforcement side, the United States brought one new WTO case against China in 2009. Joined by the EU and later Mexico, the United States initiated this WTO case in June 2009, challenging export quotas, export duties and other restraints maintained by China on the export of several key raw material inputs for which China is a leading world producer. These export restraints skew the playing field against the United States and other countries by creating potentially substantial competitive benefits for downstream Chinese producers that use the inputs in the production and export of numerous processed steel, aluminum and chemical products and a wide range of further processed products. At the request of the complaining parties, a WTO panel was established to hear this case in December 2009.

The United States also continued to pursue five other WTO cases in 2009. In each case, the United States was able to obtain either a favorable WTO ruling or a settlement agreement resolving all of its concerns.

In one case, initiated in December 2008, the United States and co-complainants Mexico and Guatemala had challenged a Chinese industrial policy that generated a vast number of central, provincial and local government programs promoting increased worldwide recognition and sales of famous brands of Chinese merchandise through what appear to be prohibited export subsidies. Following several months of intense negotiations, the parties concluded a settlement agreement in December

2009 in which China confirmed that it had taken steps to eliminate all of the export-contingent benefits in the challenged measures.

In two cases focused on remedying problems encountered in China by U.S. holders of intellectual property rights, the WTO issued rulings favorable to the United States in 2009. A January 2009 WTO panel decision, which neither side appealed, found certain aspects of China's legal regime for protecting and enforcing copyrights and trademarks to be WTO-inconsistent. Another WTO panel decision, issued in September 2009, ruled in favor of the United States on its challenges to market access restrictions affecting the importation and distribution of copyright-intensive products such as books, newspapers, journals, theatrical films, DVDs and music, and the WTO's Appellate Body upheld the panel's decision in December 2009.

Meanwhile, two other cases entered into the compliance phase in 2009. In one case, in which the United States, joined by the EU and Canada, had challenged restrictions on foreign financial information service suppliers imposed by a Chinese regulator that also operated its own competing financial information service, China took key steps toward complying with the terms of the parties' November 2008 settlement agreement by creating an independent regulator and removing the challenged restrictions on foreign financial information service suppliers. The other case involved a challenge brought by the United States, the EU and Canada to Chinese measures imposing discriminatory charges and other burdens on imported auto parts whenever they were used in the assembly of motor vehicles that failed to meet certain local content requirements. After a WTO panel had ruled in favor of the complaining parties in July 2008, and the WTO's Appellate Body had upheld this ruling in December 2008, China repealed the challenged measures in September 2009.

Despite the progress achieved in 2009, several specific issues continued to cause particular concern for the United States and U.S. industry, given China's

WTO obligations. These outstanding issues arose in a range of areas, including principally intellectual property rights, industrial policies, trading rights and distribution services, agriculture and services, as discussed below under the heading of Priority Issues.

TRENDS

China has taken many impressive steps over the last eight years to reform its economy, while implementing a set of sweeping WTO accession commitments that required it to reduce tariff rates, to eliminate non-tariff barriers, to provide national treatment and improved market access for goods and services imported from the United States and other WTO members, to protect intellectual property rights and to improve transparency. Although it still does not appear to be complete in every respect, China's implementation of its WTO commitments has led to increases in U.S. exports to China, while deepening China's integration into the international trading system and facilitating and strengthening the rule of law and the economic reforms that China began thirty years ago. Since China's accession to the WTO in 2001, U.S. exports of goods to China have increased by nearly 270 percent, rising from a 2001 total of \$19 billion to \$70 billion in 2008. While U.S.-China trade slowed in 2009 like trade in the rest of the world in the face of the global economic downturn, China remains the United States' third largest goods export market. China is also a substantial market for U.S. services, as the cross-border supply of services totaled \$16 billion in 2008, and services supplied through majority U.S.-invested companies in China totaled an additional \$14 billion in 2007, the latest date for which data is available.

Nevertheless, as this year's report again confirms, in some areas it appears that China has yet to fully implement important commitments, and in other areas, significant questions have arisen regarding China's adherence to ongoing WTO obligations, including core WTO principles. Frequently, as in recent years, these problems can be traced to China's pursuit of industrial policies that rely on

excessive, trade-distorting government intervention intended to promote or protect China's domestic industries. This government intervention, still evident in many areas of China's economy, is a reflection of China's historic yet unfinished transition from a centrally planned economy to a free-market economy governed by rule of law.

As previously reported, through the first four years after China's accession to the WTO, China made noteworthy progress in adopting economic reforms that facilitated its transition toward a market economy. However, beginning in 2006, progress toward further market liberalization began to slow. It became clear that some parts of the Chinese government did not yet fully embrace the key WTO principles of market access, non-discrimination and transparency or the carefully negotiated conditions for China's WTO accession designed to lead to significantly reduced levels of trade-distorting government intervention. Differences in views and approaches between China's central government and China's provincial and local governments also continued to frustrate economic reform efforts, while China's difficulties in fully implementing the rule of law exacerbated this situation.

Beginning in 2007, USTR reported that one of the critical issues for the international trading system would be to ensure that China's leadership does not retreat from the substantial progress made to date in reducing levels of trade-distorting government intervention and liberalizing China's market. USTR explained that evidence of a possible trend toward a more restrictive trade regime appeared most visibly in an array of Chinese measures over the preceding two years, signaling new restrictions on market access and foreign investment in China.

In 2008 and again this past year, U.S. companies pointed to further examples evidencing such a trend, including:

- the continued and incrementally more restrictive use of export quotas and export duties on a large number of raw material inputs;

- the selective use of other border measures such as value-added tax rebates to encourage or discourage exports of particular products;
- the setting and enforcement of unique Chinese national standards, such as an informal requirement that all new 3G mobile handsets be enabled with a unique Chinese national standard for wireless Internet access;
- China's government procurement practices, including an array of new central, provincial and local government "Buy China" policies;
- a new *Postal Law* that excludes foreign suppliers from a major segment of the domestic express delivery market;
- an informal ban on new entrants in China's basic telecommunications sector and impediments to the foreign supply of value-added services; and
- continuing significant restrictions on foreign investment in China, and the continuing consideration of "national economic security" when evaluating foreign investment through mergers and acquisitions.

In a written submission provided in connection with this year's public hearing on China's WTO compliance, one major U.S. industry association noted its "growing concern that the pace of economic reform in China appears to have slowed in key sectors, and there are growing indications that China's movement toward a market economy has stalled." A similar view was also expressed by a number of other entities.

Despite the many remaining challenges, China's WTO membership has continued to provide substantial ongoing benefits to the United States. Each year since China joined the WTO in 2001, with the exception of this year, which was affected by the global economic downturn, U.S.-China trade has expanded dramatically, providing numerous and substantial opportunities for U.S. businesses,

workers, farmers and service suppliers and a wealth of affordable goods for U.S. consumers. In 2009, China remained the United States' second largest goods trading partner and a significant services trading partner.

PRIORITY ISSUES

At present, several specific areas cause particular concern for the United States and U.S. industry in terms of China's adherence to the obligations of WTO membership. The key concerns in each of these areas are summarized below, while a detailed summary of China's WTO compliance efforts is set forth in Table 1.

Intellectual Property Rights

Since its accession to the WTO, China has put in place a framework of laws and regulations aimed at protecting the intellectual property rights of domestic and foreign right holders, as required by the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (the TRIPS Agreement). However, some critical reforms are still needed in a few areas, such as further improvement of China's measures for copyright protection on the Internet following China's accession to the World Intellectual Property Rights Organization (WIPO) Internet treaties, and correction of continuing deficiencies in China's criminal IPR enforcement measures.

In addition, effective enforcement of China's IPR laws and regulations remains a significant challenge. Despite repeated anti-piracy campaigns in China and an increasing number of civil IPR cases in Chinese courts, counterfeiting and piracy remain at unacceptably high levels and continue to cause serious harm to U.S. businesses across many sectors of the economy. The U.S. copyright industries estimate that losses in 2008 due to piracy were approximately \$3.5 billion for the music recording and software industries alone. These figures indicate little or no overall improvement over the previous year. USTR's annual Special 301 report, issued in April 2009, similarly confirmed a lack of

progress through 2008, as USTR continued to place China on the Priority Watch List.

In 2009, the United States continued to seek ways to work with China to improve China's IPR enforcement regime. Recognizing that China has an increasing stake in effective IPR enforcement as evidenced by its efforts to develop innovative industries and technologies, a variety of U.S. agencies held regular bilateral discussions with their Chinese counterparts. U.S. government officials also conducted numerous technical assistance programs for central, provincial and local government officials on TRIPS Agreement rules, enforcement methods and rule of law issues.

In addition, in October 2009, the United States was able to use the JCCT process to secure commitments from China to impose maximum administrative penalties, including the revocation of business licenses, for Internet piracy, to issue a notice ensuring compliance with all copyright laws in state-run and academic libraries, especially with regard to electronic journals, and to work to ensure that the Ministry of Culture's prescreening requirements do not hamper the distribution of legitimate sound recordings online. In addition, China agreed to cooperative discussions on a range of other IPR issues, such as the relationship between IPR and innovation, China's development of guidelines on IPR and standards, public-private discussions on copyright and Internet piracy challenges including intermediary liability on the Internet, how to reduce the sale of pirated and counterfeit goods at wholesale and retail markets, and the development of recommendations on bad faith trademark registrations.

The United States also obtained a favorable ruling from a WTO panel in a case challenging deficiencies in China's legal regime for protecting and enforcing copyrights and trademarks. Specifically, in a case in which 12 other WTO members had joined in as third parties, a WTO panel found WTO-inconsistent China's denial of copyright protection to works that do not meet China's content review standards as well as China's handling of border enforcement

seizures of counterfeit goods, while clarifying important legal standards relating to China's criminal enforcement of copyrights and trademarks. Neither side appealed the panel's decision, and China subsequently agreed to bring the measures at issue into compliance by March 2010.

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

Industrial Policies

China continued to pursue industrial policies in 2009 that seek to limit market access for non-Chinese origin goods and foreign service suppliers while offering substantial government resources to support Chinese industries and increase exports. In some cases, the objective of these policies seems to be to promote the development of advanced Chinese industries that are higher up the economic value chain than China's current labor-intensive industrial base. Policies aimed at promoting "indigenous innovation" through preferential government procurement and other measures are an important component of this effort. In other cases, China appears simply to be protecting less competitive state-owned enterprises.

In 2009, China continued to deploy export quotas, export license fees, minimum export prices, export duties and other export restraints on a number of raw material inputs where it holds the advantage of being one of the world's leading producers. Through these export restraints, it appears that China is able

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to provide substantial artificial advantages to a wide range of downstream producers in China, both in China's market and other markets around the world. The U.S. response, as noted above, was the filing of a WTO case in June 2009 challenging the export restraints that China maintains on certain inputs of key interest to U.S. industry.

As in prior years, the Chinese government also attempted to manage the export of many intermediate and downstream products in 2009, often by raising or lowering the value-added tax rebate available upon export and sometimes by imposing or retracting export duties. These practices have caused tremendous disruption, uncertainty and unfairness in the global markets for some products, particularly ones for which China is a leading world producer or exporter such as steel. Domestic industries from many of China's trading partners have responded to these and other trade-distortive practices by petitioning their governments to impose trade remedies such as antidumping and countervailing duties and China-specific safeguards on imports from China.

Through the pursuit of a WTO case initiated last December, the United States was able to bring about the elimination of a Chinese industrial policy designed to expand the market share of famous Chinese brands of merchandise around the world through the use of what appear to be prohibited forms of financial support, provided through a multitude of measures issued by the central government and provincial and local governments throughout China. As a result of months of intense negotiations, as noted above, China took steps to remove all of the export-contingent benefits from the numerous Chinese measures at issue, as confirmed in a settlement agreement executed in December 2009.

Another problematic industrial policy was also eliminated through the WTO dispute settlement process this year. In September 2009, as noted above, China complied with the WTO's ruling by

repealing measures that had imposed discriminatory charges and other burdens on imported auto parts whenever they were used in the assembly of motor vehicles that failed to meet certain local content requirements.

Meanwhile, in the standards area, China continues to pressure foreign companies seeking to participate in the standards-setting process to license their technology or intellectual property on unfavorable terms. China also continues to pursue unique national standards in a number of areas of high technology where international standards already exist. For example, in 2009, China was working to finalize draft rules on information security certification that would potentially have barred several types of U.S. high technology products from China's market. As noted above, bilateral discussions yielded progress in resolving U.S. concerns when China confirmed earlier this year that the compulsory certification requirement only applies when products are sold to government agencies, and not to state-owned enterprises or other sectors of China's economy. Another example of China's pursuit of unique national standards involves third generation (3G) mobile handsets. In 2009, China began requiring new 3G mobile handsets to be enabled with China's home-grown WAPI standard, despite the growing commercial success of other products in China complying with the internationally recognized WiFi standard. To date, bilateral engagement has yielded no progress in resolving this matter.

China has also sought to protect many domestic industries through an increasingly restrictive investment regime. Since 2006, for example, China has pursued more restrictive foreign investment screening processes, particularly in "pillar industries," by taking advantage of vaguely defined powers granted to regulators under the rules governing foreign mergers and acquisitions, which can be used to restrict legitimate foreign investment. To date, sustained bilateral engagement by the United States has not led to any relaxation in these

investment restrictions, although the United States and China continue to pursue bilateral investment treaty negotiations.

In 2010, the United States will continue to pursue vigorous and expanded bilateral engagement to resolve the serious disagreements that remain over China's various industrial policy measures. The United States will also continue to seek the elimination of China's export restraints on raw material inputs through the WTO dispute settlement process.

Trading Rights and Distribution Services

For many U.S. companies, China's commitments to fully liberalize trading rights (the right to import and the right to export) and distribution services (wholesale, retail, direct selling and franchising services) are critically important. While China has implemented these commitments in most sectors, enabling many U.S. companies to import and export goods directly without using middlemen and to establish their own distribution networks in China, some significant challenges remain unresolved.

As previously reported, despite extensive and persistent bilateral engagement by the United States, China refused to remove import and distribution restrictions on copyright-intensive products such as books, newspapers, journals, theatrical films, DVDs and music, in apparent contravention of China's trading rights and distribution services commitments. These restrictions reduce and delay market access for these copyrighted products, creating additional incentives for infringement in China's market. Consequently, in April 2007, the United States initiated WTO dispute settlement proceedings. In August 2009, as noted above, a WTO panel ruled in favor of the United States, and China appealed. In December 2009, the WTO's Appellate Body rejected China's appeal on all counts.

In the area of retail services, where China had been requiring foreign retailers to satisfy burdensome

requirements not applicable to domestic retailers when seeking to open new stores, the United States began to see incremental progress in 2009. During the run-up to the September 2008 JCCT meeting, China had announced that it was delegating authority for foreign retail outlet license approvals to the provincial government level. Over the last year, U.S. retailers have reported that this change has streamlined and facilitated approvals for foreign retail outlets.

Incremental progress was also achieved in the area of direct selling services in 2009. While China is a major market for U.S. direct sellers, China continues to subject foreign direct sellers to unwarranted restrictions on their business operations, and China had not issued any new licenses for direct sellers since 2007. Working closely with U.S. industry, the United States sought improvements in this area in 2008 and 2009. At the October 2009 JCCT meeting, China indicated that it was in the process of concluding its licensing procedures for certain qualified direct selling companies, and since then it has issued one new license to a U.S. direct selling company.

Agriculture

While U.S. exports of agricultural commodities to China continue to perform strongly and largely fulfill the potential envisioned by U.S. negotiators during the years leading up to China's WTO accession, China remains among the least transparent and predictable of the world's major markets for agricultural products, largely because of selective intervention in the market by China's regulatory authorities. As in past years, capricious practices by Chinese customs and quarantine agencies can delay or halt shipments of agricultural products into China, while SPS measures with what seem to be questionable scientific bases and a generally opaque regulatory regime frequently bedevil traders in agricultural commodities, who require as much predictability and transparency as possible in order to preserve margins and reduce the already substantial risks involved in agricultural trade.

In 2009, the principal targets of questionable practices by China's regulatory authorities were raw poultry and pork products, and anticipated growth in U.S. exports of these products was not realized. In particular, China continued to maintain overly restrictive pathogen and residue standards for raw meat and poultry. China also continued to maintain several state-level Avian Influenza bans on poultry. Additionally, China imposed bans on imports of U.S. pork and pork products and live swine in April 2009, ostensibly related to its concern about the transmission of the H1N1 influenza A virus. In addition, China continued to block the importation of U.S. beef and beef products, well over two years after these products had been declared safe to trade under international scientific guidelines.

The United States was able to achieve progress on China's H1N1-related bans. At the October 2009 JCCT meeting, China announced its intent to reopen the China market to U.S. pork, pork products and live swine, and in December 2009, China issued a measure removing the bans on imports of U.S. pork and pork products. In 2010, the United States will monitor China's implementation of this measure closely, while continuing to urge China to lift the remaining ban on imports of U.S. live swine. The United States will also continue to pursue vigorous bilateral engagement with China and take other necessary actions, as appropriate, to achieve progress on its other outstanding concerns.

Services

While the United States continued to enjoy a substantial surplus in trade in services with China and the market for U.S. service providers in China remains promising, Chinese regulators continue to use an opaque regulatory process, overly burdensome licensing and operating requirements and other means to frustrate efforts of U.S. suppliers of banking, insurance, express delivery, telecommunications and legal services to achieve their full market potential in China. In addition, China has not yet fully opened up its market to foreign companies that supply electronic payment

and related services to banks and other companies that issue credit and debit cards, and China recently excluded foreign suppliers from a major segment of the domestic express delivery market.

Through its pursuit of a WTO case, the United States was able to convince China to remove restrictions that China had placed on foreign suppliers of financial information services and to remedy China's failure to establish an independent regulator in this sector. As noted above, by June 2009, China had complied with the terms of a November 2008 settlement agreement, which had required China to install an independent regulator and remove the restrictions at issue.

In 2010, the United States will continue to engage China on the many outstanding services issues and will closely monitor developments in an effort to ensure that China fully adheres to its WTO commitments.

Transparency

One of the core principles of the WTO Agreement, reinforced throughout China's WTO accession agreement, is transparency. Transparency permits markets to function effectively and reduces opportunities for officials to engage in trade-distorting practices behind closed doors. China's transparency commitments in many ways required a profound historical shift in Chinese policies, and China made important strides to improve transparency across a wide range of national and provincial authorities following its accession to the WTO. However, two shortcomings stood out, as China delayed adopting a single official journal for publishing all trade-related measures and did not regularize the use of notice-and-comment procedures for new or revised trade-related measures prior to implementation.

Following sustained U.S. engagement, China finally adopted a single official journal in 2006, to be administered by the Ministry of Commerce. Then, in 2008, the National People's Congress instituted

notice-and-comment procedures for draft laws. Shortly thereafter, China also committed to publish all proposed trade- and economic-related regulations and departmental rules for public comment, subject to specified exceptions. These steps signaled increasing recognition by many Chinese government officials that improved transparency and greater input from stakeholders and the public contribute to better regulatory practices and improved policymaking.

Once China fully implements its commitments to adopt a single official journal and to use notice-and-comment procedures for new or revised trade-related measures, it should lead to significantly improved transparency. Currently, however, China's implementation is incomplete, and the United States continues to engage with China on this issue and to monitor China's progress closely.

THE YEAR AHEAD

In 2010, the Administration will continue to pursue increased benefits for all Americans from our trade and economic ties with China by focusing on productive, outcome-oriented dialogue at all levels of engagement, while also taking further steps to enforce China's adherence to its international trade obligations, including both full implementation of China's WTO accession commitments and full adherence to the fundamental obligations that China has taken on as a WTO member. To achieve these

objectives, the Administration will continue to consult closely with U.S. stakeholders to ensure that U.S. policies and actions advance their interests.

On the bilateral front, the United States will continue to pursue a robust set of formal and informal meetings and dialogues with China, including high-level meetings under the auspices of the newly created S&ED and the JCCT, in order to ensure that the benefits of China's WTO membership are fully realized by the United States and other WTO members and that problems in the U.S.-China trade relationship are appropriately resolved. Through these efforts, the United States will place particular emphasis on reducing Chinese government intervention in the market. Based on the willingness that China's leadership displayed in 2009 to work cooperatively and pragmatically with the new Administration on contentious issues, the United States is optimistic that significant progress is obtainable in 2010.

Nevertheless, as the United States has demonstrated on several occasions, when bilateral dialogue is not successful in resolving WTO-related concerns, the United States will not hesitate to invoke the dispute settlement mechanism at the WTO where appropriate. Similarly, when U.S. interests are being harmed by unfairly traded or surging imports from China, the United States will continue to rigorously enforce U.S. trade remedy laws, in accordance with WTO rules, including China's WTO accession commitments.

2009 USTR Report to Congress on China's WTO Compliance

Table 1

Summary Analysis of China's WTO Compliance Efforts

TRADING RIGHTS <p>China appears to be in compliance with its trading rights commitments in most areas, although one significant concern involves the right to import copyright-intensive products such as books, newspapers, journals, theatrical films, DVDs and music, which China still reserves for state trading.</p>
DISTRIBUTION SERVICES <p>Wholesaling Services<p>China has issued regulations generally implementing its commitments in the area of wholesaling and commission agents' services, although the regulations do not remove significant restrictions on the distribution of copyright-intensive products such as books, newspapers, journals, theatrical films, DVDs and music. U.S. companies in some industries also have concerns about continuing restrictions on the distribution of other products, such as pharmaceuticals and crude oil and processed oil.</p>Retailing Services<p>China has issued regulations generally implementing its commitments in the area of retailing services, although concerns remain with regard to licensing discrimination, restrictions related to urban commercial networks and restrictions on processed oil.</p>Franchising Services<p>China has issued regulations generally implementing its commitments in the area of franchising services, although some concerns remain.</p>Direct Selling Services<p>China has issued regulations generally implementing its commitments in the area of direct selling services, although significant regulatory restrictions imposed on the operations of direct sellers continue to generate concern. In a positive step, it appears that China has resumed issuing direct selling licenses after a two-year moratorium.</p></p>
IMPORT REGULATION <p>Tariffs<p>China has timely implemented its tariff commitments for industrial goods each year.</p>Customs and Trade Administration<p><u>Customs Valuation</u><p>China has issued measures that bring its legal regime for making customs valuation determinations into compliance with WTO rules, but implementation of these measures has been inconsistent from port to port, both in terms of customs clearance procedures and valuation determinations.</p><u>Rules of Origin</u><p>China has issued measures that bring its legal regime for making rules of origin determinations into compliance with WTO rules.</p><u>Import Licensing</u><p>China has issued measures that bring its legal regime for import licenses into compliance with WTO rules, although a variety of specific compliance issues continue to arise, as in the case of China's import licensing procedures for iron ore imports.</p>Non-tariff Measures<p>China has adhered to the agreed schedule for eliminating non-tariff measures.</p>Tariff-rate Quotas on Industrial Products<p>Concerns about transparency and administrative guidance have plagued China's tariff-rate quota system for industrial products, particularly fertilizer, since China's accession to the WTO.</p>Other Import Regulation<p><u>Antidumping</u><p>China has issued measures bringing its legal regime in the AD area largely into compliance with WTO rules, although China still needs to issue additional rules covering expiry reviews. In 2009, China became a more active user of the AD remedy, making it even more important that China improve its adherence to the transparency and procedural fairness requirements embodied in WTO rules.</p><u>Countervailing Duties</u><p>China has issued measures bringing its legal regime in the CVD area largely into compliance with WTO rules, although China still needs to issue additional rules covering expiry reviews. Now that China has begun initiating CVD investigations, it has become apparent that China needs to improve its adherence to the transparency and procedural fairness requirements embodied in WTO rules, just as in the AD area.</p><u>Safeguards</u><p>China has issued measures bringing its legal regime in the safeguards area largely into compliance with WTO rules, although concerns about potential inconsistencies with WTO rules continue to exist.</p></p></p></p>

2009 USTR Report to Congress on China's WTO Compliance

Table 1 (cont'd)

Summary Analysis of China's WTO Compliance Efforts

EXPORT REGULATION

China maintains numerous export restraints that raise serious concerns under WTO rules, including specific commitments that China made in its Protocol of Accession to the WTO.

INTERNAL POLICIES AFFECTING TRADE

Non-discrimination

While China has revised many laws, regulations and other measures to make them consistent with WTO rules relating to MFN and national treatment, concerns about compliance with these rules still arise in some areas.

Taxation

China has used its taxation system to discriminate against imports in certain sectors, raising concerns under WTO rules relating to national treatment.

Subsidies

China continues to provide injurious subsidies to its domestic industries, and some of these subsidies appear to be prohibited under WTO rules. China has also failed to file annual WTO subsidy notifications since 2006, and its 2006 notification was incomplete.

Price Controls

China has progressed slowly in reducing the number of products and services subject to price control or government guidance pricing.

Standards, Technical Regulations and Conformity Assessment Procedures

Restructuring of Regulators

China has restructured its regulators for standards, technical regulations and conformity assessment procedures in order to eliminate discriminatory treatment of imports, although in practice China's regulators sometimes do not appear to enforce regulatory requirements as strictly against domestic products as compared to imports.

Standards and Technical Regulations

China continues to pursue the development of unique Chinese national standards, despite the existence of well-established international standards, apparently as a means for protecting domestic companies from competing foreign technologies and standards.

Conformity Assessment Procedures

China appears to be turning more and more to in-country testing for a broader range of products, which goes in the opposite direction of common international practices that generally accept foreign test results and conformity assessment certifications.

Transparency

China has made progress but still does not appear to notify all new or revised standards, technical regulations and conformity assessment procedures as required by WTO rules.

Other Internal Policies

State-Owned and State-Invested Enterprises

The Chinese government has heavily intervened in the investment decisions made by state-owned and state-invested enterprises in certain sectors.

State Trading Enterprises

It is difficult to assess the activities of China's state-trading enterprises, given inadequate transparency.

Government Procurement

While China is moving slowly toward fulfilling its commitment to accede to the GPA, it is maintaining and adopting government procurement measures that give domestic preferences.

INVESTMENT

China revised many laws and regulations on foreign-invested enterprises to eliminate WTO-inconsistent requirements relating to export performance, local content, foreign exchange balancing and technology transfer, although some of the revised measures continue to "encourage" one or more of those requirements. China has also issued industrial policies covering the auto and steel sectors that include guidelines that appear to conflict with its WTO obligations. In addition, China has added a variety of restrictions on investment that appear designed to shield inefficient or monopolistic Chinese enterprises from foreign competition.

2009 USTR Report to Congress on China's WTO Compliance

Table 1 (cont'd)

Summary Analysis of China's WTO Compliance Efforts

AGRICULTURE
<p>Tariffs China has timely implemented its tariff commitments for agricultural goods each year.</p> <p>Tariff-rate Quotas on Bulk Agricultural Commodities China's administration of TRQs on bulk agricultural commodities still does not seem to be functioning entirely as envisioned in China's WTO accession agreement, as it continues to be impaired by inadequate transparency.</p> <p>China's Biotechnology Regulations Despite continuing problems with China's biotechnology approval process, major trade disruptions have been avoided.</p> <p>Sanitary and Phytosanitary Issues In 2009, China's regulatory authorities imposed non-transparent SPS measures that appear to lack scientific bases, including BSE-related bans on beef and some low-risk bovine products, pathogen standards and residue standards for raw meat and poultry products, Avian Influenza bans on poultry and H1N1-related bans on pork. Meanwhile, China has made progress but still does not appear to have notified all proposed SPS measures as required by WTO rules.</p> <p>Inspection-related Requirements China's regulatory authorities continue to administer inspection-related requirements in a seemingly arbitrary manner.</p> <p>Export Subsidies It is difficult to determine whether China maintains export subsidies on agricultural goods, in part because China has not notified all of its subsidies to the WTO.</p>
INTELLECTUAL PROPERTY RIGHTS
<p>Legal Framework While China's framework of laws, regulations and implementing rules remains largely satisfactory in most respects, reforms are needed in a few key areas, such as further improvement of China's measures for copyright protection on the Internet following China's accession to the WIPO Internet treaties and changes to address a number of continuing deficiencies in China's criminal IPR enforcement measures.</p> <p>Enforcement Effective IPR enforcement has not been achieved, and IPR infringement remains a serious problem throughout China. IPR enforcement is hampered by lack of coordination among Chinese government ministries and agencies, lack of training, resource constraints, lack of transparency in the enforcement process and its outcomes, and local protectionism and corruption.</p>
SERVICES
<p>Financial Services</p> <p><u>Banking</u> China has taken a number of steps to implement its banking services commitments, although these efforts have generated concerns, and there are some instances in which China still does not seem to have fully implemented particular commitments, such as with regard to Chinese-foreign joint banks and bank branches.</p> <p><u>Motor Vehicle Financing</u> China has implemented its commitments with regard to motor vehicle financing.</p> <p><u>Insurance</u> China has issued measures implementing most of its insurance commitments, but these measures have also created problems in the areas of licensing, branching and transparency.</p> <p><u>Financial Information</u> In 2008, China agreed to implement its commitment to establish an independent regulator for the financial information sector and to remove restrictions that had placed foreign suppliers at a serious competitive disadvantage.</p> <p><u>Electronic Payment Processing</u> It appears that China has not yet implemented electronic payment processing commitments that should have been phased in no later than December 11, 2006.</p>

2009 USTR Report to Congress on China's WTO Compliance

Table 1 (cont'd)

Summary Analysis of China's WTO Compliance Efforts

SERVICES (cont'd)
<p>Legal Services China has issued measures intended to implement its legal services commitments, although these measures give rise to WTO compliance concerns because they impose an economic needs test, restrictions on the types of legal services that can be provided and lengthy delays for the establishment of new offices.</p>
<p>Telecommunications It appears that China has nominally kept to the agreed schedule for phasing in its WTO commitments in the telecommunications sector, but restrictions maintained by China, such as informal bans on new entry, a requirement that foreign suppliers can only enter into joint ventures with state-owned enterprises and exceedingly high capital requirements for basic services as well as the reclassification of some value-added services as basic services, have created serious barriers to market entry.</p>
<p>Construction and Related Engineering Services China has issued measures intended to implement its construction and related engineering services commitments, although these measures are problematic because they also impose high capital requirements and other requirements that limit market access.</p>
<p>Express Delivery Services China has continued to allow foreign express delivery companies to operate in the express delivery sector and has implemented its commitment to allow wholly foreign-owned subsidiaries by December 11, 2004, but China has issued a new law that undermines market access for foreign companies in the domestic express delivery sector and raises questions in light of China's WTO obligations.</p>
<p>Aviation Services Although most air transport services are excluded from WTO coverage by the GATS Annex on Air Transport Services, China has provided significant additional market access to U.S. providers of air transport services through a bilateral air services agreement with the United States.</p>
<p>Maritime Services Even though China made only limited WTO commitments relating to its maritime services sector, it has increased market access for U.S. service providers through a bilateral agreement.</p>
<p>Other Services The United States has not identified significant concerns related to China's implementation of commitments made in other service sectors.</p>
LEGAL FRAMEWORK
<p>Transparency</p>
<p><u>Official Journal</u> In 2007, China re-committed to use a single official journal for the publication of all trade-related laws, regulations and other measures. While it appears that most government entities regularly publish their trade-related measures in this journal, it is not yet clear whether all types of trade-related measures are being published.</p>
<p><u>Public Comment</u> In 2008, China adopted notice-and-comment procedures for new laws and committed to use notice-and-comment procedures for new trade- and economic-related regulations and departmental rules, subject to specified exceptions.</p>
<p><u>Enquiry Points</u> China has complied with its obligation to establish enquiry points.</p>
<p>Uniform Application of Laws Some problems with the uniform application of China's laws and regulations persisted in 2008.</p>
<p>Judicial Review China has established courts to review administrative actions related to trade matters, but few U.S. or other foreign companies have had experience with these courts.</p>

INTRODUCTION

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).

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 arose in the areas of agriculture, SPS 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 mechanisms include a special textile safeguard (which expired on December 11, 2008, 7 years after China's WTO accession), 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),

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.

OVERVIEW OF U.S. ENGAGEMENT

DIALOGUE

Bilateral Engagement

In 2009, the United States pursued intensified, focused bilateral dialogue with China. Working together, the United States and China engaged in a set of formal and informal bilateral dialogues and meetings, including numerous working groups and meetings under the auspices of the U.S.-China Joint Commission on Commerce and Trade (see Box 1) and the U.S.-China Strategic and Economic Dialogue (see Box 2). Through the JCCT process, the United States sought resolutions to particular pressing trade issues while also encouraging China to accelerate its movement away from reliance on government intervention and toward full institutionalization of market mechanisms. At the same time, the United States used the Economic Track of the S&ED process to address cross-cutting and long-term economic issues.

The JCCT met for the 20th time in October 2009 (see Appendix 3). Chaired by Commerce Secretary Locke and U.S. Trade Representative Kirk on the U.S. side and Vice Premier Wang on the Chinese side, the JCCT meets annually and focuses on seeking resolutions to discrete, pressing trade issues. This bilateral engagement produced near-term results in several areas, including (1) China's pledge to reopen its market to U.S. pork products, (2) China's agreement to remove local content requirements on wind turbines, (3) the completion of licensing procedures for qualified direct selling services companies, (4) a commitment to issue rules requiring products produced in China by foreign-invested enterprises to be treated as domestic products for government procurement purposes, (5) a commitment that China will submit a revised offer to the WTO as early as possible in 2010 in its accession to the Government Procurement Agreement, (6) confirmation that rules on information security certification that would potentially bar several types of U.S. products from

China's market only apply to products procured by Chinese government agencies, (7) assurance that maximum administrative penalties will be imposed on Internet infringers, (8) a commitment to strengthened protection of copyrighted academic and medical journals, (9) an agreement to address U.S. concerns regarding a Ministry of Culture measure relating to online music distribution, (10) a commitment to avoid duplicative or redundant product recall procedures, (11) increased recognition of prior foreign clinical trials and approvals for imported medical devices and (12) strengthened oversight and enforcement of bulk chemicals used as active pharmaceutical ingredients and counterfeit pharmaceuticals, among other results. At the same time, the two sides agreed to continue discussions in a number of other important areas, including industrial policies, competitiveness, intellectual property rights, agriculture, China's *Anti-Monopoly Law*, global distribution services, standards and conformity assessment procedures, the regulation of dietary supplements, clean energy, scrap recycling, health care reform and transparency, among other areas.

Box 1: JCCT

The United States and China founded the U.S.-China Joint Commission on Commerce and Trade in 1983 as a government-to-government consultative mechanism between the U.S. Department of Commerce and MOFCOM's predecessor, the Ministry of Foreign Economic Relations and Trade, designed to provide a forum for resolving trade concerns and pursuing bilateral commercial opportunities. In 2003, President Bush and Premier Wen agreed to elevate the JCCT, with the Commerce Secretary and the U.S. Trade Representative chairing the U.S. side and a Vice Premier chairing the Chinese side. The JCCT holds plenary meetings on an annual basis, while a number of JCCT working groups and dialogues meet throughout the year in areas such as industrial policies, competitiveness, intellectual property rights, structural issues, steel, agriculture, pharmaceuticals and medical devices, information technology, insurance, tourism, environment, trade remedies and statistics.

The inaugural meeting of the S&ED, which includes a Strategic Track and an Economic Track, took place in

July 2009 (see Appendix 4). The purpose of the Economic Track of the S&ED is to provide a long-term and comprehensive framework for managing the U.S.-China economic relationship under the guidance of Treasury Secretary Geithner and Vice Premier Wang. Complementing its broad focus, the S&ED produced near-term results in the trade area this year, including additional market access in the securities sector, streamlining approval procedures for foreign investment and a commitment to treat products produced in China by foreign-invested enterprises as domestic products for government procurement purposes. The two sides also agreed to discussions in some important areas, including insurance, express delivery services and labor, and continued discussions in other areas, including bilateral investment treaty negotiations, trade in high-technology products and transportation.

Box 2: S&ED

In April 2009, President Obama and President Hu announced the establishment of a Cabinet-level dialogue known as the U.S.-China Strategic and Economic Dialogue. The S&ED expands the economic focus of the former Strategic Economic Dialogue to cover political and security issues through the addition of a Strategic Track. This dialogue facilitates robust engagement between the United States and China in order to achieve meaningful and sustained progress on a wide range of bilateral, regional and global issues of immediate and long-term strategic and economic interest. The first S&ED meeting, which took place in July 2009 and included high-level representatives from USTR and 12 other U.S. government agencies and 15 of China's ministries, laid the groundwork for the Administration's broad engagement with China. In the Economic Track, chaired by Treasury Secretary Geithner and Chinese Vice Premier Wang, the two sides agreed on four pillars that will form the basis of their economic engagement over the course of the Administration: (1) promoting a strong recovery and achieving more sustainable and balanced growth; (2) promoting more resilient, open and market-oriented financial systems; (3) strengthening trade and investment; and (4) strengthening the international financial architecture. The S&ED convenes annually.

Multilateral Meetings

In 2009, as in prior years, the United States supplemented its bilateral engagement of China with

robust participation in meetings at the WTO focusing on China and its adherence to the obligations that it assumed upon acceding to the WTO in December 2001. Throughout the year, the United States raised China-related issues at regular meetings of several WTO committees and councils. The United States also actively participated in meetings before a number of WTO committees and councils conducting the annual Transitional Review Mechanism for China (see Box 3) from September through December 2009, both through the submission of written questions and by commenting on China's WTO compliance efforts. This review culminated in a stocktaking meeting before the WTO's General Council in December 2009.

Box 3: Transitional Review Mechanism

In paragraph 18 and Annexes 1A and 1B of its Protocol of Accession to the WTO, China agreed to a special WTO mechanism that requires an annual review of the efforts that China has made to comply with its WTO obligations. This annual review takes place before 16 WTO committees and councils every Fall for the first 8 years after China's accession, with a final review by year 10. As part of these transitional reviews, China is required to submit information on matters identified in Annex 1A to its Protocol of Accession to relevant committees and councils. WTO members also have the right to submit written questions and comments to China in advance of transitional review meetings, and China in turn is obligated to provide responses in advance of those meetings. In practice, China has refused to provide advance written responses and instead provides oral responses at the meetings themselves, which the WTO Secretariat reproduces in the meeting minutes along with the comments made by other WTO members. Each of these bodies prepares a report on matters falling within its mandate, and these reports are ultimately considered by the WTO's General Council. The General Council can make recommendations regarding China's WTO compliance efforts, but any recommendations must meet with China's approval because the General Council operates by consensus.

ENFORCEMENT

While engaging in intensified dialogue with China, the United States also continued to hold China accountable for adherence to WTO rules when that dialogue did not resolve U.S. concerns. The United

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States brought one new WTO case against China in 2009, while it continued to pursue four other WTO cases against China, as set out in Table 2 below.

In the newest WTO case, initiated in June 2009, the United States, joined by the EU and later Mexico, are challenging export quotas, export duties and other restraints maintained by China on the export of several key raw material inputs for which China is a leading world producer. The materials at issue include bauxite, coke, fluorspar, magnesium, manganese, silicon metal, silicon carbide, yellow phosphorus and zinc. These types of export restraints can skew the playing field against the United States and other countries by creating substantial competitive benefits for downstream Chinese producers that use the inputs in the production and export of numerous processed steel, aluminum and chemical products and a wide range of further processed products. Joint consultations were held in July and September 2009, and a WTO panel was established to hear this case at the complaining parties' request in December 2009.

In one of the five other active WTO cases, initiated in December 2008, the United States and Mexico, later joined by Guatemala, had challenged a Chinese industrial policy that generated a vast number of central, provincial and local government programs promoting increased worldwide recognition and sales of famous brands of Chinese merchandise through what appear to be prohibited exported subsidies. Joint consultations were held in February 2009, followed by intense discussions as China took steps to repeal or modify the numerous measures at issue. In December 2009, the parties concluded a settlement agreement in which China confirmed that it had eliminated all of the export-contingent benefits in the challenged measures.

In another active WTO case, initiated in February 2008, the United States, joined by the EU and Canada, had challenged restrictions on foreign financial information service suppliers imposed by a Chinese regulator that also operates its own competing financial information service. As

previously reported, the United States was pleased that China agreed to settle this case in November 2008 by agreeing, among other things, to create an independent regulator of financial information service companies and to remove restrictions that had been placed on foreign financial information service suppliers. In 2009, China took key steps toward complying with the terms of the settlement agreement by creating an independent regulator and removing the challenged restrictions on foreign financial information service suppliers.

In another active WTO case, initiated in March 2006, the United States, the EU and Canada had challenged Chinese measures imposing discriminatory charges and other burdens on imported auto parts, whenever the parts are incorporated into vehicles in which the number or value of imported parts exceeds certain thresholds China has set – or, in other words, when there is not enough local content. In July 2008, a WTO panel ruled in favor of the United States and the other complaining parties. China subsequently appealed the panel's decision in September 2008, and the WTO's Appellate Body issued its ruling in December 2008, upholding the panel's decision. China came into compliance with this ruling in September 2009 by repealing the measures at issue.

The two remaining WTO cases that were active in 2009 involved U.S. challenges focused on remedying problems being encountered in China by U.S. holders of intellectual property rights. One WTO case challenged key aspects of China's IPR enforcement regime, and the other WTO case challenged market access restrictions affecting the importation and distribution of copyright-intensive products such as books, newspapers, journals, theatrical films, DVDs and music.

In the IPR enforcement WTO case, proceedings before a WTO panel took place in 2008, and the panel issued its decision in January 2009. The panel ruled in favor of the United States on two of three claims, finding WTO-inconsistent China's denial of copyright protection to works that do not meet

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China's content review standards as well as China's handling of border enforcement seizures of counterfeit goods. On the third claim, the panel supported the U.S. position by clarifying important legal standards relating to the criminal enforcement of copyrights and trademarks, but determined that it did not have sufficient factual information to find WTO-inconsistent China's quantitative thresholds for criminal prosecution and liability. Neither party appealed the panel's decision, and China agreed to come into compliance with it by March 2010.

In the market access WTO case, proceedings before a WTO panel took place in 2008, and the panel issued its decision in August 2009, ruling in favor of the United States on every significant issue in this case. China appealed the panel's decision in September 2009. The WTO's Appellate Body rejected China's appeal on all counts in December 2009.

Table 2

Active U.S. WTO Disputes Against China in 2009

China – Auto Parts	
<u>Initiation:</u>	March 2006
<u>Dispute:</u>	The United States, Canada and the EU challenged Chinese measures imposing discriminatory charges and other burdens on imported auto parts, whenever the parts are incorporated into vehicles in which the number or value of imported parts exceeds certain thresholds China has set (or, in other words, when there is not enough local content).
<u>Third Parties:</u>	Argentina, Australia, Brazil, Japan, Mexico, Chinese Taipei and Thailand
<u>Status:</u>	A WTO panel issued its decision in July 2008, ruling that China's charges on imported auto parts were inconsistent with WTO rules. China appealed this decision in September 2008. The WTO's Appellate Body upheld the panel's decision in December 2008. China repealed the challenged measures in September 2009.
China – IPR Enforcement	
<u>Initiation:</u>	April 2007
<u>Dispute:</u>	The United States challenged certain deficiencies in China's legal regime related to the enforcement of copyrights and trademarks.
<u>Third Parties:</u>	Argentina, Brazil, Canada, the EU, Japan, Korea, Mexico and Chinese Taipei
<u>Status:</u>	A WTO panel issued its decision in January 2009, finding in favor of the United States on two of its three claims and clarifying important legal principles related to the third claim. Neither party appealed the panel's decision. China has agreed to come into compliance by March 2010.
China – Market Access for Books, Movies and Music	
<u>Initiation:</u>	April 2007
<u>Dispute:</u>	The United States is challenging China's barriers to importing and distributing books, newspapers, journals, theatrical films, DVDs and music in China.
<u>Third Parties:</u>	Australia, the EU, Japan, Korea and Chinese Taipei
<u>Status:</u>	A WTO panel issued its decision in August 2009. China appealed the panel's decision in September 2009. The WTO's Appellate Body rejected China's appeal in December 2009.
China – Financial Information Services	
<u>Initiation:</u>	March 2008
<u>Dispute:</u>	The United States, the EU and Canada challenged China's restrictions on foreign financial information service suppliers like Bloomberg, Dow Jones and Reuters.
<u>Third Parties:</u>	None
<u>Status:</u>	In November 2008, the United States, the EU and Canada concluded a settlement agreement with China, in which China agreed to remove the challenged restrictions on foreign financial information service suppliers beginning by January 31, 2009 and concluding by May 30, 2009. China has taken key steps toward complying with terms of the settlement agreement.

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Table 2

Active U.S. WTO Disputes Against China in 2009 (cont'd)

China – Famous Brand Export Subsidies	
<u>Initiation:</u>	December 2008
<u>Dispute:</u>	The United States, Mexico and Guatemala are challenging what appear to be numerous prohibited export subsidies being used by China in part to support an industrial policy promoting increased worldwide recognition and sales of famous brands of Chinese merchandise.
<u>Third Parties:</u>	Australia, Canada, Colombia, Ecuador, the EU, New Zealand and Turkey
<u>Status:</u>	Joint consultations took place in February 2009. In December 2009, the parties concluded a settlement agreement, in which China confirmed that it had taken steps to eliminate all of the export-contingent benefits at issue.
China – Export Restraints on Raw Materials	
<u>Initiation:</u>	June 2009
<u>Dispute:</u>	The United States, the EU and Mexico are challenging China's export restraints on several key raw material inputs used to produce downstream products in steel, aluminum and chemical sectors around the world.
<u>Third Parties:</u>	Canada and Turkey
<u>Status:</u>	Joint consultations took place in July and September 2009. A WTO panel was established to hear this case at the complaining parties' request in December 2009.

CHINA'S WTO COMPLIANCE

Set forth below is a detailed analysis of the commitments that China made upon acceding to the WTO on December 11, 2001, the progress that China has made in complying with those commitments and the United States' efforts to address compliance concerns that have arisen as of December 2009. As noted above, a summary of China's WTO compliance efforts is reproduced in Table 1.

TRADING RIGHTS

China appears to be in compliance with its trading rights commitments in most areas, although one significant concern involves the right to import copyright-intensive products such as books, newspapers, journals, theatrical films, DVDs and music, which China still reserves for state trading.

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). Nevertheless, together with China's distribution services commitments, China's trading rights commitments call for the elimination of significant barriers to a wide range of U.S. and other foreign industries doing business, or seeking to do business, in China.

Until shortly before its WTO accession, China severely restricted the number and types of enterprises that could import or export goods, and it also restricted the goods 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, China committed to substantial liberalization in the area of trading rights. Most importantly, 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.

As previously reported, the National People's Congress issued a revised *Foreign Trade Law*, which provided for trading rights to be automatically available through a registration process for all domestic and foreign entities and individuals, effective July 1, 2004, while MOFCOM issued implementing rules setting out the procedures for registering as a foreign trade operator. U.S. companies have continued to report few problems with this trading rights registration process, although to date it appears that China has not yet complied with its trading rights commitments as they relate to books, movies and music.

Books, Movies and Music

Under the terms of China's accession agreement, it appears that trading rights for copyright-intensive products such as books, newspapers, journals, theatrical films, DVDs and music 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. These products are not included in the list of products for which China reserved the right to engage in state trading.

Nevertheless, China has not yet liberalized trading rights for these products. China continues to wholly reserve the right to import these products to state trading enterprises, as reflected in a complex web of measures issued by numerous agencies, including the State Council, the State Administration of Radio, Film and Television (SARFT), MOFCOM, the National Development and Reform Commission (NDRC), the Ministry of Culture, the General Administration of Press and Publication (GAPP) and the General Administration of Customs.

As previously reported, after raising this matter and China's related restrictions on distribution in numerous bilateral meetings with China and at the WTO during the annual transitional reviews before the Committee on Market Access and before the Council for Trade in Goods, the United States initiated a WTO dispute settlement case against China in April 2007, challenging China's restrictions on the importation and distribution of copyright-intensive products such as books, newspapers, journals, theatrical films, DVDs and music. Proceedings before the WTO panel took place in July and September 2008, and the panel issued its decision in August 2009, ruling in favor of the United States on all significant issues. China appealed the panel's decision in September 2009. The WTO's Appellate Body rejected China's appeal on all counts in December 2009.

DISTRIBUTION SERVICES

China has made substantial progress in implementing its distribution services commitments, although significant concerns remain in a number of areas, including wholesale services, retail services and direct selling services.

Prior to its WTO accession, China generally did not permit foreign enterprises to distribute products in China, i.e., to provide wholesaling, commission agents', retailing or franchising services or to provide related services, such as repair and maintenance services. These services were largely reserved to Chinese enterprises, although some foreign-invested

enterprises were allowed to engage in distribution services within China under certain circumstances. For example, joint ventures have had the right to supply wholesaling and retailing services for the goods they manufacture in China since the issuance of the *Regulations for the Implementation of the Law on Chinese-Foreign Equity Joint Ventures* by MOFCOM's predecessor, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), in December 1987. Similarly, wholly foreign-owned enterprises had this same right under the *Detailed Rules for the Implementation of the Law on Wholly Foreign-Owned Enterprises*, issued by MOFTEC in April 2001.

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

Overall, China has made substantial progress in implementing its distribution services commitments. However, it appears that foreign retailers seeking licenses for new outlets continue to face discriminatory requirements, and China continues to place severe restrictions on direct selling, although China did address some problems in these areas in 2009. In addition, the distribution of some products seems to remain unjustifiably restricted. Affected products include copyright-intensive products such as books, newspapers, journals, theatrical films, DVDs and music – currently, the subject of a WTO dispute settlement case brought by the United States – as well as pharmaceuticals, crude oil and processed oil.

Meanwhile, U.S. and other foreign companies continue to face challenges unrelated to China's WTO obligations, particularly as they attempt to

create nationwide distribution networks in China. Currently, distribution networks remain highly fragmented in China, as there are no Chinese distribution companies with nationwide networks and no Chinese distribution company holds a market share greater than two percent, due largely to infrastructure limitations and restrictive provincial and local requirements.

Wholesaling Services

China has issued regulations generally implementing its commitments in the area of wholesaling and commission agents' services, although the regulations do not remove significant restrictions on the distribution of copyright-intensive products such as books, newspapers, journals, theatrical films, DVDs and music. U.S. companies in some industries also have concerns about continuing restrictions on the distribution of other products, such as pharmaceuticals and crude oil and processed oil.

China committed that, immediately upon its accession to the WTO, it would begin to eliminate national treatment and market access limitations on foreign enterprises providing wholesaling services and commission agents' services through a local presence pursuant to an agreed schedule of liberalization. Within three years after accession (or by December 11, 2004), almost all of the required liberalization should have been implemented. By this time, China agreed to permit foreign enterprises to supply wholesaling services and commission agents' services within China through wholly foreign-owned enterprises. In addition, exceptions that China had been allowed to maintain for books, newspapers, magazines, pharmaceutical products, pesticides and mulching films were to be eliminated. Exceptions for chemical fertilizers, processed oil and crude oil (but not salt and tobacco) were to be eliminated within five years after accession (or by December 11, 2006).

As previously reported, MOFCOM issued the *Measures on the Management of Foreign Investment in the Commercial Sector* in April 2004 following

sustained engagement by the United States, including through the JCCT process. Among other things, these regulations lifted market access and national treatment restrictions on wholly foreign-owned enterprises and removed product exceptions for books, newspapers, magazines, pesticides and mulching films as of the scheduled phase-in date of December 11, 2004. The regulations also required enterprises to obtain central or provincial-level MOFCOM approval before providing wholesale services, and they appeared to set relatively low qualifying requirements, as enterprises needed only to satisfy the relatively modest capital requirements of the *Company Law* rather than the high capital requirements found in many other services sectors. Following the issuance of the regulations, MOFCOM's application and approval process remained opaque and was beset with a variety of problems, but these problems largely disappeared in 2006.

With these developments, U.S. companies have been able to improve the efficiency of their China supply chain management. In addition, many of them have been able to restructure their legal entities to integrate their China operations into their global business more fully and efficiently, although problems remain in certain areas.

Books, Movies and Music

As in the area of trading rights, China continues to impose restrictions on foreign enterprises' distribution of copyright-intensive products such as books, newspapers, journals, theatrical films, DVDs and music, despite its commitments to remove most market access and national treatment restrictions applicable to the distribution of these products by no later than December 11, 2004. China's continuing restrictions are set forth in a complex web of measures issued by numerous agencies, including the State Council, NDRC, MOFCOM, the Ministry of Culture, SARFT and GAPP.

As previously reported, after raising this matter and China's related restrictions on importation in

numerous bilateral meetings with China and at the WTO during the annual transitional reviews before the Council for Trade in Services, the United States initiated a WTO dispute settlement case against China in April 2007 covering the importation and distribution restrictions applicable to copyright-intensive products such as books, newspapers, journals, theatrical films, DVDs and music. As discussed above in the Trading Rights section, a WTO panel issued its decision in August 2009, ruling in favor of the United States on all significant issues, and China appealed. The WTO's Appellate Body rejected China's appeal on all counts in December 2009.

Automobiles

China began to implement several measures related to the distribution of automobiles by foreign enterprises in 2005, including the February 2005 *Implementing Rules for the Administration of Brand-Specific Automobile Dealerships*, jointly issued by MOFCOM, the NDRC and the State Administration for Industry and Commerce (SAIC). In November 2005, the NDRC followed up with the *Rules for Auto External Marks*, and in January 2006 MOFCOM issued the *Implementing Rules for the Evaluation of Eligibility of Auto General Distributors and Brand-specific Dealers*. While U.S. industry has generally welcomed these measures, they do contain some restrictions on foreign enterprises that may not be applied to domestic enterprises. As in 2009, the United States will closely monitor how China applies these measures in 2010 in an effort to ensure that foreign enterprises are not adversely affected by these restrictions.

Pharmaceuticals

China committed to allow foreign suppliers to distribute pharmaceuticals by December 11, 2004, and it began accepting applications from and issuing wholesale licenses to foreign pharmaceutical companies about 6 months after that deadline. At the same time, despite overall progress in this area, many other restrictions affecting the

pharmaceuticals sector make it difficult for foreign pharmaceutical companies to realize the full benefits of China's distribution commitments. The United States is continuing to engage the Chinese regulatory authorities in these areas as part of an effort to promote comprehensive reform of China's healthcare system and to reduce the unnecessary trade barriers that foreign companies face.

Crude Oil and Processed Oil

China committed to permit foreign enterprises to engage in wholesale distribution of crude oil and processed oil, e.g., gasoline, by December 11, 2006. Shortly before this deadline, as previously reported, China issued regulations that prevent U.S. and other foreign enterprises from realizing the full benefits of this important commitment. In particular, China's regulations impose high thresholds and other potential impediments on foreign enterprises seeking to enter the wholesale distribution sector, such as requirements relating to levels of storage capacity, pipelines, rail lines, docks and supply contracts. The United States has raised concerns about these regulations in connection with past transitional reviews before the Council for Trade in Services, while U.S. industry has attempted to compete under difficult circumstances. In consultation with U.S. industry, the United States will continue to assess the effects of China's restrictive regulations in 2010 while urging China to remove unwarranted impediments to market entry.

Retailing Services

China has issued regulations generally implementing its commitments in the area of retailing services, although concerns remain with regard to licensing discrimination, restrictions related to urban commercial networks and restrictions on processed oil.

China committed that, immediately upon its accession to the WTO, it would begin to eliminate national treatment and market access limitations on foreign enterprises providing retailing services

through a local presence pursuant to an agreed schedule of liberalization. Within three years after accession (or by December 11, 2004), almost all of the required liberalization should have been implemented. By this time, China agreed to permit foreign enterprises to supply retailing services through wholly foreign-owned enterprises. In addition, by this time, exceptions that China had been allowed to maintain for pharmaceutical products, pesticides, mulching films and processed oil were to be eliminated. An exception for chemical fertilizers was to be eliminated within five years after accession (or by December 11, 2006).

As previously reported, the April 2004 distribution regulations issued by MOFCOM lifted market access and national treatment limitations on wholly foreign-owned enterprises and removed the product exceptions for pesticides and mulching films as of the scheduled phase-in date of December 11, 2004, while removing the product exception for chemical fertilizer as of the scheduled phase-in date of December 11, 2006. As in the wholesale area, these regulations require enterprises to obtain central and provincial-level MOFCOM approval before providing retail services, and they appear to set relatively low qualifying requirements, including relatively modest capital requirements, although in practice foreign (but not domestic) retailers reportedly must meet higher capital requirements.

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

Licensing Process

In 2007, the U.S. retail industry became concerned about other extra burdens that it faces, in comparison to domestic retailers, when attempting to expand their operations in China. At the time, the licensing process for a foreign retailer seeking to establish a new store began with a MOFCOM process, which was multi-layered and slow-moving, requiring approvals at the local, provincial and central government levels. Only after the MOFCOM process is completed could the foreign retailer obtain an actual license from SAIC. In contrast, domestic retailers could quickly obtain licenses directly from SAIC. In addition, domestic retailers did not need to satisfy substantive requirements that are imposed on foreign companies, whether by law or by practice, such as an additional minimum capital requirement for each new store or, as discussed below, a requirement that the location city for the new store have an urban commercial network plan in place.

As previously reported, following U.S. engagement of China both bilaterally and at the WTO, including the November 2007 transitional review before the Council for Trade in Services and China's second Trade Policy Review in May 2008, the United States began to see incremental progress in this area. China announced during the run-up to the September 2008 JCCT meeting that it had delegated authority for foreign retail outlet license approvals to the provincial government level. Since then, U.S. retailers have welcomed this change as a positive step in streamlining and facilitating approvals for foreign retail outlets. In 2010, the United States will continue to monitor how this new licensing process works in practice while continuing to urge China to stop imposing additional capital requirements on foreign retailers.

Urban Commercial Network Plans

In April 2006, MOFCOM issued a notice explaining that foreign-invested enterprises would not be

granted approvals for projects in cities that had not yet finalized their urban commercial network plans. The United States has raised concerns about this notice, both bilaterally and during subsequent transitional reviews before the WTO's Council for Trade in Services, because it appeared that domestic enterprises were continuing to receive approvals for their projects in cities without urban commercial network plans in place. In 2010, the United States will continue to monitor this situation in close coordination with U.S. industry.

Processed Oil

China committed to allow wholly foreign-owned enterprises to sell processed oil, e.g., gasoline, at the retail level by December 11, 2004, without any market access or national treatment limitations. However, to date, China has treated retail gas stations as falling under the chain store provision in its Services Schedule, which permits only joint ventures with minority foreign ownership for "those chain stores which sell products of different types and brands from multiple suppliers with more than 30 outlets." This treatment has severely restricted foreign suppliers' access to China's retail gas market, a situation that has since been exacerbated by China's restrictions on foreign enterprises that seek to engage in wholesale distribution of crude oil and processed oil. As in prior years, the United States is working with U.S. industry to assess the effects of China's unwarranted restrictions on wholesale and retail distribution in this sector and will continue to engage the Chinese government in 2010 in an effort to ensure that U.S. industry realizes the full benefits to which it is entitled in this sector.

Franchising Services

China has issued regulations generally implementing its commitments in the area of franchising services, although some concerns remain.

As part of its distribution commitments, China committed to permit the cross-border supply of franchising services immediately upon its accession

to the WTO. It also committed to permit foreign enterprises to provide franchising services in China, without any market access or national treatment limitations, by December 11, 2004.

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

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

Direct Selling Services

China has issued regulations generally implementing its commitments in the area of direct selling services, although significant regulatory restrictions imposed on the operations of direct sellers continue to generate concern. In a positive step, it appears that China has resumed issuing direct selling licenses after a two-year moratorium.

China first permitted direct selling in 1990, and numerous domestic and foreign enterprises soon began to engage in this business. In the ensuing years, however, serious economic and social problems arose, as so-called "pyramid schemes" and

other fraudulent or harmful practices proliferated. China outlawed direct selling in 1998, although some direct selling companies were permitted to continue operating in China after altering their business models.

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

As previously reported, the Chinese authorities issued two direct selling implementing measures – the *Measures for the Administration of Direct Selling* and the *Regulations on the Administration of Anti-Pyramid Sales Scams* – in August 2005, followed by the *Administrative Measures on the Establishment of Service Network Points for the Direct Sales Industry* in September 2006. These measures contained several problematic provisions. For example, one provision essentially outlaws multi-level marketing practices allowed in every country in which the U.S. industry operates – reportedly 170 countries in all – by refusing to allow direct selling enterprises to pay compensation based on team sales, where upstream personnel are compensated based on downstream sales. Other problematic provisions include a three-year experience requirement that only applies to foreign enterprises, not domestic enterprises, a cap on single-level compensation, restrictions on the cross-border supply of direct selling services and high capital requirements that may limit smaller direct sellers' access to the market. The measures also include vague requirements that could prove excessively burdensome for small and medium-sized direct sellers.

MOFCOM's application and review process subsequently proved to be opaque and slow, although a number of companies, including several foreign companies, eventually obtained direct selling licenses. However, beginning in May 2007, it appeared that MOFCOM was not issuing any new

licenses even though several companies had applied for them.

Using the JCCT process, the transitional reviews before the WTO's Council for Trade in Services in 2007 and 2008 and China's second Trade Policy Review, held in May 2008, the United States urged China to resume issuing direct selling licenses. In addition, the United States continued to urge China to reconsider the problematic provisions in its direct selling measures in order to facilitate legitimate commerce and to address U.S. concerns about China's WTO compliance. The United States also explained how China could revise its measures while still addressing its legitimate concerns about pyramid schemes.

In 2009, the United States continued to press its concerns during the run-up to the October 2009 JCCT meeting. At that meeting, China indicated that it was in the process of concluding its licensing procedures for certain qualified direct selling companies. Since then, China has issued a direct selling license to one additional U.S. direct selling company, and the United States has stressed the importance of China following the time frames set forth in its regulations to quickly approve any additional qualified applicants.

In 2010, the United States will closely monitor MOFCOM's progress in issuing new direct selling licenses. The United States will also continue to press China to reconsider the problematic provisions in its direct selling measures.

IMPORT REGULATION

Tariffs

China has timely implemented its tariff commitments for industrial goods each year.

During 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 2009 on schedule. These reductions, made on January 1, involved only a few products, most of which were chemical products, as almost all of China’s tariff reductions took place during the first five years of China’s WTO membership.

In 2009, U.S. exports benefited from China’s ongoing 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 performed well in 2009, taking into account the global economic downturn, as they were projected to total \$10 billion by the end of the year.

U.S. exports also continued to benefit from China’s ongoing adherence to another significant tariff initiative, the WTO’s Chemical Tariff Harmonization Agreement, completed in 2005. U.S. exports of chemicals covered by this agreement increased each year from 2005 through 2008, when they exceeded \$8 billion. Largely because of the global economic downturn, U.S. exports of these chemicals declined by 22 percent from January through September 2009, when compared to the same time period in 2008, although exports of pharmaceuticals were up nearly 17 percent.

Overall, China’s tariff changes since WTO accession have significantly increased market access for U.S. exporters in a range of industries, as China reduced

tariffs on goods of greatest importance to U.S. industry from a base average of 25 percent (in 1997) to 7 percent during the first five years of its WTO membership, while it made similar reductions throughout the agricultural sector (see the Agriculture section below). The United States continued to benefit from these tariff reductions in 2009. Even though overall U.S. exports to China decreased by 12 percent from January through September 2009, when compared to the same time period in 2008, the global economic downturn caused U.S. exports to the world to decline by twice as much (23 percent).

Customs and Trade Administration

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

CUSTOMS VALUATION

China has issued measures that bring its legal regime for making customs valuation determinations into compliance with WTO rules, but implementation of these measures has been inconsistent from port to port, both in terms of customs clearance procedures and valuation determinations.

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.

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

Customs Clearance Procedures

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

Valuation Determinations

China has still not uniformly implemented the various customs valuation measures issued following its accession to the WTO. U.S. exporters continue to report that they are encountering valuation problems at many ports.

According to U.S. exporters, even though the Customs Administration's measures provide that imported goods normally should be valued on the basis of their transaction price, meaning the price the importer actually paid, many Chinese customs officials are still improperly using "reference pricing," which usually results in a higher dutiable value. For example, imports of wood products are often subjected to reference pricing.

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

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

When the United States first presented its concerns about the customs valuation problems being encountered by U.S. companies, China indicated that it was working to establish more uniformity in its adherence to WTO customs valuation rules. Since then, the United States has sought to assist in this

effort in part by conducting technical assistance programs for Chinese government officials on WTO compliance in the customs area. In addition, the United States has continued to raise its concerns about particular customs valuation problems during the transitional reviews before the WTO's Committee on Customs Valuation, including in 2009.

RULES OF ORIGIN

China has issued measures that bring its legal regime for making rules of origin determinations into compliance with WTO rules.

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

As previously reported, it took China nearly three years after its accession to the WTO for China's State Council to issue the *Regulations of the Place of Origin for Imported and Exported Goods*, the measure intended to bring China's rules of origin into conformity with WTO rules for import and export purposes. Shortly thereafter, the Customs Administration issued implementing rules addressing the issue of substantial transformation. U.S.

exporters have not raised concerns with China's implementation of these measures.

IMPORT LICENSING

China has issued measures that bring its legal regime for import licenses into compliance with WTO rules, although a variety of specific compliance issues continue to arise, as in the case of China's import licensing procedures for iron ore imports.

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

As previously reported, 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. In 2009, as in prior years, the United States continued to monitor MOFCOM's implementation of these regulations.

Iron Ore

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

Since then, the United States has continued to monitor this situation closely. It sets a troubling precedent for the handling of imports of other raw materials and could provide an unfair advantage to Chinese steel producers in international contract negotiations.

In 2006, because the Chinese government had apparently worked with CISA and other Chinese industry groups to restrict the availability of iron ore

import licenses, the United States raised its concerns with China bilaterally in meetings of the U.S.-China Steel Dialogue (Steel Dialogue). The United States also addressed this issue during the transitional review before the Committee on Import Licensing, held in October 2006, as did Australia.

In 2007, China reduced the number of licensed traders from 48 to 42. It also reportedly instituted further restrictions on qualifying criteria for iron ore import licenses, including tighter limitations on the size of the enterprises eligible to import iron ore and shipment sizes. In 2008, China went one step further. It reportedly temporarily suspended the issuance of licenses to importers of Australian iron ore in an effort to limit price increases being negotiated between foreign exporters of iron ore and Chinese steelmakers. In both years, the United States raised concerns about China's actions, both bilaterally through Steel Dialogue meetings and during transitional review meetings before the Committee on Import Licensing.

The United States continued to examine developments in this area closely in 2009. In March 2009, China issued a stimulus plan to revitalize its steel industry. The plan provides that the Chinese government will regulate iron ore imports to ensure market order and that Chinese steel producers and iron ore suppliers will establish a mutually beneficial import pricing mechanism and long-term cooperation relationship. In reality, however, the Chinese market was in disarray throughout 2009, as individual licensed Chinese steel producers and traders continued to purchase iron ore on the spot market, and contract negotiations between CISA, on behalf of Chinese steel producers, and foreign iron ore producers dragged on without CISA securing sought-after reductions of up to 40 percent in iron ore contract prices. Meanwhile, some of the large Chinese steel producers with licenses giving them access to imported iron ore reportedly re-sold up to 10 percent of their imports to small Chinese steel producers at higher prices, thereby profiting from the iron ore import licensing system and undermining the Chinese government's efforts to

control the growth of small steel producers. As the year wore on, China's steel production accelerated, and iron ore imports surged to record high levels. CISA responded by proposing, without success, that the Chinese government shut down spot markets and impose a unified price for iron ore in order to stabilize the market within China. However, the Chinese government is reportedly considering further reductions in the number of licensed iron ore traders.

In 2010, the United States will continue to monitor closely China's iron ore import licensing system as well as other Chinese government actions seeking to influence iron ore prices.

Other Issues

The United States has focused considerable attention on import licensing issues that have arisen in a variety of other specific contexts since China's WTO accession. In 2009, these included the administration of tariff-rate quota systems for fertilizer and cotton (discussed below in the sections on Tariff-rate Quotas on Industrial Goods and Tariff-rate Quotas on Bulk Agricultural Commodities), various SPS measures (discussed below in the section on Sanitary and Phytosanitary Issues) and inspection-related requirements for soybeans, meat and poultry (discussed below in the section on Inspection-Related Requirements).

Non-tariff Measures

China has adhered to the agreed schedule for eliminating non-tariff measures.

In its WTO accession agreement, China agreed that it would eliminate numerous trade-distortive non-tariff measures (NTMs), including import quotas, licenses and tendering requirements covering hundreds of products. Most of these NTMs, including, for example, the NTMs covering chemicals, agricultural equipment, medical and scientific equipment and civil aircraft, had to be eliminated by the time that China acceded to the

WTO. China committed to phase out other NTMs, listed in an annex to the accession agreement, over a transition period ending on January 1, 2005. These other NTMs included import quotas on industrial goods such as air conditioners, sound and video recording apparatus, color TVs, cameras, watches, crane lorries and chassis, and motorcycles as well as licensing and tendering requirements applicable to a few types of industrial goods, such as machine tools and aerials.

As previously reported, China's import quota system was beset with problems, despite consistent bilateral engagement by the United States. 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. However, China did fully adhere to the agreed schedule for the elimination of all of its import quotas as well as all of its other NTMs, the last of which China eliminated in January 2005. In some cases, China even eliminated NTMs ahead of schedule, as it did with the import quotas on crane lorries and chassis, and motorcycles.

Tariff-rate Quotas on Industrial Products

Concerns about transparency and administrative guidance have plagued China's tariff-rate quota system for industrial products, particularly fertilizer, since China's accession to the WTO.

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

applications, allocate quotas and reallocate unused quotas.

As previously reported, since China began implementing its TRQ system for industrial products in 2002, U.S. exporters have expressed concern about a lack of transparency, which made it difficult to assess whether the quota allocations followed the rules set out in China's Goods Schedule, and about the Chinese government's issuance of administrative guidance that discouraged some TRQ holders from freely utilizing their quotas. Despite repeated bilateral engagement and multilateral engagement at the WTO, including formal consultations with China in Geneva under the headnotes in China's Goods Schedule, concerns about transparency and administrative guidance have persisted.

At the same time, U.S. fertilizer exports to China declined significantly, dropping from \$676 million in 2002 to \$232 million in 2006. Although it was initially anticipated that U.S. fertilizer exports to China might increase following the scheduled phase-in of foreign enterprises' rights to engage in wholesale and retail distribution of fertilizer within China as of December 11, 2006, U.S. fertilizer exports sharply declined in 2007, dropping by 58 percent to \$97 million, and then rebounded to \$193 million in 2008, before dropping by 68 percent in the first nine months of 2009 when compared to the same time period in 2008.

It appears that separate Chinese government policies restricting the export of a key fertilizer input, phosphate rock, have had a significant impact on China's fertilizer market. In November 2006, China began restricting the export of phosphate rock through the imposition of a 10 percent export duty. China increased the export duty to 20 percent in June 2007 and then to 120 percent in May 2008 while also establishing minimum export prices for phosphate rock. China subsequently reduced the export duty to 95 percent in December 2008, and then to 70 percent in January 2009. Among other things, these export restraints appear to have decreased the price of phosphate rock within the

China market, enabling China's downstream producers to produce more fertilizer at lower prices and thereby making it difficult for foreign producers to compete in the China market.

As discussed below in the Export Regulation section, China's export restraints on phosphate rock and several other raw materials raise serious WTO concerns. After bilateral dialogue with China failed to lead to a resolution of these concerns, the United States initiated WTO dispute settlement in June 2009 regarding export restraints maintained by China on several raw material inputs. Shortly thereafter, China lowered the export duty on phosphate rock to 20 percent.

Other Import Regulation

ANTIDUMPING

China has issued measures bringing its legal regime in the AD area largely into compliance with WTO rules, although China still needs to issue additional rules covering expiry reviews. In 2009, China became a more active user of the AD remedy, making it even more important that China improve its adherence to the transparency and procedural fairness requirements embodied in WTO rules.

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

China has become a leading user of AD measures since its accession to the WTO. Currently, China has in place 101 antidumping measures, some of which

pre-date China's membership in the WTO, affecting imports from 16 countries or regions. China also has 20 AD investigations in progress. The greatest shortcomings in China's AD practice continue to be in the areas of transparency and procedural fairness, which generated increasing concern in 2009 as China became a much more active user of the AD remedy. The United States continues to press China both bilaterally and multilaterally to address these concerns.

Legal Regime

As previously reported, China has put in place much of the legal framework for its AD regime. Under this regime, MOFCOM's 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. In cases where the subject merchandise is an agricultural product, the Ministry of Agriculture may be involved in the injury investigation. The State Council Tariff Commission continues to make the final decision on imposing, revoking or retaining AD duties, based on recommendations provided by the BOFT and the IBII, although its authority relative to MOFCOM has not been clearly defined in the regulations and rules since MOFCOM was established.

China continues to add new regulations and rules to its AD legal framework, although not all of these measures have been notified to the WTO in a timely manner. Most recently, in July 2009, MOFCOM solicited public comment on draft revisions of its rules on new shipper reviews, antidumping duty refunds, and price undertakings. Once finalized, China is also obligated to notify these revised rules to the WTO so that all Members have an opportunity to review the rules for compliance with the AD Agreement and seek any needed clarifications.

Meanwhile, in one area, China has still not issued necessary regulations. China has not issued any regulations specifically establishing the rules and procedures governing expiry reviews.

Conduct of Antidumping Investigations

In practice, it appears that China's conduct of AD investigations in many respects continues to fall short of full adherence to the fundamental tenets of transparency and procedural fairness embodied in the AD Agreement. In 2009, respondents from the United States and other WTO members continued to express concerns about key lapses in transparency and procedural fairness in China's conduct of AD investigations. The principal areas of concern include the inadequate disclosure of key documents placed on the record by domestic Chinese producers, insufficiently detailed disclosures of the essential facts underlying MOFCOM decisions, such as the results of on-site verification, dumping margin calculations and evidence supporting injury and dumping conclusions, and MOFCOM not adequately addressing critical arguments or evidence put forward by interested parties. These concerns took on added importance for U.S. respondents, as China initiated four new AD investigations involving U.S. exports in 2009.

As China's antidumping regime has matured, many of the AD orders put in place have reached the five-year mark, warranting expiry reviews. MOFCOM is currently conducting 11 expiry reviews, three of which involve products from the United States, and several more are scheduled for next year. To date, every expiry review involving U.S. products has resulted in the measure being extended. Given the problems that respondents have encountered in China's AD investigations, it is critical that China publish rules and procedures specifically governing the conduct of expiry reviews, as required by the AD Agreement. The United States has pressed China to issue regulations governing expiry reviews for more than two years and will continue to do so in 2010.

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

The United States continues to engage China vigorously on these matters, principally through the Trade Remedies Working Group, which was established under the auspices of the JCCT in April 2004. This working group has given U.S. AD experts a dedicated forum to engage China's AD authorities directly and in detail on issues facing U.S. exporters subject to Chinese AD investigations. The working group has held several meetings since its creation in April 2004, with the next meeting planned for early 2010. In between working group meetings, U.S. AD experts also have frequent informal exchanges with China's AD authorities, which help to promote greater accountability in China's AD regime.

At the WTO, the United States continues to address problems with China's AD practices both during regular meetings and the annual transitional reviews before the AD Committee. During the most recent transitional review, held in October 2009, the United States and Japan reiterated their longstanding concerns regarding transparency and procedural fairness.

At the same time, the United States continues to work closely with U.S. companies affected by Chinese AD investigations in an effort to help them better understand the Chinese system. The United States also advocates on their behalf in connection with ongoing AD investigations, with the goal of obtaining fair and objective treatment for them, consistent with the AD Agreement. As previously reported, when the United States notified China that it would be filing a request for WTO consultations challenging MOFCOM's September 2005 final determination in the AD investigation of unbleached kraft linerboard (a cardboard-like packaging material), MOFCOM issued an "administrative reconsideration" the next day in which it rescinded the antidumping duties on kraft linerboard imports. It also appears that the United States' focus on China's WTO obligations may have played a role in MOFCOM's March 2007 termination of the AD investigation of butanols imported from the United States.

COUNTERVAILING DUTIES

China has issued measures bringing its legal regime in the CVD area largely into compliance with WTO rules, although China still needs to issue additional rules covering expiry reviews. Now that China has begun initiating CVD investigations, it has become apparent that China needs to improve its adherence to the transparency and procedural fairness requirements embodied in WTO rules, just as in the AD area.

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

China initiated its first CVD investigation in 2009 and currently has 3 ongoing CVD investigations. Each of these investigations involves imports of products from the United States. Many of the shortcomings observed in China's AD practice with regard to transparency and procedural fairness can now be found in China's CVD practice. In addition, China has committed significant procedural errors in its initial CVD investigations that appear to be inconsistent with Subsidies Agreement rules. The United States has pressed China both bilaterally and multilaterally to address these concerns.

Legal Regime

As previously reported, China has put in place much of the legal framework for its CVD regime. Under

this regime, like in the AD area, MOFCOM's BOFT is charged with making subsidies determinations, and MOFCOM's IBII is charged with making injury determinations.

It appears that China has attempted 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. In addition, China has not yet issued regulations specifically establishing the rules and procedures governing expiry reviews.

Since China's accession to the WTO, the United States and other WTO members have sought clarifications on a variety of issues concerning China's regulatory framework and have pressed China for greater transparency both during regular meetings and the annual transitional reviews before the Subsidies Committee. The United States will continue to seek clarifications as needed in 2010.

Conduct of Countervailing Duty Investigations

In June 2009, acting on a petition from the Chinese steel industry, MOFCOM initiated China's first CVD investigation. The petition had alleged that subsidies were being provided to the U.S. grain-oriented electrical steel industry. Since then, MOFCOM has initiated two additional CVD investigations involving imports of chicken parts and automobiles from the United States.

As in the AD area, it has become evident that China needs to improve its adherence to the transparency and procedural fairness requirements embodied in WTO rules when conducting CVD investigations. In addition, the United States has noted apparent procedural errors specific to China's conduct of CVD investigations. For example, China has initiated investigations of alleged subsidies despite an apparent lack of "sufficient evidence," as required by

Article 11.2 of the Subsidies Agreement. Indeed, many of the allegations on which China has relied are simple assertions unsupported by any evidence. The United States is also concerned that China may not be taking appropriate measures to ensure that information designated by respondents as confidential is protected from public release. Additionally, the United States is concerned that China has been imposing unreasonably short deadlines for questionnaire responses, even while arguing in an ongoing WTO case involving certain U.S. CVD investigations that Article 12.1.1 of the Subsidies Agreement requires Members to provide at least thirty days to respond to all questionnaires issued by an investigating authority.

The United States has raised its concerns bilaterally with MOFCOM as well as at the WTO in regular and transitional review meetings before the SCM Committee. The United States has also actively participated in MOFCOM's ongoing CVD investigations, and will continue to do so as envisioned by WTO rules, in order to safeguard the interests of U.S. industry and to impress upon China the importance of adhering to WTO rules.

SAFEGUARDS

China has issued measures bringing its legal regime in the safeguards area largely into compliance with WTO rules, although concerns about potential inconsistencies with WTO rules continue to exist.

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.

Legal Regime

As previously reported, it appears that China has made an effort to establish a WTO-consistent

safeguard regime through the issuance of regulations and procedural rules that became effective in January 2002. While the provisions of these measures generally track those of the Safeguards Agreement, there are some potential inconsistencies, and certain omissions and ambiguities remain. In addition, some provisions do not have any basis in the Safeguards Agreement. In earlier transitional reviews before the WTO's Committee on Safeguards, the United States noted several areas of potential concern, including transparency, determination of developing country status, treatment of non-WTO members, protection of confidential data, access to non-confidential information, refunding of safeguard duties collected pursuant to provisional measures when definitive measures are not imposed, and the conditions governing the extension of a safeguard measure.

Conduct of Safeguards Investigations

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

EXPORT REGULATION

China maintains numerous export restraints that raise serious concerns under WTO rules, including specific commitments that China made in its Protocol of Accession to the WTO.

Upon acceding to the WTO, China took on the obligations of Article XI of the GATT 1994, which generally prohibits WTO members from maintaining export restraints (other than duties, taxes or other charges), although certain limited exceptions are

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

As in prior years, China maintains numerous export restraints that appear to violate WTO rules, including specific commitments that China made in its Protocol of Accession. These export restraints affect trade in raw materials as well as intermediate and downstream products.

Export Restraints on Raw Materials

Despite its commitments, since its accession to the WTO, China has continued to impose restraints on exports of raw materials, including export quotas, related export licensing and bidding requirements, minimum export prices and export duties, as China's economic planners have continued to guide the development of downstream industries. These export restraints are widespread. For example, China maintains some or all of these types of export restraints on antimony, bauxite, coke, fluorspar, indium, magnesium, magnesium carbonate, manganese, molybdenum, phosphate rock, rare earths, silicon, silicon carbide, talc, tin, tungsten, yellow phosphorus and zinc, all of which are of key interest to U.S. downstream producers.

These types of export restraints can significantly distort trade, and for that reason WTO rules normally outlaw them. In the case of China, the trade-distortive impact would be exacerbated because of the size of China's production capacity. Indeed, for many of the raw materials at issue, China is the world's leading producer.

China's export restraints affect U.S. and other foreign producers of a wide range of downstream

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

China's treatment of coke, a key steel input, provides a relevant example. China currently limits exports of coke to 12 million metric tons (MT) per year and additionally imposes 40 percent duties on coke exports. In 2008, with these export restraints in place, China produced 336 million MT of coke, and all but 12 million MT of this production was sold in the domestic market. The effects of the export restraints on pricing were dramatic. In August 2008, the world price for coke reached \$740 per MT at the same time that China's domestic price was \$472 per MT. A \$268 per MT price difference creates a huge competitive advantage for China's downstream steel producers over their foreign counterparts, as coke represents about one-third of the input costs for integrated steel producers.

Beginning shortly after China's WTO accession, the United States raised its concerns about China's continued use of export restraints, particularly on coke and fluorspar, both bilaterally and at the WTO during the annual transitional reviews before the Committee on Market Access and the Council for Trade in Goods. The United States also worked with other WTO members with an interest in this issue, including the EU and Japan. In response to these efforts, as previously reported, China refused to modify its policies in this area. In fact, over time,

China's economic planners have made the export quotas on coke and fluorspar more restrictive and imposed and then increased export duties on these two raw materials. At the same time, China's economic planners were placing increasing export restraints on numerous other raw materials.

During the run-up to the JCCT meeting scheduled for December 2007, the United States pressed China to eliminate the export restraints on a number of raw materials of key interest to U.S. industry. At the JCCT meeting, however, China indicated that it would not modify its policies. The United States continued to pursue this matter in 2008, making its concerns widely known through China's second Trade Policy Review and the transitional reviews before the Committee on Market Access and the Council for Trade in Goods.

In June 2009, the United States and the EU initiated a WTO case challenging export quotas, export duties and other restraints maintained by China on the export of several key raw material inputs for which China is a leading world producer. The materials at issue include bauxite, coke, fluorspar, magnesium, manganese, silicon carbide, silicon metal, yellow phosphorus and zinc. Joint consultations were held in July 2009. Mexico subsequently became a co-complainant in August 2009, and another round of joint consultations was held in September 2009. A WTO panel was established to hear this case at the complaining parties' request in December 2009.

VAT Export Rebates and Export Duties on Intermediate and Downstream Products

China's economic planners also attempt to manage the export of many intermediate and downstream products, often by raising or lowering the value-added tax (VAT) rebate available upon export and sometimes by imposing or retracting export duties. These practices have caused tremendous disruption, uncertainty and unfairness in the global markets for some products, particularly ones for which China is a leading world producer or exporter such as steel, aluminum and soda ash.

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

In other recent situations, China has reduced or eliminated VAT export rebates and imposed export duties in a stated attempt to rein in out-of-control expansion of production capacity in particular sectors in China. In some instances, the adjustments have benefited U.S. producers by slowing surges in low-priced exports from China to the United States. However, the adjustments can also have harmful consequences, whether or not intended.

For example, China reduced or eliminated VAT export rebates in November 2006 and April 2007 and imposed export duties in May and July 2007 and January 2008 on a wide range of semi-finished and finished steel products, seeking to discourage further unneeded creation of production capacity for these products. At the same time, these changes did not target all steel products, and the result was that Chinese steel producers shifted their production to value-added steel products for which full or partial VAT export rebates were still available, particularly wire products and steel pipe and tube products, causing a surge in exports of these products, many of which ended up in the U.S. market.

Once the global economic downturn took hold late last year and global steel demand plummeted, China

did not cut steel production even though all of its major trading partners did. Instead, China responded by seeking to boost its exports through changes to its VAT export rebate and export duty regimes. Thus, in December 2008, China eliminated export duties on some but not all semi-finished and finished steel products. Then, in a series of moves over the next several months, China eliminated export duties on additional semi-finished and finished steel products while it also reinstated or increased VAT export rebates. As a result, as of November 2009, Chinese steel production was on track to reach a record 565 million MT for 2009, a 13 percent increase when compared to the same time period in 2008. In contrast, steel production in the United States and other major steel producing countries declined between 30 and 50 percent as their steel producers responded to the steep decline in demand in the global steel market.

China's moves to encourage exports during a period of steeply declining global demand in 2009 were not confined to the steel sector. Not unexpectedly, domestic industries around the world responded by petitioning their governments to impose trade remedies such as antidumping and countervailing duties and China-specific safeguards on imports of a variety of products from China. For example, during the first six months of 2009, WTO members initiated approximately 40 AD and CVD investigations of Chinese imports.

For several years, the United States and other WTO members have questioned China's VAT export rebate and export duty practices. For example, during China's first Trade Policy Review at the WTO, held in April 2006, and again during China's second Trade Policy Review, held in May 2008, the United States specifically urged China to undertake the economic reforms necessary for China to complete its transition to a market economy, so that it can rely on the market rather than government intervention to bring about needed production capacity adjustments in the steel sector. In addition, in the case of export duties not authorized by Annex 6 to China's Protocol of Accession, the United States

urged China to eliminate them, given China's specific commitment not to use them. The United States has also raised these same concerns during bilateral meetings, such as the Steel Dialogue meetings in October 2006, August 2007 and October 2008 and the April 2007 and October 2008 meetings of the Structural Issues Working Group, a bilateral working group that was created at the April 2004 JCCT meeting.

In 2009, the United States raised broad concerns about the trade-distortive effects of China's VAT export rebate practices in connection with both the July S&ED meeting and the October JCCT meeting. However, China was unwilling to commit to any disciplines on its use of VAT export rebates, although it has acknowledged that its eventual goal is to provide full VAT rebates for all exports like other WTO members with VAT systems.

In 2010, the United States will continue to engage China in this area. The United States' basic message will continue to be that China needs to pursue the additional economic reforms that will allow it to rely on the market, rather than government intervention, to bring about needed production capacity adjustments in particular sectors of the economy. The United States will also continue to urge China to remedy the trade-distortive effects of its VAT export rebate and export duty practices on steel, aluminum and soda ash products.

INTERNAL POLICIES AFFECTING TRADE

Non-discrimination

While China has revised many laws, regulations and other measures to make them consistent with WTO rules relating to MFN and national treatment, concerns about compliance with these rules still arise in some areas.

In its WTO accession agreement, China agreed to assume the obligations of GATT 1994, the WTO agreement that establishes the core principles that constrain and guide WTO members' policies relating

to trade in goods. The two most fundamental of these core principles are the Most-Favored Nation (MFN), or non-discrimination, rule – referred to in the United States as “normal trade relations” – and the rule of national treatment.

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

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

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

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

As previously reported, China reviewed its pre-WTO accession laws and regulations and revised many of those which conflicted with its WTO MFN and national treatment obligations in 2002 and 2003. However, concerns remain regarding China's observation of MFN and national treatment requirements in some areas. In particular, a number of problematic policies and practices have persisted from prior years.

ACFTU Fees

Chinese law provides for the right to associate and form a union, but does not allow workers to form or join an independent union of their own choice. Any union formed must affiliate with the official All-China Federation of Trade Unions (ACFTU). The ACFTU is controlled by the Communist Party of China. Once a union chapter is established, the enterprise is required to pay fees to the ACFTU, often through the local tax bureau, equaling two percent of total payroll, regardless of the number of union members in the enterprise. The workers at these enterprises

are required to accept the ACFTU as their representative; they cannot instead select another union or decide not to have any union representation.

While China's laws on union formation apply equally to domestic enterprises and foreign-invested enterprises, since 2006 the ACFTU has engaged in a campaign to organize ACFTU chapters in foreign-invested enterprises, particularly large multinational corporations. In December 2008, an ACFTU official publicly stated that ACFTU would continue to push multinational corporations, including Fortune 500 companies, to set up trade unions in China in 2009, and reaffirmed ACFTU's goal of unionizing all foreign-invested enterprises by the end of 2009.

The ACFTU campaign may be discriminatory, both because it does not appear to be directed at private Chinese companies and because it appears to specifically target Fortune 500 companies, to the disproportionate impact of U.S.-invested companies. The United States is monitoring this situation and attempting to assess its effects on U.S.-invested companies and their workers.

Other Issues

Several U.S. industries reported that China continued to apply the value-added tax in a manner that unfairly discriminates between imported and domestic goods, both through official measures and on an *ad hoc* basis, as discussed below in the Taxation and Subsidies sections. In addition, China's industrial policies on automobiles and steel appear to discriminate against foreign producers as well as imported goods, as discussed below in the Investment section. It also appears that China has applied sanitary and phytosanitary measures in a discriminatory manner since it acceded to the WTO, as discussed below in the Agriculture section, while discriminatory treatment also remains prevalent in a variety of services sectors, as discussed below in the Services section. The United States continued to address these and other MFN and national treatment issues with China in 2009, both bilaterally

and in WTO meetings, including regular meetings and transitional reviews before the Committee on Market Access, the Committee on Sanitary and Phytosanitary Measures (SPS Committee), 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 2010.

Taxation

China has used its taxation system to discriminate against imports in certain sectors, raising concerns under WTO rules relating to national treatment.

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

Since China's WTO accession, certain aspects of China's taxation system have raised serious national treatment concerns under Article III of GATT 1994. One of these issues – the discriminatory VAT rates applied to imports versus domestically produced integrated circuits – was resolved in 2004 after the United States filed a WTO case, as previously reported. Other taxation issues remain, however.

Fertilizer VAT

China has also used VAT policies to benefit domestic fertilizer production. In July 2001, the Ministry of Finance (MOF) and the State Administration of Taxation (SAT) issued a circular exempting all phosphate fertilizers except diammonium phosphate (DAP) from a 13 percent VAT. DAP, a product that the United States exports to China, competes with similar phosphate fertilizers produced in China, particularly monoammonium phosphate. The circular also allowed a partial VAT rebate for domestic producers of urea, a nitrogen fertilizer, through the end of 2002. The United States raised this issue bilaterally with China soon after it acceded to the WTO and in many subsequent bilateral

meetings, including high-level meetings. The United States has also raised this issue at the WTO, both in regular meetings of the Committee on Market Access and during the annual transitional reviews, including in 2009. China did allow the special tax treatment for domestic urea to expire at the end of 2002, but it has not made any other changes. The United States will continue to press its concerns regarding this issue in 2010, although at present a larger concern for U.S. fertilizer exporters remains the rapid expansion of China's domestic fertilizer production. This expansion, which may have been brought on in part by China's export restraints on phosphate rock, has saturated China's market with low-priced fertilizer and greatly reduced demand for imported fertilizer.

VAT Irregularities

Several U.S. industries have continued to express concerns more generally about the unfair operation of China's VAT system. They report that Chinese producers are often 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 apparently discriminatory treatment effectively accorded to foreign products, while also continuing to emphasize the value to China of a properly functioning VAT system as a revenue source.

Border Trade

China's border trade policy also continues to generate MFN and other concerns. China provides preferential import duty and VAT treatment to certain products, often from Russia, apparently even when those products are not confined to frontier traffic as envisioned by Article XXIV of GATT 1994. In June 2003, China began to address these concerns when it eliminated preferential treatment for boric acid and 19 other products. However, several other products continue to benefit from preferential

treatment. During past transitional reviews before the WTO's Council for Trade in Goods, the United States has urged China to eliminate the preferential treatment for these remaining products.

Consumption Taxes

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

Subsidies

China continues to provide injurious subsidies to its domestic industries, and some of these subsidies appear to be prohibited under WTO rules. China has also failed to file annual WTO subsidy notifications since 2006, and its 2006 notification was incomplete.

Upon its accession to the WTO, China agreed to assume the obligations of the WTO Subsidies Agreement, which addresses not only the use of CVD measures by individual WTO members (see the section above on Import Regulation, under the heading of Countervailing Duties), but also a government's use of subsidies and the application of remedies through enforcement proceedings at the WTO. As part of its accession agreement, China committed that it would eliminate, by the time of its accession, all subsidies prohibited under Article 3 of the Subsidies Agreement, which includes subsidies

contingent on export performance (export subsidies) and subsidies contingent on the use of domestic over imported goods (import substitution subsidies). This commitment expressly extended throughout China's customs territory, including in special economic zones and other special economic areas.

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

Subsidies Notification

As previously reported, following increasing pressure from the United States and other WTO members, China finally submitted its long-overdue subsidies notification to the WTO's Subsidies Committee in April 2006. Although the notification reported on more than 70 subsidy programs, it was also notably incomplete, as it failed to notify any subsidies provided by provincial and local government authorities or by state-owned banks. In addition, while China notified several subsidies that appear to be prohibited, it did so without making any commitment to withdraw them, and it failed to notify other subsidies that appear to be prohibited.

The United States has devoted significant time and resources to monitoring and analyzing China's subsidy practices, and these efforts have helped to identify significant omissions in China's subsidy

notification. These efforts have also made clear that provincial and local governments play an important role in implementing China's industrial policies, including through subsidization of enterprises. Recent academic literature, for example, indicates that provincial and local governments are responsible for nearly 20 percent of China's investment in industry, much of which is misdirected into sectors with excess capacity, such as steel.

In accordance with Subsidies Committee procedures, the United States submitted extensive written comments on China's subsidies notification in July 2006, as did several other WTO Members, including the EU, Japan, Canada, Mexico, Australia and Turkey. China responded to those submissions in September 2007, although many of China's responses were inadequate and did not appear to provide much of the information required by WTO rules.

In 2009, as in prior years, the United States raised concerns about China's incomplete subsidy notification and identified numerous unreported subsidies during the transitional review before the Subsidies Committee. To date, in response, China has only stated that it continues to study the most effective and efficient way to collect the necessary information and has not provided any indication of when it expects to complete its subsidy notification.

In 2010, the United States will continue to pursue its own research and analysis of possible Chinese subsidy programs. The United States will also continue to raise its concerns with China's subsidies practices in bilateral meetings with China, including through future meetings of the Structural Issues Working Group and the Steel Dialogue. At the WTO, using meetings before the Subsidies Committee, U.S. engagement will continue to press China to make its annual subsidy notifications and to withdraw any subsidies that are prohibited under WTO rules.

Prohibited Subsidies

Immediately after China submitted its subsidies notification in April 2006, the United States began

seeking changes to China's subsidies practices. In particular, through a series of bilateral meetings in Beijing, including high-level meetings, the United States made clear that China needed to withdraw both the prohibited tax-related subsidies that it had notified and several additional prohibited subsidies that it had not notified. The subsidies at issue provided refunds, reductions and exemptions from income tax, VAT and other payments and benefited a wide range of industries in China. They took the form of both export subsidies, which make it more difficult for U.S. manufacturers to compete against Chinese manufacturers in the U.S. market and third-country markets, and import substitution subsidies, which make it more difficult for U.S. manufacturers to export their products to China. As previously reported, after it had become clear that continued bilateral dialogue would not resolve this matter, the United States, together with Mexico, initiated WTO dispute settlement proceedings against China in February 2007, and China subsequently agreed to and did eliminate all of the subsidies at issue by January 2008.

After bringing the WTO case challenging China's tax-related prohibited subsidies, the United States developed information that appeared to show that China may have been attempting to use prohibited subsidies outside its taxation system in an effort to increase the market share of numerous Chinese brands in markets around the world. Many of these subsidies appeared to be provided by provincial and local governments seeking to implement central government directives found in umbrella programs, such as the "Famous Export Brand" program and the "World Top Brand" program. These subsidies appear to offer significant payments and other benefits tied to qualifying Chinese companies' exports. The United States also developed information about several other export subsidies apparently provided by sub-central governments independent of the two brand programs. As previously reported, after unsuccessfully pressing China to withdraw all of these subsidies, both through high-level bilateral engagement and transitional review and Trade Policy Review

meetings at the WTO, the United States, together with Mexico, initiated a WTO dispute settlement proceeding against China in December 2008. Guatemala subsequently became a co-complainant in January 2009. Joint consultations were held in February 2009, followed by intense discussions as China took steps to repeal or modify the numerous measures at issue. In December 2009, the parties concluded a settlement agreement in which China confirmed that it had eliminated all of the export-contingent benefits in the challenged measures.

U.S. CVD Investigations

Many U.S. industries, including the steel, textiles, chemicals, tires and paper industries, among others, continued to express concern about the injurious effects of various Chinese subsidies in the U.S. market as well as in China and third-country markets. These concerns had led to the U.S. paper industry's filing of a petition with the Commerce Department in October 2006 requesting the initiation of a CVD investigation based on allegations of subsidized imports of coated free sheet paper from China causing injury in the U.S. market. As previously reported, in the ensuing investigation, the Commerce Department changed its longstanding policy of not applying U.S. CVD law to China or any other country considered a "non-market economy" for AD purposes. The Commerce Department began applying U.S. CVD law to China after finding that reforms to China's economy in recent years had removed the obstacles to applying the CVD law that were present in the "Soviet-era economies" at issue when the Commerce Department first declined to apply the CVD law to non-market economies in the 1980s.

Since then, several other U.S. industries concerned about subsidized Chinese imports have filed CVD petitions, together with companion AD petitions. In response, the Commerce Department has initiated CVD investigations of imports of Chinese off-road tires, various types of steel pipe, laminated woven sacks, magnets, thermal paper, citric acid, kitchen racks and shelves, lawn groomers, oil-country

tubular goods, pre-stressed concrete wire strand, steel grating, wire decking, narrow woven ribbons, carbon bricks, seamless pipe, coated paper for high-quality print graphics, steel fasteners and phosphate salts. The subsidy allegations being investigated involve preferential loans, income tax and VAT exemptions and reductions, the provision of goods and services on non-commercial terms, among other subsidies provided by the central government, along with a variety of provincial and local government subsidies.

In September 2008, China requested WTO consultations with the United States regarding the Commerce Department's final determinations in the AD and CVD investigations on Chinese imports of steel pipe, tires and laminated woven sacks. Consultations were held in Geneva in November 2008, and a WTO panel was established at China's request in January 2009. Proceedings before the panel took place later in 2009, and a final decision by the panel is expected in 2010.

Price Controls

China has progressed slowly in reducing the number of products and services subject to price control or government guidance pricing.

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 2009, China continued to maintain price controls on several products and services provided by both state-owned enterprises and private enterprises. Published through the China Economic Herald and

NDRC's website, these price controls may be in the form of either absolute mandated prices or specific pricing policy guidelines as directed by the government. Products and services subject to government-set prices include pharmaceuticals, tobacco, natural gas and certain telecommunications services. Products and services subject to government guidance prices include gasoline, kerosene, diesel fuel, fertilizer, cotton, various grains, various forms of transportation services, professional services such as engineering and architectural services, and certain telecommunications services.

The United States obtained additional information about China's use of price controls in connection with the Trade Policy Reviews of China at the WTO, held in April 2006 and May 2008. In addition, as in prior years, the United States sought updated information from China during the transitional review before the Subsidies Committee, held in October 2009. The United States will continue to monitor China's progress in eliminating price controls in 2010.

Medical Devices

In July 2006 and October 2007, NDRC released proposals for managing the prices of medical devices, with the stated objectives of avoiding excessive mark-ups by distributors and reducing health care costs. Among other things, the proposals impose limits on the allowable mark-ups on medical devices. The proposals also require manufacturers to provide sensitive pricing information. The United States and U.S. industry have been concerned about the proposals' limits on price mark-ups, which would reduce competition as well as patient and physician choice, and the proposals' collection of sensitive pricing data, the publication of which could be very damaging to U.S. companies' operations in China. Indeed, municipalities such as Beijing and Shanghai moved forward with medical device procurement tendering programs in 2007 that have threatened the confidentiality of pricing information.

Since July 2006, the United States and U.S. industry have repeatedly raised their concerns about NDRC's proposals. In particular, U.S. industry has been able to engage in an informal dialogue with NDRC, and the United States has pressed China in this area in connection with the JCCT meetings held in December 2007 and September 2008. While acknowledging China's legitimate concerns regarding the need to provide effective and affordable medical devices to patients and the need to address inefficiency, excessive mark-ups and irregular business practices among wholesalers and distributors of medical devices, the United States and U.S. industry have urged China to develop an approach that will not inhibit increased imports of the same innovative and effective health care products that China is seeking to encourage. In a positive development, at the September 2008 JCCT meeting, China formally agreed to seek input from the United States and industry stakeholders on its draft revised medical device pricing policies and has since entered into discussions directly with U.S. industry. In September 2009, NDRC informally engaged U.S. stakeholders to discuss possible new proposals related to medical device pricing. Going forward, the United States will continue to work to ensure that NDRC seeks its input and input from industry stakeholders in a transparent and meaningful way as it develops new regulations, building on China's commitment at the 2008 JCCT meeting.

Separately, in May and June 2008, China's Ministry of Health (MOH) published procedures for the centralized tender of certain medical devices. These tendering procedures built on a 2007 MOH measure establishing a centralized procurement system for medical devices for the stated purposes of reigning in escalating healthcare costs and ensuring high-quality healthcare. The United States and U.S. industry immediately expressed concern to the Chinese government that MOH's tendering procedures could operate to unfairly disadvantage high-quality, advanced technology products, a large proportion of which are made by U.S. companies. In response to these concerns, at the September 2008

JCCT meeting, China agreed to hold discussions with the United States and U.S. industry to ensure that MOH's tendering policies are fair and transparent and that the quality and innovation of medical devices are given adequate consideration in purchasing decisions. MOH has since entered into discussions directly with U.S. industry. In 2010, the United States will continue to work closely with U.S. industry and promote a cooperative resolution of U.S. concerns.

Standards, Technical Regulations and Conformity Assessment Procedures

China continues to take actions that generate WTO compliance concerns in the areas of standards, technical regulations and conformity assessment procedures, particularly with regard to transparency, national treatment, the pursuit of unique Chinese national standards, and duplicative testing and certification requirements.

With its accession to the WTO, China assumed obligations under the Agreement on Technical Barriers to Trade (TBT Agreement), which establishes rules and procedures regarding the development, adoption and application of standards, technical regulations and the conformity assessment procedures (such as testing or certification) used to determine whether a particular product meets such standards or regulations. Its aim is to prevent the use of technical requirements as unnecessary barriers to trade. The TBT Agreement applies to all products, including 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 by WTO members and should be based on relevant international standards and guidelines, when appropriate.

In its WTO accession agreement, China also specifically committed that it would ensure that its

conformity assessment bodies operate in a transparent manner, apply the same technical regulations, standards and conformity assessment procedures to both imported and domestic goods and use the same fees, processing periods and complaint procedures for both imported and domestic goods. In addition, China agreed to ensure that all of its conformity assessment bodies are authorized to handle both imported and domestic goods within one year of accession. China also consented to accept the Code of Good Practice (set forth in Annex 3 to the TBT Agreement) within four months after accession, which it has done, and to speed up its process of reviewing existing technical regulations, standards and conformity assessment procedures and harmonizing them with international norms.

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

RESTRUCTURING OF REGULATORS

China has restructured its regulators for standards, technical regulations and conformity assessment procedures in order to eliminate discriminatory treatment of imports, although in practice China's regulators sometimes do not appear to enforce regulatory requirements as strictly against domestic products as compared to imports.

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 the State Administration of Quality Supervision, Inspection and Quarantine (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 Electrotechnical Commission.

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

Despite these changes, U.S. industry still has concerns about significant conformity assessment and testing-related issues in China. For example, U.S. exporters representing several sectors continue to report that China's regulatory requirements are not enforced as strictly or uniformly against domestic producers as compared to foreign producers. In addition, in some cases, China's regulations provide only that products will be inspected or tested upon entry into China's customs

territory, without any indication as to whether or how the regulations will be applied to domestic producers. The United States will continue to monitor these issues in 2010 to determine if U.S. industry is being adversely affected.

STANDARDS AND TECHNICAL REGULATIONS

China continues to pursue the development of unique Chinese national standards, despite the existence of well-established international standards, apparently as a means for protecting domestic companies from competing foreign technologies and standards.

Shortly after its accession to the WTO, China began the task of bringing its standards regime more in line with international practice. One of its first steps was AQSIQ's issuance of rules designed to facilitate China's adoption of international standards. China subsequently embarked on the task of reviewing all of China's existing 21,000 standards and technical regulations to determine their continuing relevance and consistency with international standards. During transitional reviews before the TBT Committee, China has periodically reported on the status of this review process and the number of standards and technical regulations that have been nullified, but it remains unclear whether these actions have had a beneficial impact on U.S. market access.

The United States continues to make efforts to assist China through bilateral exchanges, education and training, as China works to improve 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, such as the

relationship between intellectual property rights and standards, and specific standards in a number of industries, including information and telecommunications technology, chemicals, steel, petroleum, water conservation, energy efficiency, hydrogen infrastructure, elevators, electrical safety, gas appliances, distilled spirits, heating, ventilation and air conditioning, and building fire safety. The United States has also conducted programs addressing China's regulation of hazardous substances and China's new chemical management system.

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

At the same time, concern has grown over the past few years that China seems to be actively pursuing the development of unique requirements, despite the existence of well-established international standards, as a means for protecting domestic companies from competing foreign standards and technologies. Indeed, China has already adopted unique standards for digital televisions, and it is trying to develop unique standards and technical regulations in a number of other sectors, including, for example, autos, telecommunications equipment, Internet protocols, wireless local area networks, radio frequency identification tag technology, audio and video coding and fertilizer as well as software encryption and mobile phone batteries. This strategy has the potential to create significant

barriers to entry into China's market, as the cost of compliance will be high for foreign companies, while China will also be placing its own companies at a disadvantage in its export markets, where international standards prevail.

WAPI Encryption Standards

As previously reported, a particularly troubling example of China's pursuit of unique requirements arose in May 2003, when China issued two mandatory standards for encryption over Wireless Local Area Networks (WLANs), applicable to domestic and imported equipment containing WLAN (also known as Wi-Fi) technologies. These standards, which were originally scheduled to go into effect in December 2003 and were never notified to the TBT Committee, incorporated the WLAN Authentication and Privacy Infrastructure (WAPI) encryption technique for secure communications. This component of the standards differed significantly from the internationally recognized standard that U.S. companies have adopted for global production, and China was set to enforce it by providing the necessary algorithms only to eleven Chinese companies. U.S. and other foreign manufacturers would have had to work with and through these companies, some of which were their competitors, and provide them with technical product specifications, if their products were to continue to enter China's market.

Focusing on the WTO compatibility of China's implementation of the standards, the United States repeatedly raised its concerns with China throughout the remainder of 2003 and made WAPI one of the United States' priority issues during the run-up to the April 2004 JCCT meeting. The United States was particularly concerned about the precedent that could be established if China were allowed to enforce unique mandatory standards in the fast-developing information technology sector. The United States and China were ultimately able to resolve the issue at the April 2004 JCCT meeting, as China agreed to an indefinite delay in the implementation of the WAPI standards.

China subsequently submitted a voluntary WAPI standard for consideration by the International Organization for Standardization (ISO). The technical merits of the WAPI standard were considered by the ISO in 2005, and its adoption as an international standard was rejected by an ISO vote in March 2006.

In 2009, China moved forward with plans to mandate the use of the WAPI standard in mobile handsets, despite the growing commercial success of computer products in China complying with the internationally recognized standard, the ISO/IEC 8802-11 standard, otherwise known as "WiFi." In this regard, over the past several years, global mobile handset makers have increasingly added WLAN/Internet capability into their mobile handsets, expanding the interest in WLAN equipment from laptop computers and home computers to mobile handsets. The operative standard for this expansion of WLAN/Internet capability has been the WiFi ISO/IEC 8802-11 standard. No other competing standard is in commercial-scale use anywhere in the world. However, China has never issued type approvals for handsets that connect to the Internet through WLANs, and instead has only issued type approvals for handsets that connect to the Internet through cellular networks. This practice has required foreign equipment makers to disable WLAN/Internet capability before their handsets can be marketed in China. Recently, however, in concert with its plan for encouraging an aggressive roll out of third generation (3G) mobile handsets by Chinese telecommunications operators, many of which are Internet-enabled via WLAN networks, China's Ministry of Industry and Information Technology (MIIT) established a process for approving hand-held wireless devices such as cell phones and smart phones that are Internet-enabled. During bilateral discussions in September 2009, MIIT officials indicated to U.S. government officials that MIIT will approve devices that use the WiFi ISO/IEC 8802-11 standard only if those devices are also enabled with the WAPI standard. MIIT officials acknowledged that there is no published or written measure setting out this requirement, and that China has not notified this requirement to the WTO. The United States

subsequently elevated this issue to the level of the JCCT in October 2009, expressing serious concerns about MIIT's WAPI mandate for Internet-enabled mobile handsets as well as the lack of transparency and fairness in the regulatory process associated with MIIT's development of this policy. Although no resolution of this issue was reached at the JCCT meeting, the United States will continue to vigorously pursue a resolution of this issue in 2010.

3G Telecommunications Standards

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

By the end of 2004, it had become evident that there was still pressure from within the Chinese government to ensure a place for China's home-grown 3G telecommunications standard, known as TD-SCDMA. In 2005, China continued to take steps to promote the TD-SCDMA standard. It also became evident that they had not ceased their attempts to influence negotiations on royalty payments. Then, in February 2006, China declared TD-SCDMA to be a "national standard" for 3G telecommunications,

heightening concerns among U.S. and other foreign telecommunications service providers that Chinese mobile telecommunications operators will face Chinese government pressure when deciding what technology to employ in their networks.

The United States again raised the issue of technology neutrality in connection with the April 2006 JCCT meeting. At that meeting, China restated its April 2004 JCCT commitment to technology neutrality for 3G telecommunications standards, agreeing to ensure that mobile telecommunications operators would be allowed to make their own choices as to which standard to adopt. China also agreed to issue licenses for all 3G telecommunications standards in a technologically neutral manner that does not advantage one standard over others.

Throughout 2008, China's test market for its TD-SCDMA standard continued to grow, and widespread test networks were put in place in time for the August 2008 Summer Olympics in Beijing. In January 2009, China's MIIT issued 3G licenses based on the three different technologies, with a TD-SCDMA license for China Mobile, a W-CDMA license for China Unicom and a CDMA2000 EV-DO license for China Telecom. However, despite the issuance of licenses for all three standards, the Chinese government continued to heavily promote, support and favor the TD-SCDMA standard. For example, China's economic stimulus-related support plan for Information Technology and Electronics, approved by the State Council and published in April 2009, specifically identifies government support for TD-SCDMA as a priority.

The United States will continue to carefully monitor developments in this area in 2010. The United States will also work to ensure that China's regulators adhere to China's JCCT commitments.

Recycled Scrap

As previously reported, in 2004, AQSIQ began requiring exporters of recycled scrap to China to

comply with a new registration system. U.S. exporters, which account for nearly \$2 billion of recycled scrap exports to China annually, were concerned because AQSIQ imposed a deadline for registering, and the registration process included a number of procedural and substantive requirements that lacked clarity. Following U.S. engagement, AQSIQ provided needed clarifications and subsequently showed some flexibility by agreeing to extend the registration deadline. By the end of 2004, 87 percent of applicants, including hundreds of U.S. exporters, had reportedly become registered suppliers of recycled scrap. AQSIQ also indicated that it would institute a rolling application process, which it began to implement in 2005. However, despite these improvements, U.S. exporters reported problems with AQSIQ's registration system in 2007, such as inconsistent or unexplained rejections of license applications, rejections of shipments at the point of entry, new requirements imposed with little or no notice, and unclear procedures for license renewals.

In 2008, the United States and China addressed AQSIQ's licensing of recyclable materials like scrap as part of a transparency dialogue held under the auspices of the SED. The two sides discussed ways in which to make the licensing process more transparent and predictable. Since then, the United States has continued to engage China as necessary to ensure that AQSIQ's registration system for scrap exporters does not restrict legitimate trade.

Patents Used in Chinese National Standards

China has prioritized the development of Chinese national standards in documents such as the *Outline for the National Medium to Long-Term Science and Technology Development Plan (2006-2020)*, issued by the State Council in February 2006, and amplified shortly thereafter in the *11th Five Year Plan (2006-2010) for Standardization Development*, issued by the Standardization Administration of China. More recently, China has also publicly expressed its resolve to rely on either non-patented technology or patented technology made available at prices lower

than those that patent owners would otherwise seek to charge when developing standards. As a result, China's treatment of patents in the standard setting process has garnered increasing attention and concern around the world, including in the United States.

In November 2009, SAC circulated a draft of the *Provisional Rules regarding Administration of the Establishment and Revision of National Standards Involving Patents* for public comment. This draft measure would implement China's vision for a standards development process that uses government power to deny or lower the royalty rates owed to owners of patents incorporated into Chinese national standards. The draft measure would establish the general principle that mandatory national standards should not incorporate patented technologies. However, when they do incorporate patented technologies, the draft measure provides for the possibility of a compulsory license if a patent holder does not grant a royalty-free license. In 2004, SAC circulated a similar draft measure – the *Interim Regulations for National Standards Relating to Patents* – for public comment, although it was never finalized. SAC's November 2009 draft measure appears to incorporate many of the problematic aspects of the 2004 draft measure.

As in prior years when SAC appeared to be revising the 2004 draft measure, the United States will discuss with SAC and other Chinese agencies the important matters addressed by the November 2009 draft measure, highlighting U.S. concerns and seeking clarifications where needed. The United States will continue to emphasize that, in contrast to China's proposed approach, standards organizations around the world 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.

Meanwhile, in June 2009, China's Supreme People's Court (SPC) published a draft *Interpretation on*

Several Issues regarding Legal Application in the Adjudication of Patent Infringement Cases for public comment. Article 20 of this draft measure indicates how the SPC will interpret Chinese law in court cases involving national, industry and local standard-setting organizations and patented technology. The United States has since met with the SPC to discuss the draft measure. The United States explained, among other things, that one aspect of the draft measure that should be clarified is the need for a Chinese court to find that a patent holder was a participant in the group developing a standard incorporating patented technology in order to find that the patent holder had consented to the inclusion of its patented technology in that standard. The United States also emphasized that the draft measure should make clear that a Chinese court must enforce agreed licensing terms if a patent holder's consent is given only in conjunction with those terms.

Distilled Spirits Standards

As previously reported, China notified a proposed revision of its distilled spirits standard in August 2006, after several years of bilateral engagement and discussions at the WTO during meetings of the TBT Committee. This proposed revision was welcomed by U.S. industry, as it would eliminate the requirement for tolerance levels of superior alcohols, or fusel oil, and bring China's standard in line with international norms. China issued this same standard in final form and began implementing it in 2007. U.S. industry did not report any problems with regard to China's implementation of this standard in 2009.

Information Security Standards

In August 2007, China notified to the TBT Committee a series of 13 proposed technical regulations relating to information security for various information technology products, including routers, smart cards and secure databases and operating systems. China requested that comments be provided within 60 days, but did not specify implementation dates for

the proposed regulations. Subsequently, in March 2008, CNCA issued an announcement indicating that the final regulations would be published on May 1, 2008, and would become mandatory on May 1, 2009.

In part because of past actions that China has taken in this area, including China's issuance of mandatory encryption standards for Wi-Fi technologies in 2003 and rules that China issued in 1999 requiring the registration of a wide range of hardware and software products containing encryption technology, these proposed regulations generated immediate concerns for the United States and U.S. industry. In particular, the proposed regulations go substantially beyond global norms by mandating testing and certification of information security in commercial information technology products, not just products for government use in national security applications. In other countries, mandatory testing and certification for information security is only required for products used in sensitive government and national security applications.

The United States and other WTO members expressed serious concerns to China about these proposed regulations in numerous bilateral meetings, including during the run-up to the September 2008 JCCT meeting, as well as at meetings of the TBT Committee in 2008 and during China's second Trade Policy Review, held in May 2008. At the September 2008 JCCT meeting, China announced that it would delay publication of final regulations while Chinese and foreign experts continue to discuss the best ways to ensure information security in China.

In April 2009, CNCA, AQSIQ and the Ministry of Finance announced that the implementation of compulsory certification for thirteen types of information security products would be delayed until May 2010, and would only be applied when products are sold to the government, representing a significant reduction in the scope of the requirements from China's original plan. In September 2009, during the run-up to the October

2009 JCCT meeting, China confirmed that the compulsory certification requirement only applies when products are sold to government agencies, and not to state-owned enterprises or other sectors of China's economy. At the October 2009 JCCT meeting, China also agreed to a dialogue with the United States regarding global best practices for trade in information security products. The United States looks forward to inaugurating this dialogue and will continue to urge China in 2010 to refrain from adopting any measures that mandate information security testing and certification for commercial products.

Mobile Telephone Battery Standards

In July 2007, U.S. industry became aware that China's Ministry of Information Industry (MII), re-named the Ministry of Industry and Information Technology (MIIT) in 2008, was developing a standard that would specify requirements for the size, electrical performance, safety performance and labeling of mobile telephone batteries. MII released a draft of this standard to U.S. industry in September 2007.

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

Working closely with U.S. industry, the United States has raised its concerns in this area bilaterally with MII and at the WTO during TBT Committee meetings in 2007, 2008 and 2009. The United States will monitor developments in this area closely in 2010.

Green Dam Internet Filtering Software

In May 2009, China's MIIT issued a measure mandating that all computers sold in China, whether imported or manufactured domestically, be pre-installed with the Chinese-produced "Green Dam – Escort of the Youth Flowers" Internet filtering software, effective July 2009. This software functions like anti-virus software and regularly connects to the Internet to download a current list of content to be blocked. Senior U.S. government officials, as well as a broad coalition of global industry groups, expressed serious concerns about this regulatory measure shortly after it was made public and urged China to revoke it. Among other things, the measure generated questions about regulatory transparency and compliance with WTO rules, such as notification obligations. Additionally, global technology companies, Chinese citizens and the worldwide media expressed serious concerns about the stability of the software, the scope and extent of the filtering activities and its security weaknesses. All of these problems suggested serious implications for businesses and consumers if the measure were implemented. In June 2009, China announced the indefinite suspension of the measure.

CONFORMITY ASSESSMENT PROCEDURES

China appears to be turning more and more to in-country testing for a broader range of products, which goes in the opposite direction of common international practices that generally accept foreign test results and conformity assessment certifications.

Over the last two years, China's regulatory authorities appear to be turning more and more to in-country testing for a broader range of products. This policy direction is troubling, as it goes in the opposite direction of common international conformity assessment practices, which favor processes that accept test results from internationally recognized laboratories, the concept of a "supplier's declaration of conformity" and other similar trade-facilitating conformity assessment

mechanisms. The United States is unaware of any meaningful efforts by China to move toward a system that recognizes test results or conformity assessment certifications from bodies other than Chinese government-run testing, certification, or accreditation entities. Instead, China developed plans to expand the CCC mark scheme and its mandatory testing requirements to information security, an area in which most countries do not engage in government certification. China also continues to prepare to implement in-country government testing for compliance with its new regulations on hazardous substances in electronic information products. In addition, China issued a measure, which it subsequently suspended, establishing a burdensome new regime for government inspection of imported medical devices that have already satisfied applicable Chinese certification requirements before being exported to China. Working with U.S. industry, the United States will continue to urge China in 2010 to reverse this trend and move in the direction of more globally recognized conformity assessment practices.

CCC Mark System

As previously reported, CNCA regulations establishing a new Compulsory Product Certification System, issued in December 2001, took full effect in August 2003. Under this system, there is now one safety mark – the CCC mark – issued to both Chinese and foreign products. Under the old system, domestic products were only required to obtain the "Great Wall" mark, while imported products needed both the "Great Wall" mark and the "CCIB" mark. In 2009, as in prior years, U.S. companies continued to express concerns that the regulations lack clarity regarding the products that require a CCC mark. They have also reported that China is applying the CCC mark requirements inconsistently and that many domestic products required by CNCA's regulations to have the CCC mark are still being sold without the mark. In addition, despite the changes made by the regulations, U.S. companies in some sectors continued to express concerns in 2009 about

duplication in certification requirements, particularly for radio and telecommunications equipment, medical equipment and automobiles.

Meanwhile, to date, China has granted 153 Chinese enterprises accreditation to test and 14 Chinese enterprises accreditation to certify for purposes of the CCC mark. Despite China's commitment that qualifying majority foreign-owned joint venture conformity assessment bodies would be eligible for accreditation and would be accorded national treatment, China so far has only accredited six foreign-invested conformity assessment bodies. It is not clear whether these six foreign-invested conformity assessment bodies play a sizeable role in accrediting products sold in China. China has also not developed any alternative, less trade-restrictive approaches to third-party certification, such as recognition of a supplier's declaration of conformity. As a result, U.S. exporters to China are often required to submit their products to Chinese laboratories for tests that may be unwarranted or have already been performed abroad, resulting in greater expense and a longer time to market. One U.S.-based conformity assessment body has entered into a Memorandum of Understanding (MOU) with China allowing it to conduct follow-up inspections (but not primary inspections) of manufacturing facilities that make products for export to China requiring the CCC mark. However, China has not been willing to grant similar rights to other U.S.-based conformity assessment bodies, explaining that it is only allowing one MOU per country. Reportedly, Japan has MOUs allowing two conformity assessment bodies to conduct follow-up inspections, as does Germany.

In 2009, as in prior years, the United States raised its concerns about the CCC mark system and China's limitations on foreign-invested conformity assessment bodies with China both bilaterally and during meetings of the WTO's TBT Committee. The United States will continue to be in close contact with the relevant Chinese authorities in these areas in 2010.

Telecommunications Equipment Testing and Certification

In the past, the product testing and certification processes in China for mobile phones have been significantly more burdensome and time-consuming than in other markets, which increases the costs of exporting products to China. With the rollout of 3G licenses in China in 2009, U.S. industry has expressed concern that there will be growing problems because a surge in new handset models will be running through the approval process.

China's three main type approval certification processes for mobile phones are the Network Access License (NAL), the Radio Type Approval (RTA), and the China Compulsory Certification (CCC) mark. While each one represents a different certification process, there are overlapping testing requirements among them, particularly between the NAL and the RTA with regard to radio telecommunications testing requirements for electromagnetic interference and between the NAL and the CCC mark with regard to electromagnetic compatibility and product safety. In addition to redundancy, China's testing requirements are often unclear and subject to change without written notification and adequate time for companies to adjust. Companies must often determine what testing requirements are applicable by communicating directly with the relevant regulatory body, rather than by having access to a comprehensive, published list of testing requirements. The WAPI mandate in MIIT's approval certification process for mobile phones, described above, represents a clear example of unpublished requirements. Companies have also reported that, in some cases, testing requirements for products can change on an almost monthly basis.

In bilateral meetings in 2009, including working group meetings held under the auspices of the JCCT, the United States and China discussed testing and certification redundancies in the area of telecommunications equipment. The United States will continue to pursue these discussions in 2010.

Medical Devices Testing and Certification

Since the creation of China's CCC Mark system, one of the more significant problem areas has been duplicative certification requirements for imported medical equipment. At the April 2006 JCCT meeting, as previously reported, the United States was able to obtain China's commitment to eliminate the redundancies to which imported medical equipment has been subjected. However, China only took steps to address duplicative product testing. China did not address the more burdensome duplicative factory inspection, certification and registration requirements applicable to imported electro-medical equipment or additional product-specific concerns, such as redundancies on border inspections for imported pacemakers. The United States raised its continuing concerns in this area through various bilateral meetings in 2006, 2007 and 2008, including the JCCT meetings held in December 2007 and September 2008, as well as during the transitional reviews before the TBT Committee in November 2006 and November 2007. In September 2008, CNCA and China's State Food and Drug Administration (SFDA) jointly issued an announcement eliminating redundant testing, fees and factory inspections.

In April 2009, SFDA circulated for public comment a draft measure intended to supersede the *Administrative Measures on Medical Device Registration*, originally issued in 2004, but did not notify the draft measure to the WTO. The United States subsequently expressed concerns about this draft measure in bilateral discussions with SFDA and during the October 2009 JCCT meeting as well as at the transitional review before the WTO's TBT Committee. Particular provisions of concern include proposed requirements that a medical device must be registered in the country of export before it can be accepted for registration in China and that a registrant must produce evidence that it has registered a medical device in its country of legal residence. These types of requirements could block or inordinately delay access for safe, high-quality medical devices in the Chinese market, as there are

many reasons why a manufacturer may not seek approval of a device in its home country or the country of export. For example, a medical device may be designed specifically for patients in a third country, such as China, or it may be manufactured in a third country for export only. In these situations, a manufacturer would have no business need to seek approval in its home country or the country of export and would likely forego that process in order to avoid the associated burdens of time and money. Consequently, the lack of registration in the manufacturer's home country or country of export would not necessarily be an indication that a medical device is unsafe.

In April 2009, AQSIQ circulated draft *Regulations on the Recall of Defective Products*, which would apply to medical devices. Given that the Ministry of Health and SFDA began a process in 2008 to develop a recall system that would also cover medical devices, the United States became concerned about the possibility of redundant recall procedures. In bilateral discussions with China during the run-up to the October 2009 JCCT meeting, as well as at the transitional review before the TBT Committee, held in early October 2009, the United States raised its concerns. At the October 2009 JCCT meeting, China indicated that it would ensure that its product recall procedures for medical devices would not be redundant and that the Ministry of Health and SFDA would be the relevant regulatory authorities for medical device recalls. In 2010, the United States will monitor developments in this area to ensure that China's regulatory approach is consistent with China's JCCT commitment.

Medical Devices Inspection

AQSIQ issued Decree 95 – the *Administrative Measures on Examination and Supervision of Imported Medical Devices* – in June 2007, with an effective date of December 1, 2007. Decree 95 imposed an examination and supervision regime on imported medical devices. In particular, Decree 95 established three risk categories for imported medical devices, and it divided importers into three

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

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

Since then, the United States has continued to monitor China's plans regarding the examination and supervision of imported medical devices. In November 2009, U.S. government officials met with AQSIQ officials on this issue, urging China to refrain from adopting measures that create redundancies or differ from common international practices. The United States will continue these efforts in 2010.

China RoHS

The United States continues to be concerned by China's *Administrative Measures for Controlling Pollution Caused by Electronic Information Products*, issued by MII and several other Chinese agencies effective on March 1, 2007. This regulation is modeled after an existing European Union regulation and is known as "China RoHS." While both regulations seek to ban lead and other hazardous substances from a wide range of electronic products, there are significant differences between the two regulatory approaches. Throughout the process of MII's developing the China RoHS regulation, there was no formal process for interested parties to provide comments or consult with MII, and as a result foreign stakeholders had only limited opportunity to comment on proposals or to clarify MII's implementation intentions. China did eventually notify the regulation to the TBT Committee, but the regulation did not provide basic information such as the specific products for which mandatory testing will be required or any details on the applicable testing and certification protocols, generating concern among U.S. and other foreign companies that they will have insufficient time to adapt their products to China's requirements and that in-country testing requirements will be burdensome and costly.

In October 2009, China finally circulated for public comment its first draft catalogue, covering electronic information products that will be subject to hazardous substance restrictions and mandatory testing and conformity assessment under the China RoHS regulation. The draft catalogue includes mobile phones, other phone handsets and computer printers and is supposed to come into force ten months after its adoption. However, information on the applicable testing, certification and conformity assessment regime were still not included in the draft catalogue. The United States is working with affected U.S. companies in analyzing the draft catalogue and will carefully monitor developments in this area in 2010.

Cotton Registration Requirements

In August 2008, AQSIQ issued Announcement No. 87, which establishes a new registration process for foreign cotton suppliers. A related AQSIQ measure issued in November 2008 addresses quality credit assessment. Under these measures, effective March 2009, consignees of foreign cotton shipments must present registration certificates for the shipments to border authorities upon import, at which time a government inspection of the shipment is to be conducted. Foreign suppliers that do not register under this system are automatically subject to a lower "quality credit assessment grade" and are required to include a pre-shipment inspection clause in their contracts.

At the September 2008 JCCT meeting, the United States identified these measures as a potential problem, and over the next several months held meetings with AQSIQ officials to discuss U.S. concerns. In addition, U.S. cotton producers, and cotton producers from Australia, Brazil and other countries, raised their concerns. In response, AQSIQ agreed to consider suggestions for revisions to particular provisions of these measures, both from the interested governments and foreign industry representatives. AQSIQ agreed to establish a central testing lab and appeal process, to exchange standards, to conduct round testing with relevant labs and to continue information exchanges and personnel training.

In 2010, the United States will continue to monitor AQSIQ's implementation of the measures at issue in order to ensure that China's cotton registration requirements do not create a market access barrier for U.S. exporters.

TRANSPARENCY

China has made progress but still does not appear to notify all new or revised standards, technical regulations and conformity assessment procedures as required by WTO rules.

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

However, in 2009, as in prior years, almost all of the notified measures have emanated from AQSIQ, SAC or CNCA and have rarely included measures from other agencies that appear to require notification, such as MOH, MII, the State Environmental Protection Administration and SFDA. Six 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 SPS) matters, but progress has been inconsistent in this area.

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

One recent example of especially serious transparency problems can be found in MIIT's requirement that all mobile phones be set up for using China's unique WAPI standard in order for an application for certification even to be accepted by MIIT. As discussed above, MIIT confirmed in bilateral discussions with the United States in September 2009 that this requirement has not been published, written down or notified to the WTO, even though the only existing commercial-scale standard currently being employed in the world is the WiFi ISO/IEC 8802-11 standard, which is used annually in more than 50 million mobile phones. The United States strongly objected to this requirement on transparency and other grounds at the October 2009 transitional review before the TBT Committee and during the October 2009 JCCT meeting and will continue to pursue a resolution to this matter vigorously in 2010.

Other Internal Policies

STATE-OWNED AND STATE-INVESTED ENTERPRISES

The Chinese government has heavily intervened in the investment decisions made by state-owned and state-invested enterprises in certain sectors.

While many provisions in China's WTO accession agreement indirectly discipline the activities of state-owned and state-invested enterprises, China also agreed to some specific disciplines. In particular, it agreed that laws, regulations and other measures relating to the purchase of goods or services for commercial sale by state-owned and state-invested enterprises, or relating to the production of goods or supply of services for commercial sale or for non-governmental purposes by state-owned and state-invested enterprises, would be subject to WTO rules. China also affirmatively agreed that state-owned and state-invested enterprises would have to make purchases and sales based solely on commercial considerations, such as price, quality, marketability and availability, and that the government would not influence the commercial decisions of state-owned and state-invested enterprises.

In the first few years after China's accession to the WTO, U.S. officials did not hear many complaints from U.S. companies regarding WTO compliance problems in this area, although a lack of available information made it a difficult area to assess. However, after China's establishment of the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) in 2003, it became evident that the Chinese government was intent on heavily intervening in the commercial decisions of state-owned enterprises, including decisions related to their strategies, management and investments. SASAC was specifically created to represent the state's shareholder interests in state-owned enterprises, and its basic functions include guiding and pushing forward the reform of state-owned enterprises, taking daily charge of supervisory panels assigned to large state-owned enterprises, appointing and removing chief executives of state-owned enterprises, supervising the preservation and appreciation of value of state-owned assets, and drafting laws, regulations and departmental rules relating to the management of state-owned assets.

Key Sectors

In December 2006, the State Council issued the *Guiding Opinions on Promoting the Adjustment of State-owned Assets and the Restructuring of State-owned Enterprises*, which calls on SASAC to "enhance the state-owned economy's controlling power," "prevent the loss of state-owned assets," encourage "state-owned capital to concentrate in major industries and key fields relating to national security and national economic lifelines" and "accelerate the formation of a batch of predominant enterprises with independent intellectual property rights, famous brands, and strong international competitiveness." The decree then specifically identifies seven "strategic" industries, where state capital must play a leading role in every enterprise. These industries include civil aviation, coal, defense, electric power and grid, oil and petrochemicals, shipping and telecommunications. The decree also provides that key enterprises in "pillar" industries

must remain under state control. These industries include automotive, chemical, construction, equipment manufacturing, information technology, iron and steel, nonferrous metals, and surveying and design, among others.

In October 2008, China's National People's Congress passed the *Law on State-owned Assets of Enterprises*, which became effective in May 2009. The objectives of this law are to safeguard the basic economic system of China, consolidate and develop China's state-owned enterprise assets, enable state-owned enterprises to play a dominant role in the national economy, especially in "key" sectors, and promote the development of China's "socialist market economy." The law calls for the adoption of policies to promote these objectives and to improve the management system for state-owned assets. It also addresses SASAC's role, the rights and obligations of state-owned enterprises, corporate governance and major matters such as mergers, the issuance of bonds, enterprise restructuring and asset transfers. The law further stipulates that the transfer of state assets to foreigners should follow relevant government policies and shall not harm national security or the public interest.

Separately, China has also issued a number of measures that restrict the ability of state-owned and state-invested enterprises to accept foreign investment, particularly in key sectors. Some of these measures are discussed below in the Investment section, and include restrictions on foreign investment not only in the public sector but also in China's private sector.

In 2009, as in prior years, the United States sought to engage China on a variety of issues related to state-owned enterprises, including through bilateral avenues such as the economic track of the S&ED and the JCCT process as well as at the WTO, principally through the transitional review before the Subsidies Committee. The United States will continue these efforts in 2010 in order to ensure that SOE-related issues do not impede U.S. investment in China.

Anti-monopoly Law

In August 2007, after several years of development, China issued its *Anti-monopoly Law*, which became effective in August 2008. Under this law, an Anti-Monopoly Commission with oversight and coordinating responsibilities has been established, drawing its members from several Chinese ministries and agencies. Enforcement responsibilities have been divided among three agencies. MOFCOM has assumed responsibility for reviewing mergers. NDRC has assumed responsibility for reviewing monopoly activities, abuse of dominance and abuse of administrative power when they involve pricing, while SAIC reviews these same types of activities when they are not price-related.

After the *Anti-monopoly Law* was issued, MOFCOM, SAIC, NDRC and other Chinese government ministries and agencies began to formulate implementing regulations, departmental rules and other measures. Generally, these ministries and agencies have been willing to seek public comment on their proposed measures. In commenting on these proposed implementing measures, the United States has urged China not to use its *Anti-monopoly Law* to pursue industrial policy objectives. The United States has also specifically pressed China to ensure that any implementing measures do not create disguised or unreasonable barriers to trade and do not provide less favorable treatment to foreign goods and services or foreign investors and their investments.

The United States also launched an *Anti-monopoly Law* technical assistance program in 2008, funded by the U.S. Trade and Development Agency and led by a multi-agency team of U.S. experts. Since June 2008, several workshops have taken place under this program in China on important substantive issues, such as merger review, abuse of dominance and cartels. Chinese government officials from MOFCOM, SAIC, NDRC, SCLAO and the NPC have also come to Washington as part of this program. During the October 2009 JCCT meeting, the two sides

recognized the importance of this program and agreed that it would continue in 2010.

The *Anti-monopoly Law* does contain provisions that have generated concern. For example, it remains unclear how China will implement one provision that requires protection for the lawful operations of state-owned enterprises and government monopolies in industries deemed nationally important. On the other hand, the inclusion of provisions on the abuse of administrative power in the *Anti-monopoly Law*, which also appear in NDRC's and SAIC's draft implementing regulations, could be important instruments for promoting the establishment and maintenance of increasingly competitive markets in China.

To date, China's enforcement of the *Anti-monopoly Law* has been most active in the merger area overseen by MOFCOM, largely due to the requirement to pre-notify merger transactions. Although MOFCOM's initial merger decisions were brief, over the last year MOFCOM has begun to release more detailed explanations of its merger decisions, some of which have been criticized by U.S. industry observers for lack of adequate bases to find that a merger has or may have the effect of eliminating or restricting competition. In addition, MOFCOM seems to have focused more on scrutinizing mergers involving foreign enterprises than those involving China's enterprises. While more than 70 percent of the mergers notified to MOFCOM since the *Anti-monopoly Law* went into effect have involved multinational corporations, all five cases in which approval was granted with conditions have involved offshore transactions between foreign parties rather than transactions between Chinese enterprises.

STATE TRADING ENTERPRISES

It is difficult to assess the activities of China's state-trading enterprises, given inadequate transparency.

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

While China is moving slowly toward fulfilling its commitment to accede to the GPA, it is maintaining and adopting government procurement measures that give domestic preferences.

The WTO Agreement on Government Procurement (GPA) is a plurilateral agreement that currently covers the United States and 40 other WTO members. The GPA applies to the procurement of goods and services by central and sub-central government agencies and government enterprises specified by each party, subject to specified 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 conduct their procurement in accordance with procedures designed to ensure transparency, fairness and predictability in the procurement process.

China is not yet a party to the GPA. It committed to become an observer to the WTO Committee on Government Procurement upon its WTO accession. China also committed, in its WTO accession agreement, to initiate negotiations for accession to the GPA "as soon as possible." Until it completes its accession to the GPA, China has committed in its

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

GPA Accession

U.S. firms have made clear that China's timely GPA accession is a top priority for them. As a result, shortly after China became an observer to the WTO Committee on Government Procurement in February 2002, the United States began pressing China both bilaterally and in WTO meetings to move as quickly as possible toward GPA accession.

At the April 2006 JCCT meeting, China agreed to initiate GPA negotiations no later than December 2007. China subsequently initiated negotiations on its accession to the GPA in December 2007 with the submission of its application for accession and its initial offer of coverage, known as its Appendix I Offer. In May 2008, the United States submitted its Initial Request for improvements in China's Initial Appendix I Offer, and other GPA parties submitted similar requests. In 2009, the United States held three rounds of negotiations with China on the terms and conditions of China's GPA accession.

At the July 2009 S&ED meeting, China agreed to submit to the WTO's Government Procurement Committee, before its October 2009 meeting, a report setting out the improvements that China would make in its revised offer. At the Government Procurement Committee's meeting, China submitted a report on the coverage that it intends to include in its revised offer, which will provide for the coverage of more entities, goods and services and lower thresholds. At the same time, however, China noted that it was encountering difficulties in completing its revised offer. Subsequently, following further bilateral engagement by the United States, China committed during the October 2009 JCCT meeting to submit a revised offer as early as possible in 2010.

During the July 2009 S&ED meeting, the United States and China also agreed to strength their cooperation in order to accelerate China's accession to the GPA. Shortly before that meeting, the United States hosted a Chinese delegation, led by the Ministry of Finance, for a three-day seminar aimed at enhancing China's understanding of the GPA and implementation of the GPA by the United States.

In 2010, the United States will continue to work with China and other interested GPA parties in an effort to ensure that China's accession to the GPA takes place expeditiously and on robust terms.

China's Government Procurement Regime

In January 2003, China implemented its *Government Procurement Law*, which generally reflects the GPA and incorporates provisions from the United Nations Model Law on Procurement of Goods. However, China's *Government Procurement Law* also directs central and sub-central government entities to give priority to "local" goods and services, with limited exceptions, as China is permitted to do, because it is not yet a party to the GPA. China envisioned that its *Government Procurement Law* would improve transparency, reduce corruption and lower government costs. This law was also seen as a necessary step toward reforming China's government procurement system in preparation for China's accession to the GPA. Since the adoption of the *Government Procurement Law*, MOF has issued various implementing measures, including regulations that set out detailed procedures for the solicitation, submission and evaluation of bids for government procurement of goods and services and help to clarify the scope and coverage of the *Government Procurement Law*. MOF also issued measures relating to the announcement of government procurements and the handling of complaints by suppliers relating to government procurement.

It is notable, however, that the *Government Procurement Law* does not cover tendering and bidding for public works projects, which represent at

least one-half of China's government procurement market. Those projects are subject to a different regulatory regime, established by China's *Tendering and Bidding Law*, which entered into force in January 2000. Unfortunately, it has taken nearly 10 years for the responsible agency, NDRC, to draft implementing regulations for the *Tendering and Bidding Law*. In September 2009, the State Council finally circulated NDRC's draft regulations for public comment. In October 2009, the United States submitted written comments on these draft regulations in which it emphasized, among other things, the need for greater clarification of the relationship between the *Tendering and Bidding Law* and China's *Government Procurement Law*, and the need to define "domestic products."

As previously reported, beginning in 2003, the United States expressed concerns about policies that China was developing with regard to government procurement of software. In 2003, the United States specifically raised concerns about MOF implementing rules on software procurement, which reportedly contained guidelines mandating that central and local governments – the largest purchasers of software in China – purchase only software developed in China to the extent possible. The United States was concerned not only about the continuing access of U.S. software exporters to China's large and growing market for packaged and custom software – \$7.5 billion when the MOF rules went into effect – 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 July 2005 JCCT meeting, China indicated that it would indefinitely suspend its drafting of implementing rules on government software procurement.

Subsequently, in 2007 and 2008, the United States grew concerned with statements and announcements being made by some Chinese government officials indicating that state-owned enterprises should give priority to the purchase of

domestic software. In response, at the September 2008 JCCT meeting, China clarified that its formal and informal policies relating to software purchases by Chinese enterprises, whether state-owned or private, will be based solely on market terms without government direction.

A similar issue had arisen in December 2005, when China announced that products incorporating the WAPI standards should be given preference in government procurement, as discussed above (in the Standards and Technical Regulations section). More recently, in August 2007, China issued another set of rules for government-supported e-government projects requiring priority to be given to the purchase of domestic goods and services. The United States is concerned that these measures may unfairly discriminate against U.S. firms and has therefore been closely monitoring developments in this area. However, so far, the trade effects of these measures appear to be limited.

In December 2007, one day before China tabled its Initial Appendix I Offer in connection with its GPA accession, MOF issued two measures that would substantially restrict the Chinese government's purchase of foreign goods and services. The first measure, the *Administrative Measures for Government Procurement on Initial Procurement and Ordering of Indigenous Innovative Products*, is directed at restricting government procurement of "indigenous innovative" products to "Chinese" products manufactured within China. The central government and provincial governments have since followed up by creating catalogues of qualifying "indigenous innovation products." The second measure, the *Administrative Measures for Government Procurement of Imported Products*, severely restricts government procurement of imported foreign products and technologies. While China may maintain these measures until it completes its GPA accession, the United States has raised strong concerns about them, as they run counter to the liberalization path expected of a WTO member seeking to accede to the GPA.

In 2009, China reinforced its existing “Buy China” measures at the central, provincial and local government levels. For example, in May 2009, MIIT issued a circular entitled *Government Procurement Administration Measures*, which applies to MIIT and its direct subsidiaries. The measure requires government procurement to give priority to domestic products, projects and services as well as to indigenous innovation products, except where the products or services cannot be produced or provided in China or are for use outside of China. In addition, China included “Buy China” policies in its new stimulus projects even though it had committed not to do so in its G-20 pledge. For example, in May 2009, nine central government ministries and agencies jointly issued the *Opinions on Further Strengthening Supervision of Tendering and Bidding Activities in Construction Projects*, which included a “Buy China” directive for all projects under China’s stimulus package. This directive specifically requires that priority be given to “domestic products” for all government-invested projects, unless the products are not available in China, cannot be purchased on reasonable commercial terms in China or are for use abroad.

Meanwhile, using the S&ED and JCCT processes in 2009, the United States obtained important commitments from China that, if implemented, should lead to a government procurement regime that is more favorable to foreign-invested enterprises. First, during the July 2009 S&ED meeting, China committed to treat products produced in China by foreign-invested enterprises the same as products produced in China by Chinese enterprises for purposes of its *Government Procurement Law*. China later reaffirmed this commitment and further committed to issues rules implementing it during the October 2009 JCCT meeting. In addition, the United States and China agreed to establish a multi-agency working group to conduct regular discussions addressing issues raised by government procurement and by the purchases of state-affiliated enterprises and organizations and private entities pursuing national strategic objectives.

In November 2009, the Ministry of Science and Technology (MOST), NDRC and MOF issued the *Circular on Launching the 2009 National Indigenous Innovation Product Accreditation Work*, requiring companies to file applications by December 2009 for their products to be considered for accreditation as “indigenous innovation products.” This measure provides for preferential treatment in government procurement to any products that are granted this accreditation. The United States has since expressed serious concerns to China about this measure, as it appears to establish a system designed to provide preferential treatment in government procurement to products developed by Chinese enterprises.

In 2010, the United States will work with China in the newly formed multi-agency working group to address a range of government procurement issues. In addition, the United States will continue to monitor the treatment accorded to U.S. suppliers under China’s government procurement regime and will continue to urge China to apply its regulations and implementing rules in a transparent, non-discriminatory manner. The United States will also continue to encourage China to develop its government procurement system in a manner that will facilitate its expeditious accession to the GPA.

INVESTMENT

China revised many laws and regulations on foreign-invested enterprises to eliminate WTO-inconsistent requirements relating to export performance, local content, foreign exchange balancing and technology transfer, although some of the revised measures continue to “encourage” one or more of those requirements. China has also issued industrial policies covering the auto and steel sectors that include guidelines that appear to conflict with its WTO obligations. In addition, China has added a variety of restrictions on investment that appear designed to shield inefficient or monopolistic Chinese enterprises from foreign competition.

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 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.

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

One example can be found in the *State Council Opinions on the Revitalization of the Industrial Machinery Manufacturing Industries*, issued in June 2006. This measure identifies 16 types of equipment manufacturing as the focus of a new initiative, including semiconductor manufacturing equipment, power generation equipment, civilian aircraft and aircraft engines, textiles machinery, large excavators and pollution control equipment. The initiative calls for a variety of policy supports designed to promote, develop and expand the market share of domestic companies in these sectors, including preferential import duties on parts and material needed for

research and development, encouragement for procuring domestically manufactured new major technical equipment, a dedicated fund to facilitate capital market financing for domestic firms and strict review of imports. At the same time, the measure indicates that new foreign investment controls are being contemplated for these sectors, including new approval requirements when foreign entities seek majority ownership or control and the strengthening of the management of equipment and machinery imports.

In August 2006, China made a further move toward a more restrictive investment regime when it issued new regulations on mergers and acquisitions (M&A regulations) involving foreign investors. These regulations strengthen MOFCOM's supervisory role over foreign investment, in part by requiring MOFCOM's approval of M&A transactions that it believes impact "national economic security" or involve famous Chinese brands. The regulations also place MOFCOM in the role of determining if the domestic acquisition target has been appropriately valued.

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

In December 2006, as discussed above in the State-owned and State-Invested Enterprises section, the

SASAC, the government entity charged with overseeing China's interests in state-owned enterprises, published an expansive list of key sectors that it deemed critical to the national economy. SASAC committed to restrict foreign participation in these sectors by preventing further foreign investment in state-owned enterprises operating in these sectors. In practice, it appears that China allows foreign investment in a particular key sector, unless it perceives that it could lead to foreign dominance of the sector.

In August 2007, as also discussed above in the State-owned and State-Invested Enterprises section, China issued its *Anti-monopoly Law*. Among other things, this law indicates that China will establish a review process to screen inward investment for national security implications.

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

In 2009, as in prior years, the United States raised its concerns about China's investment restrictions on multiple occasions, using bilateral mechanisms such as the economic track of the S&ED and the JCCT process as well as meetings at the WTO, including

the transitional review before the Committee on Trade-Related Investment Measures (TRIMS Committee). The United States and China also continued to pursue bilateral investment treaty negotiations in 2009. In one positive development, at the July 2009 S&ED meeting, China agreed to further decentralize approval authority and streamline approval procedures for foreign investment, including by increasing over time the threshold for central government review. The United States welcomed this commitment and will continue to monitor developments in this area closely in 2010.

Encouragement of Performance Requirements

Before acceding to the WTO, China began revising its laws and regulations on foreign-invested enterprises to eliminate WTO-inconsistent requirements relating to export performance, local content, foreign exchange balancing and technology transfer. However, seven years after China's WTO accession, some of the revised laws and regulations continue to encourage technology transfer, without formally requiring it. U.S. companies remain concerned that this "encouragement" in practice can amount to a "requirement" in many cases, particularly in light of the high degree of discretion provided to Chinese government officials when reviewing investment applications. Similarly, some laws and regulations "encourage" exportation or the use of local content. Moreover, according to U.S. companies, some Chinese government officials in 2009 – 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 a project.

The United States, the EU, Japan and other WTO members have raised concerns in this area during the annual transitional reviews conducted by the TRIMS Committee. The United States will continue to follow this situation closely in 2010.

Auto Policy

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

In 2005, China began to issue measures implementing the new automobile industrial policy. One measure that generated strong criticism from the United States, the EU, Japan and Canada was the *Measures on the Importation of Parts for Entire Automobiles*, which was issued by the NDRC in February 2005 and became effective in April 2005. These rules impose charges that unfairly discriminate against imported auto parts and discourage automobile manufacturers in China from using imported auto parts in the assembly of vehicles. Specifically, the rules require all vehicle manufacturers in China that use imported parts to register with China's Customs Administration and provide specific information about each vehicle they assemble, including a list of the imported and domestic parts to be used, and the value and supplier of each part. If the number or value of imported parts in an assembled vehicle exceeds specified thresholds, the regulations require the vehicle manufacturer to pay a charge on each of the imported parts in an amount equal to the tariff on complete automobiles (typically 25 percent), which

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

As previously reported, the United States, the EU, Japan and Canada initiated a WTO case challenging China's auto parts rules in March and April 2006, once it had become clear that dialogue would not lead to a satisfactory resolution. A WTO panel issued its decision in March 2008, ruling in favor of the United States and the other complaining parties and finding that China's rules were WTO-inconsistent. China appealed the panel's decision to the WTO's Appellate Body in September 2008, and the Appellate Body issued its ruling in December 2008, upholding the panel's decision. China came into compliance with this ruling in September 2009 by repealing its discriminatory rules.

In March 2009, China issued a stimulus plan for revitalizing the auto industry. This new plan calls for a reduction in the sales tax on vehicles with small engines, the creation of a RMB 10 billion (\$1.5 billion) fund to promote technical innovation, central, provincial and local government subsidies to encourage the development of environmentally friendly cars and government support for industry consolidation, the development of proprietary brands and the building of export bases for autos and auto parts.

The United States has been monitoring the implementation of China's 2004 auto policy, along with the new stimulus plan issued in March 2009. The United States will continue this effort in 2010, working with U.S. industry.

Steel Policy

China issued a Steel and Iron Industry Development Policy in July 2005. As previously reported, this

policy restricts foreign investment in a number of ways. For example, it requires that foreign investors possess proprietary technology or intellectual property in the processing of steel. Given that foreign investors are not allowed to have a controlling share in steel and iron enterprises in China, this requirement would seem to constitute a *de facto* technology transfer requirement, in conflict with the commitment in China's accession agreement not to condition investment on the transfer of technology. This policy also appears to discriminate against foreign equipment and technology imports. Like other measures, this policy encourages the use of local content by calling for a variety of government financial support for steel and iron projects utilizing newly developed domestic equipment. It also 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.

China's 2005 steel policy is also striking because of the extent to which it attempts to dictate industry outcomes and involve the government in making decisions that should be made by the marketplace. This high degree of government direction regarding the allocation of resources into and out of China's steel industry raises concerns not only because of the commitment that China made in its WTO accession agreement that the government would not influence, directly or indirectly, commercial decisions on the part of state-owned or state-invested enterprises, but also more generally because it represents another significant example of China reverting to a reliance on government management of market outcomes instead of moving toward a reliance on market mechanisms. Indeed, it is precisely that type of regressive approach that is at the root of many of the WTO compliance concerns raised by U.S. industry.

While China's 2005 steel policy remains in effect, China also issued a stimulus plan to revitalize its

steel industry in March 2009. This new plan represents the first major adjustment to the 2005 steel policy. The new plan seeks to control steel output volume and to eliminate outdated and inefficient capacity while emphasizing technological improvement. The new plan also seeks to stimulate exports, a significant difference from the 2005 steel policy. In addition, the new plan calls for further industry consolidation and the creation of large steel enterprises with capacity exceeding 50 million MT.

In 2006, shortly after China issued its 2005 steel policy, the United States and China began a new dialogue on the steel industry under the auspices of the JCCT (Steel Dialogue). The two sides have held several Steel Dialogue meetings since then, with the most recent one taking place in October 2008. The objectives of these meetings, which have included participation from U.S. and Chinese steel industry officials, is to increase mutual understanding of the challenges faced by each industry and to discuss strategies for addressing trade imbalances, including the benefits of increased reliance on market mechanisms.

At the WTO, the United States has also pressed its concerns regarding China's steel policy, in regular meetings and through the transitional reviews before the Committee on Import Licensing, the TRIMS Committee, the Subsidies Committee and the Council for Trade in Goods, with support from other WTO members, including Canada, Mexico, the EU and Japan. The United States also focused on China's steel policy in connection with China's first two Trade Policy Review at the WTO, held in 2006 and 2008, and in plurilateral fora such as meetings of the Organization for Economic Cooperation and Development (OECD) Steel Committee.

In April 2009, the United States, Canada and Mexico submitted a joint response to a request for comments by China's MIIT on possible revisions to the 2005 steel policy. This joint response called for China to eliminate subsidies to its steel industry except for those designed to facilitate capacity elimination or to address worker dislocation, to

implement steel industry stimulus policies in a manner that encourages domestic consumption rather than exports and does not discriminate against imports, to eliminate the use of differential VAT rebates and duties on steel exports as a tool of industrial policy, to allow market forces rather than restraints on imports and exports to determine steelmaking raw material input supply and to eliminate restrictions on foreign investment in China's steel industry. Several steel industry associations from North and South America and Europe submitted similar comments.

Despite China's stated goal of eliminating inefficient steel capacity, steel production in China in 2009 continued to grow rapidly and at a faster rate than domestic steel consumption. As discussed above in the Export Regulation section, as of November 2009, Chinese steel production was on track to reach a record 565 million MT for 2009, a 13 percent increase when compared to the same time period in 2008, even while steel production in the United States and other major steel producing countries declined between 30 and 50 percent as their steel producers responded to the steep decline in demand in the global steel market. This situation raises concerns that exports from China may start to surge when U.S. and other foreign steel producers begin to recover from the global economic downturn.

In September 2009, China issued an urgent measure calling for, among other things, tightening of rules for the establishment of new production facilities in six overheated industries, including steel. The United States is working with Canada and Mexico and other like-minded trading partners to monitor and support concrete steps by China to reign in its steelmaking capacity.

In 2010, the United States will continue to closely scrutinize the implementation of China's 2005 steel policy and the new stimulus plan issued in March 2009. The United States will also continue to engage China, through the Steel Dialogue, at the WTO and in plurilateral fora such as the OECD.

Foreign Investment Catalogue

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

In November 2007, the State Council issued a revised catalogue without having provided an opportunity for public comment. This catalogue places new restrictions on industries on several industries, including chemicals, auto parts, rare earths processing, biofuel production and edible oil processing, while the prohibitions and restrictions facing copyright-intensive products and genetically modified plant seeds remain in place. It also moves the mining of raw materials such as antimony, fluorite, molybdenum, tin and tungsten from the "restricted" category to the "prohibited" category. From a positive standpoint, the catalogue encourages foreign investment in highway cargo transport and modern logistics, while it removes from the "encouraged" category projects of foreign-invested enterprises that export all of their production.

AGRICULTURE

While China has timely implemented its tariff commitments for agricultural goods, a variety of

non-tariff barriers continue to impede market access, particularly in the areas of SPS measures and inspection-related requirements.

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

In the area of market access, WTO members committed to the establishment of a tariff-only regime, tariff reduction and the binding of all tariffs. As a result of its accession negotiations, China agreed to significant reductions in tariff rates on a wide range of agricultural products. China also agreed to eliminate quotas and implement a system of TRQs designed to provide significant market access for certain bulk commodities upon accession. This TRQ system is very similar to the one governing fertilizers (discussed above in the Import Regulation section). China's goods schedule sets forth detailed rules intended to limit the discretion of the agriculture TRQ administrator – originally the State Development and Planning Commission (SDPC), which is now called the NDRC – and to require it to operate with transparency and according to precise procedures for accepting quota applications, allocating quotas and reallocating unused quotas.

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

countries use in determining whether the cap has been reached.

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

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

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

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

While tariff reductions have certainly encouraged U.S. exports to China, which reached record highs for many agricultural products in 2008 before declining as a result of the global economic downturn in 2009, the increases continued to be largely the result of greater demand. In addition, China's administration of TRQs on bulk agricultural commodities still did not appear to be functioning entirely as envisioned in China's WTO accession agreement, as it continued to be impaired by inadequate transparency.

At the same time, a variety of non-tariff barriers have continued to impede U.S. agricultural trade with China, particularly in the area of sanitary and phytosanitary measures, where China's actions often have not appeared to be guided by scientific principles. As in prior years, the United States and China have only been able to resolve some of these issues, and those resolutions have required protracted negotiations.

In 2009, serious problems have remained for U.S. exporters, who are faced with non-transparent application of sanitary and phytosanitary measures, many of which have appear to lack scientific bases and have impeded market access for many U.S. agricultural products. China's seemingly unnecessary and arbitrary inspection-related import requirements also continued to impose burdens and regulatory uncertainty on U.S. agricultural producers exporting to China in 2009. Products most affected in 2009 included poultry and pork.

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 exceeded \$12 billion in 2008, nearly six times the level in 2002. Through the first nine months of 2009, U.S. exports did decline by 12 percent, when compared to the same period in 2008, but this decline appears to be attributable largely to the global economic downturn.

In 2010, as in prior years, the United States will continue to pursue vigorous engagement with China in order to obtain progress on outstanding concerns. As part of this effort, the United States will continue to use the high-level U.S.-China agricultural working group, created at the April 2004 JCCT meeting, as well as JCCT plenary meetings to make progress on the range of issues in the agriculture area. In addition, the United States will not hesitate to take further actions, including WTO dispute settlement, if appropriate, to address U.S. concerns.

Tariffs

China has timely implemented its tariff commitments for agricultural goods each year.

Tariffs on agricultural goods of greatest importance to U.S. farmers and ranchers were lowered from a 1997 average of 31 percent to 14 percent, in almost all cases over a period of five years running from January 1, 2002, or by January 1, 2006. China did not have to implement any new tariff reductions in 2009, as the last few required tariff reductions on agricultural goods took place in 2008.

The accumulated tariff reductions made by China, coupled with increased demand, contributed to continued healthy exports of certain U.S. exports to China in 2009, despite the global economic downturn. Exports of some bulk agricultural commodities have increased dramatically in recent years, and continue to perform strongly, including soybeans and cotton, as discussed below in the sections on China's Biotechnology Regulations and Tariff-rate Quotas for Bulk Agricultural Commodities. Exports of forest products such as lumber encountered sluggish demand, decreasing by 11

percent for the first nine months of 2009. Fish and seafood exports, after having increased from \$119 million in 2001 to \$553 million in 2008, also decreased in 2009, down 14 percent for first nine months of 2009. Meanwhile, exports of consumer-oriented agricultural products decreased by 23 percent from January through September 2009, when compared to the same period in 2008.

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

Tariff-rate Quotas on Bulk Agricultural Commodities

China's administration of TRQs on bulk agricultural commodities still does not seem to be functioning entirely as envisioned in China's WTO accession agreement, as it continues to be impaired by inadequate transparency.

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

As previously reported, in 2002, the first year of this TRQ system, it appeared that SDPC had decided to allocate TRQs in a manner that would protect domestic farm interests and maintain the monopoly enjoyed by state trading enterprises. SDPC operated with only limited transparency, refusing to provide specific details on the amounts and the recipients of the allocations. At the same time, SDPC reserved a

significant portion of the TRQs for the processing and re-export trade, despite China's commitment to provide market access and national treatment for imported products. SDPC also allocated a portion of the TRQs for some commodities in smaller than commercially viable quantities, and it employed burdensome licensing requirements. As these problems became apparent, the United States repeatedly engaged China bilaterally, at all levels of government, and it also raised its concerns at the WTO during meetings of the Committee on Agriculture. In July 2002, the United States requested formal consultations with China under the headnotes contained in China's WTO goods schedule, and those consultations took place in September 2002 in Geneva.

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

In 2004, as the United States focused on how NDRC was enforcing its new regulations in a series of bilateral meetings during the run-up to the April 2004 JCCT meeting, improvements in NDRC's TRQ administration became evident. NDRC implemented the regulatory provision calling for the elimination of separate allocations for general trade and processing trade, increased the size of quota allocations, and improved its handling of reallocations. At the same time, transparency continued 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, rose as high as \$2.1 billion in 2006, and most recently in 2008 totaled \$1.6 billion. In contrast, while U.S. exports of wheat totaled an unusually high amount of \$495 million in 2004, as the TRQ allocations for wheat did not appear to act as a limiting factor, in subsequent years they declined dramatically, totaling only \$142,000 in 2008.

Throughout 2009, the United States continued to raise transparency and other concerns about NDRC's TRQ administration, both bilaterally and at the WTO. In 2010, the United States will continue to work to ensure that NDRC administers TRQs transparently and in a manner that is consistent with China's commitments and that does not impede market access or commercial decisions.

China's Biotechnology Regulations

Despite continuing problems with China's biotechnology approval process, major trade disruptions have been avoided.

As previously reported, one of the most contentious agriculture trade issues that arose during China's first year of WTO membership involved new rules implementing June 2001 regulations relating to biotechnology safety, testing and labeling. The implementing rules, issued by China's Ministry of Agriculture (MOA) shortly before China's WTO accession, did not provide adequate time for scientific assessment and the issuance of formal safety certificates for biotechnology products. 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 issue temporary safety certificates until formal safety certificates could be issued. China subsequently issued a formal safety certificate for a U.S. biotechnology soybean variety known as Roundup Ready soybeans in February 2004. 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 China's market through the issuance of temporary safety certificates, trade disruptions were minimized, and U.S. exports performed strongly. In 2003, U.S. soybean exports reached a record level of \$2.9 billion, representing an increase of 190 percent over 2002. In 2004, U.S. soybean exports declined to \$2.3 billion, although this figure was still twice the level of any year prior to 2003. In 2005, U.S. soybean exports remained approximately steady at \$2.2 billion before rising to \$2.5 billion in 2006, \$4.1 billion in 2007 and \$7.3 billion in 2008, as China remained the leading export destination for U.S. soybeans.

In November 2006, MOA issued an announcement about the renewal requirements for existing safety certificates covering imported biotechnology crops. Because safety certificates for cotton, soybeans, corn and canola expired beginning in February 2007, it was possible that trade in these products would be disrupted. However, U.S. intervention ensured the timely renewal of the events that were about to expire.

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's

National Biosafety Committee normally reviews new product applications only during three meetings each year. These practices present significant and unnecessary delays for bringing U.S. goods into the China market. China's lack of clarity on the requirements applicable to products stacked with multiple traits is a cause for additional concern, as are China's sometimes duplicative and unprecedented testing requirements.

In 2007, MOA developed, issued and implemented some troubling new regulations without circulating them for public comment in advance or even consulting with relevant stakeholders such as the United States and U.S. industry. For example, in January 2007, MOA added a new requirement that biotechnology seed companies turn over key intellectual property as part of the application process when seeking safety certificates. MOA later dropped this requirement, although it still unnecessarily requires the submission of other intellectual property. In another example, in March 2007, MOA halted a pilot program, which had been developed over two years of bilateral discussions, aimed at allowing MOA to review products under development in the United States prior to completion of the U.S. approval process. As a result, the MOA approval process can still only begin after the completion of the U.S. approval process. Even if the MOA approval process proceeds quickly, trade may still be disrupted, as importers need time to apply for vessel based safety certificates and Quarantine Inspection Permits, both of which require valid safety certificates for biotechnology products and can take up to 30 working days.

In 2007 and 2008, the United States raised its concerns about these developments in several bilateral meetings, including JCCT working group meetings and plenary meetings. At the December 2007 JCCT meeting, China addressed one of the U.S. concerns that had arisen in 2007 when it agreed to eliminate a requirement to submit viable biotechnology seeds for testing during the approval process, which will reduce the possibility of illegal copying of patented agricultural materials. Despite

continuing concerns about the approval process, in September 2008 MOA approved the first foreign "second generation" biotechnology event, while several other foreign "second generation" biotechnology events remain in the application pipeline.

In 2009 meetings, including working group meetings held under the auspices of the JCCT, the United States continued to raise concerns about China's regulatory system for biotechnology products. Potential disruptions to trade continue to be a concern due to China's asynchronous approval process, excessive data requests, duplicative requirements and an onerous process for extension of existing certificates. Investment restrictions also constrain foreign companies' ability to increase product development in China and maintain control over important genetic resources. In 2010, the United States will continue to work to ensure that MOA's approval process does not create barriers for U.S. agricultural interests.

Sanitary and Phytosanitary Issues

In 2009, China's regulatory authorities imposed non-transparent SPS measures that appeared to lack scientific bases, including BSE-related bans on beef and some low-risk bovine products, pathogen standards and residue standards for raw meat and poultry products, Avian Influenza bans on poultry and H1N1-related bans on pork. Meanwhile, China has made progress but still does not appear to have notified all proposed SPS measures as required by WTO rules.

In 2009, China's SPS measures continued to pose increasingly serious problems for U.S. agricultural producers exporting to China. As in prior years, the United States repeatedly engaged China on a number of SPS issues, in high-level bilateral meetings and technical discussions as well as during meetings of the WTO's SPS Committee, including the transitional review held in October 2009. The United States also continued to provide extensive training to China's regulatory authorities and to urge them to

ensure full compliance with China's transparency obligations under the SPS Agreement.

While market access for U.S. soybeans and grain has been maintained, little progress was made in 2009 in addressing SPS barriers for raw meat, poultry and pork products, while market entry requirements for processed foods and horticultural products remain burdensome. In 2009, China's market continued to be closed to U.S. beef and beef products because of China's BSE-related ban. China also continued to maintain several state-level Avian Influenza (AI) bans on poultry. Additionally, China imposed bans on imports of U.S. pork and pork products and live swine in April 2009, ostensibly related to its concern about the transmission of the H1N1 influenza A virus, although by October 2009 China had committed to lift these bans.

In many instances, progress was made difficult by China's inability to provide relevant risk assessments or its science-based rationale for maintaining its import restrictions against U.S.-origin products. For example, in 2009, China was unable to provide a science-based rationale for import restrictions on U.S. beef products and some U.S. poultry and pork products, as described below. In addition, China's regulatory authorities continued to issue significant new SPS measures without first notifying them to the SPS Committee and providing WTO members with an opportunity to comment. The United States will continue to press for resolution of these and other outstanding issues in 2010.

BSE-related Bans

In December 2003, China and other countries imposed a ban on imports of U.S. cattle, beef and processed beef products in response to a case of BSE found in the United States. Since that time, the United States has repeatedly provided China with extensive technical information on all aspects of its BSE-related surveillance and mitigation measures, internationally recognized by the World Organization of Animal Health (known by its historical acronym OIE) as effective and appropriate, for both food

safety and animal health. After four years, China still has not provided any scientific justification for continuing to maintain its ban.

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

In May 2007, the United States received a risk classification as a "controlled risk" country by the OIE, indicating that all U.S. beef and beef products are safe to trade, provided that certain risky materials are removed during processing. Later that month, while in Washington for the May 2007 SED meeting, Vice Premier Wu offered to open China's market to both boneless and bone-in beef, although still with the age restriction of 30 months or less. The United States rejected this offer because the applicable OIE classification has no age restrictions.

Since May 2007, U.S. and Chinese officials have met repeatedly, but to date China has not indicated any willingness to begin accepting U.S. beef and beef products into its market in a manner consistent with the OIE's classification. The United States will continue to press China to re-open its market in 2010.

At the same time that it banned U.S. cattle, beef and processed beef products, China also banned bovine-origin products (i.e., bovine semen, bovine embryos,

and protein-free tallow) that are listed in OIE guidelines as safe to trade regardless of a country's BSE status. Additionally, China banned imports of U.S.-origin non-ruminant feeds and fats (such as pet food, rendered products and porcine proteins) even though these products were of non-bovine-origin and presented absolutely no BSE-related risk.

After numerous bilateral meetings and technical discussions in 2004, including a visit to U.S. bovine facilities by Chinese food safety officials, China announced a lifting of its BSE-related ban for these low-risk" 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 products.

In November 2004, U.S. and Chinese officials finalized and signed amended protocols that would enable the resumption of exports of U.S.-origin bovine semen and bovine embryos, contingent on facility-by-facility certification by China's regulatory authorities in accordance with the original protocols that had been signed more than 10 years earlier. Additionally, U.S. and Chinese authorities signed a new protocol which authorized a resumption of exports of U.S.-origin non-ruminant feeds and fats. In July 2005, shortly before the July 2005 JCCT meeting, China finally announced the resumption of trade in bovine semen and bovine embryos, following facility certifications completed in June 2005. However, it was not until early 2006 that imports of U.S.-origin bovine semen and bovine embryos actually resumed.

Additionally, in June 2005, China agreed to accept a systems approach audit (as opposed to facility-by-facility certification) to approve U.S. facilities to export U.S.-origin non-ruminant feeds and fats (pet food, rendered products, porcine proteins, etc.) to China. The initial shipment of U.S.-origin non-ruminant pet food occurred in September 2005. By January 2006, trade in the full range U.S.-origin non-ruminant feed and fat products had also resumed, after negotiation and resolution of a series of

onerous, detailed and unnecessary non-BSE related information requirements proposed by China that appear to be inconsistent with OIE guidelines and contrast sharply with U.S. requirements.

To date, U.S. and Chinese officials continue to be unable to reach agreement on provisions of a protocol for in protein-free tallow, a product listed by the OIE as safe to trade regardless of a country's BSE status. As a result, trade in protein-free tallow has still not resumed.

H1N1-Related Bans

In April 2009, China imposed import bans on U.S. pork and pork products and live swine, ostensibly related to its concern about the transmission of the H1N1 influenza A virus. Import bans based of this type of concern are not consistent with international guidelines to control the spread of the H1N1 influenza A virus. International scientific bodies, including the Food and Agricultural Organization of the United Nations, the World Health Organization and the OIE, have repeatedly explained that the H1N1 influenza A virus is not transmitted by food products. Furthermore, the OIE has stated that "the imposition of ban measures related to the import of pigs and pig products does not comply with international standards published by the OIE and all other competent standard setting international bodies for animal health and food safety." However, China still banned imports of pork, pork products and live swine from any states in which human cases of the H1N1 influenza A virus are present, and further imposed overly restrictive disinfection requirements, effectively blocking all imports from the United States because the virus is present in all 50 states. Technically, cooked pork products are allowed to be imported if containers are "disinfected," although bilateral discussions failed to identify a practical way to disinfect containers so that trade in cooked pork products could resume.

Throughout 2009, the United States pressed China to remove its H1N1-related bans on imports of U.S. pork, pork products and live swine, using high-level

bilateral meetings as well as JCCT working group meetings and the transitional review before the WTO's SPS Committee. At the October 2009 JCCT meeting, China announced its intent to reopen the China market to U.S. pork, pork products and live swine. In December 2009, MOA and AQSIQ issued a measure removing the bans on imports of U.S. pork and pork products. The United States will monitor China's implementation of this measure closely, while continuing to urge China to lift the remaining ban on imports of U.S. live swine.

Pathogen Standards and Residue 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 Alimentarius (Codex) guidelines or current scientific testing practices. One requirement establishes a zero tolerance limit for the presence of Salmonella bacteria. Similar zero tolerance standards exist for Listeria and other pathogens. Meanwhile, the complete elimination of these enteropathogenic bacteria is generally considered unachievable without first subjecting raw meat and poultry to a process of irradiation. Moreover, China apparently does not apply this same standard to domestic raw poultry and meat, raising national treatment concerns.

In 2008, despite assurances from China's regulatory authorities that they were in the process of revising China's pathogen standards, little progress was seen. At the September 2008 JCCT meeting, China did agree to re-list several U.S. poultry plants that had earlier been de-listed for alleged violations of zero tolerance standards for pathogens or detection of certain chemical residues, such as ractopamine. Although this step did not address the important underlying need for China to revise its pathogen standards, it did enable some U.S. poultry plants to resume shipment to China. Despite positive results from USDA investigations of the plants, and extensive follow-up efforts by USDA, these plants have not been re-listed as approved to ship product to China.

In December 2008, the United States hosted a team of Chinese government officials and academic experts to observe how the U.S. government and U.S. industry regulate the use of veterinary drugs related to animal health. This visit was intended to address China's continuing ban on ractopamine residue in pork. China maintains that it has serious concerns about the safety of ractopamine, but to date it has not provided any evidence that it has conducted a risk assessment despite repeated U.S. requests. During September 2009 JCCT working group meetings, the United States requested that China adopt an interim maximum residue level (MRL) for ractopamine in order to address the problems presented by China's current zero-tolerance policy, while China awaited the results of deliberations at the Codex Commission regarding the finalization of international MRLs for ractopamine. However, China has not yet agreed to take any steps to address its current zero-tolerance policy.

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

In 2010, the United States will continue to press China to revise its problematic pathogen and residue standards.

Avian Influenza Bans

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

December 2004, China lifted its nationwide ban on U.S. poultry, leaving in place a ban only for the states of Connecticut and Rhode Island.

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

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

Following the eradication of AI in Connecticut, Rhode Island, New York, Pennsylvania, West Virginia, Virginia and Nebraska, the United States asked China to re-open trade in poultry and poultry products from these states, consistent with OIE guidelines. In response to U.S. engagement, at the September 2008 JCCT meeting, China announced the lifting of the state-level bans covering Rhode Island, Connecticut, New York, Pennsylvania, West Virginia and Nebraska. However, China's state-level ban on Virginia remained in place, and China imposed new state-level bans on poultry from the state of Arkansas in August 2008, the state of Idaho in September 2008 and the state of Kentucky in April 2009. In bilateral meetings in 2009, including JCCT working group meetings, the United States pressed for removal of the current state-level bans and for China's adoption of OIE-consistent policies governing the import of poultry and poultry products. Despite China's continued unwillingness to address these issues, the United States in 2010 will continue to press for removal of the remaining state-level bans,

and will continue to express its concerns about China's misinterpretation of the OIE's guidelines on Avian Influenza.

Transparency

As in the TBT context, some of China's SPS measures continue to enter into force without having first been notified to the SPS Committee, and without other WTO members having had the opportunity to comment on them, even though they appear to be the type of measures that are subject to the notification requirements of the SPS Agreement. Many of these unnotified measures are of key concern to foreign traders. Indeed, since January 2003, the United States has identified more than 250 SPS measures implementing important new registration requirements, residue standards, inspection requirements and quarantine requirements – none of which China notified to the SPS Committee, even though these measures constrain U.S. exports of frozen meat, dairy products, grain, poultry, feed, horticultural products, a variety of processed products and alcoholic beverages.

In 2009, as in prior years, the United States urged China's regulatory authorities to improve the transparency of their SPS regime by notifying more measures. The United States also highlighted this concern during regular meetings and the annual transitional reviews before the SPS Committee. The United States will continue to seek improvements from China in this area in 2010.

Inspection-related Requirements

China's regulatory authorities continue to administer inspection-related requirements in a seemingly arbitrary manner.

Through two measures issued in 2002, the *Administrative Measures for the Entry-Exit Inspection and Quarantine for Grains and Feed Stuff* and the *Administrative Measures for Entry Animal and Plant Quarantine*, 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.

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

Traders continue to be hesitant to press AQSIQ for change because they would risk falling out of favor. Many traders would at least like AQSIQ to eliminate

the quantity requirements that it unofficially places on QIPs. These quantity requirements have been used often by AQSIQ during peak harvest periods to limit the flow of commodity imports. In 2006, traders reported that MOFCOM not only limited QIP quantities, but also required some companies to use up the majority of a QIP before being issued another one and required other companies to use up their QIPs or risk being "de-listed." Eliminating these requirements would make the QIP system more dependent on market forecast.

Little improvement in the QIP system has taken place over the last three years, despite U.S. engagement. 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 2010.

Meanwhile, MOFCOM administers an additional import permit system for poultry products. Through its issuance of Automatic Registration Forms (ARFs) to importers, MOFCOM allocates a volume amount to an importer for imports of particular commodities each year. However, problems periodically arise with MOFCOM's administration of this system. In July 2009, for example, U.S. poultry industry representatives reported that MOFCOM's issuance of ARFs to importers of U.S. but not other foreign poultry products slowed dramatically for a short period of time. Especially in light of these problems, the United States has continued to urge MOFCOM to either eliminate ARFs or issue them in a more transparent, flexible manner so that trade is not disrupted.

Export Subsidies

It is difficult to determine whether China maintains export subsidies in the agricultural sector, in part

because China has not notified all of its subsidies to the WTO.

Shortly after China's WTO accession, U.S. industry became concerned that China was providing export subsidies on corn, despite China's commitment to eliminate all export subsidies upon accession. 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 China's domestic prices. 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 in bilateral meetings. The United States has also raised its concerns and sought additional information about China's corn policies – including the use of potentially excessive VAT export rebates – during meetings before the Committee on Agriculture, including the transitional reviews.

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

The United States will continue to investigate China's subsidization practices and VAT rebate system for the agricultural sector in 2010, although China's incomplete subsidy notification hinders those efforts. The United States will make every effort to ensure that any use of export subsidies is eliminated.

INTELLECTUAL PROPERTY RIGHTS

China is in the process of revising its legal regime and updating a comprehensive set of laws and

regulations aimed at protecting the intellectual property rights of domestic and foreign entities in China, but some key improvements in China's legal framework are still needed, and China has continued to demonstrate little success in actually enforcing its laws and regulations in the face of the challenges created by widespread counterfeiting, piracy and other forms of infringement.

With its acceptance of the TRIPS Agreement, China took on obligations to adhere to generally accepted international norms to protect and enforce the intellectual property rights held by U.S. and other foreign companies and individuals. 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.

China is in the process of revising its legal regime and updating a comprehensive set of laws and regulations aimed at protecting the intellectual property rights of domestic and foreign entities in China. Some key improvements in China's legal framework are still needed, and China has continued to demonstrate little success in actually enforcing its laws and regulations in the face of the challenges created by widespread counterfeiting, piracy and other forms of infringement. As a result, in 2009, the United States continued to pursue bilateral engagement with China, focusing on obtaining improvements to multiple aspects of China's system of IPR protection and enforcement so that significant reductions in IPR infringement in China could be realized and sustained over time.

Several weaknesses in all aspects of China's enforcement system – criminal, civil and administrative – contribute to China's poor IPR enforcement record. For example, one major weakness is China's chronic underutilization of deterrent criminal remedies. In particular, the thresholds established by China for criminal investigation, prosecution and conviction preclude criminal remedies in many instances of commercial-scale counterfeiting and piracy, creating a "safe harbor" for infringers and raising concerns that China may not be complying with its obligations under the TRIPS Agreement. The United States sought to address this concern, along with concerns regarding border enforcement and copyright protection for works that have not obtained approval from China's censorship authorities, in a WTO case that it filed in April 2007 focusing on deficiencies in China's legal regime for protecting and enforcing copyrights and trademarks on a wide range of products. Proceedings before the WTO panel took place in 2008, and the panel issued its decision in January 2009. The panel ruled in favor of the United States on two of its three claims, finding WTO-inconsistent China's denial of copyright protection to works that do not meet China's content review standards as well as China's handling of border enforcement seizures of counterfeit goods. On a third issue, the panel clarified important legal standards relating to the criminal enforcement of copyrights and trademarks, but determined that it did not have sufficient factual information to find WTO-inconsistent China's quantitative thresholds for criminal prosecution and liability. Neither party appealed the panel's decision, and China has agreed to come into compliance with that decision by March 2010.

A factor that exacerbates the weaknesses in China's IPR enforcement regime is China's continued maintenance of import and distribution restrictions for certain types of legitimate copyright-intensive products, such as books, newspapers, journals, theatrical films, DVDs and music, as these restrictions inadvertently help to ensure that infringing products continue to dominate those

sectors within China. As discussed above in the sections on Trading Rights and Distribution Services, the United States has been addressing these restrictions in a separate WTO case filed in April 2007. In that case, the WTO panel issued its decision in August 2009, ruling in favor of the United States on every significant issue in this case, and China appealed the panel's decision in September 2009. The WTO's Appellate Body rejected China's appeal on all counts in December 2009.

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

As previously reported, the United States elevated China to the Special 301 "Priority Watch List" in April 2005 and at the same time developed a comprehensive strategy for addressing China's ineffective IPR enforcement regime, which included the possible use of WTO mechanisms, as appropriate. Through this strategy, the United States sought China's agreement through the JCCT process to take a series of specific actions designed to (1) increase prosecutions of IPR violators, (2) improve enforcement at the border, (3) counter piracy of movies, audio visual products and software, (4) address Internet-related piracy and (5) assist small and medium-sized U.S. companies

experiencing China-related IPR problems, among other things.

China has since taken steps to address many of these concerns. It adopted amended rules governing the transfer of administrative and customs cases to criminal authorities, and it took some steps to pursue administrative actions against end user software piracy. China posted an IPR Ombudsman to its Embassy in Washington, who has facilitated contacts between U.S. government officials and their counterparts in Beijing, and has been a source of information for U.S. businesses, including small and medium size companies. China has also expanded enforcement cooperation.

Through an October 2005 request under Article 63.3 of the TRIPS Agreement, the United States sought more information from China on IPR infringement levels and enforcement activities in China, with the objective of obtaining a better basis for assessing the effectiveness of China's efforts to improve IPR enforcement since China's accession to the WTO. However, China provided only limited information in response, hampering the United States' ability to evaluate whether China is taking all necessary steps to address the rampant IPR infringement found throughout China, and contributing to the eventual launching of the United States' WTO case against China on IPR enforcement issues.

Despite this lack of cooperation, the United States continued to use bilateral discussions to encourage China to improve its IPR enforcement regime. These discussions focused on concrete steps that China could take to improve both legal protections and enforcement efforts. By April 2007, however, it had become clear that dialogue was yielding inadequate progress, and it was then that the United States filed the WTO case on IPR enforcement issues, along with the related WTO case seeking better market access for copyright-intensive products.

Shortly thereafter, in April 2007, USTR issued its annual Special 301 report, which continued to place China on the Priority Watch List. Notably, this report

also discussed a special review conducted in 2006 and 2007 to examine the adequacy and effectiveness of IPR protection and enforcement in China at the provincial government level. As the report explains, the provincial review revealed strengths, weaknesses and inconsistencies in and among China's provinces.

After these events, the United States continued to seek ways in which to work with China to improve China's IPR enforcement regime. These efforts yielded some results in 2007. However, China decided to limit its cooperation because of dissatisfaction with the United States' decision to invoke the WTO dispute settlement mechanism, despite the fact that the issues in dispute involved specifically drawn legal issues and the two sides had made sustained but unsuccessful attempts to resolve them through dialogue.

In April 2008, the United States kept China on the Priority Watch List when it issued its Special 301 report, while China continued to shun bilateral cooperation on IPR issues. Later in the year, however, the United States was able to use the SED and JCCT processes to secure a renewed commitment from China to engage in cooperative discussions, including through regular meetings of the JCCT IPR Working Group, on a range of IPR issues, such as IPR and innovation, China's development of guidelines on IPR and standards, public-private discussions on copyright and Internet piracy challenges, including infringement on user-generated content sites, and reducing the sale of pirated and counterfeit goods at wholesale and retail markets, among other areas of mutual interest.

The United States again kept China on the Priority Watch List in 2009 and plans to conduct another provincial review in 2010. However, 2009 was also a year marked by China's increased willingness to engage in bilateral cooperative efforts. JCCT IPR Working Group meetings held in early October allowed for constructive dialogue on the intellectual property regimes of both countries. Following these meetings, China made commitments at the JCCT

meeting held later that month to impose maximum administrative penalties, including the revocation of business licenses, for internet piracy, and to work with the United States to ensure that the Ministry of Culture's prescreening requirements do not hamper the distribution of legitimate sound recordings online. China also announced that it had issued a notice conveying the importance of compliance with all copyright laws, especially with respect to electronic journals, in state-run and academic libraries.

Legal Framework

While China's framework of laws, regulations and departmental rules remains largely satisfactory in most respects, reforms are needed in a few key areas, such as further improvement of China's measures for copyright protection on the Internet following China's accession to the WIPO Internet treaties and changes to address a number of continuing deficiencies in China's criminal IPR enforcement measures.

In most respects, China's framework of IPR laws, regulations and departmental rules remains largely satisfactory. However, reforms are needed in a few key areas, such as further improvement of China's measures for copyright protection on the Internet following the notable achievement of China's accession to the WIPO Internet treaties. In particular, more work is needed at both the national level and the provincial level to meet the challenges of Internet piracy and fully implement the WIPO Internet treaties. Right holders have also pointed to a number of continuing deficiencies in China's criminal IPR enforcement measures.

As previously reported, at the time of its accession to the WTO, China was in the process of modifying the full range of IPR laws, regulations and departmental rules, including those relating to patents, trademarks and copyrights. Within several months after its accession, China had completed amendments to its *Patent Law*, *Trademark Law* and *Copyright Law*, along with regulations and

departmental rules for them. China had also issued regulations and departmental rules covering specific subject areas, such as integrated circuits, computer software and pharmaceuticals. U.S. experts carefully reviewed these measures after their issuance and, together with other WTO members, participated in a comprehensive review of them as part of the first transitional review before the TRIPS Council in 2002. Since then, China has periodically issued new IPR measures. The United States has reviewed these measures through bilateral discussions and subsequent TRIPS Council reviews. Encouragingly, China became more willing to circulate proposed measures for public comment and to discuss proposed measures with interested trading partners and stakeholders. Taking advantage of this openness, the United States and U.S. right holders provided written comments to China on several drafts of regulations for the protection of copyrights on information networks and on drafts of *Patent Law* amendments and regulations, among other draft measures.

In 2008, China took steps to make notice-and-comment procedures mandatory for proposed trade and economic-related laws, regulations and departmental rules, as discussed below in the Public Comment section. China also announced an updated Action Plan for revising its legal regime in order to better protect intellectual property rights. Among other things, this Action Plan sets out China's intentions for revising various laws and other measures, including the *Patent Law*, the *Trademark Law*, the *Copyright Law* and related measures. These efforts are ongoing, and the United States has been assessing the potential ramifications of the contemplated revisions for U.S. right holders.

China has also been working on other proposed legal measures that could have significant implications for the intellectual property rights of foreign right holders. In particular, China issued an *Anti-monopoly Law* in August 2007, which became effective in August 2008, and has issued draft regulations relating to standards that incorporate patents. The United States has been carefully

monitoring these efforts and raised concerns with particular aspects of these proposals, both in bilateral meetings and at the WTO during the annual transitional reviews before the TRIPS Council and the TBT Committee.

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

The United States has also sought improvements in China's copyright protection in the context of electronic information networks since the April 2004 JCCT meeting. China took an important step at the time of that meeting when the National Copyright Administration (NCA) issued the *Measures for Administrative Protection of Copyright on the Internet*. That measure requires Internet service providers to take remedial actions to delete contents that infringe on copyrights upon receipt of a complaint from the right holder, or face administrative penalties ranging from confiscation of illegal gains to fines of up to RMB 100,000 (\$14,600).

During the run-up to the July 2005 JCCT meeting, the United States also urged China to accede to the WIPO Internet treaties and to fully harmonize its regulations and implementing rules with them. Compliance with these treaties is not required under WTO rules, but they still reflect important international norms for providing copyright protection over the Internet. These treaties have been ratified by many developed and developing countries since they entered into force in 2002. In the case of China, this type of copyright protection is especially important in light of its rapidly increasing number of Internet users, many of whom have broadband access. At the July 2005 JCCT meeting, the United States obtained China's commitment to submit the legislative package necessary for China's accession to the WIPO Internet treaties to the National People's Congress by June 2006. Although China's fulfillment of this commitment was delayed for technical reasons relating to coordination with Hong Kong and Macau, China acceded to these treaties in 2007. However, a number of gaps remain to be filled for China to meet the challenges of Internet piracy and fully implement the WIPO Internet treaties.

In May 2006, the State Council adopted an important Internet-related measure, the *Regulations on the Protection of Copyright over Information Networks*, which went into effect in July 2006. Although it does not appear to fully implement the WIPO Internet Treaties, this measure represents a welcome step, demonstrating China's determination to improve protection of the Internet-based right of communication to the public. Several aspects of this measure nevertheless would benefit from further clarification. For example, China could clarify that certain Internet "deep linking" and other services that effectively encourage or induce infringement are unlawful under Chinese law.

With respect to software piracy, China issued new rules during the run-up to the April 2006 JCCT meeting that require computers to be pre installed with licensed operating system software and

government agencies to purchase only computers satisfying this requirement. Combined with ongoing implementation of previous JCCT commitments on software piracy, it was hoped that these rules will contribute to significant further reductions in industry losses due to software piracy. According to the U.S. software industry, China's software piracy rate dropped 12 percentage points between 2003 and 2007. However, the U.S. software industry also reports that compliance with these rules has fallen from approximately 65 percent in 2006 to 50 percent in 2008. Achieving sustained reductions in end user software piracy will therefore require more enforcement by China's authorities, followed by high profile publicity of fines and other remedies imposed. Another necessary tool is the use of Software Asset Management audits, not only by Chinese government agencies but also by state-owned enterprises, to ensure that these agencies and enterprises are not running illegal software.

In the customs area, the United States is encouraged by the Customs Administration's increased efforts to provide effective enforcement against counterfeit and pirated goods destined for export and the Customs Administration's agreement in 2007 to cooperate with U.S. customs authorities to fight exports of counterfeit and pirated goods. In addition, once China complies with the WTO's ruling on the border enforcement claim in the United States' IPR enforcement WTO case, the United States expects that the Customs Administration will no longer allow for the auction of confiscated counterfeit goods following the simple removal of infringing trademark features. Nevertheless, the United States remains concerned about various aspects of the *Regulations on the Customs Protection of Intellectual Property Rights*, issued by the State Council in December 2003, and the Customs Administration's May 2004 implementing rules, which had been intended to improve border enforcement, make it easier for right holders to secure effective enforcement at the border and strengthen fines and punishments.

The United States also remains concerned about a variety of weaknesses in China's legal framework that do not effectively deter, and that may even encourage, certain types of infringing activity, such as the "squatting" of foreign company names, designs and trademarks, the theft of trade secrets, the registration of other companies' trademarks as design patents and vice versa, the use of falsified or misleading license documents or company documentation to create the appearance of legitimacy in counterfeiting operations, and false indications of geographic origin of products. The United States has continued to discuss these and other problems with China and to seek solutions for them. In a positive development, SAIC announced in August 2007 that it was launching a 6-month campaign targeting the unauthorized use of well-known trademarks and company names in the enterprise registration process. In addition, during the October 2009 JCCT IPR Working Group meetings, China committed to form a task force to develop recommendations on how to further address this problem.

In the pharmaceuticals sector, the United States continues to have a range of concerns. The United States has urged China to provide more effective protection against unfair commercial use for undisclosed information, test data and other data generated to obtain marketing approval for pharmaceutical products. The United States has also encouraged China to more closely coordinate patent grants with pharmaceutical marketing approvals and to consider the adoption of a system of patent term restoration. In addition, built-in delays in China's marketing approval system for pharmaceuticals continue to create incentives for counterfeiting, as does China's inadequate regulatory oversight of the production and sale of active pharmaceutical ingredients by domestic chemical manufacturers. In 2009, as in prior years, the United States sought to address all of these issues as part of its broader effort to work with China to improve China's regulatory regime for the pharmaceuticals sector.

Enforcement

Effective IPR enforcement has not been achieved, and IPR infringement remains a serious problem throughout China. IPR enforcement is hampered by lack of coordination among Chinese government ministries and agencies, lack of training, resource constraints, lack of transparency in the enforcement process and its outcomes, and local protectionism and corruption.

The TRIPS Agreement requires China to ensure that enforcement procedures are available so as to permit effective action against any act of IPR infringement covered by the TRIPS Agreement, including expeditious remedies to prevent infringement and remedies that constitute a deterrent to further infringement. Although the central government has modified the full range of China's IPR laws and regulations in an effort to bring them into line with China's WTO commitments, effective IPR enforcement has not been achieved, and IPR infringement remains a serious problem throughout China. IPR enforcement is hampered by lack of coordination among Chinese government ministries and agencies, lack of training, resource constraints, lack of transparency in the enforcement process and its outcomes, and local protectionism and corruption.

Despite repeated anti-piracy campaigns in China and an increasing number of civil IPR cases in Chinese courts, overall piracy and counterfeiting levels in China remained unacceptably high in 2009. IPR infringement continued to affect products, brands and technologies from a wide range of industries, including films, music and sound recordings, publishing, business and entertainment software, pharmaceuticals, chemicals, information technology, apparel, athletic footwear, textile fabrics and floor coverings, consumer goods, food and beverages, electrical equipment, automotive parts and industrial products, among many others.

U.S. industry estimates that levels of piracy in China across most lines of copyright products, except

business software, ranged between 90 and 95 percent, while business software piracy rates were approximately 80 percent. Trade in pirated optical discs continues to thrive, supplied by both licensed and unlicensed factories and by smugglers. Small retail shops continue to be the major commercial outlets for pirated movies and music (and a variety of counterfeit goods). Piracy of books and journals and end user piracy of business software also remain key concerns, although improvements have been seen in business software piracy rates, as discussed above. In addition, Internet piracy is increasing, as is piracy over enclosed networks such as universities, although China's regulatory authorities did take initial steps to address text book piracy on university campuses in late 2006 and 2007. In addition, in October 2009, the NCAC, the Ministry of Education, the Ministry of Culture and the National Anti-Pornography Office issued the *Notice on Strengthening Library Protection of Copyright*, which directs libraries to strictly adhere to the disciplines of the *Copyright Law*. The United States will closely monitor compliance with this directive in 2010.

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

China's widespread counterfeiting not only harms the business interests of foreign right holders, but also includes many products that pose a direct threat to the health and safety of consumers in the United States, China and elsewhere, such as pharmaceuticals, food and beverages, batteries, auto parts, industrial equipment and toys, among many other products. At the same time, the harm from counterfeiting is not limited to right holders and consumers. China estimated its own annual tax

losses due to counterfeiting at more than \$3.2 billion back in 2002, and this figure could only have grown in the ensuing years.

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

As in prior years, the United States worked with central, provincial and local government officials in China in 2009 in a sustained effort to improve China's IPR enforcement, with a particular emphasis on the need for dramatically increased utilization of criminal remedies as well as the need to improve the effectiveness of civil and administrative enforcement mechanisms. A variety of U.S. agencies held regular bilateral discussions with their Chinese counterparts and have conducted numerous technical assistance programs for central, provincial and local government officials on TRIPS Agreement rules, enforcement methods and rule of law issues.

The United States' efforts have also benefited from cooperation with other WTO members in seeking improvements in China's IPR enforcement, both on the ground in China and at the WTO during meetings of the TRIPS Council. For example, several WTO

members participated as supportive third parties in the United States' two April 2007 IPR-related WTO cases against China. Previously, Japan and Switzerland had joined the United States in making coordinated requests under Article 63.3 of the TRIPS Agreement in order to obtain more information about IPR infringement levels and enforcement activities in China. In addition, the United States and the EU have increased coordination and information sharing on a range of China IPR issues over the last two years. China's membership in the Asia-Pacific Economic Cooperation (APEC) forum also brings increased importance to APEC's work to develop regional IPR best practices.

The United States has also continued to pursue a comprehensive initiative to combat the enormous global trade in counterfeit and pirated goods, including exports of infringing goods from China to the United States and the rest of the world. That initiative, the Strategy Targeting Organized Piracy (STOP!), was announced in October 2004. It is a U.S. government wide effort to stop fakes at the U.S. border, to empower U.S. businesses to secure and enforce their intellectual property rights in overseas markets, to expose international counterfeiters and pirates, to keep global supply chains free of infringing goods, to dismantle criminal enterprises that steal U.S. intellectual property and to reach out to like-minded U.S. trading partners in order to build an international coalition to stop counterfeiting and piracy worldwide. China's share of infringing goods seized at the U.S. border stood at 81 percent in 2008, representing a 40 percent increase over 2007, according to U.S. customs data.

At the same time, China is making genuine efforts to improve IPR enforcement, and cooperation between the United States and China has produced some successful enforcement actions. For example, China's Ministry of Public Security (MPS) has engaged with U.S. law enforcement authorities on enforcement initiatives as part of the Intellectual Property Criminal Enforcement Working Group of the U.S.-China Joint Liaison Group for Law Enforcement Cooperation. This working group

focuses on the development of joint U.S.-China operations to combat transnational IPR crimes, particularly crimes committed by organized criminal groups and crimes that threaten public health and safety. In July 2007, this collaboration with MPS resulted in the largest ever joint U.S.-China piracy investigation and prosecution, code-named "Operation Summer Solstice." This joint operation netted seizures of more than 290,000 counterfeit software discs worth more than \$500 million and arrests of 25 Chinese nationals. This joint operation is believed to have dismantled the largest piracy syndicate of its kind in the world, estimated to have distributed more than two billion copies of counterfeit Microsoft software.

U.S. industry has confirmed that some of China's special campaigns, such as the "Mountain Eagle" campaign against trademark infringement crimes that ended in 2006, have in fact resulted in increased arrests and seizures of infringing materials, although the disposition of seized goods and the outcomes of criminal cases remain largely obscured by lack of transparency. The 2008 Action Plan announced that China will launch more special crackdown efforts with regard to various IPR infringement problems. The United States has urged China to use its implementation of such efforts as an opportunity to tackle emerging enforcement challenges, particularly the sale of pirated and counterfeit goods on the Internet. In addition, the United States has suggested that China use this opportunity to examine the potential benefits of specialized national IPR courts and prosecutors, providing faster trademark examination, and ensuring that the resources available to local administrative, police, and judicial authorities charged with protecting and enforcing intellectual property rights are adequate to the task. The United States will continue to pursue these efforts in 2010.

Despite its many positive efforts to improve IPR enforcement, China has pursued other policies that continue to impede effective enforcement. These policies led the United States to resort to the WTO dispute settlement mechanism in April 2007, where

it sought needed changes to China's legal framework that would facilitate the utilization of criminal remedies against piracy and counterfeiting, enhance border enforcement against counterfeit goods and provide copyright protection for works that have not obtained approval from China's censorship authorities. These changes should be an important objective for China, given the lack of deterrence clearly evident in China's current enforcement regime, and the United States welcomes China's confirmation that it will comply with the WTO rulings in this case by March 2010. At the same time, other changes are needed on the market access side. As the WTO ruled this year, China maintains market access barriers, such as import and distribution restrictions, which discourage and delay the introduction of numerous types of legitimate foreign products into China's market. These barriers create additional incentives for infringement of copyrighted products like books, newspapers, journals, theatrical films, DVDs and music and inevitably lead consumers to the black market, again compounding the severe problems already faced by China's enforcement authorities.

SERVICES

While China has implemented most of its services commitments, it appears that China has not implemented or has only partially implemented its commitments in some service sectors. In addition, challenges still remain in ensuring the benefits of many of the commitments that China has nominally implemented are available in practice, as China has continued to maintain or erect restrictive or cumbersome terms of entry in some sectors. These entry barriers prevent or discourage foreign suppliers from gaining market access through informal bans on new entry, high capital requirements, branching restrictions or restrictions taking away previously acquired market access rights. In addition, the licensing process in some sectors has generated national treatment concerns or inordinate delays.

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 over time 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, distribution and professional services. At the time, these commitments were viewed as a good start toward opening up China's services sectors, 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, the company could continue to operate with those rights.

In the licensing area, prior to China's WTO accession, foreign companies in many services 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.

Under the terms of its Services Schedule, China was allowed to phase in many of its services commitments over time. The last of these commitments was scheduled to have been phased in by December 11, 2007.

At present, eight years after China's accession to the WTO, significant challenges still seem to remain in securing the benefits of many of China's services commitments. Through WTO dispute settlement, the United States was able to fully open China's financial information services sector this past year, as China followed through on the terms of a settlement agreement requiring China to create an independent regulator and remove restrictions that had been placed on foreign financial information service suppliers. However, concerns remain with regard to the implementation of other important services commitments, such as in the area of electronic payment services, where China has not yet fully opened up its market to foreign companies that supply electronic payment and related services to banks and other companies that issue credit and debit cards, and in the area of express delivery services, where China this past year excluded foreign suppliers from a major segment of the domestic express delivery market.

In 2009, China also continued to maintain or erect restrictive or cumbersome terms of entry in some sectors that prevent or discourage foreign suppliers from gaining market access and therefore raise questions about commitments made by China in its Services Schedule. For example, China maintains an informal ban on entry in the basic telecommunications sector, and despite its

commitments to open this sector China has not granted any new licenses since acceding to the WTO on December 11, 2001. The requirement that licensees for basic services be majority government-owned provides a direct, non-transparent mechanism for enforcing this ban, and shuts off foreign suppliers from private Chinese enterprises that may be more attractive partners. In addition, excessive and sometimes discriminatory capital requirements continued to prove unduly burdensome for foreign suppliers in many sectors, such as banking, telecommunications, retailing and construction services, among others. In addition, in sectors such as banking, insurance and legal services, uneven and sometimes discriminatory application of branching regulations limit or delay market access for foreign suppliers. In other sectors, particularly construction services, problematic measures appear to be taking away previously acquired market access rights. In 2010, the United States will continue its efforts to resolve the concerns that have arisen in these areas.

Financial Services

BANKING

China has taken a number of steps to implement its banking services commitments, although these efforts have generated concerns, and there are some instances in which China still does not seem to have fully implemented particular commitments, such as with regard to Chinese-foreign joint banks and bank branches.

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. Within five years after accession, foreign banks were to be able to conduct domestic currency business with Chinese enterprises and individuals, and all geographic restrictions were to be lifted. Foreign banks were also to be permitted to provide financial leasing services at the same time that Chinese banks are permitted to do so.

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

As previously reported, shortly after China's accession to the WTO, the People's Bank of China (PBOC) issued regulations governing foreign-funded banks, along with implementing rules, which became effective February 2002. The PBOC also issued several other related measures. Although these measures appeared to keep pace with the WTO commitments that China had made, it became clear that the PBOC had decided to exercise extreme caution in opening up the banking sector. In particular, it imposed working capital requirements and other prudential rules that far exceeded international norms, both for the foreign banks' headquarters and branches, which made it more difficult for foreign banks to establish and expand their market presence in China. Many of these requirements, moreover, did not apply equally to foreign and domestic banks.

For example, China appears to have fallen behind in implementing its commitments regarding the establishment of Chinese-foreign joint banks. In its Services Schedule, China agreed that qualified foreign financial institutions would be permitted to establish Chinese-foreign joint banks immediately after China acceded, and it did not schedule any limitation on the percentage of foreign ownership in these banks. To date, however, China has limited the sale of equity stakes in existing state-owned banks to a single foreign investor to 20 percent, while the total equity share of all foreign investors is limited to 25 percent. Through SED and U.S.-China Joint Economic Committee meetings, the United States has urged China to relax these limitations. The United States and other WTO members have also pressed China on this issue during the annual transitional reviews before the Committee on Trade in Financial Services, including in 2009, although no progress has yet been achieved.

Another problematic area involves the ability of U.S. and other foreign banks to participate in the domestic currency business in China, the business that foreign banks were most eager to pursue in China, particularly with regard to Chinese individuals. As previously reported, despite high capital requirements and other continuing impediments to entry into the domestic currency business, participation of U.S. and other foreign banks in the domestic currency business expanded tremendously after China acceded to the WTO on December 11, 2001, first with regard to foreign-invested enterprises and foreign individuals and later with regard to Chinese enterprises, subject to geographic restrictions allowed by China's WTO commitments. China had committed to allow foreign banks to conduct domestic currency business with Chinese individuals by December 11, 2006, but it was only willing to do so subject to a number of problematic restrictions.

In November 2006, the State Council issued the *Regulations for the Administration of Foreign-Funded Banks*. Among other things, these regulations mandated that only foreign-funded banks that have

had a representative office in China for two years and that have total assets exceeding \$10 billion can apply to incorporate in China. After incorporating, moreover, these banks only become eligible to offer full domestic currency services to Chinese individuals if they can demonstrate that they have operated in China for three years and have had two consecutive years of profits. The regulations also restricted the scope of activities that can be conducted by foreign banks seeking to operate in China through branches instead of through subsidiaries. In particular, the regulations restricted the domestic currency business of foreign bank branches. While foreign bank branches can continue to take deposits from and make loans to Chinese enterprises in domestic currency, they can only take domestic currency deposits of RMB 1 million (\$146,000) or more from Chinese individuals and cannot make any domestic currency loans to Chinese individuals. In addition, unlike foreign banks incorporated in China, foreign bank branches cannot issue domestic currency credit and debit cards to Chinese enterprises or Chinese individuals.

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

In 2007 and 2008, working closely with U.S. banks, the United States was able to use the SED process and meetings of the U.S.-China Joint Economic Committee to improve the access of U.S. banks to the domestic currency business. For example, China committed to act on the applications of foreign banks incorporated in China seeking to issue their own domestic currency credit and debit cards, although the PBOC is insisting as a condition of its approval that the banks move the data processing for these credit and debit cards onshore. In addition, China agreed to reduce its limitations on foreign bank issuance of local currency denominated

subordinated debt in order to be able to raise capital to expand operations. China also agreed to allow foreign incorporated banks to trade bonds in the interbank market on the same basis as Chinese banks and to allow foreign banks to increase liquidity on an exceptional basis through guarantees or loans from affiliates abroad.

This year, at the July 2009 S&ED meeting, China reiterated its commitment to deepen financial system reform. In addition, it agreed to continue to allow foreign-invested banks incorporated in China that meet relevant prudential requirements to enjoy the same rights as domestic banks with regard to underwriting bonds in the interbank market. CBRC subsequently approved one U.S. bank's application to underwrite bonds on the interbank market.

In 2010, the United States will continue to press China to allow U.S. banks full access to the domestic currency business. The United States will make every effort to ensure that China fully implements its WTO commitments and that U.S. banks realize the full benefits to which they are entitled.

MOTOR VEHICLE FINANCING

China has implemented its commitments with regard to motor vehicle financing.

In its WTO accession agreement, China agreed to open up the motor vehicle financing sector to foreign non-bank financial institutions for the first time, and it did so without any limitations on market access or national treatment. These commitments became effective immediately upon China's accession to the WTO. As previously reported, China finally implemented the measures necessary to allow foreign financial institutions to obtain licenses and begin offering auto loans in October 2004, nearly three years after its accession to the WTO.

INSURANCE

China has issued measures implementing most of its insurance commitments, but these measures have

also created problems in the areas of licensing, branching and transparency.

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

In its WTO accession agreement, China agreed to phase out existing geographic restrictions on all types of insurance operations during the first three years after accession. It also agreed to expand the ownership rights of foreign companies over time. Specifically, China committed to allow foreign life insurers to hold a 50-percent equity share in a joint venture upon accession. China also committed to allow foreign property, casualty and other non-life insurers to establish as a branch or as a joint venture with a 51-percent equity share upon accession and 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 to establish as a wholly foreign-owned subsidiary five years after accession. China further agreed to permit all foreign insurers 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 committed 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. These regulations implemented many of China's commitments, but they also created problems in the critical areas of capitalization requirements and branching. The regulations also failed to establish adequate transparency, as they continued to permit considerable bureaucratic discretion in the licensing process and to offer limited predictability to foreign insurers seeking to operate in China's market.

In May 2004, CIRC issued rules implementing its new insurance regulations. These rules lowered capital requirements and also streamlined licensing application procedures and shortened approval times. However, the rules did not adequately address branching rights, as many aspects of this area remained vague. The rules also did not address another issue that U.S. and other foreign insurers had begun to complain about – in practice, it appeared that established Chinese insurers were being granted new branch approvals on a concurrent basis, meaning more than one branch at a time, while foreign insurers had only received approvals on a consecutive basis, meaning one branch at a time. The rules did provide some guidance regarding foreign non-life insurers wishing to convert from a branch to a subsidiary, although uncertainty remained.

In October 2005, CIRC issued regulations specifically covering reinsurance. These regulations generated uncertainty, particularly with regard to the issue of whether they effectively require insurers in China to conclude contracts only with reinsurers invested in China – a requirement that would raise questions about China's compliance with its WTO commitments, which permit the insurers the flexibility to source reinsurance from cross-border suppliers.

Since China's accession to the WTO, foreign insurers have often faced restrictions or obstacles that hinder them from expanding their presence in China's market, particularly in the critical areas of

capitalization requirements, branching and transparency. In response, the United States has used all available opportunities to engage China and its insurance regulator, CIRC, on needed improvements to China's insurance regime. On the bilateral front, this engagement has included the JCCT process, the SED and S&ED processes and an Insurance Dialogue with CIRC, while multilateral engagement has included transitional review meetings before the WTO's Committee on Trade in Financial Services and the Trade Policy Reviews for China. As previously reported, U.S. engagement has led to some improvements with regard to capital requirements and licensing, although many needed improvements remain.

In 2008, a new problem arose when the United States became aware of a draft CIRC regulation, the *Administrative Method of the Equity Interest in Insurance Companies*, which would have unfairly shut out foreign insurance companies from holding multiple investments in Chinese domestic insurance companies. The United States pressed its concerns during the run-up to the June 2008 SED meeting, and CIRC agreed to take U.S. and industry comments into account. The United States also obtained useful clarifications from China regarding the procedures that insurance companies in China need to follow for overseas investment of their assets. Subsequently, in September 2009, CIRC circulated a revised draft of the regulation that is much narrower in scope and should avoid many of the adverse implications for foreign subsidiaries and joint ventures that would have resulted from the prior draft.

In other areas, the United States has continued to engage China, both bilaterally and multilaterally. For example, the United States has continued to press China regarding the need for CIRC to follow non-discriminatory procedures to approve U.S. companies for internal branches and sub-branches, following established regulatory time frames and recognizing the right to obtain approval for multiple, concurrent branches. The United States has also urged CIRC to quickly lift its September 2008 moratorium on new sales offices for insurance

companies and that any new regulations in this area not discriminate against foreign companies. In addition, the United States has continued to press CIRC and other relevant agencies for better market access for U.S. suppliers of political risk insurance.

In August 2009, CIRC circulated a draft measure, the *Administrative Measures on Insurance Companies*, which included application procedures for branches and sub-branches and also addressed the earlier moratorium on sales offices. The United States used an Insurance Dialogue meeting in September 2009 and additional engagement during the run-up to the October 2009 JCCT meeting to persuade CIRC to modify the draft measure to avoid over-penalizing companies for minor violations of regulations, which would have inordinately delayed them from seeking new branches. The United States will continue to work with CIRC to advocate for non-discrimination in its application of the final measure, which entered into force in October 2009.

Through its engagement of CIRC, the United States was also able to address uncertainty in the area of cross-border reinsurance, which had been created by regulations that CIRC issued in October 2005. CIRC issued an amended *Law on Insurance*, effective October 2009, which contains important improvements to ensure that China fully applies cross-border reinsurance commitments.

In 2009, despite many continuing challenges, foreign insurers' operations in China continued to grow. Currently, a large number of U.S. and other foreign insurers are operating in China, although their market shares are concentrated in major coastal municipalities, and they were continuing to work to broaden their presence in China.

In 2010, as in prior years, the United States will continue to use both bilateral and multilateral engagement to address issues of concern to U.S. insurers. The United States is committed to seeking market access for U.S. insurers on a transparent, fair and equitable basis.

FINANCIAL INFORMATION

In 2008, China agreed to implement its commitment to establish an independent regulator for the financial information sector and to remove restrictions that had placed foreign suppliers at a serious competitive disadvantage.

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

In September 2006, a major problem developed when Xinhua abruptly issued the *Administrative Measures on News and Information Release by Foreign News Agencies within China*. These rules abolished the *Measures for Administering the Release of Economic Information in China by Foreign News Agencies and their Information Subsidiaries*, which had been issued in 1996. Among other things,

under the 2006 rules, Xinhua precluded foreign providers of financial information services from contracting directly with or providing financial information services directly to domestic Chinese clients. Instead, foreign financial information service providers were required to operate through a Xinhua-designated agent, and the only agent designated was a Xinhua affiliate. These new restrictions did not apply to domestic financial information service providers and, in addition, contrasted with the rights previously enjoyed by foreign information service providers since the issuance of the 1996 rules, well before China's accession to the WTO in December 2001.

The United States immediately raised strong concerns with the new rules during a series of bilateral meetings in Beijing, as did the EU, as a number of potential WTO concerns were implicated, including China's national treatment obligation, commitments that China made in its Services Schedule and China's commitment to establish an independent regulator. The United States reiterated its concerns about these rules during the transitional review before the WTO's Committee on Trade in Financial Services in November 2006. The United States also raised this issue on the margins of the December 2006 SED meeting. In 2007, working closely with the U.S. and European industries and the EU, the United States established a regular dialogue with Xinhua on this issue, securing Xinhua's agreement to maintain the status quo until this issue was resolved. The United States also raised this issue in connection with the May 2007 SED meeting and pressed for a resolution at the December 2007 JCCT meeting.

In March 2008, the United States and the EU initiated WTO dispute settlement proceedings against China, after it had become clear that Xinhua was not prepared to remove the 2006 rules and the resulting market uncertainty was beginning to adversely affect relations between U.S. and European suppliers and their Chinese customers. Joint consultations were subsequently held in Geneva in April 2008. A series of further discussions

took place among the parties, and Canada joined in these discussions in September 2008 after it had initiated its own WTO dispute settlement proceedings against China. In November 2008, an MOU was signed in which China addressed all of the concerns that had been raised by the United States, the EU and Canada. Among other things, China agreed to establish an independent regulator, to eliminate the agency requirement for foreign suppliers and to permit foreign suppliers to establish local operations in China, with all necessary implementing measures issued by April 30, 2009, effective no later than June 1, 2009. Subsequently, in 2009, China timely issued the measures necessary to comply with the terms of the MOU.

ELECTRONIC PAYMENT PROCESSING

It appears that China has not yet implemented electronic payment processing commitments that were scheduled to have been phased in no later than December 11, 2006.

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

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

related services can only provide these services for foreign currency transactions.

In the second half of 2006, a number of troubling proposals were attributed to CUP and apparently supported by the PBOC. The common theme of these proposals was that CUP would be designated as a monopoly provider of electronic payment processing services for Chinese consumers for RMB processing, and that no other providers would be able to enter this market. Through a series of bilateral meetings beginning in September 2006, the United States cautioned China that none of the proposals being attributed to CUP seemed to satisfy the commitments that China had made to open up its market to foreign providers of electronic payment processing and related services. The United States reinforced this message during the transitional reviews before the Committee on Trade in Financial Services, held in November 2006. The United States also raised this issue on the margins of the first SED meeting, held in December 2006.

After China's deadline of December 11, 2006, which passed without any action having been taken by China, the United States again pressed China. The United States raised its concerns in connection with SED meetings and other bilateral meetings in 2007 and 2008 as well as at the WTO during the transitional reviews before the Committee for Trade in Financial Services in 2007, 2008 and 2009 and China's second Trade Policy Review, without making progress. The United States will continue to pursue this issue vigorously in 2010, taking further appropriate actions seeking to ensure that U.S. providers of electronic payment processing and related services enjoy the full benefits of the market-opening commitments that China made in its Services Schedule.

Legal Services

China has issued measures intended to implement its legal services commitments, although these measures give rise to WTO compliance concerns because they impose an economic needs test,

restrictions on the types of legal services that can be provided and lengthy delays for the establishment of new offices.

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

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

As previously reported, the State Council issued the *Regulations on the Administration of Foreign Law Firm Representative Offices* in December 2001, and the Ministry of Justice issued implementing rules in July 2002. While these measures removed some market access barriers, they also generated concern among foreign law firms doing business in China. In many areas, these measures were ambiguous. Among other things, these measures could be interpreted as imposing an economic needs test for foreign law firms that want to establish offices in China, which raises WTO concerns. In addition, the

procedures for establishing a new office or an additional office seem unnecessarily time-consuming. For example, a foreign law firm may not establish an additional representative office until its most recently established representative office has been in practice for three consecutive years. Furthermore, new foreign attorneys must go through a lengthy approval process that can take more than one year.

These measures also include other restrictions that make it difficult for foreign law firms to take advantage of the market access rights granted by China's WTO accession agreement. For example, foreign attorneys may not take China's bar examination, and foreign law firms may not hire registered members of the Chinese bar as attorneys to provide advice on Chinese law, nor may foreign attorneys working in China otherwise provide advice on Chinese law to clients. Foreign law firms are also subject to taxes at both the firm and individual levels, while domestic law firms are only taxed as partnerships.

The United States has raised its concerns in this area both bilaterally and at the WTO during the annual transitional reviews before the Council for Trade in Services and China's second Trade Policy Review, with support from other WTO members. To date, although a number of U.S. and other foreign law firms have been able to open additional offices in China, little progress has been made on the other issues affecting access to China's legal services market. The United States will continue to engage China in 2010 in an attempt to resolve these outstanding concerns. In particular, the United States will work with China's Ministry of Justice and industry associations in the United States and China to establish information exchange programs dedicated specifically to addressing market access issues in the legal services sector.

Telecommunications

It appears that China has nominally kept to the agreed schedule for phasing in its WTO

commitments in the telecommunications sector, but restrictions maintained by China, such as informal bans on new entry, a requirement that foreign suppliers can only enter into joint ventures with state-owned enterprises and exceedingly high capital requirements for basic services as well as the reclassification of some value-added services as basic services, have created serious barriers to market entry.

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 equity stake permitted in the joint ventures was to increase over time, reaching a maximum of 49 percent for basic telecommunications services and 50 percent for value-added services. In addition, all geographical restrictions were 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 (known as MIIT since 2008), which had been both the telecommunications regulatory agency in China and the operator of China Telecom, upon its accession. China also became obligated to adopt pro-competitive regulatory principles, such as cost-based pricing and the right of interconnection, which are necessary for foreign-invested joint ventures to compete with incumbent suppliers such as China Telecom, China Unicom and China Mobile.

Even though China appears to have nominally implemented its WTO commitments on schedule, no meaningful market-opening progress has taken place in the basic telecommunications services sector through 2009. As previously reported, MIIT's

imposition of excessive capital requirements for basic telecommunications services and MIIT's reclassification of certain value-added services as basic services when provided by foreign suppliers, together with the limitations that MIIT has placed on foreign suppliers' selection of Chinese joint venture partners, have continued to present formidable barriers to market entry for foreign suppliers.

As China nears the end of its eighth year of WTO membership, the United States is unaware of any domestic or foreign application for a new stand-alone license to provide basic telecommunications services that has completed the MIIT licensing process, even in commercially attractive areas such as the re-sale of basic telecommunications services, leased line services or corporate data services. In fact, at present, the number of suppliers of basic telecommunications services appears to be frozen at three Chinese state-owned enterprises, limiting the opportunities for new joint ventures and reflecting a level of competition that is extraordinarily low given the size of China's market.

Meanwhile, with regard to satellite services, such as video transport services for Chinese broadcasters or cable companies, U.S. satellite operators remain severely hampered by Chinese policies that prohibit foreign satellite operators from obtaining licenses to provide these services in China and that instead only allow a foreign satellite operator to use a licensed Chinese satellite operator as an agent to provide these services. These policies have made it difficult for foreign satellite operators to develop their own customer base in China, as Chinese satellite operators essentially have a "first right of refusal" with regard to potential customers.

Many of the difficulties faced by foreign suppliers in accessing China's telecommunications market seem directly attributable to the actions of China's telecommunications regulator. While the current regulator, MIIT, like its predecessor, MII, is nominally separate from China's telecommunications operators, it maintains extensive influence and control over their operations and continues to use

its regulatory authority to disadvantage foreign firms.

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

Over the years, the United States has raised its many telecommunications concerns with China, using bilateral engagement, particularly the JCCT process, and WTO meetings, including the annual transitional reviews before the Council for Trade in Services and China's Trade Policy Reviews, where the United States has received support from other WTO members. In 2009, the United States engaged China principally during the run-up to the October JCCT meeting, urging China to further liberalize its market for both basic and value-added telecommunications services. The United States focused its engagement on China's requirement that foreign suppliers can only joint venture with state-owned enterprises for basic services and China's restrictions on foreign suppliers' direct provision of international corporate data (or IP-VPN) services. The United States also continued to press China to substantially reduce its capital requirements for basic services. Even though China reduced its capital requirements from RMB 2 billion (\$292 million) to RMB 1 billion (\$146 million) in 2008, these reduced capital requirements remain excessive by international norms, particularly when most WTO members do not even impose capital requirements on providers of basic telecommunications services, as the United States has made clear to China. Although these efforts did not yield progress in 2009, the United States will continue to engage China vigorously on these and other issues that contribute to the absence of meaningful market-opening in China's telecommunications sector in 2010.

Construction and Related Engineering Services

China has issued measures intended to implement its construction and related engineering services commitments, although these measures are problematic because they also impose high capital requirements and other requirements that limit market access.

Upon its WTO accession, China committed to permit foreign enterprises 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, including construction projects wholly financed by foreign investment.

As previously reported, in September 2002, the Ministry of Construction (MOC), which was renamed the Ministry of Housing and Urban-Rural Development in 2008, and MOFTEC jointly issued the *Rules on the Administration of Foreign-Invested Construction Enterprises* (known as Decree 113) and the *Rules on the Administration of Foreign-Invested Construction Engineering Design Enterprises* (known as Decree 114). These decrees provide schedules for the opening up of construction services and related construction engineering design services to joint ventures with majority foreign ownership and wholly foreign-owned enterprises. The necessary implementing rules for Decree 113 were issued in April 2003, but Decree 114 implementing rules were delayed until early 2007.

Decrees 113 and 114 created concerns for U.S. 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 MOC rules. In particular, these decrees for the first time require foreign firms to obtain qualification certificates. In addition, these decrees for the first time require foreign-invested enterprises to incorporate in China, and they impose high minimum registered capital requirements and technical personnel staff requirements that are difficult for many foreign-invested enterprises to satisfy.

With regard to the Decree 113 regulatory regime for construction enterprises, the United States has actively engaged China, both bilaterally and at the annual transitional reviews before the Council for Trade in Services, in an effort to obtain needed improvements. In particular, the United States has urged China to maintain non-discriminatory procedures under Decree 113 to enable foreign-invested enterprises to carry out the same kinds of projects that domestic companies can provide. The United States also has sought a reduction in the registered minimum capital requirements under Decree 113 or the use of other arrangements, such as bonds or guarantees in lieu of the capital requirements.

With regard to the Decree 114 regulatory regime for construction engineering design enterprises, the United States generally welcomed the implementing rules issued by MOC in January 2007, as they temporarily lifted foreign personnel residency and staffing requirements imposed by Decree 114, and recognized the foreign qualifications of technical experts when considering initial licensing. The United States has since continued to press China to make these improvements permanent, using both the March 2008 U.S.-China Best Practices Exchange on Architecture, Construction and Engineering and the transitional reviews before the Council for Trade in Services in November 2007, December 2008 and November 2009. Separately, the United States has also urged China to give foreign construction engineering design companies the right to immediately apply for a comprehensive, "Grade A" license, like domestic design companies can do.

Under existing rules, set forth in Circular 202, the *Implementation of the Administrative Provisions on the Qualification of Construction and Engineering Supervision and Design*, issued by MOC in August 2007, foreign companies are subjected to more restrictive licensing procedures than domestic companies, although foreign companies have begun to have more success with regard to their licensing requests in 2009.

Meanwhile, in November 2004, MOC 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, contrary to the common practice of U.S. companies. Decree 200 also imposes burdensome licensing requirements.

In 2010, the United States will continue to engage China bilaterally through appropriate avenues, such as the U.S.-China Best Practices Exchange on Architecture, Construction and Engineering, in an attempt to achieve improved market access for U.S. companies. The United States will also supplement these efforts with engagement of China at the annual transitional review before the Council for Trade in Services.

Express Delivery Services

China has allowed foreign express delivery companies to operate in the express delivery sector and has implemented its commitment to allow wholly foreign-owned subsidiaries by December 11, 2004, but China has issued a new law that undermines market access for foreign companies in the domestic express delivery sector and raises questions in light of China's WTO obligations.

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.

Since its WTO accession, foreign express delivery companies have continued to operate in China's express delivery sector, and China has implemented its commitment to allow wholly foreign-owned subsidiaries. Nevertheless, over the years, China has also issued a variety of measures that have appeared to undermine market access for foreign companies and have raised questions in light of China's WTO obligations.

As previously reported, shortly after becoming a WTO member in December 2001, China issued two problematic measures. These measures required Chinese and foreign-invested international express delivery companies, including ones already licensed by MOFTEC, to apply for and obtain so-called "entrustment" authority from China's postal authority, China Post, their direct competitor, if they wanted to continue to provide express delivery services. Following sustained engagement by the United States and other affected WTO members, China revised these measures in September and October 2002 and implemented a more streamlined entrustment application process, although it was still unnecessarily burdensome, requiring separate entrustment certificates for all of a company's branches. Following the May 2007 SED meeting, China agreed to simplify the application process and require only a single entrustment certificate covering a foreign-invested express delivery company and all of its branches in China.

The December 2001 measures had also placed new weight and rate restrictions on the letters that foreign-invested international express delivery companies could handle, giving rise to concerns in light of the horizontal "acquired rights" commitment in China's Services Schedule. While China withdrew these restrictions when it revised these measures in September and October 2002, less than one year later China began selectively circulating draft

amendments to its *Postal Law*, which included different but still problematic weight restrictions, along with other troubling elements. The United States then made express delivery services one of its priority issues, and at the April 2004 JCCT meeting Vice Premier Wu committed that old problems, like the weight restrictions, would not resurface as new problems. Nevertheless, in the ensuing years, China continued to circulate revised drafts of the *Postal Law*, which invariably contained problematic weight restrictions. At the April 2006 JCCT meeting, Vice Premier Wu reiterated China's commitment that the regulatory environment for express delivery services by foreign suppliers would not be negatively impacted by the issuance of new rules, including the *Postal Law*, but problematic revised drafts continued to emerge. Moreover, new concerns arose when these revised drafts also included provisions that would exclude foreign suppliers from a major segment of the domestic express delivery market in China. These provisions would allow China Post and private Chinese companies to deliver both packages and documents in the domestic market, while foreign suppliers would be excluded from the delivery of documents, placing them at a severe competitive disadvantage.

As previously reported, the draft of a new *Postal Law* went before the National People's Congress for consideration in August 2008 and was circulated for public comment. Among other things, this draft excluded foreign suppliers from the document segment of China's domestic express delivery market. In addition, it indicated that the scope of the postal monopoly would be set in regulations issued by the State Council. At the September 2008 JCCT meeting, the United States urged China to revise the draft *Postal Law* to remove the discriminatory exclusion of foreign suppliers from a major segment of China's domestic express delivery market, while noting that the draft *Postal Law* also contains other troubling elements. The United States also raised its concerns in bilateral meetings with MOFCOM, the State Postal Bureau, the State Council's Legislative Affairs Office, and the National People's Congress as well as during the September

2008 convocation of the U.S.-China Symposium on Postal Reform and Express Delivery and the December 2008 transitional review before the WTO's Council for Trade in Services. The United States continued these efforts in 2009. However, the *Postal Law*, as approved by the National People's Congress, effective October 2009, continued to exclude foreign suppliers from the document segment of China's domestic express delivery market. In addition, the law generated new concerns that this exclusion would apply to certain foreign suppliers but not others.

Meanwhile, in August 2006, the State Council finalized its Postal Reform Plan, which called for the separation of China's postal operations from the administrative function of regulating China's postal system, with the State Postal Bureau (SPB) to serve as the regulator and a new state-owned enterprise – the China Post Group Corporation – to be set up to conduct postal business. China promptly put this plan into effect, and since then the United States has been monitoring how SPB has been exercising its new authority to license and regulate the express delivery sector.

Currently, regulation of the express delivery sector in China seems to be overly burdensome and restrictive. China's new *Postal Law*, along with related regulatory measures, such as express business permitting measures and various standards that China has developed and imposed relating to services, labor and packaging, seem to impose undue burdens on an industry that would normally not be subject to such intrusive regulation. The United States has been closely monitoring developments in this area and pressing China to move toward international norms. The United States will continue these efforts in 2010.

Aviation Services

China has provided significant additional market access to U.S. providers of air transport services through a bilateral agreement with the United States.

As previously reported, China took a significant step in July 2004 to increase market access for U.S. providers of air transport services. At that time, China signed a landmark bilateral aviation agreement with the United States that would more than double the number of U.S. airlines allowed to serve points in China and increase by five times the number of flights allowed for passenger and cargo services between the two countries over a six-year period. The agreement also expanded opportunities for code sharing and charter operations, granted cargo carriers the right to provide surface transportation in connection with international air services and eliminated government regulation of pricing as of 2008. U.S. passenger and cargo carriers have since obtained additional routes and increased flight frequencies, as envisioned by the agreement.

Bilateral engagement with China to improve the existing aviation agreement resumed in April 2006 and yielded an amended agreement in May 2007, which allows for significantly expanded passenger and all-cargo air services and has further facilitated trade, investment, tourism and cultural exchanges between the United States and China. Among other things, the agreement added ten new daily passenger flights that U.S. carriers could operate to the Chinese gateway cities of Beijing, Shanghai and Guangzhou by 2012, allowed unlimited U.S. cargo flights to any point in China and an unlimited number of U.S. cargo carriers to serve the China market as of 2011, increased from six to nine the number of U.S. passenger carriers that may serve the China market by 2011, and expanded opportunities for U.S. carriers to code-share on other U.S. carriers' flights to China. The agreement also committed the United States and China to launch Open Skies negotiations in 2010.

However, China's interpretation of cargo hub provisions in the agreement has resulted in U.S. cargo carriers experiencing difficulties in getting their operating schedules approved by the General Administration of Civil Aviation in China. U.S. and Chinese negotiators are currently involved in a series of technical discussions to resolve this issue.

Maritime Services

Even though China made only limited WTO commitments relating to its maritime services sector, it has increased market access for U.S. service providers through a bilateral agreement.

As previously reported, even though China made only limited WTO commitments relating to 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 agreement, with automatic one-year extensions, 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

The United States has not identified significant concerns related to China's implementation of commitments made in other service sectors.

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 identified significant concerns related to 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, with one exception. U.S. and European companies have expressed GATS and other concerns regarding China's regulation of foreign suppliers of global distribution system services.

LEGAL FRAMEWORK

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

Transparency

OFFICIAL JOURNAL

In 2007, China re-committed to use a single official journal for the publication of all trade-related laws, regulations and other measures. While it appears that most government entities regularly publish their trade-related measures in this journal, it is not yet clear whether all types of trade-related measures are being published.

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

Following its accession to the WTO, China did not establish or designate an official journal. Rather, China relied on multiple channels, including ministry websites, newspapers and a variety of journals, to provide information on trade-related measures.

As previously reported, following sustained U.S. engagement, the State Council issued a notice in March 2006 directing all central, provincial and local government entities to begin sending copies of all of their trade-related measures to MOFCOM for

immediate publication in the *MOFCOM Gazette*. The United States subsequently monitored the effectiveness of this notice, both to assess whether all government entities regularly publish their trade-related measures in the *MOFCOM Gazette* and whether all types of measures are being published. It appeared that adherence to the State Council's notice was far from complete. As a result, the United States continued to engage China bilaterally on the need for a fully compliant single official journal, and China reconfirmed its WTO commitment to publish all final trade-related measures in a designated official journal at the December 2007 SED meeting. Since then, the United States has been monitoring the effectiveness of this commitment, and it appears that most government entities are now regularly publishing their trade-related measures in this journal, although it is still not clear whether all types of trade-related measures are being published.

PUBLIC COMMENT

In 2008, China adopted notice-and-comment procedures for new laws and committed to use notice-and-comment procedures for new trade- and economic-related regulations and departmental rules, subject to specified exceptions.

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

As previously reported, in the first few years after China acceded to the WTO, China's ministries and

agencies 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 WTO accession, and no notable progress took place in 2003. Typically, the ministry or agency drafting a new or revised law or regulation consulted with and submitted drafts to other ministries and agencies as well as Chinese experts and affected Chinese companies. At times, it also consulted with select foreign companies, although it would not necessarily share drafts with them. As a result, only a small proportion of new or revised laws and regulations were issued after a period for public comment, and even in those cases the amount of time provided for public comment was generally too short.

In 2004, some improvements took place, particularly on the part of MOFCOM, which began following the rules set forth in its *Provisional Regulations on Administrative Transparency*, issued in November 2003. Those rules had the potential to serve as a model for other ministries and agencies seeking to improve their transparency. Nevertheless, basic compliance with China's notice-and-comment commitment continued to be uneven in the ensuing years, as numerous major trade-related laws and regulations were finalized and implemented without the NPC or the responsible ministry circulating advance drafts for public comment.

In numerous bilateral meetings with the State Council, MOFCOM and other Chinese ministries since China's WTO accession, including high-level meetings such as JCCT meetings and SED meetings, the United States emphasized the importance of China's adherence to the notice-and-comment commitment in China's accession agreement, both in terms of fairness to WTO members and the benefits that would accrue to China. Together with other WTO members, the United States also raised this

issue repeatedly during regular WTO meetings and as part of the annual transitional reviews conducted before various WTO councils and committees.

At the SED meeting in December 2006, the United States and China agreed to make transparency, including notice-and-comment procedures and other rulemaking issues, a topic for discussion in future SED meetings. These discussions began at the May 2007 SED meeting, while the United States continued to provide technical assistance to facilitate Chinese government officials' understanding of the workings, and benefits, of an open and transparent rulemaking process. At the December 2007 SED meeting, China specifically committed to publish, when possible, proposed trade-related measures and provide interested parties a reasonable opportunity for comment. China also agreed that it would publish these proposed measures either in its designated official journal or on an official website. At the June 2008 SED meeting, China then committed to publish all proposed trade- and economic-related regulations and departmental rules for public comment, subject to specified exceptions, and to provide a comment period of no less than 30 days. China indicated that it would publish these proposed measures on the Legislative Information Website maintained by the State Council's Legislative Affairs Office.

Two months earlier, in April 2008, the NPC's Standing Committee had instituted notice-and-comment procedures for draft laws. Comments on the draft laws are to be submitted to the NPC's Legislative Affairs Commission, and a new dedicated website provides information about the comments that have been submitted.

The United States has been monitoring the effectiveness of these changes. While the NPC has been regularly publishing draft laws for public comment, and the State Council has also been regularly publishing draft regulations for public comment, it appears that China has had more difficulty implementing China's new policy regarding trade- and economic related departmental rules. To

date, only a few proposed departmental rules have been published on the State Council's website for public comment. While some ministries publish departmental rules on their own websites, they often allow less than 30 days for public comment, making it difficult for foreign interested parties to submit timely and complete comments.

Over the years, China has had a much better record when it comes to making new or revised trade-related laws and regulations available to the public after they have been finalized. In accordance with State Council regulations issued in December 2001, which require the publication of new or amended regulations 30 days before their implementation, almost all new or revised regulations have been available (in Chinese) soon after issuance and prior to their effective date, an improvement over pre-WTO accession practice. New or revised laws have also been regularly published by the NPC after enactment. 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 providing the agreed translations of these laws and regulations.

ENQUIRY POINTS

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

Uniform Application of Laws

Some problems with the uniform application of China's laws and regulations persisted in 2008.

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

As previously reported, in China's first year of WTO membership, the central government launched an extensive campaign to inform and educate both central and local government officials and State-owned enterprise managers about WTO rules and their benefits. In addition, several provinces and municipalities established their own WTO centers, designed to supplement the central government's efforts and to position themselves so that they would be able to take full advantage of the benefits of China's WTO membership. In 2002, China also established an internal review mechanism, now overseen by MOFCOM's Department of WTO Affairs, to handle cases of non-uniform application of laws, although the actual workings of this mechanism remain unclear.

During 2009, as in prior years, some problems with uniformity persisted. These problems are discussed above in the sections on Customs and Trade Administration, Taxation and Intellectual Property Rights.

Judicial Review

China has established courts to review administrative actions related to trade matters, but few U.S. or other foreign companies have had experience with these courts.

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, educational background and experience, rather than through politics or favoritism. However, existing judges, many of whom had no legal training,

were grandfathered in. In part because of this situation, many U.S. companies in 2009 continued to express serious concern about the independence of China's judiciary. In their experience and observation, Chinese judges continue to be influenced by political, government or business pressures, particularly outside of China's big cities. Meanwhile, in 2009, 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 U.S. or other foreign companies have had experience with these courts.

APPENDICES

- Appendix 1* List of Written Submissions Commenting on China's WTO Compliance
September 22, 2009
- Appendix 2* List of Witnesses Testifying at Hearing on China's WTO Compliance
October 2, 2009
- Appendix 3* Fact Sheet for 20th U.S.-China Joint Commission on Commerce and Trade Meeting
October 29, 2009
- Appendix 4* Excerpts from Joint Fact Sheet for 1st U.S.-China Strategic and Economic Dialogue
July 28, 2009
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2009 USTR Report to Congress on China's WTO Compliance

Appendix 1

List of Written Submissions Commenting on China's WTO Compliance September 22, 2009

1. U.S.-China Business Council
 2. U.S. Chamber of Commerce
 3. International Intellectual Property Alliance
 4. American Chamber of Commerce-China
 5. American Iron and Steel Institute
 6. Coalition of Service Industries
 7. National Pork Producers Council
 8. National Council of Textiles Organizations
 9. American Apparel & Footwear Association
 10. United States Information Technology Office
 11. BASF Corporation
 12. W.R. Grace & Company
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Appendix 2

**List of Witnesses Testifying at Public Hearing on China's WTO Compliance
October 2, 2009**

1. John Frisbie
President
U.S.-China Business Council
 2. Jeremie Waterman
Senior Director, Greater China
U.S. Chamber of Commerce
 3. Barry Solarz
Senior Vice President
American Iron and Steel Institute
 4. Robert Vastine
President
Coalition of Services Industries
 5. Nick Fetchko
Director, International and Government Affairs
Telecommunications Industry Association
 6. Mark Bohannon
General Counsel and Senior Vice President, Public Policy
Software and Information Industry Association
 7. John Neuffer
Vice President, Global Policy
Information Technology Industry Council
 8. Cass Johnson
President
National Council of Textile Organizations
 9. Michael Schlesinger
Vice President
International Intellectual Property Alliance
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2009 USTR Report to Congress on China's WTO Compliance

Appendix 3

20th U.S.-China Joint Commission on Commerce and Trade Meeting October 29, 2009 Fact Sheet

Intellectual Property Rights

- China gave assurances that it will impose maximum administrative penalties on Internet infringers and has begun a four-month campaign to clamp down on Internet piracy.
- China announced its public notice, published yesterday, conveying to state-run libraries the importance of strengthening protection of copyright-protected academic and medical journals.
- China agreed that it will work closely with the United States to resolve U.S. concerns about a new Ministry of Culture circular relating to online music distribution that is creating serious problems for the U.S. music industry.
- The Intellectual Property Working Group identified next steps on key issues, including: China's further promotion of software legalization of enterprises and exchanges of information on measures for promoting software legalization; China's establishment of a Broadcast Tariff Rate as soon as possible; and opportunities for interested rights holders and government experts to provide feedback on China's new Patent Law amendments and new implementing regulations.

Information Security

- China confirmed in working group discussions that the April 29, 2009, announcement by AQSIQ, MOF and CNCA, that China's Compulsory Certification (CCC) testing and certification rules for 13 categories of information security products apply only to products procured by Chinese government agencies.
- China agreed to establish a dialogue with the United States regarding global practices for trade in information security products.

Distribution Services

- The United States welcomed news that China was in the process of concluding its licensing procedures for certain qualified direct selling services companies.

Agriculture

- China announced its intent to re-open the Chinese market to U.S. pork products and live swine. The United States awaits China's official announcement to ensure that the measure is consistent with science-based, international standards.

Clean Energy

- China agreed to remove local content requirements on wind turbines.

Government Procurement Agreement

- China will require that products produced in China by foreign invested enterprises (FIEs) are treated as domestic products and will issue rules in this regard.
- The United States and China will establish a multi-agency working group to regularly conduct discussions on issues involving government procurement and purchases by state-affiliated enterprises and organizations and private parties that make purchases in accordance with national strategic objectives.
- China committed to submit a revised offer as early as possible in 2010 to accede to the WTO Government Procurement Agreement (GPA).

Medical Devices

- China committed that product recall regulations will not be duplicative or redundant and the Ministry of Health and the State Food and Drug Administration will be the relevant authorities for medical device recalls.
 - China will adopt a risk-based approach that will not automatically lead to clinical trials for medical devices in a given class, and consider the use of results from a clinical trial conducted outside of China to support a local clinical trial exemption.
 - China will accept a prior approval document of a medical device issued by a foreign country regardless of its exporting origin, country of manufacture or legal manufacture to satisfy any prior approval registration requirement.
 - China will consider an exemption of requiring product samples to be tested in Chinese test labs prior to approval if the manufacturer demonstrates compliance with international standards and provides sound scientific evidence.
 - China will strive to implement regulations, rules, and notices that are consistent with guidance documents for medical devices issued by the Global Harmonization Task Force and the Asia Harmonization Working Party.
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Appendix 3 (cont'd)

**20th U.S.-China Joint Commission on Commerce and Trade Meeting
October 29, 2009
Fact Sheet**

Pharmaceuticals

- China will continue to strengthen its oversight and enforcement of active pharmaceutical ingredients (APIs) and counterfeit pharmaceuticals by undertaking initiatives such as the establishment of a Drug Master File system, enforcement of record-keeping requirements for companies that manufacture and sell APIs, and regulation of unregistered Chinese companies advertising and marketing APIs at foreign trade shows and on the Internet.
- China identified SFDA as its single point of contact for the Interagency Coordination Conference for Fighting the Production and Sales of Counterfeit Drugs.
- China agreed to share information with the U.S. Food and Drug Administration on the activities of the Interagency Coordination Conference.
- China and the United States agreed to continue the dialogue on pharmaceutical data protection.

Travel and Tourism

- The United States and China agreed to implement Phase II of the Memorandum of Understanding (MOU) that opened the market for the sale of packaged leisure travel from China to the United States to include an additional 12 jurisdictions, bringing the total to 21.
 - The United States and China have agreed to hold a high-level meeting of the JCCT Tourism Working Group in January 2010 to sign a program of work that will enhance travel under the MOU.
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Appendix 4

**1st U.S.-China Strategic and Economic Dialogue
July 28, 2009
Excerpts from Joint Fact Sheet**

Trade and Investment

- The United States and China are among the beneficiaries of and participants in the global trading system. Both countries are committed to work for a more open global trade and investment system and jointly fight protectionism.
 - The United States and China agree to call upon all other WTO members to work together for an ambitious and balanced conclusion to the Doha Development Agenda in 2010, consistent with its mandate, building on the progress already made, including with regard to modalities. Both sides re-affirm that, at a time of economic uncertainty, the ongoing bilateral investment treaty negotiations, could contribute to the implementation of G-20 Summit commitments to an open global economy.
 - To promote trade and investment, China will further decentralize approval authority and streamline approval procedures for foreign investment, including by increasing over time the threshold for central government review. China agrees to commit itself to the implementation of the Generally Accepted Principles and Practices governing Sovereign Wealth Funds.
 - In addition, the United States confirms that the Committee on Foreign Investment in the United States process ensures the consistent and fair treatment of all foreign investment without prejudice to the place of origin. The U.S. reaffirms its commitment to the open and non-discriminatory principles for recipients of sovereign wealth fund investment as identified by the Organization for Economic Cooperation and Development. The United States also recognizes the continued progress China has made in its market reforms and will earnestly consider China's concerns, and will consult through the JCCT in a cooperative manner to work toward China's Market Economy Status in an expeditious manner. The United States and China agree to accelerate the implementation of "Guidelines for China-U.S. High Technology and Strategic Trade Development" and expeditiously formulate the Action Plan on Expansion of China-U.S. High Technology and Strategic Trade Cooperation in Priority Sectors.
 - The United States and China recognize the importance of non-discriminatory government procurement policies. To that end, the U.S. and China agree to strengthen their cooperation in order to accelerate China's accession to the WTO Government Procurement Agreement. This will include China's submission, to the WTO Government Procurement Committee before the Committee's October 2009 meeting, of a report that sets out the improvements that China will make in its revised offer. Moreover, China commits to treat, under its Government Procurement Law, products produced in China by foreign invested enterprises the same as products produced in China by Chinese enterprises. The United States confirms that products produced in the United States by an enterprise established in the United States are treated under its procurement regulations as domestic products regardless of the ownership of the enterprise.
 - Both sides also recognize the importance of trade financing for accelerating sustainable economic growth and the Export-Import Banks of the two countries will continue cooperation in this area. The two countries will strengthen their cooperation on anti-money laundering and countering the financing of terrorism, including counterfeiting.
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