CHINA

TRADE SUMMARY

The U.S. goods trade deficit with China was $226.8 billion in 2009, down $41.2 billion from 2008. U.S. goods exports in 2009 were $69.6 billion, down 0.2 percent from the previous year. Corresponding U.S. imports from China were $296.4 billion, down 12.2 percent. China is currently the 3rd largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to China were $15.9 billion in 2008 (latest data available), and U.S. imports were $9.8 billion. Sales of services in China by majority U.S.-owned affiliates were $14.0 billion in 2007 (latest data available), while sales of services in the United States by majority China-owned firms were $315 million.

The stock of U.S. foreign direct investment (FDI) in China was $45.7 billion in 2008 (latest data available), up from $28.6 billion in 2007. U.S. FDI in China is led by the manufacturing sector.

IMPORT BARRIERS

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

Trading Rights

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

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

However, China has not yet given entities other that state trading enterprises trading rights for the importation of copyright-intensive products such as theatrical films, DVDs, music, books, newspapers, and journals. Under the terms of China's Protocol of Accession to the WTO, China's trading rights commitments appear to apply fully to these products, since they are not among the products for which China reserved the right to engage in state trading. As a result, trading rights for these products should have been automatically available to all Chinese enterprises, Chinese-foreign joint ventures, wholly foreign-owned enterprises, and foreign individuals as of December 11, 2004. Nevertheless, China continued to wholly reserve the right to import these products to state trading enterprises. As a result, in April 2007, the United States filed a request for WTO dispute settlement consultations with China concerning market access restrictions in China on copyright-intensive products such as theatrical films, DVDs, music, books, newspapers, and journals. The WTO panel was established in late November 2007, and the European Union (EU), Japan, Korea, Taiwan, and Australia joined as third parties. 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. The United States will closely monitor China's implementation of this ruling. (For further information, please refer to the section below on Audiovisual and Related Services.)

Import Substitution Policies

Throughout the 1990s, China gradually reduced formal import substitution policies. When it acceded to the WTO, China agreed to eliminate all subsidies prohibited under Article 3 of the WTO Agreement on Subsidies and Countervailing Measures (Subsidies Agreement), including all forms of subsidies contingent on the use of domestic over imported goods. In its Protocol of Accession to the WTO, China also committed that it would not condition import or investment approvals on whether there are competing domestic suppliers or impose other performance requirements. In anticipation of this commitment, China enacted legal changes in 2000 and 2001 to eliminate local content requirements for foreign investments. Under the prevailing rules, however, investors are still "encouraged" to follow some of the formerly mandated practices. Instances in which the Chinese government has reportedly pursued import substitution or similar policies are described below.

Automotive Parts

In May 2004, China issued a new automobile industrial policy, the Policy on Development of the Automotive Industry, which included provisions discouraging the importation of automotive parts and encouraging the use of domestic technology in new vehicles assembled in China. In 2005, China issued regulations implementing the new automobile industrial policy. One measure that generated strong criticism from the United States, the EU, Japan, and Canada was the Administrative Rules on Importation of Automobile Parts Characterized as Complete Vehicles, which was issued in February 2005 and became effective in April 2005. These rules imposed charges that unfairly discriminated against imported automotive parts and discouraged automobile manufacturers in China from using imported automotive parts in the assembly of vehicles. In March and April 2006, the United States, the EU, and Canada initiated dispute settlement proceedings against China at the WTO. In March 2008, a WTO panel ruled in favor of the United States and the other complaining parties, finding that China's rules discriminated against imported auto parts and were inconsistent with several WTO provisions, including Article III of the GATT 1994. In September 2008, China appealed the panel's decision to the WTO's Appellate Body. In December 2008 the Appellate Body upheld the panel's finding that the measures are inconsistent with China's WTO obligations. In September 2009, China repealed the challenged measures.

Steel

China issued a new Steel and Iron Industry Development Policy (Steel Policy) in July 2005. Although many aspects of this new Steel Policy have not been implemented, it includes a host of objectives and guidelines that raise serious concerns. For example, the Steel Policy requires that foreign enterprises seeking to invest in Chinese iron and steel enterprises possess proprietary technology or intellectual property in the processing of steel. 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, raising concerns given China's commitments under its Protocol of Accession to the WTO not to condition investment rights or approvals on the transfer of technology. The Steel Policy also appears to discriminate against foreign equipment and technology imports, encouraging the use of local content by calling for a variety of government financial supports for steel and iron projects using newly developed domestic equipment. Even more troubling, however, it calls for the use of domestically produced steel manufacturing equipment and domestic technologies whenever domestic suppliers exist, raising questions, given China's commitment under its Protocol of Accession to the WTO not to condition the right of investment or importation on whether competing domestic suppliers exist. The Steel Policy is also troubling because it prescribes the number and size of steel producers in China, where they will be located, the types of products that will and will not be produced, and the technology that will be used. This high degree of government direction and decision-making regarding the allocation of resources into and out of China's steel industry raises concerns because of the commitment that China made in its Protocol of Accession to the WTO that the government would not influence, directly or indirectly, commercial decisions on the part of state-owned or state-invested enterprises.

China's steel production has grown rapidly and at a faster rate than the growth in its domestic steel consumption. China became the largest steel exporting economy in 2006, and its steel exports have increasingly become subject to trade remedy actions by other countries in the past two years. In March 2006, the United States and China held the inaugural meeting of a new U.S.-China Joint Commission on Commerce and Trade (JCCT) dialogue on the steel industry (Steel Dialogue). Since then, the two sides have held three more Steel Dialogue meetings, with the most recent one taking place in October 2008. In bilateral and multilateral meetings, the United States has argued that China has acted to impose different levels of taxes on different exports of steel products and steelmaking inputs in a manner that appears to encourage the export of certain value-added steel products. In response to the financial downturn in the fall of 2008, China rapidly reduced or removed export duties on many, but not all, 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, Chinese steel production reached a record 567.8 million MT for 2009, a 13.5 percent increase when compared to 2008. The United States has cautioned China that accelerating efforts to offset falling steel demand in China using these policies is likely to increase trade tensions.

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 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, Mexico, the EU, and other trading partners to monitor and support concrete steps by China to rein in its steelmaking capacity.

Semiconductors

China’s Tenth Five-Year Plan called for an increase in Chinese semiconductor output from $2 billion in 2000 to $24 billion in 2010. In pursuit of this policy, China has attempted to encourage the development of China’s domestic integrated circuit (IC) industry through, among other things, discriminatory VAT policies. As discussed below in the section on Value Added Taxes, the United States initiated formal WTO consultations with China in March 2004 to address this problem, and China agreed to and did eliminate the measures at issue by April 2005. The United States continues to monitor closely new financial support that China is making available to its domestic IC producers for consistency with the WTO Subsidies Agreement’s disciplines.

Fertilizer

In 2001, China began exempting all phosphate fertilizers except diammonium phosphate (DAP) from the VAT. DAP, a product that the United States exports to China, competes with other phosphate fertilizers produced in China, particularly monoammonium phosphate. Both the United States Government and U.S. producers have complained that China has employed its VAT policies to benefit domestic fertilizer production.

Telecommunications Equipment

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

In February 2009, China's State Council approved MIIT’s stimulus plan to boost the country's electronics and information industries through preferential policies and increased investment. The plan aims to promote three key goals: promoting innovation; increasing availability of financing; and fostering the use of information technologies over a three year period. Investment will focus on promoting the adoption of new technologies such as 3G services and digital TV. Additional policy support will also be given to the sector, including VAT rebates for electronics and information product exports.

Tariffs and Other Import Charges

China still maintains high duties on some products that compete with sensitive domestic industries. For example, the tariff on large motorcycles is 30 percent. Likewise, most video, digital video, and audio recorders and players still face duties of approximately 30 percent. Raisins face duties of 35 percent.

Tariff Classification

Chinese customs officers have wide discretion in classifying a particular import. While foreign businesses might at times benefit from their ability to negotiate classification of products into tariff categories with lower import duty rates, lack of uniformity makes it difficult to anticipate border charges.

Customs Valuation

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. Reportedly 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.

More generally, U.S. exporters continue to be concerned about inefficient and inconsistent customs clearance procedures in China. These procedures vary from port to port, lengthy delays are not uncommon, and the fees charged appear to be excessive, giving rise to concerns that they are not related to the cost of services rendered as required under GATT 1994.

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.

Antidumping, Countervailing Duty, and Safeguard Measures

Since acceding to the WTO, China has emerged as a significant user of antidumping (AD) measures. In 2009, China became a particularly active user of the antidumping remedy, underscoring the importance of China's full adherence to the transparency and procedural fairness requirements embodied in WTO rules. As of January 2010, China had a total of 102 antidumping measures in place (some of which predate China's membership in the WTO) affecting imports from 17 countries and regions, and 18 antidumping investigations in progress. In 2009 alone, China initiated four new AD investigations involving U.S. exports. Chemical products remain the most frequent target of Chinese antidumping actions.

Most of the rules and regulations that the Ministry of Commerce (MOFCOM) uses to conduct its antidumping investigations were issued by its predecessor agencies – the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) and the State Economic and Trade Commission (SETC). While these measures generally represent good faith efforts to implement the relevant WTO commitments and to improve China's pre-WTO accession measures, they also contain vague language, have gaps in areas of practice, and allow inordinate discretion in their application. 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.

In practice, it appears that China's conduct of AD investigations in many respects raises questions, given the need for 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 given the initiation of 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. 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.

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 concerns developed from observations of China's AD practice with regard to transparency and procedural fairness are now also emerging concerning China's CVD practice. In addition, China has committed significant procedural errors in its initial CVD investigations, raising questions in light of the standards set forth in the Subsidies Agreement.

Nontariff Barriers

China's Protocol of Accession to the WTO obligated China to address many of the nontariff barriers it had historically used to restrict trade. For example, China is obligated to phase out its import quota system, apply international norms to its testing and standards administration, remove local content requirements, and make its licensing and registration regimes transparent. At the national level, China made progress following its WTO accession in reforming its testing system, revising regulations requiring local content, and improving overall regulatory transparency, including in the licensing area. Despite this progress, however, as China's trade liberalization efforts have moved forward, some nontariff barriers remain in place and others have been added.

Eight years after China's WTO accession, many U.S. industries complain that they face significant nontariff barriers to trade, which are discussed in more detail in various sections below. These barriers include, for example, regulations that set high thresholds for entry into service sectors such as banking, insurance, and telecommunications, selective and unwarranted inspection requirements for agricultural imports, and the use of questionable sanitary and phytosanitary measures to control import volumes.

Tariff-Rate Quotas (TRQs)

As part of its WTO accession commitments, China was to establish large and increasing TRQs for imports of wheat, corn, rice, cotton, wool, sugar, rapeseed oil, palm oil, soybean oil, and fertilizer, with most in-quota duties ranging from 1 percent to 9 percent. Under these TRQ systems, China places quantitative restrictions on the amount of these commodities that can enter at a low "in quota" tariff rate, and any imports over that quantity are charged a prohibitively high duty. Each year, a portion of each TRQ is to be reserved for importation through non-state trading entities. China's Protocol of Accession to the WTO sets forth specific rules for administration of the TRQs, including increased transparency and reallocation of unused quotas to end users that have an interest in importing. China phased out the vegetable oil TRQs in 2006, but currently maintains a TRQ regime on six agricultural products including wheat, cotton, corn, rice, wool, and sugar, as well as three chemical fertilizers, including di-ammonium phosphate.

The administration of China's TRQ system for fertilizer, handled by SETC and subsequently MOFCOM, has suffered from systemic problems since China's WTO accession. By 2007, this system was still operating with insufficient transparency, and administrative guidance still seemed to be affecting how the allocated quota was used. U.S. fertilizer exports to China have declined throughout the post-WTO accession period, due in part to continuing problems with MOFCOM's administration of the fertilizer TRQ system and in part to Chinese government policies restricting the export of a key fertilizer input, phosphate rock, which has led to overcapacity in China's domestic fertilizer industry. U.S. fertilizer exports to China decreased 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 this reduction and the scheduled phase-in of foreign enterprises' rights to engage in wholesale and retail distribution of fertilizer within China, 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 (latest data available).

Import Licenses

China's inspection and quarantine agency, the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ), and MOFCOM have imposed inspection-related requirements that have led to restrictions on imports of many U.S. agricultural goods. In particular, AQSIQ issued measures in 2002 that require importers to obtain a Quarantine Inspection Permit (QIP) prior to signing purchase contracts for nearly all traded agricultural commodities as well as a Meat Quarantine Import Permit (MQIP) for the import of meat and poultry products. In addition to the AQSIQ-regulated MQIP, MOFCOM also administers a separate import permit system for poultry importers, the Automatic Registration Form (ARF), which allocates a specific volume amount to eligible importers. These permit systems have significant adverse effects on the United States and China's other agricultural trading partners.

AQSIQ sometimes slows down or even suspends issuance of QIPs at its discretion without notifying traders in advance or explaining its reasons, resulting in significant commercial uncertainty. Because of the commercial necessity to contract for commodity shipments when prices are low, combined with the inherent delays in having QIPs issued, many cargos 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 shipments are often closely scrutinized and are at risk for disapproval if they are considered too large in quantity.

Little improvement in the QIP system has taken place over the last six years, and in 2009, traders continued to be concerned that the rules and regulations of the QIP system remain available as an administrative tool to limit the quantity of imports. However, traders remain hesitant to press AQSIQ for change, because they believe they would risk reprisals. Many of them would at least like AQSIQ to eliminate the quantity requirements that it unofficially places on QIPs. These quantity requirements have been used often by AQSIQ during peak harvest periods to limit the flow of commodity imports. Eliminating this requirement would help to ensure that QIPs do not interfere with the market.

Additionally, China's Ministry of Agriculture (MOA) mandates a registration procedure for animal feed, feed ingredients, and feed additives. The license applicants have reported that in order to secure licenses, they had to provide product or manufacturing details, which can be business confidential information. MOA's registration period can be unpredictable, and license applicants complain that the evaluation process often lacks transparency. Moreover, regulations published in 2009 indicate that AQSIQ plans to introduce a system that duplicates MOA's registration process for animal feed products.

In 2004, China implemented regulations requiring foreign scrap suppliers to register with AQSIQ (see the "Scrap Recycling" section below). According to AQSIQ, the registration serves to prevent disreputable foreign scrap suppliers from sending sub-standard or illegal scrap and waste to China. The application process has been opaque, with foreign companies experiencing significant delays in receiving notification from AQSIQ. In 2007, the three-year license expired for many foreign scrap suppliers, and AQSIQ required them to renew their licenses in a process that lacked transparency and predictability. In December 2009, citing environmental objectives, China revised its license requirements for importers of iron and steel scrap, narrowing the criteria used to determine which companies may qualify to import scrap. USTR will continue to monitor China's evolving licensing procedures to ensure they are not unnecessarily trade restrictive and are consistent with China's WTO obligations.

Import Ban

China continues an import ban on medical devices containing bovine materials that was instituted in August 2006, even though the U.S. bovine products included in the devices are deemed safe to trade by the World Organization for Animal Health (OIE). U.S. companies have shared extensive scientific evidence with China to demonstrate that the United States has in place appropriate controls to prevent the transmission of bovine spongiform encephalopathy (BSE). China, however, continues to maintain the ban.

INTERNAL POLICIES

Non-discrimination

All China Federation of Trade Union (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-owned companies and because it appears to specifically target Fortune 500 companies, disproportionately affecting 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.

Taxation

Value Added Taxes (VAT)

Uneven application of China's single most important revenue source – the VAT, which ranges between 5 percent and 17 percent, depending on the product – continues. Importers from a wide range of sectors report that, because taxes on imported goods are reliably collected at the border, they are sometimes subject to application of a VAT that their domestic competitors often fail to pay. In addition, China's selective exemption of certain fertilizer products from the VAT has operated to the disadvantage of imports from the United States.

In the MOU China signed to settle the WTO dispute on prohibited tax subsidies, China committed to eliminate VAT and income tax refunds tied to the purchase of domestic products over imported products. In addition, China committed to end VAT exemptions available to foreign invested enterprises with regard to imported equipment used to produce their products, provided that they exported 100 percent of their production, as discussed below in the section on Export Subsidies. China eliminated all of these subsidies, as agreed, effective January 1, 2008.

According to a notice issued by the MOF, Customs, and SAT, from July 1, 2009 through December 31, 2010, foreign-invested research and development centers are eligible for VAT exemption on imports of scientific and technological development products, while both domestic and foreign-invested enterprises can enjoy a VAT rebate for their purchases of domestically manufactured products. China has sometimes provided preferential VAT treatment for domestic enterprises when purchasing imported products in support of the government's strategic development policies. As of July 1, 2009, China exempts domestic enterprises from import tax and import VAT for imports of designated key parts and raw materials for production of certain technical equipment and products.

China retains an active VAT rebate program for exports. However, rebate payments to exporters are often delayed and in some cases have been reduced.

In 2008, the global economic crisis and China's stated desire to remove barriers to exports as part of its stimulus programs led to a reversal of the trend of gradually reducing export VAT rebates. Since July 2008, China has increased export VAT rebates on many products seven times. On July 30, 2008, VAT rebates for certain textile and bamboo products were increased. In October 2008, China announced VAT rebate increases on 3,486 products including textiles, toys, garments, furniture, and some high value-added electrical machinery, representing approximately one quarter of China's total exports. Specifically, the rebate on toys was raised from 11 to 14 percent, the rebate for high-technology and high value-added electrical machinery products increased from 11 to 13 percent, and the rebate on clothing and textiles increased from 13 to 14 percent. In December 2008, China announced an increase in VAT rebates for selected high-technology and high-value-added machinery and electronic products effective January 1, 2009. Effective February 1, 2009, the government again increased VAT rebates on clothing and textiles to 15 percent. Effective June 1, 2009, the government increased VAT rebates for a variety of products, including selected steel products, sewing machines, certain agricultural products, toys, furniture, selected plastic and glass products, and alcohol. Among the products affected by recent changes in VAT treatment was soda ash. On April 1, 2009, China raised the VAT rebate from zero to 9 percent for exports of soda ash, which compete with U.S. exports in important third-country markets.

Currently, 70 percent of machinery and electronic product tariff lines enjoy full VAT rebates, but the rebates are still imposed in a manner to favor the export of some products over others. China also stated in several sector specific stimulus policies that it would continue to use "flexible" border tax policies to "maintain China's share of the global market." In January-August 2009, China rebated a total of $39 billion to exporters, up nearly 9 percent from a year earlier, according to official data.

Consumption Taxes

China's 1993 consumption tax system continues to raise concerns among U.S. exporters. Since China uses a substantially different tax base to compute consumption taxes for domestic and imported products, the tax burden imposed on imported consumer goods ranging from alcoholic beverages to cosmetics to automobiles is higher than for competing domestic products.

Business Tax on Foreign Services

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

EXPORT REGULATION

Export Duties, Licenses, and Quotas

Despite China's commitment in connection with its accession to the WTO to eliminate all taxes and charges on exports, including export duties, except as included in Annex VI to the Protocol of Accession or applied in conformity with Article VIII of GATT 1994, China has continued to impose restrictions on exports of raw materials – including quotas, duties and related fees, licensing requirements, and other restraints – as the Chinese government has continued to guide the development of downstream industries. These export restraints are widespread. For example, China maintains export quotas and sometimes export duties on antimony, bauxite, coke, fluorspar, indium, magnesium carbonate, molybdenum, rare earths, silicon, talc, tin, tungsten, and zinc, all of which are of key interest to U.S. producers of downstream products. These types of export restraints can significantly distort trade. In the case of China, the trade-distortive impact is exacerbated because China is the world's leading producer of each of the raw materials (except for molybdenum and bauxite, for which China is the world's second 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 can 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 can artificially lower China's domestic prices for the raw materials due to significant domestic oversupply, enabling China's domestic producers of downstream products to produce lower-priced products from the raw materials and thereby creating significant advantages for China's domestic downstream producers when competing against foreign producers of these products both in the China market and in export markets.

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

In June 2009, the United States and the EU initiated a WTO case challenging export quotas, export duties, and other restraints maintained by China on the export of several key raw material inputs for which China is a leading 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 in December 2009.

As discussed above in the section on Value Added Taxes, China also attempts to manage the export of many intermediate and downstream products by raising or lowering the VAT rebate available upon export and sometimes by imposing or retracting export duties. These practices have disrupted and injected uncertainty into the markets for particular products.

Sometimes the objective of these adjustments appears to be to make larger quantities of a product available domestically at lower prices than the rest of the world. In other situations, China has reduced or eliminated VAT export rebates and raised export duties in an attempt to rein in out-of-control expansion of production capacity in particular sectors. In some instances, the adjustments have benefited U.S. producers by slowing significant increases in low-priced exports from China to global markets. However, the adjustments can also have harmful consequences, whether or not intended. For example, in November 2006 and April 2007, China reduced export VAT rebates and raised export duties on a wide range of semi-finished and finished steel products, as part of its efforts to discourage further unneeded creation of production capacity for these products in China. At the same time, these export VAT rebate reductions did not target all steel products, and the result was that Chinese steel producers shifted their production to steel products for which full export VAT rebates were still available, particularly steel pipe and tube products, causing a significant increase in exports of these products, many of which found their way into the U.S. market. In 2009, in the face of the economic crisis and in apparent contradiction to its stated goals of discouraging excess capacity, China eliminated most steel export duties and raised VAT rebates on many steel products while continuing to apply differential border tax treatment to encourage the export of more value-added products.

To date, China has been willing to take certain steps toward remedying some of the unintended consequences of its measures when the United States has brought them to China’s attention. In July 2007, for example, China issued a notice extending export VAT rebate reductions to most steel pipe and tube products, with the notable exception of oil country tubular goods. In 2009, through JCCT dialogues and bilateral contacts, USTR raised concerns about differential VAT rebates and export duties that appear to encourage the exports of downstream products such as steel wire products, steel pipe and tube and aluminum foil, to the rising concern of U.S. producers of these products.

Export Subsidies

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

In its Protocol of Accession to the WTO, China committed to eliminate all subsidies prohibited under Article 3 of the WTO Subsidies Agreement, including all forms of export subsidies on industrial and agricultural goods, upon its accession to the WTO in December 2001. China finally submitted its long overdue subsidies notification to the WTO's Subsidies Committee in April 2006. Although the notification is lengthy, with over 70 subsidy programs reported, it is also notably incomplete, as it failed to notify any subsidies provided by state-owned banks or by provincial and local government authorities. In addition, while China notified several subsidies that appeared to be prohibited under WTO rules, it did so without making any commitment to withdraw them, and it failed to notify other subsidies that appeared to be prohibited.

Through the remainder of 2006, the United States pressed China to withdraw the subsidies that appeared to be prohibited, which included both export subsidies and import substitution subsidies, benefiting a wide range of industries in China principally through income tax and VAT exemptions and reductions. However, China was unwilling to commit to the immediate withdrawal of these subsidies. Accordingly, the United States, with Mexico as a co-complainant, initiated a challenge to these subsidies under the WTO's dispute settlement procedures in February 2007. The WTO established a panel in August 2007 to hear the dispute. Following extensive negotiations with China, the United States and Mexico suspended the dispute settlement proceedings with China in November 2007 when China agreed to eliminate all of the prohibited subsidies at issue by January 1, 2008. As agreed, China issued measures that formally eliminated these subsidies effective January 1, 2008.

In December 2008, the United States requested WTO dispute settlement consultations regarding China's "Famous Brand" initiatives, with Mexico and subsequently Guatemala joining as co-complainants. Designed primarily to promote the development of global Chinese brand names and increase sales of Chinese branded merchandise around the world, these initiatives appeared to incorporate prohibited export subsidies that unfairly disadvantage U.S. manufacturers, farmers, ranchers, and workers. 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 to the dispute concluded a settlement agreement in which China confirmed that it had eliminated all of the export-contingent benefits in the challenged measures.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

China was listed on the Priority Watch List in the 2009 Special 301 report because of continuing concerns regarding IPR protection and enforcement. Key concerns listed in the report included unacceptable levels of retail and wholesale counterfeiting, as well as persistently high-levels of book and journal piracy, end-user piracy of business software, and copyright piracy over the Internet. The report describes these enforcement-related concerns and summarizes the legal difficulties right holders face when attempting to assert their IPR rights in China. The lack of deterrent penalties and other policies, such as barriers to the market for legitimate products, contribute to the poor record on reducing IPR crime in China. The report also recognizes industry concerns about the possibility that laws or policies in a variety of fields might be used to unfairly favor domestic intellectual property (IP) over foreign IP, including procurement preferences for products with domestically developed IP, the treatment of IPR in setting standards, and reports that officials, apparently motivated by the financial crisis and the need to maintain jobs, are urging more lenient enforcement of IPR laws.

The United States continues to urge China to provide stronger protection against unfair commercial use of undisclosed test and other data submitted by foreign pharmaceuticals companies seeking marketing approval for their products. The United States has also encouraged China to implement an effective system to prevent the issuance of marketing approvals for unauthorized copies of patented pharmaceutical products. In addition, built-in delays in China's marketing approval system for pharmaceuticals and inadequate regulatory oversight of the production of active pharmaceutical ingredients by domestic chemical manufacturers continue to create incentives for counterfeiting.

The JCCT IPR Working Group meetings held in October 2009 featured 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, in cases of Internet piracy, and to work with the United States to ensure that the Ministry of Culture's prescreening requirements for sound recordings do not hamper the distribution of legitimate copies online. China also announced that it had issued a notice stressing the importance of complying with all copyright laws, especially with respect to electronic journals, in state-run and academic libraries.

A troubling trend that has emerged, however, is China's willingness to encourage domestic or "indigenous" innovation at the cost of foreign innovation and technologies. For example, as noted below in the Government Procurement section, in November 2009, China issued the Circular on Launching the 2009 National Indigenous Innovation Product Accreditation Work with the aim of improving "indigenous" innovation in computer and other technology equipment. In order to qualify as "indigenous" innovation under the accreditation system, and therefore be entitled to procurement preferences, a product's intellectual property must originally be registered in China.

Another example of this broad trend is the draft Regulations for the Administration of the Formulation and Revision of Patent-Involving National Standards that the Standardization Administration of China (SAC) released for public comment in November 2009. These proposed regulations have raised a number of concerns regarding their expansive scope, the feasibility of certain patent disclosure requirements, and the undermining of IP rights through possible compulsory licensing of essential patents included in national standards. If adopted in their current form, these provisions may have the unintended effect of undermining the incentives for innovation and, by discouraging right holders from participating in the development of standards in China, depriving the standard setting process of potentially superior technology. The United States has provided comments on the draft regulations and has suggested that SAC defer implementation in favor of proceeding with additional consultations to assess the situation.

On October 1, 2009, the Third Amendment to China's Patent Law, passed in December 2008, went into effect. While many areas of the Patent Law were clarified and improved, right holders have raised a number of concerns about the new law and implementing regulations. The United States will be closely following implementation of these measures in 2010.

With respect to copyright piracy and trademark counterfeiting, weaknesses in China's enforcement system – criminal, civil, and administrative – contribute to China's poor IPR enforcement record. The United States sought to resolve specific concerns about China's high legal thresholds for criminal enforcement along with other concerns regarding weaknesses in China's laws concerning border enforcement and the denial of copyright protection and enforcement to creative works that are awaiting or have not received Chinese censorship approval. When bilateral attempts to address these concerns did not succeed, the United States requested WTO dispute settlement consultations in April 2007. A WTO panel was composed to hear the dispute in December 2007, and it circulated its decision in January 2009, finding for the United States on two out of three claims, and clarifying important legal principles related to the third claim. Neither China nor the United States appealed the panel's decision, and China has agreed to bring its measures into compliance with the WTO's findings by March 2010. The United States is monitoring China's implementation process.

An exacerbating factor contributing to China's poor IPR protection has been China's maintenance of restrictions on the right to import and distribute legitimate copyright-intensive products, such as theatrical films, DVDs, music, books, newspapers, and journals. These restrictions impose burdens on legitimate, IPR-protected goods and delay their introduction into the market. These burdens and delays faced by legitimate products create advantages for infringing products and help to ensure that those infringing products continue to dominate the markets within China. As discussed above in the sections on Trading Rights and Distribution Services, the United States raised these restrictions in another WTO dispute filed in April 2007. In August 2009, a WTO panel ruled in favor of the United States on all significant issues, and the WTO's Appellate Body rejected China's subsequent appeal on all counts in December 2009.

SERVICES BARRIERS

The market for services in China has significant growth potential in both the short and long term. However, China imposes restrictions in a number of services sectors that prevent or discourage foreign suppliers from gaining or further expanding market access. For example, for certain sectors, China does not grant new licenses or maintains a licensing review process that is opaque or slow-moving. In certain cases, China imposes foreign equity limitations or other discriminatory measures on foreign suppliers. High minimum capital requirements plague other sectors. China also sometimes applies overly burdensome regulatory regimes or other restrictions.

Insurance Services

China continues to maintain certain market access barriers for the insurance sector. Foreign life insurance companies can only be established as joint ventures, with foreign equity capped at 50 percent. China's markets for third party liability automobile insurance and for political risk insurance are closed to foreign participation.

Although China has shown some recent improvement in the insurance sector, U.S. and other foreign companies already established in China continue to have difficulty setting up internal branches in order to expand their operations. The China Insurance Regulatory Commission (CIRC) is not always consistent in following its own deadlines for reviewing and approving internal branch applications from foreign life and non-life companies. Unlike domestic companies, foreign companies also report difficulties in applying for and receiving multiple, concurrent internal branch approvals. The United States will be monitoring how China implements the October 1, 2009 Measures for the Administration of Insurance Companies and whether foreign insurance companies begin to receive the same treatment as domestic insurance companies regarding approvals for new branches and sub-branches.

In addition, the United States has urged the relevant Chinese authorities to ensure that China Post, which has been granted a license to supply insurance through its existing network of postal facilities, is not given advantages in terms of how it is regulated and to what extent it is required to provide distribution possibilities for insurance products of other companies.

Private Pensions—Enterprise Annuities

U.S. and other foreign companies have found it difficult to obtain a license to participate in China's market for "enterprise annuities" services (private pensions similar to the U.S. 401(k) system), which will grow in importance as China develops alternatives to its state-funded social security system. Under existing regulations, licenses to manage enterprise annuities must be obtained from the China Banking Regulatory Commission (CBRC), the China Securities Regulatory Commission, and the Ministry of Labor and Social Security. China has licensed very few foreign operators and only for limited elements of enterprise annuities services. The United States remains very concerned that China's licensing process appears to be largely closed, and has urged China to open its licensing process and ensure that such licensing procedures do not impose quotas on the number of licenses granted to qualified suppliers.

Banking Services

The Regulations for the Administration of Foreign-Funded Banks, issued in November 2006, allow foreign banks to compete in all lines of banking business on the same terms as domestic banks, subject to certain conditions. These regulations require foreign banks to incorporate in China. Moreover, the regulations mandate 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, 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.

To date, numerous foreign banks have received approval to convert to subsidiaries. In 2008, the first application to issue local currency debit and credit cards was approved, although administrative barriers have hindered the approval of other applications and the actual issuance of RMB cards. Also in 2008, the CBRC announced that foreign banks would be allowed to trade and underwrite bonds on the interbank market, albeit via a gradual phasing-in process. At the inaugural July 2009 meeting of the U.S.-China Strategic and Economic Dialogue (S&ED), launched by President Barack Obama and Chinese President Hu Jintao to discuss bilateral and global economic, environmental and diplomatic issues, 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 in the interbank market.

Foreign banks seeking to operate in China through branches instead of through subsidiaries saw some relaxation of prior restrictions, but not enough to allow them to compete effectively in the retail domestic currency business. Specifically, foreign bank branches can continue to take deposits from, and make loans to, Chinese enterprises in domestic currency, but they can only take domestic currency deposits of RMB 1 million ($133,000) or more from Chinese individuals and cannot make any domestic currency loans to Chinese individuals. Foreign bank branches also cannot issue domestic currency credit cards to Chinese enterprises or Chinese individuals.

The rules on the establishment of Chinese-foreign joint venture banks remain a concern. China continues to follow a 2003 regulation that defines a “Chinese bank” as one that has less than 25 percent foreign ownership, with no single foreign investor having over 19.9 percent ownership (the so-called 20/25 rule). China draws a distinction between domestic and foreign companies through different treatment and requirements relating to experience in China. Under this bifurcated regulatory structure, if a Chinese bank were to sell over 25 percent of its shares to foreign investors, it would be classified as a foreign bank and fall under separate rules, which would reduce its permitted scope of business. While the November 2006 State Council regulations appear to virtually eliminate any significant differences in rules for locally incorporated foreign banks and domestic Chinese banks, the possibility of increasing foreign stakes in Chinese banks above the 25 percent threshold, thus falling under the regulatory scrutiny for foreign banks, and attempting to continue the full range of banking business has not been tested.

In September 2009, the State-owned Assets Supervision and Administration Commission (SASAC) announced that it would investigate fuel oil derivative contracts, and that state-owned enterprises (SOEs) could unilaterally terminate such derivative contracts with foreign banks that provide over-the-counter commodity hedging services. These actions raised serious concerns among foreign banks regarding derivative deals signed with Chinese SOEs.

Securities Services

In December 2005, China instituted a moratorium on foreign investment in the securities sector, claiming the need to better regulate domestic companies and further develop the sector. In December 2007, as follow up to a U.S.-China Strategic Economic Dialogue (SED) commitment, China announced that it had lifted the moratorium on the securities sector, and several foreign firms subsequently began discussions with potential joint venture partners. Since that time, China has begun to license some new Chinese-foreign joint ventures. However, China continues to apply a 33 percent foreign equity limit in this sector (as well as a 49 percent foreign equity limit for the asset management sector).

In late 2007, China issued rules that allow foreign joint venture securities firms to gradually expand their scope of business over an extended time frame. However, the regulations contain a number of troublesome aspects that will continue to limit competition in the securities sector, whether for new entrants or for acquisitions of shares in existing companies.

Financial Information Services

In September 2006, Xinhua issued the Administrative Measures on News and Information Release by Foreign News Agencies within China. These regulations precluded foreign suppliers of financial information services from contracting directly with, or providing financial information services directly to, domestic Chinese clients. Instead, foreign financial information service suppliers would have to operate through a Xinhua-designated agent, and the one agent designated was a Xinhua affiliate. Xinhua told foreign financial information service suppliers that the new rules would not be applied to them until after an implementing measure was issued; however, Xinhua subsequently required foreign financial information service suppliers to conclude agreements with the Xinhua affiliate before they could renew their annual licenses. Foreign financial information service suppliers continued to operate, but without renewed licenses.

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, and effective no later than June 1, 2009. Subsequently in 2009, China issued the implementing measures, and since then foreign suppliers have not reported any problems with the new regulatory regime.

Electronic Payment Processing

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

The United States remains concerned that China has not yet issued regulations to allow foreign companies to operate electronic payment systems for single brand, RMB-denominated credit and debit cards. China Union Pay, an entity created by the People's Bank of China and owned by participating Chinese banks, remains the sole authorized provider of electronic payment services in China.

Retailing Services

Although China has made great strides since September 2008 in approving foreign retail outlets, the United States continues to have concerns that China treats domestic companies more favorably than foreign companies regarding zoning and urban development requirements and imposes additional informal minimum capital requirements on foreign suppliers. The United States also would like China to lift ownership restrictions on foreign retailers operating more than 30 stores in China and selling certain commodities.

Sales Away From a Fixed Location

Since 2005, China has significantly liberalized its regime for direct selling services, and a number of foreign direct sellers have received licenses to operate. In October 2009, China finally approved some additional applications for direct selling licenses, the first such approvals since July 2007. This is a welcome step, but the United States will be closely monitoring how future foreign applications are treated. A number of concerns remain, as China maintains unduly burdensome "service center" establishment requirements, caps and other restrictions on sales force compensation, and discriminatory qualification requirements affecting foreign direct sellers.

Express Delivery Services

A number of aspects of China's express delivery regime continue to cause concern for the United States. For example, in October 2009, China enacted a new Postal Law that excludes foreign suppliers from the document segment of China's domestic express delivery market. The United States also has a general concern that the practical implementation of the law and related regulations and standards by China's State Postal Bureau (SPB) will not treat foreign and domestic companies equally. Indeed, China already may be interpreting the law to exclude certain foreign suppliers, but not others, from such activity. The United States is also concerned that China may interpret the universal service fund requirement of the law to require private companies to pay into that fund and, in effect, be forced to subsidize China Post's own express delivery services.

In most economies, express delivery services are not regulated directly or even subject to licensing. For this reason, foreign companies have raised concerns about the risk that SPB will regulate the express delivery sector in an overly burdensome manner that is not necessary to ensure the quality of the service. Foreign companies are also concerned that any express delivery standards may cover operational issues, including many commercial decisions such as weight, package examination, transit time, and personnel requirements, which would normally remain within the purview of individual companies in the marketplace.

The SPB has established a national China Express Association (CEA) as well as local express associations in all of China's provinces. These associations often perform quasi-regulatory functions, such as the development of voluntary standards, and have apparently sought to discuss pricing practices. U.S. industry would like the Chinese government to issue strong, clear, and specific guidance to the CEA and the provincial-level express delivery industry associations on the types of activities that are legitimate under Chinese law. Express delivery firms also faced customs issues in 2009, including a proposed four-hour advance manifest rule that, if implemented, would seriously hobble overnight international deliveries.

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

Construction, Engineering, Architectural, and Contracting Services

In September 2002, the Ministry of Construction (re-named the Ministry of Housing and Urban-Rural Development in 2008) and the Ministry of Foreign Trade and Economic Cooperation (now MOFCOM) issued the Rules on Administration of Foreign-Invested Construction Enterprises (known as Decree 113) and Rules on the Administration of Foreign-Invested Construction Engineering and Design Enterprises (known as Decree 114). Decrees 113 and 114 create concerns for foreign firms by imposing more restrictive conditions than existed prior to China's WTO accession, when they were permitted to work in China on a project-by-project basis pursuant to Ministry of Construction rules. 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. Decree 113 also limits the scope of projects (in terms of size and scale) permitted to foreign-invested enterprises in comparison with the rights enjoyed by domestic companies.

Regarding Decree 113, the United States has urged China to broaden the scope of projects that can be undertaken. The United States also is asking China to reduce its minimum capital requirements and/or consider bonding and other guarantee arrangements in lieu of minimum capital.

Implementing rules for Decree 114 became effective in January 2007. These rules are important, as U.S. companies have a very strong interest in providing engineering and design services in China. The implementing rules were generally positive, in that they temporarily lifted foreign personnel residency requirements imposed by Decree 114, and recognized the foreign qualifications of technical experts for licensing purposes. U.S. and other foreign companies would like to see these improvements in the implementation of Decree 114 made permanent. Decree 160 provided some improvements to enable construction enterprises to apply for comprehensive in scope “Grade A” design licenses; however, Circular 202 curtails such access by imposing other requirements that disqualify certain foreign companies from such access.

Circular 200 imposes certain qualification requirements on foreign suppliers of project management services that the industry finds overly burdensome. Specifically, China does not allow foreign companies to provide project management services without already holding construction or design enterprise approvals. If China were to issue implementation rules for Decree 155 relating to foreign-invested construction engineering services enterprises, this would provide an important new avenue for foreign companies to supply project management services.

Logistics Services

In March 2008, China announced the establishment of a new Ministry of Transport (MOT) that combined responsibilities formerly held by the Ministry of Communications, the Civil Aviation Administration of China (CAAC), and SPB. Rail transport remains administered separately by the Ministry of Railways.

MOT has been slow to approve applications by foreign logistics firms and is unwilling to issue nationwide trucking licenses, which limits the ability of foreign firms to build economies of scale. In addition, according to local regulations, trucks are not allowed daytime city access in almost all major Chinese cities. China's enforcement efforts are often targeted at foreign transport/logistics firms, while local firms are permitted to operate without being in full compliance.

In February 2009, China's State Council announced a support plan for the logistics industry as part of the Chinese Government's industry revitalization plans for ten key industries. Foreign logistics firms with investments in China have raised concerns about transparency of implementing measures, equitable treatment, and efforts to strengthen industry standardization.

There also are growing concerns about the use of inappropriate standards that may hinder market access for logistics firms. Foreign companies have complained about AQSIQ standards issued in April 2005 that are unnecessarily burdensome since they establish artificial classification categories of transport, warehousing, and multi-purpose activities. In addition, freight forwarding firms are concerned that their exclusion from these regulatory categories may prevent their participation in standards-setting activities.

Aviation and Maritime Services

Under the auspices of the SED, the United States and China negotiated an amended bilateral air services agreement that was signed in July 2007. The agreement brings significant economic benefits to the aviation industry, passengers, shippers, and local communities. It is an important step to facilitate trade, investment, tourism, and cultural exchanges between the United States and China. By 2012, the agreement will add 12 new daily passenger flights that U.S. carriers may operate to the Chinese gateway cities of Beijing, Shanghai, and Guangzhou, more than doubling the number of flights allowed. The new agreement also provides for unlimited cargo flights to any point in China and allows an unlimited number of U.S. cargo carriers to serve the market as of 2011. Finally, it increases the available opportunities for carriers to code-share on other U.S. carriers' flights to China, and it commits China to begin negotiations by 2010 on a timetable for the full liberalization of the bilateral civil aviation relationship.

Since early 2008, the United States has engaged in a series of technical consultations with China to discuss differences in the interpretation of the cargo hub provision of the aviation agreement, which has created difficulties for some U.S. cargo carriers to gain approval of their flight schedules. While differences in interpretation remain, China has agreed to continue working with the United States in a pragmatic manner to approve the U.S. carriers' cargo schedules.

In 2003, China took steps to liberalize the maritime services sector. The United States and China signed a far-reaching, five-year bilateral maritime agreement, extended automatically for successive one-year periods, 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. Under the framework of the 2003 agreement, the United States and China have annual consultations. The most recent round was held in December 2008.

Telecommunications

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

Regarding basic telecommunications, not only has there been no new market entry in that sector over the past decade, China forced a consolidation of this sector in 2008, reducing the number of operators from seven to four national operators—China Mobile, China Telecom, China Unicom, and DBSat. China's policy is to permit only foreign joint ventures with existing, state-owned licensees. This policy has further reduced market access opportunities for U.S. suppliers and the potential for additional competition in the Chinese telecommunications market. Although not explicitly stated in rule or policy, China appears to apply an economic needs test to new entrants in this sector to avoid "unhealthy competition." China also shows reluctance to authorize new services or technologies which might compete with the revenue of incumbent operators, such as cable modem service, voice over-Internet protocol (VoIP) or WiFi over a mobile handset. In September 2008, in response to a long-standing U.S. request, China slightly reduced basic telecommunications capitalization requirements to RMB 1 billion (approximately $146 million). This level is still excessively high and makes it commercially unattractive for most foreign operators to invest in the sector, particularly for leased line, resale, and corporate data services, which require no new building of facilities.

After years of delay and sustained U.S. pressure, MIIT finally issued licenses in January 2009 for third-generation (3G) mobile telecommunications services to the country's three main state-owned mobile telecommunications operators. There was no public announcement or details available regarding the application process for these licenses and the company deploying the indigenous 3G technology, TD-SCDMA, appears to have chosen this standard at the government's direction, and not as a commercial decision. China Mobile received a license to operate TD-SCDMA, the Chinese-developed 3G standard. China Telecom received a license for CDMA2000, the U.S.-developed standard, and China Unicom received a license to operate W-CDMA, the European-developed standard. Although this new network roll-out provides significant opportunities for U.S. equipment and services suppliers, continued reports on plans to support and favor China's domestic 3G standard are troubling. As China considers making new spectrum available for new wireless services, improving the transparency of its licensing process will be a priority for all market participants seeking access to the services and technologies a new release of spectrum will make possible. For example, China has not been clear about why mobile wireless services using the 802.16 ("WiMax") standard are not permitted, despite interest among both Chinese service suppliers and U.S. equipment vendors.

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

The United States also has pressed China to make available its draft Telecom Law for review and comment, and it did so in the fall of 2009. This draft contains troubling elements, including provisions that would codify China's foreign equity limitations for the sector, complicating ongoing efforts in the WTO and other fora to encourage China to liberalize this sector. China has been working on the draft Law for over ten years. MIIT still lacks a specific authorizing statute for its powers.

Online Services

China operates the world's most comprehensive Internet filtering regime, which affects a broad range of commercial activity conducted via the Internet. Chinese authorities routinely filter Internet traffic entering China, focusing primarily on the content they deem objectionable on political, social, or religious grounds. In 2002, China lifted filters on most major western news sites. Nevertheless, since then, foreign news and other content websites have periodically been blocked, some apparently permanently. While the 2008 Olympics resulted in some previously blocked sites being unblocked, once the Olympics were over a concerted effort to reassert control appears to have been instituted, through what the Open Net Initiave termed "Control 2.0" and an effort to "set the agenda for coverage, rather than suppress it."

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

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

Audiovisual and Related Services

China's desire to protect the revenues earned by the state-owned audiovisual and print media importers and distributors, as well as concerns about politically sensitive materials, have resulted in continued restrictions on foreign providers of audiovisual and related services. Importation and distribution of books, newspapers, journals, sound recordings, videos, films, and television programs remain highly restricted. Inconsistent and subjective application of censorship regulations further impedes market growth for foreign providers. China's large black market for foreign DVDs and other home entertainment video products continues to grow, because these market access restrictions create a demand for pirated goods in the absence of legitimately licensed home or theatrical entertainment.

At both the central and regional levels, interconnected agencies under the State Administration for Radio, Film, and Television (SARFT) dictate the terms under which films can be produced and distributed. SARFT permits only one film importer and two film distributors (which are both components of the same monopoly managed by SARFT) to operate in China. For theatrical releases, the monopoly importer and distributor dictate the films that will be imported (currently limited by China to 20 revenue-sharing films a year, with remaining films imported only under low, fixed price terms), when they will be released in the market, and the box office revenue-sharing terms in a master contract agreement imposed unilaterally and uniformly on foreign studios by the Chinese government. In addition, the Chinese government sets strict guidelines with respect to the public screening of foreign films. Under Regulations for the Administration of Films Decree No. 342, Article 44, issued by the State Council in 2001, the total annual screening time for foreign films must not exceed one-third of the total screening time of all films (domestic and foreign).

Television quotas are also highly restrictive. The Administrative Measures on the Import and Broadcast of Extraterritorial Television Programs (No. 42), effective October 23, 2004, restricts foreign television drama and film programming to no more than 25 percent of total airtime, and other foreign programming to no more than 15 percent of total air time. Foreign programming, including animated programs, is banned on prime time between 7:00 P.M. and 10:00 P.M. on terrestrial stations. SARFT's Interim Regulation on Digital Cable TV Pay Channels (November 14, 2003) restricts foreign programming to a maximum of 30 percent of total airtime on pay television channels.

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

Regulations restricting direct distribution by non-Chinese companies of imported theatrical films, home video, public performance video, and television products remain in force. China Film dictates the contractual terms, play dates, and other aspects of film exhibition. When Chinese entities contract for the rights to distribute titles in various home video formats, the differentiation between video rights and rights for home use or public use is often ignored; home video products are often used for public performance exhibitions in mini-cinemas and by some pay-television operators providing to hotels.

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

For sound recordings, China limits market access opportunities for imported sound recordings in a manner similar to the limitations imposed on films for theatrical release or home viewing. In addition, new barriers have recently been erected. The Ministry of Culture's Opinion on the Development and Regulation of Network Music bans foreign ownership of firms supplying digital music services, requiring that entities engaging in the online distribution of sound recordings in China be wholly Chinese-owned entities. In late 2007, this regulation was amplified in new rules established jointly by MIIT and SARFT, explicitly restricting audio and video distribution services (including over electronic networks such as the Internet) to state-owned entities.

As discussed above in the section on Trading Rights, the United States initiated a WTO dispute settlement case against China in April 2007 challenging the importation and distribution restrictions applicable to certain copyright-intensive products, including books, newspapers, journals, theatrical films, videos, and sound recordings. The WTO panel that heard the case issued its decision in August 2009, ruling in favor of the United States on all significant issues. China appealed the panel's decision in September 2009. The WTO's Appellate Body rejected China's appeal on all counts in December 2009. The United States will closely monitor China's implementation of this ruling.

Investment in China's audiovisual sector is highly restricted. For television production, joint ventures or cooperative firms must have a minimum capital requirement of RMB 2 million ($275,000), and foreign capital is capped at 49 percent. In February 2005, SARFT issued a circular placing further restrictions on foreign partners and requiring two-thirds of the programs of a joint venture or cooperative firm to have Chinese themes.

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

Travel and Tourism Services

In December 2007, the United States and China signed an MOU to facilitate Chinese group leisure travel to the United States and the marketing in China of U.S. destinations or businesses. The first group of Chinese leisure travelers visited the United States under the MOU in June 2008. In November 2009, the United States and China agreed to implement phase II of the MOU to include an additional 12 jurisdictions, bringing the total to 21. However, foreign travel and tourism firms in China are still restricted from competing under the same conditions as Chinese firms. For example, wholly foreign-owned enterprises and Chinese-foreign joint ventures continue to be restricted in selling outbound travel packages and airline tickets. In addition, China requires all travel agents and airlines to connect into China's nationally owned and operated computer reservation system when booking airline tickets for domestic flights and outbound international flights. China also continues to apply an annual sales requirement on foreign travel agencies, although there are no such requirements for domestic agencies.

Education and Training Services

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

Legal Services

Foreign law firms face numerous restrictions on the scope and structure of their activities in China, as well as other barriers affecting market access. Current Chinese law prohibits foreign firms from practicing Chinese law, which means that they are unable to hire Chinese-qualified lawyers to practice Chinese law. China also maintains restrictions on cooperation with Chinese law firms (including investment and profit-sharing restrictions) that further limit market opportunities. In addition, foreign law firms are concerned that China may make it more difficult to provide other legal services (such as advisory and consultation services) that are currently widely regarded as permissible.

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

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

INVESTMENT BARRIERS

The volume of FDI in China fell by only 2.6 percent in 2009 (latest data available) amid a 39 percent decrease in FDI flows globally and despite the maintenance of significant investment barriers. According to the United Nations Conference on Trade and Development, China received $90 billion in FDI in 2009 (latest data available). China was the world's second-largest destination for FDI, after the United States. The World Bank's Doing Business Report 2010, which ranks how countries' regulatory environments are conducive to business operations, gave China a global ranking of 89 out of 183. In 2009, investors continued to complain of a lack of transparency, inconsistently enforced laws and regulations, weak IPR protection, corruption, and an unreliable legal system that fails to enforce contracts and judgments.

China's leadership has repeatedly affirmed its commitment to further open China to foreign investment, including a strong statement at the S&ED meeting in July 2009 in which China reiterated its commitment to open trade and investment. However, there is growing concern that recent steps China has taken may increasingly discriminate against or otherwise disadvantage foreign investors. For example, SASAC in December 2006 issued the Guiding Opinion Concerning the Advancement of Adjustments of State Capital and the Restructuring of State-Owned Enterprises. Statements accompanying its release identified an expansive list of sectors deemed critical to the national economy, including "pillar" industries such as equipment manufacturing, automotive, electronic information, construction, iron and steel, nonferrous metal, chemical, survey and design, and science and technology industries. SASAC committed to restrict foreign participation in these sectors by preventing further foreign investment in state-owned enterprises operating in these sectors. Furthermore, China's 2009 revision of its 2006 Provisions on the Mergers and Acquisitions of Domestic Enterprises by Foreign Investors neither removed nor provided greater clarity with respect to terms such as "national economic security" and "critical industries," and also retained a provision permitting denial of a foreign investor's acquisition if a famous trademark or a traditional Chinese brand is being acquired. Revisions in these areas would have provided useful clarity for foreign investors. Their absence raises concerns that administrative ambiguity will continue to provide a basis for uneven administration, and for differential treatment of Chinese and foreign investors. In addition, there have been indications since mid-2008 that China is developing a more integrated national security foreign investment review process. The United States is concerned about the increase in proposed and adopted measures that restrict investment. These restrictions are often accompanied by other problematic industrial policies, such as the increased use of subsidies and the development of China-specific standards. Many of these developments appear to represent protectionist tools created by industrial planners to shield inefficient or monopolistic enterprises, particularly those in which the Chinese government has an ownership interest, from competition.

Investment Requirements

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 and GATT Article XI obligations not to impose quantitative restrictions on imports. In its Protocol of Accession to the WTO, China also specifically agreed to eliminate export performance, local content, and foreign exchange balancing requirements from its laws, regulations, and other measures, and not to enforce the terms of any contracts imposing these requirements. In addition, China agreed that it would no longer condition importation or investment approvals on these requirements or on requirements such as technology transfer and offsets.

Although China has revised many laws and regulations to conform to its WTO investment commitments, some of the revised laws and regulations continue to raise WTO concerns, including ones that "encourage" technology transfers to China, without formally requiring them. U.S. companies remain concerned that this "encouragement" in practice can amount to a "requirement," 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 considered factors such as export performance and local content when deciding whether to approve an investment or to recommend approval of a loan from a Chinese policy bank, which is often essential to the success of an investment project.

Investment Guidelines

Foreign Investment Catalogue

China's foreign investment objectives are primarily defined through its Catalogue Guiding Foreign Investment in Industry, which is revised every few years and was most recently updated in November 2007. The catalogue suggests that China's investment policies may be becoming more selective in allowing foreign investment by actively targeting higher value-added sectors (including high technology research and development, advanced manufacturing, energy efficiency, environmental conservation, and modern agriculture and services) rather than basic manufacturing. Meanwhile, the catalogue places new restrictions 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, conventionally bred plant seeds, 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. Further, through the Catalogue of Priority Industries for Foreign Investment in the Central and Western Regions, updated in December 2008, China appears to be seeking to spread the benefits of foreign investment beyond China's comparatively wealthy coastal area by encouraging foreign investors to establish regional headquarters and operations in Central, Western, and Northeast China.

Administrative Measures to Restrict Investment

Over the past few years, Chinese regulators have announced a number of measures limiting the ability of foreign firms to invest in China's market.

For example, in June 2006, the State Council issued the Opinions on the Revitalization of the Industrial Machinery Manufacturing Industries, which calls for China to expand the market share of domestic companies involved in 16 types of equipment manufacturing, including large equipment for clean and efficient power generation, critical semiconductor manufacturing equipment, civilian aircraft and aircraft engines, pollution control equipment, textiles machinery, and large excavators. This measure advocates a variety of policy supports, such as preferential import duties on parts needed for research and development, encouraging domestic procurement of major technical equipment, a dedicated capital market financing fund for domestic firms and strict review of imports. This measure also suggests that China will implement controls on foreign investments in the industrial machinery manufacturing industries, including a requirement for administrative approval when foreign entities seek majority ownership or control of leading domestic firms.

As previously noted, in June 2009, revisions to the 2006 Provisions on the Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (2006 Provisions) were promulgated by MOFCOM and five other government agencies. The 2006 Provisions had added rules allowing MOFCOM to conduct anti-monopoly reviews of proposed mergers and acquisitions by foreign investors, and the primary purpose of the 2009 revisions was to remove these provisions, as the Anti-Monopoly Law came into force in September 2008 to provide for such reviews for both foreign and domestic investors (See the "Anticompetitive Practices" section below). The 2006 Provisions also revised existing rules for mergers and acquisitions involving foreign investors and, among other things, established a legal basis for a "national economic security" review process that can block proposed transactions. Under the 2006 Provisions, foreign mergers and acquisitions of domestic enterprises that would result in "actual control" of a domestic enterprise in a "key industry" with "potential impact on national economic security" or that would alter control of a famous Chinese trademark or brand require approval at the central government level by MOFCOM. The 2006 Provisions also place MOFCOM in the role of determining if the domestic acquisition target has been appropriately valued.

In November 2006, the NDRC released a Five Year Plan on foreign investment, which promised greater scrutiny over foreign capital utilization. The plan calls for the realization of a "fundamental shift" from "quantity" to "quality" in foreign investment during the period from 2006 to 2010. The state's focus would change from shoring up domestic capital and foreign exchange shortfalls to introducing advanced technology, management expertise, and talent. In addition, the plan specifically encourages foreign investments contributing to natural resource conservation and environmental protection, and discourages foreign investment in industries with a high rate of pollution and water resource depletion. The plan also demands tighter tax supervision of foreign enterprises and seeks to restrict foreign firms' acquisition of "dragon head" enterprises to prevent the "emergence or expansion of foreign capital monopolies," to protect national economic security and to prevent the "abuse of intellectual property."

As noted above, in December 2006, SASAC issued the Guiding Opinion Concerning the Advancement of Adjustments of State Capital and the Restructuring of State-Owned Enterprises. Statements accompanying its release identified an expansive list of sectors deemed critical to the national economy. This measure explained that "pillar" and "backbone" industries such as automotive, chemical, construction, electronic information, equipment manufacturing, iron and steel, nonferrous metal, science and technology, and survey and design must maintain relatively strong state control. Reportedly, SASAC officials also identified a separate set of seven strategic sectors in which state capital must play a leading role, including aviation, coal, defense, electric power and grid, oil and petrochemicals, shipping, and telecommunications. Further, in October 2008, the National People's Congress issued the Enterprise State-Owned Assets Law, which later took effect in May 2009. Among other provisions, Article 57 of the law states that where state-owned assets are transferred to a foreign investor, the transfer must not harm the national security or public interests of China. It remains unclear how SASAC will implement these policies or, in the context of the Enterprise State-Owned Assets Law, how it will interpret the "national security" and "public interests" of China.

China also continued to employ various sector-specific measures designed to impose new requirements on foreign investors. Measures affecting foreign investment in the automotive and steel sectors are discussed above in the section on Import Substitution Policies.

Other Investment Issues

Venture Capital and Private Equity

Investment exit options have, to some extent, curbed foreign participation in China's venture capital and private equity sectors, although both forms of investment enjoy high growth rates. Most foreign venture capital and private equity investments in China are actually housed in offshore holding companies, which, in the past, as with other offshore FDI, could be transferred without Chinese government approval. The Chinese Government issued new regulations in September 2006, however, that effectively shut down this method of transferring local assets to offshore “special purpose vehicles.” The 2006 regulations require pre-approval by no less than six agencies for a Chinese company to transfer assets offshore to a foreign entity. Since the issuance of these rules, no approvals have been granted.

China, in September 2006, also implemented regulations that made it more difficult to list on foreign stock exchanges, but at the same time facilitated listing on the domestic A-share market. Although private equity investors have successfully listed in the A-shares market, these investors face a three year lock up period during which they may not cash in on their listed holdings.

The Chinese government issued new regulations for domestic venture capital firms in the fall of 2005, which took effect on March 1, 2006. The regulations aimed at cultivating China's domestic venture capital industry, streamlined the incorporation process, and relaxed capital requirements for venture capital firms. Though some restrictions remained in place for foreign-invested firms, the provisions eased overall foreign venture capital investment in China.

In June 2007, an amended Partnership Law took effect, which allowed the formation of limited partnership enterprises. The law limits investor liability and exempts partnership enterprises from corporate income tax. It governs only domestic partnership enterprises, however, and calls for foreign partnerships to be guided by foreign investment partnership regulations, which are currently in draft and in circulation among relevant Chinese government agencies. It is expected that the final regulations will have a negligible effect on foreign invested partnerships, including private equity and venture capital firms.

Holding Companies

China has relaxed some restrictions on the scope and operations of holding companies, although minimum capital requirements normally make the establishment of a holding company suitable only for corporations with several large investments. Holding companies may manage human resources across their affiliates and also provide certain market research and other services. However, some restrictions on services provided by holding companies and on holding companies’ financial operations, in addition to the ability to balance foreign exchange internally, remain in place. Profit and loss consolidation within holding companies also remains prohibited.

Securities Firms

China has begun to open its domestic equity markets to investments from foreign firms. Through the Qualified Foreign Institutional Investor (QFII) program, foreign securities firms may apply for QFII status, which permits limited access to the RMB-denominated A-share market. As of January 2010, China had granted QFII status to 86 foreign entities, with quotas allotted totaling $16.7 billion. The Chinese government committed during the May 2007 SED meeting to announce an expansion of the quota to $30 billion, and did so on December 11, 2007.

Access to Capital Markets

Foreign-invested firms in China are often unable to access domestic and international stock markets, to sell corporate bonds and equity, or to engage in normal merger, acquisition, and divestment activity. However, at the SED meeting in December 2007, China agreed to allow, in accordance with relevant prudential regulations, qualified foreign-invested companies to issue RMB-denominated stocks, and qualified listed companies to issue RMB-denominated corporate bonds. This move should ease some of the capital inflow pressure from foreign investment, a major concern of Chinese policy makers given excess liquidity and the recent rise in inflation in the domestic economy.

Foreign exchange transactions on China's capital account can be concluded only through case-by-case review by the State Administration of Foreign Exchange (SAFE) and approvals are tightly regulated. During the first part of 2009, SAFE reportedly refused to allow some American companies to repatriate their earnings; these restrictions reportedly eased in the second half of the year, however. Recent regulations permitting greater capital outflows and pronouncements by Chinese government officials encouraging Chinese firms to invest abroad suggest that China now recognizes that continued large capital inflows are not sustainable. To date, foreign firms remain generally satisfied because they are able to repatriate profits. At the same time, most major foreign firms prefer to reinvest their profits, not exit the Chinese market. With respect to capital inflows, several foreign firms have noted difficulties in obtaining government approval to bring in foreign capital to expand their businesses.

GOVERNMENT PROCUREMENT

Accession to the WTO Agreement on Government Procurement

China is not a signatory to the WTO Agreement on Government Procurement (GPA). In accordance with its commitment upon accession to the WTO, China became an observer to the WTO Committee on Government Procurement in 2002. China also committed, in its Protocol of Accession to the WTO, to initiate negotiations for accession to the GPA "as soon as possible". In accordance with its further commitment on this matter at the April 2006 JCCT meeting, China initiated GPA accession by submitting its application for accession and initial offer of coverage in December 2007. The United States and other GPA Parties have noted that significant improvements will be needed in China's initial offer to bring China's coverage to the level of other Parties' coverage.

At the July 2009 S&ED meeting, China agreed to submit to the WTO Committee on Government Procurement, 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, China committed during the October 2009 JCCT meeting to submit a revised offer as early as possible in 2010.

Government Procurement Regime

In January 2003, China implemented a Government Procurement Law (GPL), which generally reflects GPA obligations and incorporates provisions from the United Nations Model Law on Procurement of Goods. However, the GPL also directs central and sub-central government entities to give priority to "local" goods and services, with limited exceptions.

The GPL does not cover tendering and bidding for public works projects, which represent at least one-half of China's $82 billion government procurement market. Those projects are subject to a different regulatory regime, established by China's Bidding and Tendering Law, which entered into force in January 2000. It has taken nearly 10 years for the responsible agency, NDRC, to draft implementing regulations for the Bidding and Tendering Law. In September 2009, the State Council finally circulated NDRC's draft implementing 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 Bidding and Tendering Law and the GPL, and the need to define "domestic products."

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. U.S. concerns were not only about the continuing access of U.S. software exporters to China's large and growing government 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 arose in 2005 when China issued a measure that required preferences for products incorporating the WLAN Authentication and Privacy Infrastructure (WAPI) standards in government procurement. In 2006, the State Council issued China's Medium-to-Long-Term Science and Technology Master Plan. The NDRC and other ministries and agencies are in charge of developing regulations to implement this plan, which includes preferences for the purchase of domestic goods as an important industrial policy tool. In September 2007, the NDRC implemented provisional rules for e-government projects, which mandate priority purchasing of domestic goods and services in national electronic government projects. The United States is concerned that these measures may unfairly discriminate against U.S. firms.

In December 2007, MOF issued two measures that would substantially restrict the Chinese government's purchase of foreign goods and services. The first measure, the Administrative Measures on the Government Procurement of Imported Products, severely restricts government procurement of imported foreign products and technologies. The second measure, Administrative Measures for Government Procurement on Initial Procurement and Ordering of Indigenous Innovation Products, is directed at restricting government procurement of "indigenous innovation" products to Chinese products developed by domestic enterprises or research institutions. The central government and provincial governments have since followed up by creating catalogues of qualifying "indigenous innovation products." While China may maintain these measures until it completes its GPA accession, the United States has raised strong concerns with regard to 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 priority to be given in government procurement to domestic products 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 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, under its Government Procurement Law, products produced in China by foreign-invested enterprises the same as products produced in China by Chinese enterprises. During the October 2009 JCCT meeting, China later reaffirmed this commitment and further committed to issue rules implementing it.

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." In order to qualify as indigenous innovation under the Circular, a product's intellectual property must originally be registered in China. The Circular applies to six broad areas: computer and application devices; communication products; modernized office equipment; software; "new energy and equipment"; and energy-efficient 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. Provinces and municipal governments have also issued their own "indigenous innovation" catalogues related to government procurement.

At the end of December 2009, MOST, MOF, MIIT and SASAC issued a Catalog Guiding Domestic Innovation in Major Technology Equipment to improve indigenous innovation in equipment used for manufacturing. The catalog covers 240 products in 18 broad categories including renewable energy products, high technology equipment, transportation, medical devices, construction and agriculture. This measure provides that when a product is successfully developed and certified as an "indigenous innovation" product, it will be included in the Catalog for Government Procurement of Indigenous Innovation Products and entitled to procurement preferences.

ELECTRONIC COMMERCE

China has experienced dramatic growth in Internet usage since 1999. According to the 20th Internet survey recently published by the China Internet Network Information Center (CNNIC), the number of Internet users in China reached approximately 384 million by the end of 2009, 94 percent of whom have broadband access. There are now more than 120 million broadband subscribers in China, including over 10 million 3G mobile subscribers, a number expected to increase exponentially over the next several years. Falling personal computer prices and the arrival of devices tailored for the Chinese market will further expand Internet access. China has also experienced a dramatic increase in the number of domain names established. By the end of 2009, there were more than sixteen million domain names registered under ".cn," almost twice as many as in 2007.

China is experiencing the rapid development of online businesses such as search engines, network education, online advertisements, audio-video service, paid electronic mail, short message, online job searches, Internet consulting, electronic trading, and online gaming. However, CNNIC reported that only 28 percent of surveyed Chinese Internet users frequently use the Internet for online shopping services.

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

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

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

ANTICOMPETITIVE PRACTICES

Competition Policy Laws and Regulations

China maintains many laws and regulations in the competition policy area. One of China's principal laws is the Anti-Unfair Competition Law, enacted by the National People's Congress (NPC) in 1993. This law addresses a variety of matters, as it: (a) prohibits firms from using a trademark, name, or packaging without a license, as well as false advertising and other practices intended to confuse consumers; (b) outlaws bribery, the purchase or sale of business secrets, and predatory pricing; (c) restricts a firm's ability to tie the sale of one product to another or impose "unreasonable conditions" on purchases; (d) bans collusion and outlaws "spreading false facts" that damage a competitor; and (e) in theory, limits the business practices of legally authorized monopolies and restricts the government's ability to require that private firms engage in certain commercial transactions with state-owned enterprises.

China maintains some laws and regulations that limit competition. For example, the national government has legislated that production in certain sectors be concentrated in monopolies or near monopolies or authorized oligopolies. As in some other countries, these enterprises are concentrated in capital intensive sectors, like electricity and transportation, or in industries such as fixed-line telephony and postal services, in which this approach may be used to ensure national coverage. Some of the key laws and regulations include the Law on Electricity (1996), Civil Aviation Law (1995), Regulations on Telecommunication (2000), Postal Law (1986), Railroad Law (1991), and Commercial Bank Law (amended in 2003), among others. The enforcement of these laws and regulations is uneven as a result of the challenges inherent in attempting to coordinate their implementation nationally and as a result of inconsistent local and provincial enforcement. More troubling are efforts by government authorities at all levels in China to regulate competition with specific firms, often state-owned enterprises. Official statements frequently suggest that these efforts are tied primarily to employment concerns. However, the ultimate beneficiaries of the resulting measures are often unclear. In addition, local governments frequently enact rules that restrict interprovincial trade. Since the central government has difficulty enforcing its own competition policy measures at the local level, these local government rules continue to restrict market access for certain imported products, raise production costs, and limit market opportunities for foreign invested enterprises.

The NPC in August 2007 passed China's first Anti-Monopoly Law, which took effect in August 2008, and China is in the midst of drafting implementing regulations. 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 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. More than 70 percent of mergers notified to MOFCOM since the law came into effect have involved multinational corporations, and most of the merger transactions challenged by MOFCOM to date have included at least one foreign party. 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.

Measures Restricting Inward Investment

In 2006, China began to revise its policies toward inward investment. While insisting that it remains open to foreign investment, China adopted policies that restrict inward investment in a range of "strategic" sectors, which appear designed to shield domestic enterprises from foreign competition. As discussed above in the Investment Barriers section, these policies include the State Council's June 2006 Opinions on the Revitalization of the Industrial Machinery Manufacturing Industries, which calls for China to expand the market share of domestic companies in 16 equipment manufacturing industries.

In addition, in August 2006, the Ministry of Commerce and five other agencies issued revised rules for foreign mergers and acquisitions, which, among other things, establish a vague "national economic security" basis for rejecting proposed transactions as well as an anti-monopoly review for foreign transactions. In November 2006, the NDRC issued a Five Year Plan on foreign investment that seeks to restrict foreign acquisitions of leading Chinese enterprises, prevent the emergence of foreign capital monopolies, protect industrial security, and prevent abuse of intellectual property. In December 2006, SASAC published an expansive list of seven "critical economic sectors" in which China should restrict foreign participation, including armaments, electrical power and distribution, oil, chemicals, telecommunications, coal, aviation, and shipping. Finally, the Catalogue Guiding Foreign Investment in Industry, which is revised every few years and was most recently issued in November 2007 suggests China's policies toward inward investment may be more selective, actively targeting higher value added sectors (including high technology research and development, advanced manufacturing, energy efficiency, and modern agriculture and services) rather than basic manufacturing.

Some of these measures maintain or create conflicts of interest by assigning regulatory power to agencies that administer state-owned enterprises competing in the same sectors. In addition, key terms in the new policies, such as "national economic security," remain undefined. The opaque standards and ill-defined processes in these measures have introduced additional ambiguity into China's investment policy.

OTHER BARRIERS

Transparency

In its Protocol of Accession to the WTO, China committed to publish all laws, regulations, and other measures that relate to trade matters, including those that affect imports, and generally to provide a reasonable period for commenting on them before implementation. China also agreed to establish or designate an official journal for the publication of these trade related measures. In addition, China agreed to provide a copy of new trade related laws, regulations, and other measures to the WTO Secretariat in Geneva, translated into one or more of the WTO's official languages (English, French, and Spanish) no later than 90 days after implementation. China further agreed to create various enquiry points for its WTO trading partners and foreign businesses to obtain information about these measures.

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 laws and regulations have been published (in Chinese) soon after issuance and prior to their effective date, an improvement over pre-WTO accession practice. These laws and regulations have been published in a wide variety of journals and on the Internet.

In late 2002, China designated the China Foreign Economic and Trade Gazette as the official journal for publishing trade related measures. In March 2006, the State Council issued a notice directing all central, provincial, and local government entities to begin sending copies of all of their trade related measures to

MOFCOM for immediate publication in the MOFCOM Gazette. So far, adherence to the State Council's notice is far from complete.

In December 2001, the State Council issued regulations explicitly allowing comment periods and hearings. However, many of China's ministries and agencies continued to follow the practice that had been followed prior to China's accession to the WTO. The ministry or agency responsible for drafting a new or revised law or regulation will normally consult with, and submit drafts to, other ministries and agencies, Chinese experts, and affected Chinese companies. At times, the responsible ministry or agency will also consult with select foreign companies, although it will not necessarily share drafts with them. As a result, only a small proportion of new or revised laws and regulations have been issued after a period for public comment, and even in these cases the amount of time provided for public comment has generally been short.

At the June 2008 SED meeting, China agreed to publish in advance for public comment, subject to specified exceptions, all trade and economic related administrative regulations and departmental rules that are proposed for adoption, and provide a public comment period of not less than 30 days from the date of publication. China further agreed to publish such measures for comment in a single location: the Chinese Government Legislative Information Website of the Legislative Affairs Office of the State Council. Since then, the United States has been monitoring the effectiveness of this commitment, and it appears that many government entities are increasingly publishing their trade related measures. However, many such proposed measures are not published on this website, or elsewhere, and it is still not clear whether all types of trade-related measures are being published. Thus, for example, the legal basis for prohibiting Wi-Fi without including a competing Chinese standard, WAPI, on cell phones is not publicly available. Additionally, in many instances, the time provided for public comment remains less than 30 days.

Legal Framework

Laws and Regulations

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

In China, regulations are also promulgated by a host of different ministries and governments at the central, provincial, and local levels; and it is not unusual for the resulting regulations to be at odds with one another. Even though finalized regulations are now routinely published in China, they often leave room for discretionary application and inconsistencies. Indeed, government bureaucracies have sometimes been accused of selectively applying regulations. China has many strict rules that are often ignored in practice until a person or entity falls out of official favor. Governmental authorities can wield their discretionary power on foreign or disfavored investors or make special demands on them simply by threatening to crack down.

This lack of a clear and consistent framework of laws and regulations can be a barrier to the participation of foreign firms in the Chinese domestic market. A comprehensive legal framework, coupled with adequate prior notice of proposed changes to laws and regulations and an opportunity to comment on those changes, would greatly enhance business conditions, promote commerce, and reduce opportunities for corruption. The U.S. Government has provided technical assistance, at the central, provincial, and local levels of government in China, in an effort to promote improvements in China's legislative and regulatory drafting processes. In its Protocol of Accession to the WTO, China committed to establish tribunals for the review of all administrative actions relating to the implementation of trade related laws, regulations, judicial decisions, and administrative rulings. These tribunals must be impartial and independent of the government authorities entrusted with the administrative enforcement in question, and their review procedures must include the right of appeal. To date, little information is publicly available regarding the frequency or outcomes of review before these tribunals.

China also committed, at all levels of government, to apply, implement, and administer all of its laws, regulations, and other measures relating to trade in goods and services in a uniform and impartial manner throughout China, including in special economic areas. In connection with this commitment, in 2002, China also established an internal review mechanism, now overseen by MOFCOM's Department of WTO Affairs, to handle cases of non-uniform application of laws. The actual workings of this mechanism remain unclear, however.

Commercial Dispute Resolution

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

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

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

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

Labor Issues

In recent years, China has expanded the scope of its national labor laws and regulations. Three important new labor laws went into effect in 2008: the Labor Contract Law, which clarifies the rights and obligations of workers and employers to promote better labor relations; the Labor Dispute Mediation and Arbitration Law, which improves and streamlines the labor dispute resolution process; and the Employment Promotion Law, which aims to stimulate employment opportunities. However, China does not adhere to certain internationally recognized labor standards with respect to freedom of association and the right to bargain collectively, and there continue to be many reports indicating that China does not effectively enforce its labor laws and regulations concerning issues such as minimum wages, hours of work, occupational safety and health, bans on child labor, forced prison labor, and participation in social insurance programs. Providing for internationally recognized labor standards and effectively enforcing those standards would help ensure that China is not promoting trade at the expense of its workers and that its goods compete on the global market on more fair terms.

Skilled workers are in relatively short supply. Restrictions on labor mobility continue to distort labor costs. China is gradually easing restrictions under the country's household registration system, which has traditionally limited the movement of workers within the country, in part due to the recognition that labor mobility is essential to the continued growth of the economy. Shanghai Municipality and Zhejiang Province both announced revised residency policies in 2009. In February, Shanghai announced an end to the quota system for hukou residency registrations and outlined requirements for converting residency from temporary to permanent status. Zhejiang Province passed new regulations in May requiring migrant workers to apply for resident permits.

Corruption

Many people expected that China's entry into the WTO, which mandated a significant reduction in tariffs, would in turn reduce incentives for smuggling-related corruption. While WTO membership has increased China's exposure to international best practices and resulted in some overall improvements in transparency, corruption remains endemic. Chinese officials themselves admit that corruption is one of the most serious problems the country faces, and China's new leadership has called for an acceleration of the country's anticorruption drive with a focus on closer monitoring of provincial-level officials. According to Chinese state media sources, China launched an anticorruption campaign in 2006 targeting Communist Party of China officials and so far has punished more than 97,000 party officials.

In July 2004, China implemented a new Administrative Licensing Law. This law is designed to increase transparency in the licensing process, an area that has long served as a source of official corruption. This law seeks to ensure the reasonable use of administrative licensing powers to protect the interests of corporations and individuals and to promote efficient administrative management by requiring government agencies to set up special offices for issuing licenses and to respond to applications within 20 days. Since its 2004 implementation, the law has increased transparency in the licensing process, while reducing procedural obstacles and strengthening the legal environment for domestic and foreign enterprises.

China issued its first law on unfair competition in 1993, and the central government continues to call for improved self-discipline and anticorruption initiatives at all levels of government. While the central government in recent years has pledged to begin awarding contracts solely on the basis of commercial criteria, it is unclear how quickly, and to what extent the government will be able to follow through on this commitment. U.S. suppliers complain that the widespread existence of unfair bidding practices in China puts them at a competitive disadvantage. This dilemma is less severe in sectors where the United States holds clear technological or cost advantages. Corruption nevertheless undermines the long-term competitiveness of both foreign and domestic entities in the Chinese market.

Land Issues

China's constitution specifies that all land is owned in common by all the people. In practice, agricultural collectives, under the firm control of local Communist Party chairmen, distribute agricultural land to the rural poor, while city governments distribute land for residential and industrial use. The State and collectives can either "grant" or "allocate" land-use rights to enterprises in return for the payment of fees. Enterprises granted land-use rights are guaranteed compensation if the State asserts eminent domain over the land, while those with allocated rights are not. Granted land-use rights cost more, not surprisingly, than allocated rights. However, the law does not define standards for compensation when eminent domain supersedes granted land-use rights. This situation creates considerable uncertainty when foreign investors are ordered to vacate. The absence of public hearings on planned public projects, moreover, can give affected parties, including foreign investors, little advance warning.

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

China’s National People’s Congress passed a Property Rights Law on March 16, 2007, the first comprehensive legal protection for private property since the founding of the People's Republic in 1949. This law, which generated years of controversy in the Chinese government but was never published in draft form, grants equal legal protection to private, state, and collectively-owned property. This protection would cover the “means of production,” such as factories, but agricultural land would remain a collective possession subject to 30 year leases. It is unclear at this time how the law will be implemented.

Given the scarcity of land resources in China, the price of land-use rights and land allocation are important considerations from both a market access and competition standpoint and from the perspective of their effect on production and trade. It is therefore of some concern to the United States that the Chinese government is recentralizing control over land administration, with the objective, in part, to ensure that land use-rights are allocated in accordance with a compulsory national land-use plan and state industrial development policies.