



**China's WTO Implementation:
An Assessment of China's Third Year of WTO Membership
Written Testimony by the US-China Business Council
Prepared on September 7, 2004**

**Submitted in response to the Office of the USTR's
Request for Comments and Notice of Hearing Concerning China's Compliance with
World Trade Organization (WTO) Commitments
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The US-China Business Council (USCBC/the Council) is pleased to provide the Office of the US Trade Representative (USTR) with the following assessment of China's compliance with its WTO commitments in its third year of WTO membership. Issues related to China's WTO entry have been integral to USCBC work for more than a decade as part of broader efforts to help US member companies succeed in the China market. The Council has systematically tracked implementation efforts since China acceded to the WTO on December 11, 2001, and the Council's WTO Working Group has met quarterly since then to discuss problems and progress. This report is not intended to be comprehensive, but rather to highlight for USTR key developments of particular significance to USCBC members. The contents of this report combine the analytical perspectives of US-China Business Council staff with a synthesis of responses from selected Council member companies to a "Year Three WTO Implementation Survey" distributed to the Council's membership in July 2004.

Because the annual reporting cycle of the Trade Policy Staff Committee and USTR focuses on submission of an Administration report to Congress on China's WTO implementation each December 11 (the anniversary of China's the WTO entry), the testimony submitted by the US-China Business Council to the TPSC each year is dated about three months before the anniversary of China's accession. Thus, the period under review in each annual USCBC report covers roughly three months of the preceding "WTO Membership Year" and nine months of the current "WTO Membership Year." It is thus not possible for the Council – or the administration in its report to Congress – to evaluate China's implementation progress on a current "Membership Year" basis. Experience has shown that in many cases China's WTO implementation actions take place on, or very close to, the December 11 deadline for successive annual phase-ins.

I. Executive Summary

- China has made considerable progress on implementation of its WTO commitments in its third year.

- Respondents to a US-China Business Council survey of its member companies in August 2004 rated China's implementation efforts a "5" on a 10-point scale. While this represents a modest improvement over last year's comparable response, it also reflects continuing concern in many areas.
- On the positive side, China implemented tariff cuts on January 1, 2004 in line with its WTO commitments, issued a law and regulations that will open trading and distribution rights to all foreign companies by the end of the year, granted operational licenses to foreign companies to engage in non-bank auto finance, and proceeded on schedule with required geographic phase-ins in banking and insurance. At the US-China Joint Commission on Commerce and Trade (JCCT) meeting in Washington, April 2004, China rescinded an earlier policy decision imposing discriminatory value-added tax (VAT) on semiconductor imports that led the US to initiate a complaint against the PRC at the WTO in Geneva. China also pledged at the JCCT to act on key items on the US agenda in regard to improving intellectual property right (IPR) protection, and followed up in early September with announcements of an intensive, multi-agency effort on IPR enforcement. China has actually exceeded its WTO commitments in one area by opening the convention services market to wholly foreign-owned enterprise participation.
- In several other areas, China has not fully implemented its WTO commitments. Foreign-invested joint ventures (JVs) continue to experience difficulty registering for trading rights even though these rights were to be extended to majority foreign-invested JVs on December 11, 2003 and to minority JVs one year earlier. Many tariff-rate quotas (TRQs) continue to be monopolized by state-owned trading companies, particularly in agriculture, despite China's WTO commitments to license and make allotments available to non-state traders. Moreover, persistently ineffective enforcement of IPR, continuing use of sanitary and phytosanitary standards in agricultural commodity trade as a non-tariff trade barrier, and ominous new regulations governing participation in the construction, engineering, and urban planning services markets have raised very serious concerns over the past year.
- USCBC member companies identified the following issues, listed below in order of priority, as their major interests and/or concerns as of August 2004; they are discussed in greater detail later in this paper:
 1. Distribution Rights (ability to distribute product to wholesalers, retailers, and end-users within China)
 2. Intellectual Property Rights: Enforcement
 3. Trading Rights (ability to import and export product)
 4. Non-tariff measures (quotas, licenses, tendering requirements)
 5. Intellectual Property Rights: Legal Framework
 6. Transparency
 7. Specific Market Access Services Commitments
 8. Standards, Technical Regulations, and Conformity Assessment
 9. Taxation

10. Customs and Trade Administration (classification, valuation, rules of origin)
11. Non-discrimination / National Treatment

II. Major Positive Development over the Past Twelve Months

Distribution: The Ministry of Commerce (MOFCOM) in April issued the Regulations on Management of Foreign Investment in the Commercial Sector, which clear up a Year 2 implementation shortfall and promise to extend distribution rights to all foreign companies by December 11, 2004. The Regulations specify how foreign-invested enterprises (FIEs) will be able to establish retail, wholesale, and commission agent service operations. Additional regulations are expected later this year to address franchising and retail away from a set location (direct selling).

Trading Rights: China's new Foreign Trade Law, issued in April 2004, provides the legal framework under which foreign-invested companies in China will be able to exercise their WTO-mandated trading rights on December 11, 2004. The law effectively brought China into compliance with its accession timetable after it missed the December 11, 2003 deadline to extend trading rights to majority foreign-invested joint ventures. In May, MOFCOM circulated draft implementation rules that were finalized on June 19 as the Rules on Registration for Trading Rights.

Transparency: MOFCOM instituted provisional regulations on administrative transparency in its own rulemaking processes in November 2003 and has routinely circulated drafts for public comment since, thereby serving as a role model for other government agencies. While other agencies have not formally followed suit yet, some companies have noted an increased willingness on the part of government officials in other central and local government agencies to discuss pending regulations.

While not specifically related to WTO commitments, the Administrative Licensing Law enacted July 1, 2003, when fully implemented, will make a major contribution to reducing procedural obstacles, increasing transparency, and the strengthening of the legal environment for foreign and domestic businesses.

Tariff-Rate Quotas (TRQs): While this issue is still of great concern (see IV, 4 below), China's agreement, following consultations with Agriculture Secretary Veneman in April 2004, to name TRQ-holder companies upon written request from a foreign company represents a step forward.

Banking: The easing of geographic restrictions for bank branching and domestic currency business is in line with commitments. The Implementing Rules for the Administrative Regulation of Foreign-Invested Financial Organizations, issued in July 2004, lowered minimum registered capital requirements and removed the restriction that only one new branch could be opened every twelve months.

Securities: Foreign interests may hold a 33 percent stake in ventures underwriting A, B, and H-share listings and trading B- and H-share listings as well as government and corporate debt issues. China appears to be on track to increase the permitted foreign equity stake in securities ventures to 49 percent on December 11, 2004.

Insurance: China is abiding by its WTO entry commitments in the area of phased expansion of geographic openings for insurance services. The China Insurance Regulatory Commission in May 2004 issued the Implementing Rules on the Administration of Foreign-Invested Insurance Companies, which streamlined application processes, shortened approval times, and lowered capital requirements for branching. Concerns remain with regard to branching in non-life insurance (see IV, 7 below).

Automobile Finance: China established the rules governing automobile finance in late 2003, and the China Banking Regulatory Commission issued licenses for non-bank financial institutions to engage in automobile financing in August 2004. A number of major international automakers have now taken steps to open auto-finance operations. The regulations, however, added little clarity on such key issues as assessing purchaser creditworthiness and questions relating to repossession rights and dispute settlement.

Advertising: Although wholly foreign-owned enterprises are not scheduled to be able to engage in advertising services until December 11, 2005, the fact that firms have been able to enter the market earlier by using the Closer Economic Partnership Agreement between Hong Kong and the Mainland augurs well for future development of foreign participation in the advertising industry.

Convention Services: China exceeded its commitments on foreign participation in the domestic convention services market in February 2004 when MOFCOM opened convention services to wholly foreign-owned enterprise participation. China only committed to permitting majority foreign-invested joint ventures in convention services, which it implemented upon accession in December 11, 2001.

III. US-China Business Council Survey

In July and August 2004, the USCBC conducted a survey of member company views on China's implementation of its WTO commitments to date. Thirty-five percent of the USCBC's 231 active member companies provided input to this year's survey.

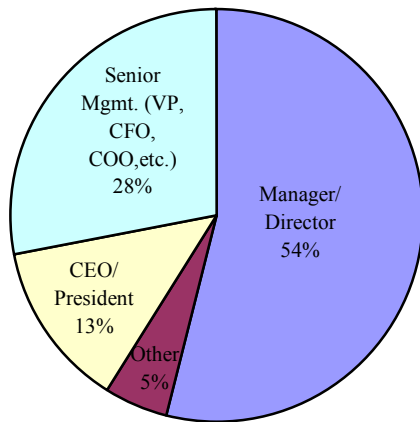
The Council notes this year that a number of member firms declined to respond to the questionnaire, indicating that questions of WTO compliance are losing saliency as China continues to evolve in the direction of a "normal" business environment. Furthermore, 19 percent of the companies that did participate provided only partial responses, explicitly stating that the WTO either does not directly address the concerns of their industry or that their company already has operational "workarounds" in place in areas of specific interest.

Of those responding, 92 percent said that their business is affected by China's WTO commitments, and 80 percent said that they are significantly affected.

On a scale of 1 (excellent) to 10 (failure), USCBC member companies gave China's WTO implementation efforts to date an average unweighted score of 5.0. While the Council's survey results are admittedly unscientific, the broad pattern of company responses suggests that, while China's implementation efforts have not exceeded respondents' expectations, China is making satisfactory progress toward fulfillment of its WTO obligations.

Responses were roughly evenly split geographically with 51 percent of complete questionnaires coming from the United States, 49 percent from China (including Hong Kong), and less than 1 percent from elsewhere in Asia.

Respondent Profile:



Respondent Industry:

Manufacturing	45%
High Tech	12%
Distribution/Logistics	10%
Other Services (i.e., construction, education, etc.)	10%
Financial Services	9%
Professional Services	5%
Agriculture	3%
Energy & Natural Resources	3%
Pharmaceuticals	3%

IV. Areas of Continuing Concern:

The survey asked USCBC companies to rank their top WTO-related concerns. The following table, showing the ranked responses from 2003 and 2004, offers suggestive comparisons.

Issue	Weighted Score	Year 3 Rank	Year 2 Rank
Distribution Rights (ability to distribute product to wholesalers, retailers, and end-users within China)	120	1	3
Intellectual Property Rights: Enforcement	96	2	5
Trading Rights (ability to import and export product	95	3	1
Non-Tariff Measures (quotas, licenses, tendering requirements)	89	4	6
Intellectual Property Rights: Legal Framework	87	5	10B
Transparency	77	6	2
Specific Market Access Services Commitments	71	7	8

Standards, Technical Regulations, and Conformity Assessment	60	8	4
Taxation	55	9	12
Customs and Trade Administration (classification, valuation, rules of origin)	49	10	10A
Non-Discrimination / National Treatment	47	11	9

1. Distribution Rights:

This issue will remain of primary importance to foreign enterprises in China until implementing regulations are issued and the government has clarified several outstanding issues such as whether companies will be required to establish an independent subsidiary in order to distribute products outside the scope of business defined in their existing business licenses. Companies still eagerly await implementing regulations for distribution services generally as well as specific regulations on franchising and direct selling (sales away from a fixed location). Numerous reports have suggested that preliminary regulations on direct selling may appear as early as September.

2. Intellectual Property Rights: Enforcement; and

5. Intellectual Property Rights: Legal Framework

Last year's USCBC testimony stated that China had failed to enforce patent, trademark, and copyright protections effectively. The fact that these two issues have jumped from last year's respective rankings of #5 and #10 reflects the widespread perception that the problem is worsening. Lack of transparency and coordination among government agencies, local protectionism and corruption, high thresholds for criminal prosecution, and lack of resources and training all hinder enforcement.

In early September, the State Council inaugurated an intensive twelve-month campaign, under the leadership of Vice Premier Wu Yi, aimed at integrating the work of dozens of government agencies to combat intellectual property abuse in fifteen provinces and cities deemed to be the locations of the most serious abuses. Initial descriptions of the effort, including remarks by Vice Premier Wu herself, suggest that the magnitude and complexity of the task is well understood at the central level, and that concentrated efforts to bring about bureaucratic changes at provincial and local levels will form the core of the campaign. The US business community welcomes this demonstration of central government determination to arrest the epidemic of IPR abuse, but will withhold judgment pending evidence of the campaign's results.

Though China continues to make important legislative efforts to combat copyright piracy and trademark counterfeiting, piracy and counterfeiting at the wholesale and retail level, and over the Internet, remain rampant. Delays in the transfer of cases from administrative bodies to judicial organs also cause problems for US companies.

3. Trading Rights:

Concern has increased given reports that majority foreign-invested joint ventures have encountered difficulty registering for trading rights at the local level.

4. Non-Tariff Measures:

China committed to license and to allocate tariff-rate quotas (TRQs) for fertilizer imports (notably DAP) to non-state trading companies. These TRQs remain concentrated under two state-owned trading companies. State trading companies similarly monopolize quotas for wheat and corn.

China's WTO accession protocols do not set import quotas for soybeans; instead, China appears to be managing trade in soybeans through a combination of import permits and phytosanitary measures. The General Administration of Quality Supervision, Inspection, and Quarantine's Decree Number 73 has recently been used to refuse cargoes of soybeans at Customs for phytosanitary reasons.

China continues to impose export quotas and licensing fees on fluorspar in contravention of the general WTO prohibition against export restrictions.

6. Transparency

As noted above, 2004 showed improvements, particularly on the part of the Ministry of Commerce.

Transparency problems remain, however, according to Council members in their survey response. Comment periods on laws and regulations, were often too short for companies to organize feedback. Further, notifications to the WTO of new regulations that affect trade have been vague, and translations of such rules into WTO languages often take months. The Council also notes that the Ministry of Information Industry, responsible for drafting China's Telecommunications Law, has purportedly already submitted the draft law to the State Council's Legislative Affairs Office, without publicly circulating it.

7. Specific Market Access Service Commitments:

While China has implemented some of its service commitments in full and on time, USCBC companies have concerns about some specific services commitments.

Service Industry	Concerns:
Insurance	China's capitalization requirements, although lower under new rules issued in May, remain high and prudentially unjustifiable. US insurers need further clarification of how foreign insurance companies will be allowed to branch and whether sub-branching will be permitted. Guaranteed branching rights for non-life insurers remains an unrealized but important desideratum for US firms. Language within the May rules does not allow for concurrent branch expansion by competing providers but will force consecutive approvals subject to government interpretation of the

	development of the overall insurance market and industry rather than individual company resources and objectives.
Auto Finance	Capitalization requirements remain well above of those imposed in other countries and a lending limit of 200 percent of registered capital restricts the availability of auto dealers to satisfy demand for their services.
Telecommunications	<p>The Ministry of Information Industry (MII) must meet a critical deadline in 2004 to demonstrate its ability to fulfill the country's WTO commitments in telecom services. China's third-year commitments, due to take effect December 11, 2004, include raising the ceiling on foreign joint venture participation in mobile voice and data services to 49 percent and opening fixed-line basic telecom services among Beijing, Shanghai, and Guangzhou to joint ventures with up to 25 percent foreign equity participation.</p> <p>The National People's Congress must still read the draft Telecommunications Law three times before it can become law, calling into question the ability of the government to meet its commitments on time.</p>

8. Standards, Technical Regulations, and Conformity Assessment:

US companies continue to express frustration about their lack of access to China's standards-setting process. No formal mechanism exists for foreign companies to participate in the development of standards in China. The standards development process remains opaque and comment periods on pending standards, when offered, are often too short to allow meaningful response. Currently, new standards approvals are on hold as the Standardization Administration of China (SAC) rationalizes the country's existing corpus of 20,000 national standards with the aim of repealing as many as 40 percent that are either outdated or WTO inconsistent.

Greater coordination is still needed between the State Administration of Quality Supervision, Inspection, and Quarantine and PRC Customs. Since China implemented new China Compulsory Certification (CCC) mark requirements in August 2003, US companies have continued to report inconsistent application at China's ports. Shipments of imported products not requiring a CCC mark have been denied entry, adding expense and delay.

9. Taxation:

During the first half of the period covered by this report, China's employment of discriminatory VAT policies to protect domestic semiconductors from import competition, in apparent violation of General Agreement on Tariffs and Trade Article III, led the United States to inaugurate a WTO dispute resolution case against China. An agreement at the April 2004 US-China Joint Commission on Commerce and Trade meeting in Washington brought the matter to a satisfactory conclusion. The year under review saw no progress, however, on China's VAT policies regarding DAP fertilizer.

10. Customs and Trade Administration:

Council member companies continue to report uneven and unpredictable customs enforcement at different ports. Other issues of concern to US companies include:

- Customs rules prohibiting the use of China-source components in manufacturing and distribution operations located within foreign-trade zones;
- Import restrictions for used products, a barrier to trade in many industries. This is particularly so for remanufactured products, which are unjustifiably classified as “used” based on design and manufacturing process criteria rather than WTO-consistent performance standards.

11. Non-Discrimination and National Treatment

Several American companies’ responses to the USCBC survey suggest widespread concern that progress remains slow in regard to the core WTO principles of non-discrimination and national treatment. In addition to the VAT concerns discussed above, import-licensing procedures, most notably in agriculture, favor goods bound for export processing over those ultimately bound for the domestic market.

China’s Automobile Industry Development Policy, released in June, makes manifest the Chinese government’s determination to protect and promote domestic industry. (See numbers 2 and 3 under Section IV below.)

V. Additional Observations – Areas of Potential Concern:

1. “Rollback” Concerns:

The US business community and the US government must remain vigilant with regard to new regulations that actually diminish, rather than increase, the opportunities for international firms, including American companies, to operate effectively in China.

New regulations governing the activities of international engineering and construction firms have led to widespread concern that the ostensible opening of this important sector will make it more, rather than less, difficult, for foreign firms to operate. The recently promulgated Decrees 113, 114, and 116 of the Ministry of Construction, if fully implemented, will impose licensing requirements that foreign companies, in particular, will find difficult if not impossible to meet.. As written, the new decrees represent a deterioration of the regulatory environment for international firms compared with the situation under “Decree 32,” which governed the industry before China entered the WTO.

US firms in the express mail sector are also very concerned that currently circulating draft amendments to the Postal Law of China would create a more restrictive and burdensome environment for international firms seeking to operate in the express delivery sector. The Conference of Asia Pacific Express Carriers has expressed its detailed views on these questions.

2. Customs Classification and Duties as a Proxy for Trade-Related Investment Measures (TRIMs):

Proposed reclassification of high-value auto parts, assemblies, complete knocked down (CKD) and semi-knocked down (SKD) kits as “finished” goods would subject them to significantly higher customs duties. That would impede foreign manufacturers’ ability to import such sub-assemblies, thus indirectly but effectively coercing companies to localize production in a fashion inconsistent with China’s accession to TRIMs.

3. Auto Industry-Specific Distribution Regulations:

Article 34 of the Automobile Industry Development Policy raises the possibility that China will issue regulations requiring the creation of separate distribution channels for domestically produced and imported automobiles, as well as for automobiles produced by different joint ventures or bearing different brand names.

4. High Capitalization Requirements:

Although industry pressure has led to some improvement for the insurance industry, the apparent trend indicated by China’s imposition of high capitalization requirements in insurance, banking, and auto finance is not promising. Attention needs to be given to ensuring that prudentially unjustified capitalization requirements do not become barriers to entry in other service sectors such as distribution and telecommunications.