

THE US-CHINA BUSINESS COUNCIL

美中贸易全国委员会

**China's WTO Implementation:
An Assessment of China's Fourth Year of WTO Membership
Written Testimony by the US-China Business Council
September 14, 2005**

**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
(Federal Register, Pages 44714-44715, August 3, 2005)**

China's entry into the World Trade Organization (WTO) has benefited American businesses. The accession agreement has introduced significant market openings in China and, as a result, US companies enjoy far greater market access than they did five years ago. China has cut import tariffs by nearly 40 percent; virtually eliminated import licenses and quotas; relaxed ownership restrictions on American businesses operating there; and allowed American companies to participate in many sectors in which they were previously prohibited.

The initial results have been undeniable: American exports increased 81 percent in the three full years since China entered the WTO on December 11, 2001, compared with 34 percent growth in the three years prior to accession. Over the last five years, US exports to China have more than doubled, and grown five times faster than exports to our second-fastest-growing export market, Belgium. China, when combined with Hong Kong, became America's fourth-largest export destination last year; in the first six months of this year, China and Hong Kong passed Japan to become our third-largest export market, exceeded only by our free-trade zone neighbors, Canada and Mexico.

China's imports overall have slowed through the first half of 2005; American exports to China have increased by only 10 percent versus the same period in 2004. We will be watching US exports in the second half of this year before drawing conclusions, but for now note our continued attention to US export performance as a critical component in assessing progress in our bilateral trade relationship.

Even with the moderation in this year's export growth, the impressive overall gains to date have occurred in just the first three years of China's WTO membership. American companies are only now realizing many of the phased-in market openings. Significant additional openings, mostly in services, where American companies have strong competitive advantages, are yet to come. We therefore expect that as China continues to open its market, American goods and services companies will increase their sales and operations there, thus bringing real economic benefit to the United States.

That is not to say that challenges do not exist—they do, and as this testimony will describe, some are significant. We must remain diligent and persistent in pursuing China’s full implementation of its WTO obligations—both in letter and spirit. Doing so is the best way to pursue the level playing field the United States seeks in our trade relationship with China.

Our testimony is based upon contributions from our 250 member companies and will focus on China’s implementation record over the past year. The US-China Business Council (USCBC) is the leading organization of American companies doing business with China. We have been tracking America’s trade performance with China for our entire 32-year history, and that long record creates a unique ability and depth of knowledge to assess China’s trade regime.

OVERVIEW

One of the vital components of a healthy business environment is certainty and predictability. China’s WTO accession agreement provided the roadmap for just such an environment to develop, and US companies expect that China will honor the commitments in that agreement.

Table 1: Most Significant WTO Commitments

Commitment	% of Responses
Tariff/duty reductions	28
Financial services	19
Trading/distribution rights	14
Intellectual property rights (IPR)	9
Foreign ownership/investment	6
Direct selling rights	3
Energy beyond petroleum	3
Market access generally	3
Right of establishment	3
Transparency	3
Other	9

Table 2: Most Significant WTO Shortfalls

Shortfall	% of Responses
Trading/distribution rights	32
IPR enforcement	19
Local content requirements	13
Market access	6
WTO commitments still pending	3
Construction	3
Direct selling	3
General barriers to trade & competition	3
Lack of bankcard law	3
Local branching	3
Transparency	3
Other	9

China has generally continued to make progress in its WTO implementation efforts this year. In a survey of USCBC member companies conducted this summer, 75 percent of respondents indicated they viewed China’s WTO entry as important to their companies’ operations and objectives, and cited the required tariff reductions as the most significant commitment China has made to date. The full report of USCBC survey results is attached to this testimony.

Thanks in part to its WTO accession, China has also made notable strides in strengthening its economy and improving its legal environment, both of which give USCBC members hope that China’s market will continue to move toward the certainty and predictability that they expect from healthy, competitive economies.

On the other hand, as the tables on the left and on page 6 show, companies view enforcement of intellectual property rights (IPR),

distribution rights, local content requirements, and transparency as the most important commitments that China has failed to implement fully. USCBC members have also noted backtracking in key sectors such as automobiles, construction, and media. This backtracking may indicate that Chinese officials believe that they have made enough significant progress on WTO compliance that they can now yield to domestic pressures to protect vulnerable industries. There are also signs that the leadership may be becoming more aggressive in developing regulations

that violate the national treatment principles of WTO, as several recent regulations appear designed to advance the interests Chinese companies at the expense of foreign competitors.

Overall, USCBC survey respondents rate China's implementation of its WTO commitments to date as either "fair" (57 percent) or "good" (38 percent). This is consistent with the results of previous years' surveys, when members gave China a middling grade on its implementation efforts. While none of our surveyed companies this year said China had done an excellent job in implementing its WTO commitments, only 5 percent indicated they viewed China's efforts as poor. However, a "fair to good" performance rating of China's WTO implementation is not good enough. China must fully implement all its WTO obligations.

This evaluation of China's WTO implementation hints at the growing complexity of our trading relationship with China. USCBC members say China is in compliance with the major elements of its WTO obligations, but observe that in some cases China does not embrace the spirit of the WTO's tenets. Council members urge China to step up its efforts to create a truly open economy by fully implementing or even going beyond its WTO commitments to achieve meaningful market access.

POSITIVE DEVELOPMENTS IN CHINA'S IMPLEMENTATION

USCBC member companies report that China's business environment has generally improved as its market develops, its economy grows, and it gradually but steadily introduces the rule of law. We first highlight positive developments over the past year in China's implementation of its WTO obligations.

Goods

Tariff reductions are a critical component of China's WTO agreement and, to the best of our knowledge, China is meeting its obligations on time. China's import tariffs have been reduced from an average of 15.3 percent at the beginning of 2001 to an average of 9.4 percent at the beginning of 2005. Tariffs on information technology products, such as computers, semiconductors, and telecommunications equipment, dropped to zero at the beginning of this year from an average of 13.3 percent. These meaningful changes result in greater market access for American companies.

In agriculture, tariff-rate quota (TRQ) amounts for palm, rapeseed, and soybean oil rose 17.3 percent, 10.3 percent, and 15 percent, respectively, on January 1, 2005, when they reached their final quota rate. Accordingly, more products are now imported at lower tariff rates. In contrast to previous years' surveys, no USCBC member company cited the administration of China's TRQ system as an area of concern.

China's WTO entry agreement required it to allow foreign-owned and domestic companies to directly import and export goods as of December 11, 2004 ("trading rights"), as opposed to dealing through designated PRC trading companies. This commitment has been met. US companies need only register for trading rights to secure their ability to do so, and none of our

members reports problems in registration. The ability to distribute these imported goods in China still has unresolved aspects, which we will address below.

Services

In its WTO entry agreement, China committed to important openings in the service sector that, when properly implemented, will provide greater market access for US companies and their products. A “scorecard” of China’s implementation of its December 11, 2004 service commitments is attached that details the areas of progress in services, but several specific developments should be noted.

The implementation of laws allowing wholly foreign-owned enterprises (WFOEs) in various sectors has been well received by US companies wishing to maintain control of their operations without Chinese partners. New regulations have permitted WFOEs in storage and warehousing enterprises and in freight transportation services. Draft rules permitting wholly foreign-owned franchising operations were circulated for comment before they took effect just prior to January 1, 2005. In an indication of the increased market access stemming in part from China’s implementation of its WTO commitments, some 75 percent of foreign investment in China is now in 100 percent foreign-owned companies.

Financial services companies report progress in certain aspects of their operational and regulatory environment. In early December 2004, China opened not only the three cities scheduled to open to foreign banks’ provision of local-currency services (Beijing; Kunming, Yunnan; and Xiamen, Fujian), but also opened Shenyang, Liaoning; and Xi’an, Shaanxi, ahead of schedule, bringing the total number of cities open to foreign banks’ services to 18. US banks anticipate further expansion opportunities at the end of 2006, when China is scheduled to lift remaining restrictions on foreign banks. And in a moment of transparency, the People’s Bank of China released for public comment draft regulations for payment and processing organizations.

China implemented on schedule its WTO commitments to allow foreign-invested insurance enterprises to provide health, group, and pension/annuities insurance to both foreign and Chinese clients. The improved market access and removal of geographic restrictions that followed China’s implementation of these WTO commitments have benefited foreign life insurers, as Chinese consumers have become more sophisticated and exposed to more insurance products. As a result, USCBC members report increasing demand from Chinese customers for insurance services. The China Insurance Regulatory Commission (CIRC) has recently been more transparent and accessible, agreeing to a US-government/business dialogue in April 2005 that had been on hold since 2003. CIRC also agreed to hold a second industry forum before the end of 2005.

As was the case when USCBC submitted its testimony to USTR in 2004, distribution rights—a core aspect of China’s WTO entry obligations—remain a top priority for our member companies. After a slow and confusing start in 2005, China progressed in a number of areas: issuing approvals for the establishment of standalone foreign-invested commercial enterprises to handle distribution activity; consulting regularly with industry on issues of concern; releasing clearer application and registration procedures; and extending distribution rights to foreign-invested

enterprises (FIEs) located in free-trade zones. At the July 2005 meeting of the US-China Joint Commission on Commerce and Trade (JCCT), China committed to accelerate the issuance of distribution licenses. Some important issues remain, however, as described below.

The publishing industry has also witnessed important regulatory reform, although control over content remains strict. In March 2003, China issued the Measures on the Administration of Foreign-Invested Distribution Enterprises of Books, Newspapers, and Periodicals, which took effect on May 1, 2003, earlier than required by the accession agreement. The Measures allow wholly foreign-owned enterprises in publication retailing and allow all forms of foreign investment in wholesale distribution from December 1, 2004. However, recent regulatory actions suggest that China might not comply fully with opening this sector, as described below.

Government Procurement

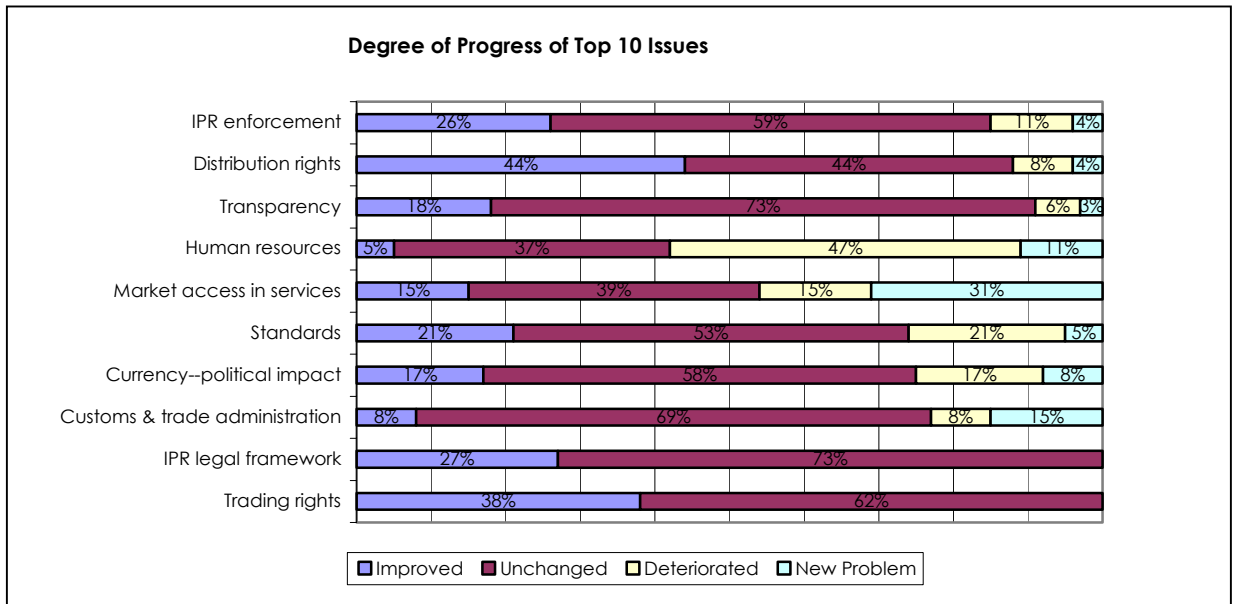
The United States and China made progress during the Joint Commission on Commerce and Trade JCCT meetings in July 2005 on the important issue of PRC government procurement of software. China agreed to delay indefinitely the release of proposed rules on government software procurement and seek public comment for revisions to these rules. The proposed rules were discriminatory and would have effectively prevented American software companies from participating in the only significant part of China's market that is not dominated by pirated product. China also committed to ensuring that government offices all use legitimate software and agreed to extend the program to include state-owned enterprises--a move that should increase software sales of US-based companies.

China also agreed to begin technical discussions on joining the WTO Government Procurement Agreement (GPA), which China committed to begin negotiations to sign "as soon as possible" at the time of its accession to the WTO. This is an important step to move China toward implementing rules that will ensure open and non-discriminatory government procurement. Getting Beijing to sign the GPA is a top priority for US government and industry to impress upon our counterparts in China.

AREAS OF CONCERN

China's progress in implementing its WTO commitments in these areas should be acknowledged and commended. Nevertheless, China's implementation in some areas has lacked the degree of commitment and coordination that PRC authorities have shown in other sectors. Some of these concerns are specific to China's accession agreement, while others center on China's apparent reluctance to embrace key underlying tenets of WTO principles. In short, China still has work to do to comply fully with the letter and the spirit of the WTO.

In the survey of our membership, we asked companies to indicate their top issues related to doing business in China and the degree of progress made in resolving these issues over the past year. The results are in the chart below. While the responses were not limited to WTO-related issues, the list of issues indicates that WTO implementation problems make up the bulk of the top 10 concerns cited by businesses.



Intellectual Property

The creation and enforcement of a workable legal framework for the protection of intellectual property rights (IPR) is now the most important problem facing USCBC members. Others testifying will likely provide specific details on China's shortcomings in meeting international standards of IPR enforcement in various industry sectors. The bottom line is that China is well aware of the international community's interest in seeing the rights of patent, copyright, and trademark holders properly enforced, but has yet to ensure that those rights are adequately protected within China and to curb the export of counterfeit products to other countries, including the United States.

IPR problems affect a broad range of industries: Media, software, publications, industrial goods, consumer goods, pharmaceuticals, and even food products are all affected. The media industry serves as one example. China permits only 20 foreign films to be imported for screening in PRC cinemas each year; such a low number of foreign films available to Chinese consumers through legitimate channels contributes to the rampant piracy of films in DVD format throughout China. China's cities are to a great extent open markets for illicit DVDs, VCDs, music CDs, and video games.

Intellectual property rights violations and these limitations on market access in the media sector constitute the greatest impediment to the development of a healthy Chinese media and entertainment industry. The situation has hurt not only American businesses, but domestic participants as well. Without a proper, functioning market where intellectual property rights are respected and laws are enforced, investment will remain depressed, content quality will continue to suffer, and the Chinese public will be left to turn to the black market.

Although an inefficient enforcement system and exceptionally low penalties for violators are the most obvious contributing factors, the large market for pirated media products is also partly the

result of limits on market access for legitimate products that place legitimate supply far below consumer demand.

Internet piracy has emerged as yet another major challenge. The increase in broadband penetration in major Chinese cities has fueled the rise of a wide range of illegal products and services that violate copyright protections, particularly those for films. Furthermore, the emergence of China as an exporter of pirated DVDs has resulted in thousands of Chinese-made illicit copies of the latest American movies being sold globally.

China issued a judicial interpretation in December 2004 that sought to widen the application of criminal penalties, provide guidelines for punishment, expand copyright laws to cover Internet-based piracy, and establish criteria for culpability. In our survey, we asked our members about the impact of the judicial interpretation. Roughly half of the respondents said they had seen some improvement in enforcement as a result of the judicial interpretation but a similar number said they had seen no improvement.

At the July 2005 JCCT meetings in Beijing, China made further commitments on IPR, including increased criminal prosecutions and the criminalization of exporting counterfeit goods. China also agreed to accede to the World Intellectual Property Organization Internet treaties by June 2006 and combat Internet piracy. These pledges are welcome, but real progress will depend on the successful implementation of these commitments by government agencies.

Distribution Rights

Despite the previously mentioned areas of progress in the implementation of distribution rights, problems remain.

Existing foreign-invested manufacturers have long sought the ability to import or source in China products they can sell alongside the products they make in-country. The Management Rules on Foreign Investment in the Commercial Sector (the “Rules”) issued in April 2004 extended, on paper, distribution rights to these companies by allowing them to expand their business license to incorporate this activity.

FIE manufacturers found this year that China’s Ministry of Commerce (MOFCOM) was not accepting applications to revise business licenses. One reason was that China was uncertain about how to address the tax treatment of these entities. Foreign manufacturers have long been offered tax holidays to encourage investment; China’s tax authorities were reluctant to extend these tax breaks to “buy-sell” activity. The resulting policy has been to allow these existing manufacturing FIEs to continue to enjoy tax breaks if the buy-sell component of their business remained under 30 percent of the FIE’s total revenues; FIEs whose buy-sell activity exceeds 30 percent of their total revenues will lose the tax holiday. While MOFCOM has now begun issuing approvals of revised business licenses on this basis, companies are uncertain about implementation, leading many to delay their applications.

In addition, FIEs whose scope of business includes distribution are apparently limited to distributing products “similar” to those they already manufacture in China; the April 2004 Rules

and, in our view, the intent of the WTO commitments in this area contemplated no such product limitation. While the unofficial guidance is that Customs classification categories will determine “similar” products, uncertainty prevents uniform implementation of distribution rights throughout the country. This inconsistency across local government agencies in interpretation of the regulations extends to other aspects of the realization of distribution rights.

Franchising: PRC authorities permitted foreign-invested franchise operations at the end of 2004, after soliciting comments on draft rules. However, the final version of the regulations placed numerous restrictions, such as high capital contributions and local presence requirements, on foreign companies wanting to access the China market via this business model.

Retail and wholesale pharmaceuticals: Regulations that allow foreign companies to retail or wholesale pharmaceuticals have not materialized even though the Rules explicitly state that separate regulations for pharmaceuticals would be issued. MOFCOM recently informed the USCBC that it is now approving foreign pharmaceutical retail and wholesale WFOEs using both the general Rules and State Food and Drug Administration Rules on the Management of Drug Business Licenses. We hope this now allows pharmaceutical companies to enjoy distribution rights, but the lack of regulatory clarity has caused delay and confusion for pharmaceutical companies that want their products exported to and distributed in China.

Direct selling: Regulations for direct selling, which were supposed to be issued by December 11, 2004, were only approved by the State Council in early August 2005, according to press reports. The USCBC, as of submission of this testimony, has not seen the final rules. The regulations may take effect in September 2005—more than nine months late. There are indications that the regulations include provisions such as high capitalization requirements, limits on the number of sales and marketing tiers, and minimum years of experience in a given industry. More important, there are reports that the regulations will, by limiting the number of sales tiers, prohibit recruiting incentives that are standard in the industry. These proposed provisions not only ignore international practices for direct selling, but also ignore comments that foreign direct sellers submitted directly to PRC regulators. While the issuance of regulations may comply with the letter of China’s WTO obligation, limitations that prevent international practice effectively prevent meaningful market access.

Media: In audiovisual services, China has, per its WTO accession agreement, allowed minority foreign participation in cinema operations. In January 2004 the State Administration of Radio, Film, and Television went beyond the original commitment, permitting up to 75 percent foreign ownership in selected cities. Recently, however, new measures appear to have rolled back these market access gains, restricting foreign companies to minority stakes in cinema management companies. Such backtracking is of significant concerns to US media companies.

Transparency

USCBC member companies in 2005 ranked transparency as the third-most-important issue for their business in China, up from sixth the previous year. In this year’s survey, respondents noted that industry rules and regulations are regularly issued late, if at all, and frequently without adequate comment periods.

The concept of transparency is fundamental to creating the stable investment environment that international companies seek. It is an essential principle: national laws, regulations, decrees, and any type of administrative act should be published and interested parties notified prior to the issuance of, or changes to, a law. Merely notifying companies of a proposed change, but not being open to suggested modifications, does not constitute a transparent legal system. Lack of transparency creates an uncertain regulatory environment for companies attempting to do business in China, thus inhibiting the sale of US goods and services that WTO membership is designed to facilitate. The broad market successes US companies are enjoying today in China will be difficult to expand upon without the steady improvements in government transparency.

Transparency problems are pervasive and affect a wide variety of US companies operating in China. Several examples to illustrate this point:

- The reform and restructuring of China Post is occurring without input from industry, and new rules are being proposed without enough detail for companies to analyze the possible effects of the regulations.
- In the energy sector, lack of access to geological data and site history makes meaningful commercial evaluation of a project impossible. Opaque means of setting prices inhibits foreign companies from participating in resource sectors open to foreign investment.
- Long, complex, and unclear product registration processes impede the delivery of US goods to the Chinese market. In pharmaceuticals, registering a drug and obtaining production and sales permits involves numerous central, provincial, and local government bodies, many of which are uncertain about the scope of their authority or have differing interpretations of official procedures.
- In agriculture, regulators often fail to provide adequate comment or transition periods for companies to respond to and comply with proposed regulatory changes. The opaque issuance of quarantine inspection permits enables the State Administration of Quality Supervision, Inspection, and Quarantine (AQSIQ) to control or limit imports of US agricultural products.
- China's veiled dumping investigation procedures raise questions about its willingness to allow market forces to operate within formerly protected sectors. In a current dumping investigation into US exports to China of kraft liner board, for example, affected US companies have expressed concern about the transparency of the process, namely the openness of the decisionmaking process, adherence to technical rather than political considerations, and notification of pertinent decisions.

In all cases, lack of transparency acts as a significant nontariff barrier to US goods.

Market Access in Services

In many instances, PRC regulators are using a two-pronged approach to implement China's services commitments. As noted in our attached services scorecard, China often enacts basic laws that "allow" or "permit" new investment in previously restricted sectors as required by WTO commitments, but sets the bar for entry prohibitively high. American investors in China's

service sectors say these restrictions and the lack of transparency in the regulatory system prevent complete market openings.

Financial services: Regulations governing the financial sector are complex and confusing. For example, while China agreed to open its market to foreign banking services, including credit, charge, and debit cards; the regulations governing bankcards have yet to be implemented, however. Additionally, the slow pace of approvals for new branch banks has made it difficult for foreign entrants to access the market. Regulations, especially in the financial sector where investment is closely tied to a country's overall investment environment, should be transparent and clear and should allow for the development of a level playing field. This will be especially important as major financial service sector openings come due at the end of 2006.

Insurance: The opaque and confusing regulatory framework leaves foreign companies vulnerable to discriminatory treatment of their applications for new branches in additional provinces. Authorities are allowing domestic insurance companies to license new branches concurrently, but foreign companies' new licenses are approved only consecutively. Allowing concurrent branching of insurance companies in multiple provinces would ensure a level playing field. Moreover, undertaking the redrafting of the Insurance Law consistent with WTO transparency principles would help to clarify the investment framework for foreign insurers.

Telecommunications: On paper, China's WTO commitments for telecommunications have already been implemented. In reality, however, few foreign telecom companies have established operations because of high capital requirements. Moreover, the Ministry of Information Industry's (MII) reclassification of some services from value added to basic, its insistence that the value-added telecom service (VATS) operations listed in China's WTO commitments are exhaustive, and its narrow interpretation of what constitutes a VATS have limited the areas in which foreign companies can provide service. The absence of many US telecom and information-technology service companies in China underscores this point.

Express delivery: Draft amendments to the PRC Postal Law would restrict the types of packages express delivery operators are allowed to carry and would impose a new tax on those firms to support postal services. These actions would hinder the competitiveness of foreign express delivery firms.

The reform and restructuring of China Post is occurring without input from the private sector. Firms are unable to analyze and comment on the proposed changes, but are deeply concerned that China Post will be given competitive advantages in the express delivery market.

Construction: PRC authorities have published regulations allowing WFOEs in China's construction sector, but strict conditions for eligibility and high capital requirements pose a serious trade barrier to foreign engineering, procurement, and construction firms and consultancies. For example, high capital requirements, in place of financial bonding or foreign parent company guarantees, go against internationally accepted practice. Requiring foreign firms to apply for type-specific engineering certification prohibits the use in China of a widely practiced international business model. Residency requirements for foreign staff prevent

companies from staffing their China projects with the most qualified personnel, potentially leading to lost bids.

Standards

US companies continue to have problems with China's standards-setting process. As the USCBC noted in its 2004 testimony, the standards development process remains opaque and comment periods on standards when offered, are often too short to allow meaningful response.

The implementation of the China Compulsory Certification (CCC) standards mark still presents problems for US companies, with long delays for some firms to secure the mark or multiple tests for the same product. Such problems make it difficult for US companies to take advantage of new opportunities to sell their goods in China's market.

To facilitate foreign company participation in the formulation of standards, China should establish transparent and regular mechanisms that would provide for mandatory public comment periods of sufficient length, perhaps similar to US Federal Register guidelines. To hasten the standards approval process, China should commit to mutual recognition of testing administered overseas and accredit foreign standards organizations to conduct CCC inspections and audits.

Standards regulators have also resisted accepting longstanding international standards and practices. For example, AQSIQ's Decree 73 gives the agency unilateral authority to reject the sanctity of international agriculture sampling and testing procedures, placing both enormous risks and costs on exporters of US agriculture goods.

In addition to these important issues, new concerns have arisen regarding China's intentions in using the standards process to promote domestic industry at the expense of foreign companies. For example, in late 2004, the Standards Administration of China (SAC) issued a draft regulation on standards that appears to mandate the compulsory licensing of patented technologies that are used for national standards. The draft refers to "mandatory" or "irrevocable" licensing, and a May 2005 speech by an SAC official indicated that SAC envisions the regulation as stipulating compulsory licensing. Under such an arrangement, any company whose patented technology is used as the basis of a national standard may be required to grant a patent license to anyone who adopts the standard. Though this provision will likely have the greatest impact on technology companies, the language in the draft regulation could easily apply to the auto and consumer goods industries, among others. The SAC leadership will likely receive an updated draft of the regulation in September and issue the final regulation by the end of the year, so this problem requires immediate attention.

Customs and Trade Administration

PRC authorities understandably face numerous hurdles in streamlining and updating nationwide processes for tracking and regulating trade. In some instances, lack of education and training prevent effective and uniform implementation of China's customs and trade laws. For example, USCBC members have reported that Customs' Anti-Smuggling Bureau employees frequently fail to understand Incoterms, internationally accepted commercial terms that define the

respective roles and responsibilities of buyers and sellers in international transactions, such as sales agreements. Consequently, they enforce their incorrect understanding, rather than the actual law. As a result, goods are held up at port, have their tariff reclassified into higher brackets, or require additional paperwork, impeding US exports to China.

National Treatment/Local Content Requirements

Disregard of national treatment, a core principle of WTO membership, remains a problem for firms in China across a wide range of sectors. A majority of USCBC firms report no progress in this area in the past year. We have already noted national treatment concerns in the issuance of insurance branch licenses. An example of local content requirements is the reclassification of completely knocked-down and semi knocked-down auto kits into a higher tariff bracket, which has forced foreign companies to localize production and created a barrier to further market access for US-based automobile and parts makers.

Members also report that local Chinese competitors, including state-owned enterprises (SOEs), are subject to different regulatory standards than are foreign companies. This is vividly seen in the enforcement of environmental regulations that target foreign companies but ignore domestic PRC companies.

These problems indicate that PRC policies in some areas continue to offer domestic companies more favorable treatment than foreign competitors. At a minimum, these policies violate the spirit of China's agreement to treat domestic and foreign firms on an equal basis. Local content requirements and unequal standards for domestic and foreign firms create an unfair prejudice against foreign firms, which is contrary to the WTO's requirements for national treatment. This entrenched problem will require significant efforts that focus on each problem area in order to attain fair treatment for foreign goods and services in China.

AREAS OF CONCERN BEYOND WTO IMPLEMENTATION

Council members listed several areas of concern that, while outside the scope of China's WTO commitment, significantly affect market access overall and the ability of US companies to export to and invest in China. One particular issue gaining attention from American companies is China's proposed antitrust legislation.

Antimonopoly Law/Standards

USCBC members from a wide variety of industries and sectors are concerned about China's draft antimonopoly law (AML). The most recent draft of the AML aims to protect consumers but contains multiple "public interest" exceptions. These exceptions raise concerns that the law may be enforced to protect domestic companies at the expense of consumers and foreign companies. Like US antitrust law, the draft AML prohibits all agreements or coordination among firms to restrict competition. Unlike US law, however, the draft AML allows exemptions for agreements or coordination that may promote "national or public interests." The draft law mandates that such exempted agreements must benefit consumers and not eliminate all competition. But the absence of definitions for key terms such as "national or public interests" leaves a potentially substantial

and worrisome loophole that will make enforcement of the law more subjective and less predictable. The legislation should promote competition, since it should be promoting greater market efficiencies and exposing inefficient companies to the full rigor of legitimate competition by more efficient companies.

By legitimately utilizing their competitive advantages, a number of American companies have established positions of market leadership in China. Many more US firms are today beginning to reap the benefits of years of hard work laying the foundation for market success in China. Unfortunately, the AML, as understood, may threaten this progress.

For agreements not exempted under the criteria listed above, the AML prohibits companies from abusing their “dominant market positions.” The draft AML defines “dominance” as the ability to control prices or eliminate competition. Individual companies that account for 50 percent or more of their market are considered to have a dominant market position, as do two companies whose combined operations control two-thirds of the market, or three companies whose combined market share is three-fourths or more. Officials involved in the drafting of the AML have indicated that dominance of the market alone will not be sufficient grounds for government action—abuse of market dominance must be established. Indications of abuse include selling or buying products at unfair prices (either high or low); refusing to sell products to purchasers to put them at a disadvantage; and requiring distributors to sell products exclusively. These constitute a broad definition of “abuse of market dominance” and may affect companies ranging from pharmaceutical manufacturers to direct sellers. USCBC members are concerned that the abusive dominance provision contained in the draft AML may be used by authorities as a sword against foreign competitors.

The most controversial possible provisions of the draft law, which may have relevance to China’s WTO commitments, are those concerning IPR. The initial drafts of the law specified that “abuses of intellectual property rights” violate the AML. Though the initial drafts did not define IPR abuse, some signals on this issue indicate that China is considering a policy shift away from current international norms. A 2004 report by the State Administration of Industry and Commerce (SAIC) on competition-restricting behavior of multinational corporations (MNCs) notes their use of financial and technological advantages to dominate markets. China has also argued in the past that IPR is an obstacle for developing countries. That is, private ownership of patents is seen as hindering China’s economic development by preventing PRC manufacturers from using the latest technology on what China sees as reasonable terms. The most recent draft of the AML excludes the IPR provisions, but some believe that the State Council Legislative Affairs Office will reinsert the provisions in the future.

The draft AML—especially if it includes the IPR provisions—and the aforementioned patent-related standards regulation raise concerns that China may seek a strategy of forcing foreign firms to transfer technology and intellectual property to Chinese companies. The broad language used in both draft measures could provide PRC officials with significant discretion to interpret the law to benefit domestic industry at the expense of foreign companies active in China.

CONCLUSION

In closing, USCBC reiterates that the trend of market opening in China is largely positive. Important exceptions are in enforcement of IPR, the complete implementation of distribution rights, and transparency. Problems remain in specific sectors as well. Given the breadth of issues, US government and industry need to focus on these areas with our counterparts in China on a regular basis. The current annual JCCT meetings have become the primary forum for those discussions, but the irregular schedule of the JCCT meetings and the limited scope of issues covered leaves many industry concerns unaddressed. A broader, more consistent engagement than JCCT is vital if we hope to make progress. Only through regularly scheduled, continued engagement with the PRC leadership and agencies will we be able to resolve these outstanding issues and others as they arise.

Thus, while acknowledging the positive developments in China's investment and business regulatory climate that occurred in the past year, we urge USTR and the other departments making up the Trade Policy Staff Committee to focus their attention and resources on the obstacles identified in this testimony that prevent US companies from enjoying the degree of market access in China required by the WTO. Now that many of the major phase-ins have taken place, the focus of the US government's efforts must center on full implementation and sector-specific barriers.

The hindrances US companies must overcome in China must nevertheless be viewed in the proper context. In almost four years of WTO implementation, China has adopted policies resulting in a far more open, predictable, and profitable business environment for US companies. Much remains to be done, but the administration should resist calls for precipitous action that would imperil the prospects of US companies operating in this dynamic market and reject the argument that China's entry into the WTO has not benefited the United States. China's WTO membership clearly has benefited United States and American companies. The US government, through robust engagement and frank discussion with its PRC counterparts, should highlight the importance of progress in the areas described here to the continued development of bilateral trade ties.