
2012 Report to Congress On China's WTO Compliance



**United States Trade Representative
December 2012**

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TABLE OF CONTENTS

FOREWORD 1

EXECUTIVE SUMMARY 2

OVERVIEW 2

CHINA'S FIRST 11 YEARS AS WTO MEMBER 2

2012 DEVELOPMENTS 4

PRIORITY ISSUES 6

 Intellectual Property Rights 6

 Industrial Policies 7

 Trading Rights and Distribution Services 9

 Agriculture 10

 Services 10

 Transparency 11

THE YEAR AHEAD 12

Table 1: Summary Analysis of China's WTO Compliance Efforts 13

INTRODUCTION 19

CHINA'S WTO ACCESSION NEGOTIATIONS 19

CHINA'S WTO COMMITMENTS 19

OVERVIEW OF U.S. ENGAGEMENT 21

DIALOGUE 21

 Bilateral Engagement 21

 Multilateral Meetings 22

ENFORCEMENT 23

Table 2: Active U.S. WTO Disputes against China 26

CHINA'S WTO COMPLIANCE 28

TRADING RIGHTS 28

DISTRIBUTION SERVICES 29

 Wholesaling Services 29

 Retailing Services 31

 Franchising Services 32

 Direct Selling Services 33

IMPORT REGULATION 33

 Tariffs 33

 Customs and Trade Administration 34

 CUSTOMS VALUATION 34

 RULES OF ORIGIN 35

 IMPORT LICENSING 36

 Non-tariff Measures 37

TABLE OF CONTENTS (cont'd)

CHINA'S WTO COMPLIANCE (cont'd)

IMPORT REGULATION (cont'd)	
Tariff-rate Quotas on Industrial Products	37
Other Import Regulation	38
ANTIDUMPING	38
COUNTERVAILING DUTIES	40
SAFEGUARDS	42
EXPORT REGULATION	43
INTERNAL POLICIES AFFECTING TRADE	46
Non-discrimination	46
Taxation	48
Subsidies	49
Price Controls	52
Standards, Technical Regulations and Conformity Assessment Procedures	54
RESTRUCTURING OF REGULATORS	54
STANDARDS AND TECHNICAL REGULATIONS	55
CONFORMITY ASSESSMENT PROCEDURES	63
TRANSPARENCY	67
Other Internal Policies	68
STATE-OWNED AND STATE-INVESTED ENTERPRISES	68
STATE TRADING ENTERPRISES	71
GOVERNMENT PROCUREMENT	71
INVESTMENT	76
AGRICULTURE	84
Tariffs	86
Tariff-rate Quotas on Bulk Agricultural Commodities	87
China's Biotechnology Regulations	88
Sanitary and Phytosanitary Issues	89
Inspection-related Requirements	94
Domestic Support	95
Export Subsidies	95
INTELLECTUAL PROPERTY RIGHTS	96
Legal Framework	100
Enforcement	104
SERVICES	108
Financial Services	110
BANKING	110
MOTOR VEHICLE FINANCING	112
INSURANCE	112
FINANCIAL INFORMATION	114
ELECTRONIC PAYMENT SERVICES	115
Legal Services	116
Telecommunications	117

TABLE OF CONTENTS (cont'd)

CHINA'S WTO COMPLIANCE (cont'd)

SERVICES (cont'd)

Construction and Related Engineering Services	118
Express Delivery Services	120
Aviation Services	121
Maritime Services	122
Other Services	122
LEGAL FRAMEWORK	122
Transparency	122
OFFICIAL JOURNAL	122
TRANSLATIONS	123
PUBLIC COMMENT	124
ENQUIRY POINTS	125
Uniform Application of Laws	126
Judicial Review	126

APPENDICES

Appendix 1: List of Written Submissions Commenting on China's WTO Compliance
September 24, 2012

Appendix 2: List of Witnesses Testifying on China's WTO Compliance
October 3, 2012

Appendix 3: U.S. Fact Sheet for 23rd U.S.-China Joint Commission on Commerce and Trade Meeting
December 19, 2012

Appendix 4: U.S. Fact Sheet for 4th U.S.-China Strategic and Economic Dialogue
May 4, 2012

2012 USTR Report to Congress on China's WTO Compliance

ABBREVIATIONS

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

FOREWORD

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

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

The focus of the report's analysis continues to be on trade concerns raised by U.S. stakeholders that, in the view of the U.S. Government, merit attention within the WTO context. The report does not attempt to provide an exhaustive analysis of those concerns or the individual commitments made in

China's WTO accession agreement that might be implicated by them.

In preparing this report, USTR drew on its experience in overseeing the U.S. Government's monitoring of China's WTO compliance efforts. USTR chairs the Trade Policy Staff Committee (TPSC) Subcommittee on China, an inter-agency body whose mandate is, *inter alia*, to assess China's efforts to comply with its WTO commitments. This TPSC subcommittee is composed of experts from USTR, the Departments of Commerce, State, Agriculture and Treasury, and the U.S. Patent and Trademark Office, among other agencies. It works closely with State Department economic officers, Foreign Commercial Service officers, Import Administration officers and Market Access and Compliance officers from the Commerce Department, Foreign Agricultural Service officers and Customs attaches at the U.S. Embassy and Consulates General in China, who are active in gathering and analyzing information, maintaining regular contacts with U.S. industries operating in China and maintaining a regular dialogue with Chinese government officials at key ministries and agencies. The subcommittee meets in order to evaluate, coordinate U.S. engagement of China in the trade context.

To aid in its preparation of this report, USTR also published a notice in the Federal Register on August 20, 2012, asking for written comments and testimony from the public and scheduling a public hearing before the TPSC, which took place on October 3, 2012. A list of the written submissions received from interested parties is set forth in Appendix 1, and the persons who testified before the TPSC are identified in Appendix 2.

EXECUTIVE SUMMARY

OVERVIEW

China acceded to the World Trade Organization more than a decade ago on December 11, 2001. The terms of its accession called for China to implement numerous specific commitments over time, with all key commitments phased in by December 11, 2006. Looking back, it is easy to see how dramatically trade and investment have expanded among China and its many trading partners, including the United States, since China joined the WTO. The impressive growth in U.S.-China trade has provided substantial opportunities for U.S. businesses, workers, farmers, ranchers and service suppliers, as well as a wealth of affordable goods for U.S. consumers. Despite these remarkable results, the overall picture currently presented by China's WTO membership remains complex.

For much of the past decade, the Chinese government has been re-emphasizing the state's role in the economy, diverging from the path of economic reform that drove China's accession to the WTO. With the state leading China's economic development, the Chinese government has pursued new and more expansive industrial policies, often designed to limit market access for imported goods, foreign manufacturers and foreign service suppliers, while offering substantial government guidance, resources and regulatory support to Chinese industries, particularly ones dominated by state-owned enterprises. This heavy state role in the economy, reinforced by unchecked discretionary actions of Chinese government regulators, has generated serious trade frictions with China's many trade partners, including the United States.

When trade frictions have arisen, the United States has preferred to pursue dialogue with China to resolve them. However, when dialogue with China has not led to the resolution of key trade issues, the United States has not hesitated to invoke the WTO's dispute settlement mechanism. In fact, the United States has used this mechanism against China more

than any other WTO member. In doing so, the United States has placed a strong emphasis on the need for China to adhere to WTO rules and has been holding China fully accountable as a mature participant in, and a major beneficiary of, the WTO's global trading system.

The United States recognizes the tremendous upside promised by the U.S.-China trade relationship for both the United States and China, and it therefore has continued to urge China to reinvigorate the economic reform that drove its accession to the WTO. If China is going to deal successfully with its economic challenges at home, it must at a minimum reduce the role of the state in planning the economy, reform state-owned enterprises and eliminate preferences for national champions. Addressing these challenges is also critical to the success of China's enterprises in expanding abroad. At the same time, these reforms are strongly in the United States' interest, not only because the Chinese government's interventionist policies and practices and the large role of state-owned enterprises in China's economy are principal drivers of trade frictions, but also because a healthier and more balanced Chinese economy will lead to increased U.S.-China trade. Although it is too early to tell, there were some positive signs in 2012 that China may be focused on re-energizing its economic reforms.

CHINA'S FIRST 11 YEARS AS WTO MEMBER

The commitments to which China's leaders agreed when China joined the WTO in 2001 were sweeping in nature and required the Chinese government to make changes to hundreds of laws, regulations and other measures affecting trade and investment. These changes largely coincided with the leadership's economic reform goals, which built on the economic reforms that China had begun under Deng Xiaoping in 1978. The Chinese leaders who negotiated China's WTO accession negotiations believed that China's economy needed to rely more on market signals and less on Chinese government economic planners and state-owned enterprises.

2012 USTR Report to Congress on China's WTO Compliance

Indeed, these leaders oversaw a dramatic and rapid reform of state-owned enterprises from the mid-1990s through 2002.

Following China's accession to the WTO, the Chinese government took many impressive steps to implement China's numerous commitments. The Chinese government made legal changes that reduced tariffs, eliminated non-tariff barriers that had denied national treatment and market access for goods and services imported from other WTO members, improved intellectual property protections and promoted regulatory transparency. These steps unquestionably deepened China's integration into the WTO's rules-based international trading system, while also strengthening China's ongoing economic reforms.

In 2003, when new leaders took over in China, the Chinese government continued to take steps to implement the WTO commitments that China had agreed to phase in over time, furthering China's economic reforms. However, beyond these steps, China's new leaders for the most part did not continue down the path pursued by their predecessors. Beginning with the creation of the State-owned Assets Supervision and Administration Commission (SASAC) in 2003, China's new leaders de-emphasized their predecessors' move toward a greater reliance on market signals and instead set out to bolster the state sector by attempting to improve the operational efficiency of state-owned enterprises and by orchestrating mergers and consolidations in order to create stronger state-owned enterprises. These actions soon led to institutionalized preferences for state-owned enterprises and the creation of national champions in many sectors.

In 2006, once China had taken steps to implement the last of its key WTO commitments, China's policy shift became more evident. USTR noted China's stronger embrace of state capitalism. USTR also reported that some Chinese government policies and practices raised increasing concerns that China had not yet fully embraced the key WTO principles

of market access, non-discrimination and transparency.

China's incomplete adoption of the rule of law has exacerbated this situation. For example, confidential accounts from foreign enterprises indicate that Chinese government officials, acting without fear of legal challenge, at times require foreign enterprises to transfer technology if they want to secure investments approvals, even though Chinese law does not – and cannot under China's WTO commitments – require technology transfer. Similarly, in the trade remedies context, China's regulatory authorities at times seem to pursue antidumping and countervailing duty investigations and impose duties for the purpose of striking back at trading partners that have exercised their WTO rights in a way that displeases China. China's regulatory authorities appear to pursue these investigations even when necessary legal and factual support for the duties is absent.

In 2012, a wide range of Chinese policies and practices continued to generate significant concerns among U.S. stakeholders. Major issues included China's export restraints, government subsidization, inappropriate use of trade remedy laws, indigenous innovation policies, technology transfer initiatives, serious problems with intellectual property rights enforcement, including in the area of trade secrets, and China's slow movement toward accession to the WTO Government Procurement Agreement (GPA). In addition, market access barriers and discrimination against foreign enterprises could still be found in numerous sectors of China's economy.

Despite these ongoing challenges, trade between the United States and China has continued to expand rapidly. Since 2001, U.S. exports of goods to China have increased by approximately 442 percent, rising from a 2001 total of \$19 billion to \$104 billion in 2011, and positioning China as the United States' largest goods export market outside of North America. China is also a substantial market for U.S. services. The cross-border supply of private commercial services totaled \$27 billion in 2011,

representing an increase of 393 percent since 2001. Services supplied through majority U.S.-invested companies in China totaled \$29 billion in 2010, the latest year for which data are available. U.S.-China trade in goods and services continued to grow at a healthy pace in 2012.

There are some positive signs suggesting recognition among China's next leaders that further economic reforms are in China's interest. For example, a major Chinese government think tank, the Development Research Center of China's State Council, was permitted to work with the World Bank and publish, in February 2012, a joint research report, entitled *China 2030: Building a Modern, Harmonious and Creative High-Income Society*, which recognizes that China's growth model will need to be changed to meet new challenges. The report lays out the case for a new development strategy for China, focused on rebalancing the role of government and the market, reforming state-owned enterprises and strengthening the private sector, among other changes, in order to reach the goal of a high income country by 2030. Vice President Xi offered another positive signal in this direction with his December 2012 decision to make Shenzhen the site of his first official visit after taking over as General Secretary of the Chinese Communist Party. Symbolically, Vice President Xi seemed to be retracing the steps of Deng Xiaoping, who famously traveled to Shenzhen in 1992 to reaffirm China's commitment to economic reforms.

Looking ahead, essential work for China includes the need to reduce market access barriers, uniformly follow the fundamental principles of non-discrimination and transparency, significantly reduce the level of government intervention in the economy, fully institutionalize market mechanisms, require state-owned enterprises to compete with other enterprises on fair and non-discriminatory terms, and fully embrace the rule of law. Completing this work is critical to realizing the tremendous potential presented by China's WTO membership, including the breadth and depth of

trade and investment – and prosperity – possible in a thriving, balanced global trading system.

2012 DEVELOPMENTS

In 2012, the United States worked hard to increase the benefits that U.S. businesses, workers, farmers, ranchers, service suppliers and consumers derive from trade and economic ties with China. Throughout the past year, the United States focused on outcome-oriented dialogue at all levels of engagement with China, while also taking concrete steps to enforce U.S. rights at the WTO when dialogue did not resolve U.S. concerns.

On the bilateral front, the United States and China pursued numerous formal and informal meetings and dialogues over the last year, including working groups and high-level meetings under the auspices of the U.S.-China Strategic and Economic Dialogue (S&ED) and the U.S.-China Joint Commission on Commerce and Trade (JCCT). The United States and China held their fourth S&ED meeting in May 2012 and the 23rd meeting of the JCCT in December 2012. Constructive dialogue also took place during Vice President Xi's visit to the United States in February 2012. The United States used all of these avenues to engage China's leadership on trade and economic matters and to seek resolutions to a number of pressing trade issues.

The two sides were able to make significant progress on the following key trade issues through their bilateral engagement in 2012:

- China committed to extend its efforts to promote the use of legal software by Chinese enterprises, in addition to more regular audits of software on computers used by the Chinese government. China also confirmed that it requires state-owned enterprises and state-owned banks under the supervision of the central government to purchase and use legal software.

2012 USTR Report to Congress on China's WTO Compliance

- China committed to further simplify and enhance the transparency of its investment approval system.
- China committed that technology transfer would be decided by businesses independently and would not be used by the Chinese government as a pre-condition for market access. China also confirmed that it would correct any measures that were inconsistent with this commitment in a timely manner.
- China committed to treat IPR owned or developed in other countries the same as IPR owned or developed in China.
- China committed to prioritize trade secrets in its IPR protection policies and to increase enforcement against trade secret misappropriation.
- China agreed to take steps to address certain regulatory obstacles that had been impeding U.S. exports.
- China agreed to open the mandatory third-party liability auto insurance market to foreign-invested insurance companies.
- China committed to provide non-discriminatory treatment to all enterprises, regardless of whether state-owned or privately owned, in terms of credit, taxation and regulatory policies.
- China agreed to participate in negotiations for new rules on official export financing with the United States and other major exporters.

While progress was made on some meaningful issues, as described above, many issues remain outstanding, and the United States was frank in expressing its view that the two sides need to redouble their efforts going forward. The United States will therefore continue to pursue discussions in areas including investment, innovation, intellectual property rights, industrial policies, state-

owned enterprises, administrative licensing, government procurement, taxation, agriculture, standards development, conformity assessment procedures, express delivery services, financial services, telecommunications services, legal services, pharmaceuticals and medical devices, among others.

On the enforcement side, the United States pursued a robust agenda over the past year. The United States brought three important new WTO cases against China, while continuing to prosecute five other cases.

One of the new cases challenges numerous subsidies provided by the central government and various sub-central governments in China to automobile and automobile-parts enterprises located in regions in China known as “export bases.” The second new case challenges antidumping and countervailing duties that China imposed on imports of U.S. automobiles. The third new case challenges export quotas, export duties and other restraints maintained by China on the export of rare earths, tungsten and molybdenum, which are key inputs in a multitude of U.S. manufacturing sectors and U.S.-made products, including hybrid car batteries, wind turbines, energy-efficient lighting, steel, advanced electronics, automobiles, petroleum and chemicals.

Among the cases launched in prior years that were active in 2012 was a challenge to China's creation of a national champion as the exclusive supplier of the electronic payment services needed to process most credit and debit card transactions in China, barring U.S. suppliers from the market. The United States won this case in 2012. The United States also continued to pursue challenges to antidumping and countervailing duties that China imposed on imports of two U.S. products, grain-oriented electrical steel (GOES) used by the power generating industry and chicken broiler products. The United States won the GOES case in 2012, while the chicken broiler products case is still being litigated. The United States secured yet another win in 2012 in a case involving a broad challenge to China's restraints on the export of several raw materials of key

importance to U.S. steel, aluminum and chemicals industries. Finally, in one other WTO case, which the United States had won, the United States and China entered into an agreement providing significant benefits to the U.S. film industry in compensation for China's inability to comply with the WTO's rulings regarding China's importation and distribution restrictions in a timely manner.

PRIORITY ISSUES

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

Intellectual Property Rights

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

Meanwhile, effective enforcement of China's IPR laws and regulations remains a significant challenge. Despite repeated anti-piracy campaigns in China and an increasing number of civil IPR cases in Chinese courts, counterfeiting and piracy remain at unacceptably high levels and continue to cause serious harm to U.S. businesses across many sectors of the economy. Indeed, in a study released in May 2011, the U.S. International Trade Commission

estimated that U.S. businesses suffered a total of \$48 billion in lost sales, royalties and license fees due to IPR infringement in China in 2009 – a figure that is more than two-thirds the value of the \$69 billion in U.S. goods exported to China in the same year.

In 2012, the United States continued to seek ways to work with China to improve China's IPR enforcement regime, as USTR's annual Special 301 report again placed China on the Priority Watch List and USTR's Out-of-Cycle Review of Notorious Markets, which identifies Internet and physical markets that exemplify key challenges in the global struggle against piracy and counterfeiting, again featured Chinese markets prominently. Given China's increasing stake in effective IPR enforcement, as evidenced by its efforts to develop innovative industries and technologies, a variety of U.S. agencies held bilateral discussions with their Chinese counterparts in 2012. Real progress was made, but much more work remains to be done.

At the May 2012 S&ED meeting and the December 2012 JCCT meeting, the United States sought to build on China's past commitments to eliminate the use of unauthorized software at all levels of government and to discourage the use of unauthorized software by enterprises, including major state-owned and state-invested enterprises. China committed to intensify its use of software audits and inspections within the government and to expand its software legalization efforts in the enterprise sector. China also confirmed that it requires state-owned enterprises and state-owned banks under the supervision of the central government to purchase and use legal software.

In 2012, the United States pressed China in the area of trade secrets, which has become a high profile problem recently. At the May 2012 S&ED meeting, China agreed to prioritize trade secrets in its IPR protection policies and to increase enforcement against trade secret misappropriation.

The United States secured further progress on Internet intermediary liability through the 2012 JCCT

process. Building on a prior JCCT commitment to develop a Judicial Interpretation making clear that those who facilitate online infringement will be jointly liable for such infringement, China announced at the December 2012 JCCT meeting that its Supreme People's Court will publish a Judicial Interpretation on Internet Intermediary Liability before the end of 2012.

In 2013, the United States will continue to work closely with U.S. industry and to devote considerable staff and resources, both in Washington and in Beijing, to address the many challenges in the IPR area. The United States will also seek to intensify its bilateral engagement with China in an effort to achieve significant reductions in IPR infringement levels in China. At the same time, as has been demonstrated, when bilateral discussions prove unable to resolve key issues, the United States will remain prepared to take other types of action on these issues, including WTO dispute settlement where appropriate, given the importance of an effective, TRIPS Agreement-compliant system for IPR enforcement.

Industrial Policies

China continued to pursue industrial policies in 2012 that seek to limit market access for imported goods, foreign manufacturers and foreign service suppliers, while offering substantial government guidance, resources and regulatory support to Chinese industries. The principal beneficiaries of these policies are state-owned enterprises, as well as other favored domestic companies attempting to move up the economic value chain.

In 2012, policies aimed at promoting "indigenous innovation" continued to represent an important component of China's industrialization efforts. Through intensive, high-level bilateral engagement, the United States had secured a series of critical commitments from China in 2011 that generated major progress in de-linking indigenous innovation policies at all levels of the Chinese government from government procurement preferences, culminating

in the issuance of a State Council measure mandating that provincial and local governments eliminate any remaining linkages by December 1, 2011. The principal challenge in 2012 was to begin addressing a range of discriminatory indigenous innovation preferences proliferating outside of the government procurement context. China took an important step in this direction by committing at the May 2012 S&ED meeting to treat intellectual property owned or developed in other countries the same as intellectual property owned or developed in China. The United States also used the 2012 JCCT process to press China to revise or eliminate specific measures that appeared to be inconsistent with this commitment. China is reviewing specific U.S. concerns, and the United States and China agreed to intensify their discussions in 2013.

On other fronts, China continued to deploy export quotas, export license restrictions, minimum export prices, export duties and other export restraints on a number of raw material inputs in which it holds the leverage of being among the world's leading producers. Through these export restraints, it appears that China is able to provide substantial economic advantages to a wide range of downstream producers in China at the expense of foreign downstream producers, while creating incentives for foreign downstream producers to move their operations, technologies and jobs to China. The U.S. responded, as noted above, by filing two WTO cases. The first one, begun in 2009, challenged the export restraints that China maintains on nine raw material inputs of key interest to the U.S. steel, aluminum and chemicals industries. The United States won that case in January 2012. Shortly thereafter, in March 2012, the United States launched a case challenging China's export restraints on rare earths, tungsten and molybdenum, which are key inputs for a multitude of U.S.-made products, including hybrid car batteries, wind turbines, energy-efficient lighting, steel, advanced electronics, automobiles, petroleum and chemicals.

China has continued to provide a range of injurious subsidies to its domestic industries, and some of

these subsidies appear to be prohibited under WTO rules. The United States has addressed these subsidies both through countervailing duty proceedings conducted by the Commerce Department and through dispute settlement proceedings at the WTO. In September 2012, the United States launched a new case challenging numerous types of support provided by the central government and various sub-central governments in China to automobile and automobile-parts enterprises located in regions in China known as "export bases." The United States and other WTO members have also continued to press China about its obligation to notify its subsidies to the WTO. Since joining the WTO eleven years ago, China has yet to submit a complete notification of subsidies maintained by central, provincial and local governments.

As in prior years, in 2012, the Chinese government attempted to manage the export of many primary, intermediate and downstream products by raising or lowering the value-added tax rebate available upon export. China sometimes reinforced its objectives by imposing or retracting export duties. These practices have caused tremendous disruption, uncertainty and unfairness in the global markets for some products, particularly downstream products where China is a leading world producer or exporter, such as steel, aluminum and soda ash. Domestic industries from many of China's trading partners have continued to respond to the effects of these and other trade-distortive practices by petitioning their governments to impose trade remedies such as antidumping and countervailing duties. At the December 2012 JCCT meeting, China agreed to hold serious discussions with the United States, beginning in the first half of 2013, in order to work toward a mutual understanding of China's VAT system and the concepts on which a trade-neutral VAT system is based.

In the standards area, Chinese government officials in some instances have reportedly pressured foreign companies seeking to participate in the standards-setting process to license their technology or

intellectual property on unfavorable terms. In addition, China has continued to pursue unique national standards in a number of areas of high technology where international standards already exist. To date, bilateral engagement has yielded minimal progress in resolving these matters.

In the area of government procurement, the United States continues to press China to take concrete steps toward fulfilling its commitment to accede to the WTO's Government Procurement Agreement and to open up its vast government procurement market to the United States and other GPA parties. China has submitted two revised offers of coverage within the past two years, following up on commitments that it made through the JCCT and S&ED processes and the January 2011 visit of President Hu to Washington, but they have demonstrated only incremental progress. The United States, the EU and other GPA parties characterized the more recent of these two offers, submitted in November 2012, as highly disappointing in scope and coverage. The United States will continue to work with China and other interested GPA parties in an effort to ensure that China's accession to the GPA takes place expeditiously and on robust terms that are comparable to the coverage of the United States and other GPA parties. At the December 2012 JCCT meeting, China acknowledged the need to engage the United States more seriously on core issues relating to the scope of projects that qualify as government procurement and the extent to which state-owned enterprises in China engage in government procurement activities.

China has also sought to protect many domestic industries through a restrictive investment regime. In addition to restrictions imposed via China's foreign investment catalogue, China can readily impose additional constraints on investment through its foreign investment approval processes, where Chinese government officials can use vaguely defined powers on an ad hoc basis to delay or restrict market entry. In addition, according to confidential reports from foreign enterprises,

Chinese government officials may use informal means to require a foreign enterprise to conduct research and development in China, transfer technology, satisfy performance requirements relating to exportation or the use of local content, or make valuable, deal-specific commercial concessions if it wants its investment approved. To date, sustained bilateral engagement by the United States has not led to significant relaxation of China's investment restrictions, nor has it appeared to curtail ad hoc actions by Chinese government officials.

An array of Chinese policies designed to assist Chinese automobile enterprises in developing cutting-edge electric vehicle technologies and in building domestic brands that can succeed in global markets continued to pose challenges in 2012, despite significant progress made in addressing these policies in 2011. As previously reported, these policies generated serious concerns about intellectual property discrimination, forced technology transfer, research and development requirements, investment restrictions and discriminatory treatment of foreign brands and imported vehicles. The United States was able to secure China's commitment at the November 2011 JCCT meeting to eliminate many of these concerns. However, more work remains, as China issued additional problematic policy measures in 2012.

As noted above, China's regulatory authorities seem to be pursuing antidumping and countervailing duty investigations and imposing duties for the purpose of striking back at trading partners that have exercised their WTO rights in a way that displeases China. Apparently emboldened by the absence of any real domestic legal check on their regulatory activities, China's regulatory authorities take these actions even when necessary legal and factual support for the duties is absent. The U.S. response has been the filing and prosecution of three WTO cases. The one case decided to date – which involves antidumping and countervailing duties on imports of GOES from the United States – confirms

that China failed to abide by WTO disciplines when imposing those duties.

In 2013, the United States will continue to pursue vigorous and expanded bilateral engagement to resolve the serious concerns that remain over many of China's industrial policy measures. The United States will also continue to seek the elimination of China's export restraints on raw material inputs through the cases that it has brought at the WTO.

Trading Rights and Distribution Services

In most sectors, China has implemented its critically important commitments to fully liberalize trading rights (the right to import and the right to export) and distribution services (wholesale, retail, direct selling and franchising services), enabling many U.S. companies to import and export goods directly without using middlemen and to establish their own distribution networks in China. Over the years, some significant restrictions persisted, but, by 2012, many of the United States' outstanding concerns were being addressed.

As previously reported, the United States mounted a successful challenge at the WTO to China's restrictions on the importation and distribution of copyright-intensive products such as books, newspapers, journals, theatrical films, DVDs and music, in contravention of its trading rights and distribution services commitments. China subsequently agreed that it would remove these restrictions by March 2011. China took positive steps by issuing several revised measures, and repealing other measures, relating to its restrictions on books, newspapers, journals, DVDs and music. As China acknowledged, however, it did not issue any measures addressing theatrical films. Instead, China proposed bilateral discussions with the United States in order to seek an alternative solution. In February 2012, the two sides reached an agreement providing for substantial increases in the number of foreign films imported and distributed in China each year,

along with substantial additional revenue for foreign film producers.

One other outstanding concern in the area of distribution services involves direct selling services. Even though China has become a major market for U.S. direct sellers, China continues to subject foreign direct sellers to unwarranted restrictions on their business operations, such as overly burdensome service center requirements. Going forward, the United States will continue to press China to reconsider these problematic restrictions.

Agriculture

In 2012, U.S. agricultural products continued to experience strong sales to China. China became the United States' largest agricultural export market in 2010, when U.S. exports to China exceeded \$17 billion, more than eight times the level in 2002. In 2011, U.S. exports to China increased by 8 percent, and continued to increase in 2012. Much of this success was enabled by the United States' persistent engagement of China's regulatory authorities.

Notwithstanding this success, China remains among the least transparent and predictable of the world's major markets for agricultural products, largely because of selective intervention in the market by China's regulatory authorities. As in past years, seemingly capricious practices by Chinese customs and quarantine agencies can delay or halt shipments of agricultural products into China. In addition, both SPS measures with what seem to be questionable scientific bases and a generally opaque regulatory regime frequently bedevil traders in agricultural commodities, who require as much predictability and transparency as possible in order to preserve margins and reduce the already substantial risks involved in agricultural trade.

In 2012, the principal targets of worrisome practices by China's regulatory authorities were poultry, pork and beef products. As a consequence, anticipated growth in U.S. exports of these products was not

realized. In particular, China continued to block the importation of U.S. beef and beef products, more than five years after these products had been declared safe to trade under international scientific guidelines. China also continued to maintain some unwarranted state-level Avian Influenza import bans on poultry. Additionally, China continued to maintain overly restrictive pathogen and residue standards for raw meat and poultry.

In 2013, the United States will continue to urge China to lift the restrictions on imports of U.S. beef and U.S. poultry products. The United States will also continue to pursue vigorous bilateral engagement with China and take other actions, as appropriate, to achieve progress on its outstanding concerns.

Services

The United States continued to enjoy a substantial surplus in trade in services with China in 2012, and the market for U.S. service suppliers in China remains promising. This success has been largely attributable to the market openings phased in by China pursuant to its WTO commitments, as well as the United States' comprehensive engagement of China's various regulatory authorities.

Nevertheless, in 2012, numerous challenges persisted in a range of services sectors. As in past years, Chinese regulators continued to use discriminatory regulatory processes, informal bans on entry, overly burdensome licensing and operating requirements and other means to frustrate efforts of U.S. suppliers of banking, insurance, express delivery, telecommunications, legal and other services to achieve success reflecting their full market potential in China. China also continued to place unwarranted restrictions on foreign companies, like the major U.S. credit card companies, which supply electronic payment services to banks and other companies that issue or accept credit and debit cards. However, as discussed above, the United States recently prevailed in a WTO

case challenging those restrictions, and China has indicated that it will comply with the WTO's rulings by July 2013.

In 2013, the United States will continue to engage China on outstanding services issues and will closely monitor developments in an effort to ensure that China fully adheres to its WTO commitments.

Transparency

One of the core principles of the WTO Agreement reflected throughout China's WTO accession agreement is transparency. Transparency permits markets to function effectively and reduces opportunities for officials to engage in trade-distorting practices behind closed doors. China's transparency commitments in many ways required a profound historical shift in Chinese policies, and China has made important strides to improve transparency across a wide range of national and provincial authorities following its accession to the WTO. However, it appears that China still has more work to do if it is to fully implement some of its commitments.

As previously reported, China committed to adopt a single official journal for the publication of all trade-related laws, regulations and other measures, and China finally adopted a single official journal, to be administered by the Ministry of Commerce (MOFCOM), in 2006. To date, it appears that most but not all government entities publish trade-related measures in this journal. Nevertheless, these government entities tend to take a narrow view of the types of trade-related measures that need to be published in the official journal. As a result, while trade-related regulations and departmental rules are often published in the journal, it is less common for other measures such as opinions, circulars, orders, directives and notices to be published, even though they are all binding legal measures.

China also committed to provide a reasonable period for public comment before implementing new trade-

related laws, regulations and other measures. China has taken several steps related to this commitment. In 2008, the National People's Congress (NPC) instituted notice-and-comment procedures for draft laws, and shortly thereafter China indicated that it would also publish proposed trade- and economic-related administrative regulations and departmental rules for public comment. These steps signaled increasing recognition by many Chinese government officials that improved transparency and greater input from stakeholders and the public contribute to better regulatory practices and improved policymaking. Since 2008, the NPC has been regularly publishing draft laws for public comment, and China's State Council has been regularly publishing draft regulations for public comment. However, many of China's ministries have not been consistent in publishing draft departmental rules for public comment.

At the May 2011 S&ED meeting, China committed that it would issue a measure in 2011 to implement the requirement to publish all proposed trade- and economic-related administrative regulations and departmental rules on the website of the State Council's Legislative Affairs Office (SCLAO) for a public comment period of not less than 30 days. In April 2012, shortly before the May 2012 S&ED meeting, the SCLAO issued two measures imposing this requirement.

Meanwhile, after eleven years of WTO membership, China still has not implemented its commitment to make available translations of all of its trade-related laws, regulations and other measures in one or more of the WTO languages (English, French and Spanish). This commitment is very important to the United States and China's other trading partners, but China has not yet even established an infrastructure to undertake the agreed-upon translations of its trade-related measures.

The United States will continue to monitor China's progress closely and push China to undertake further steps necessary to improve transparency.

THE YEAR AHEAD

In 2013, as in prior years, the Administration will continue to energetically pursue increased benefits for U.S. businesses, workers, farmers, ranchers and service suppliers from our trade and economic ties with China. The Administration will use all available tools to achieve these objectives, including the pursuit of productive, outcome-oriented dialogue in both bilateral and multilateral settings, as well as the vigorous use of the WTO dispute settlement mechanism, where appropriate.

On the bilateral front, the United States will continue to pursue a robust set of formal and informal meetings and dialogues with China at all levels of government. The United States will also take full advantage of multilateral venues such as the WTO to engage China. Key goals will include ensuring that the benefits of China's WTO commitments are fully realized by the United States and other WTO members, and that trade frictions that arise in the U.S.-China trade relationship are appropriately

resolved. In addition, the United States will continue to urge China to reduce Chinese government intervention in the economy and to reform its state-owned enterprises.

At the same time, as the United States has repeatedly demonstrated, when dialogue is not successful in resolving WTO-related concerns, the United States will not hesitate to invoke the dispute settlement mechanism at the WTO where appropriate. Similarly, the United States will continue to rigorously enforce U.S. trade remedy laws, in accordance with WTO rules, when U.S. interests are being harmed by unfairly traded or surging imports from China.

Going forward, the Administration will continue to consult closely with the Congress and with U.S. stakeholders in order to ensure that the actions being pursued by the United States advance their interests. The Administration remains dedicated to maximizing U.S. stakeholders' opportunities to compete in China and the global marketplace.

2012 USTR Report to Congress on China's WTO Compliance

Table 1

Summary Analysis of China's WTO Compliance Efforts

TRADING RIGHTS
<p>China appears to be in compliance with its trading rights commitments in most areas. One significant exception has involved restrictions on the right to import copyright-intensive products such as books, newspapers, journals, theatrical films, DVDs and music, which China reserved for state trading. China agreed to remove those restrictions in 2011 in order to comply with the rulings in a WTO case brought by the United States. To date, China has taken steps to comply with those rulings to the extent that they apply to books, newspapers, journals, DVDs and music. With regard to theatrical films, the two sides entered into an MOU in 2012 providing for substantial increases in the number of U.S. films imported and distributed in China each year and substantial additional revenue for foreign film producers.</p>
DISTRIBUTION SERVICES
<p>China has made substantial progress in implementing its distribution services commitments, although significant concerns remain in some areas.</p> <p>Wholesaling Services</p> <p>China has issued regulations generally implementing its commitments in the area of wholesaling and commission agents' services. One significant exception has involved restrictions on the distribution of copyright-intensive products such as books, newspapers, journals, DVDs, music and theatrical films. China agreed to remove those restrictions in 2011 in order to comply with the rulings in a WTO case brought by the United States. To date, China has taken steps to comply with those rulings to the extent that they apply to books, newspapers, journals, DVDs and music, although more steps are needed. With regard to theatrical films, the two sides entered into an MOU in 2012 providing for substantial increases in the number of U.S. films imported and distributed in China each year and substantial additional revenue for foreign film producers. Meanwhile, U.S. companies continue to have concerns about restrictions on the distribution of other products, such as pharmaceuticals, crude oil and processed oil.</p> <p>Retailing Services</p> <p>China has issued regulations generally implementing its commitments in the area of retailing services, although some concerns remain with regard to licensing discrimination. China continues to maintain restrictions on the retailing of processed oil.</p> <p>Franchising Services</p> <p>China has issued regulations generally implementing its commitments in the area of franchising services.</p> <p>Direct Selling Services</p> <p>China has issued regulations generally implementing its commitments in the area of direct selling services, although significant regulatory restrictions, including service center requirements, imposed on the operations of direct sellers continue to generate concerns.</p>
IMPORT REGULATION
<p>Tariffs</p> <p>China has timely implemented its tariff commitments for industrial goods each year.</p> <p>Customs and Trade Administration</p> <p><u>Customs Valuation</u></p> <p>China has issued measures that bring its legal regime for making customs valuation determinations into compliance with WTO rules, but implementation of these measures has been inconsistent from port to port, both in terms of customs clearance procedures and valuation determinations.</p> <p><u>Rules of Origin</u></p> <p>China has issued measures that bring its legal regime for making rules of origin determinations into compliance with WTO rules.</p> <p><u>Import Licensing</u></p> <p>China has issued measures that bring its legal regime for import licenses into compliance with WTO rules, although a variety of specific compliance issues continue to arise, as in the case of China's import licensing procedures for iron ore imports.</p>

2012 USTR Report to Congress on China's WTO Compliance

Table 1 (cont'd)

Summary Analysis of China's WTO Compliance Efforts

IMPORT REGULATION
<p>Non-tariff Measures China has adhered to the agreed schedule for eliminating non-tariff measures.</p>
<p>Tariff-rate Quotas on Industrial Products Concerns about transparency and administrative guidance have plagued China's tariff-rate quota system for industrial products, particularly fertilizer, since China's accession to the WTO.</p>
<p>Other Import Regulation</p> <p><u>Antidumping</u> China has issued laws and regulations bringing its legal regime in the AD area largely into compliance with WTO rules, although China still needs to issue additional procedural guidance such as rules governing expiry reviews. More significantly, China needs to improve its commitment to the transparency and procedural fairness requirements embodied in WTO rules, as the WTO found in a WTO case brought by the United States. In addition, China needs to eliminate its apparent use of trade remedy investigations as a retaliatory tool.</p> <p><u>Countervailing Duties</u> China has issued laws and regulations bringing its legal regime in the CVD area largely into compliance with WTO rules, although China still needs to issue additional procedural guidance such as rules governing expiry reviews. More significantly, China needs to improve its commitment to the transparency and procedural fairness requirements embodied in WTO rules, as the WTO found in a WTO case brought by the United States. In addition, China needs to eliminate its apparent use of trade remedy investigations as a retaliatory tool.</p> <p><u>Safeguards</u> China has issued measures bringing its legal regime in the safeguards area largely into compliance with WTO rules, although concerns about potential inconsistencies with WTO rules continue to exist.</p>
EXPORT REGULATION
<p>China maintains numerous export restraints that raise serious concerns under WTO rules, including specific commitments that China made in its WTO accession agreement. In the one WTO case decided to date in this area, the WTO found that exports restraints maintained by China on several raw material inputs violated China's WTO obligations.</p>
INTERNAL POLICIES AFFECTING TRADE
<p>Non-discrimination While China has revised many laws, regulations and other measures to make them consistent with WTO rules relating to MFN and national treatment, concerns about compliance with these rules still arise in some areas.</p>
<p>Taxation China has used its taxation system to discriminate against imports in certain sectors, raising concerns under WTO rules relating to national treatment.</p>
<p>Subsidies China continues to provide injurious subsidies to its domestic industries, and some of these subsidies appear to be prohibited under WTO rules. Although China filed a long-overdue WTO subsidies notification in 2011, its notification was far from complete.</p>

Table 1 (cont'd)

Summary Analysis of China's WTO Compliance Efforts

INTERNAL POLICIES AFFECTING TRADE (cont'd)
<p>Price Controls China has progressed slowly in reducing the number of products and services subject to price control or government guidance pricing.</p>
<p>Standards, Technical Regulations and Conformity Assessment Procedures China continues to take actions that generate WTO compliance concerns in the areas of standards, technical regulations and conformity assessment procedures, particularly with regard to transparency, national treatment, the pursuit of unique Chinese national standards, and duplicative testing and certification requirements.</p> <p><u>Restructuring of Regulators</u> China has restructured its regulators for standards, technical regulations and conformity assessment procedures in order to eliminate discriminatory treatment of imports, although in practice China's regulators sometimes do not appear to enforce regulatory requirements as strictly against domestic products as imports.</p> <p><u>Standards and Technical Regulations</u> China continues to pursue the development of unique Chinese national standards, despite the existence of well-established international standards, apparently as a means for protecting domestic companies from competing foreign technologies and standards.</p> <p><u>Conformity Assessment Procedures</u> China appears to be turning more and more to in-country testing for a broader range of products, which does not conform with international practices that generally accept foreign test results and conformity assessment certifications.</p> <p><u>Transparency</u> China has made progress but still does not appear to notify all new or revised standards, technical regulations and conformity assessment procedures as required by WTO rules.</p>
<p>Other Industrial Policies</p> <p><u>State-owned and State-invested Enterprises</u> The Chinese government has heavily intervened in investment and other strategic decisions made by state-owned and state-invested enterprises in certain sectors.</p> <p><u>State Trading Enterprises</u> It is difficult to assess the activities of China's state-trading enterprises, given inadequate transparency.</p> <p><u>Government Procurement</u> While China is moving slowly toward fulfilling its commitment to accede to the GPA, it is maintaining and adopting government procurement measures that give domestic preferences.</p>
INVESTMENT
<p>China has revised many laws, regulations and other measures on foreign investment to eliminate WTO-inconsistent requirements relating to export performance, local content, foreign exchange balancing and technology transfer. However, some of the revised measures continue to "encourage" these requirements, and it appears that Chinese government officials at times continue to use the foreign investment approval process to pressure foreign companies to accept one or more of these requirements or other conditions. China has also issued industrial plans covering the auto and steel sectors that include guidelines that appear to conflict with its WTO obligations. In addition, China has added a variety of restrictions on investment that appear designed to shield inefficient or monopolistic Chinese enterprises from foreign competition.</p>

2012 USTR Report to Congress on China's WTO Compliance

Table 1 (cont'd)

Summary Analysis of China's WTO Compliance Efforts

AGRICULTURE
<p>While China has timely implemented its tariff commitments for agricultural goods, a variety of non-tariff barriers continue to impede market access, particularly in the areas of SPS measures and inspection-related requirements.</p>
<p>Tariffs China has timely implemented its tariff commitments for agricultural goods each year.</p>
<p>Tariff-rate Quotas on Bulk Agricultural Commodities China's administration of TRQs on bulk agricultural commodities still does not seem to be functioning entirely as envisioned in China's WTO accession agreement, as it continues to be impaired by inadequate transparency.</p>
<p>China's Biotechnology Regulations Despite continuing problems with China's biotechnology approval process, major trade disruptions have been avoided.</p>
<p>Sanitary and Phytosanitary Issues In 2012, China's regulatory authorities continued to impose SPS measures in a non-transparent manner and without clear scientific bases, including BSE-related bans on U.S. beef and beef products, pathogen standards and residue standards for raw meat and poultry products, and Avian Influenza bans on poultry. Meanwhile, China has made some progress but still does not appear to have notified all proposed SPS measures as required by WTO rules.</p>
<p>Inspection-related Requirements China's regulatory authorities continue to administer inspection-related requirements in a seemingly arbitrary manner.</p>
<p>Domestic Support In recent years, China has been significantly increasing domestic subsidies and other support measures for its agricultural sector.</p>
<p>Export Subsidies It is difficult to determine whether China maintains export subsidies on agricultural goods, in part because China has not notified all of its subsidies to the WTO.</p>
INTELLECTUAL PROPERTY RIGHTS
<p>While China has undertaken a wide-ranging revision of its legal regime aimed at protecting the intellectual property rights of domestic and foreign entities, key weaknesses remain, and enforcement of China's IP-related laws and regulations remains a challenge in the face of widespread counterfeiting, piracy and other forms of infringement.</p>
<p>Legal Framework China has established a framework of laws, regulations and departmental rules that largely satisfies its WTO commitments. However, reforms are needed in a few key areas, such as further improvement of China's measures for copyright protection on the Internet following China's accession to the WIPO Internet treaties, deficiencies in China's criminal IPR enforcement measures and measures relating to technology transfer.</p>
<p>Enforcement Effective IPR enforcement has not been achieved, and IPR infringement remains a serious problem throughout China. IPR enforcement is hampered by lack of coordination among Chinese government ministries and agencies, lack of training, resource constraints, lack of transparency in the enforcement process and its outcomes, and local protectionism and corruption.</p>

Table 1 (cont'd)

Summary Analysis of China's WTO Compliance Efforts

SERVICES

While China has implemented most of its services commitments, concerns remain in some service sectors. In addition, challenges still remain in ensuring the benefits of many of the commitments that China has nominally implemented are available in practice, as China has continued to maintain or erect restrictive or cumbersome terms of entry in some sectors. These entry barriers prevent or discourage foreign suppliers from gaining market access through informal bans on new entry, high capital requirements, branching restrictions or restrictions taking away previously acquired market access rights. In addition, the licensing process in some sectors has generated national treatment concerns or inordinate delays.

Financial Services

Banking

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

Motor Vehicle Financing

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

Insurance

China has issued measures implementing most of its insurance commitments, but these measures have also created problems in the areas of licensing, branching and transparency.

Financial Information

In response to a WTO case brought by the United States, China has established an independent regulator for the financial information sector and has removed restrictions that had placed foreign suppliers at a serious competitive disadvantage.

Electronic Payment Services

China has not yet implemented electronic payment services commitments that should have been phased in no later than December 11, 2006. However, China has agreed to implement these commitments by July 2013 in order to comply with the WTO's rulings in a WTO case brought by the United States.

Legal Services

China has issued measures intended to implement its legal services commitments, although these measures give rise to WTO compliance concerns because they impose an economic needs test, restrictions on the types of legal services that can be provided and lengthy delays for the establishment of new offices.

Telecommunications

It appears that China has nominally kept to the agreed schedule for phasing in its WTO commitments in the telecommunications sector, but restrictions maintained by China on basic services, such as informal bans on new entry, a requirement that foreign suppliers can only enter into joint ventures with state-owned enterprises and exceedingly high capital requirements, and additional restrictions on value-added services, have created serious barriers to market entry.

Construction and Related Engineering Services

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

Express Delivery Services

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

Table 1 (cont'd)

Summary Analysis of China's WTO Compliance Efforts

SERVICES (cont'd)
<p>Aviation Services China has provided additional market access to U.S. providers of air transport services through progressive liberalization of a bilateral agreement with the United States.</p>
<p>Maritime Services Even though China made only limited WTO commitments relating to its maritime services sector, it has increased market access for U.S. service providers through a bilateral agreement.</p>
<p>Other Services The United States has not identified significant concerns related to China's implementation of commitments made in other service sectors.</p>
LEGAL FRAMEWORK
<p>Transparency</p> <p><u>Official Journal</u> China has re-committed to use a single official journal for the publication of all trade-related laws, regulations and other measures. To date, it appears that most but not all government entities publish trade-related measures in this journal, although they take a narrow view of the types of trade-related measures that need to be published.</p> <p><u>Translations</u> China has not yet established an infrastructure to undertake the agreed upon translations of its trade-related measures into one or more of the WTO languages.</p> <p><u>Public Comment</u> China has adopted notice-and-comment procedures for proposed laws and committed to use notice-and-comment procedures for proposed trade- and economic-related regulations and departmental rules, subject to specified exceptions.</p> <p><u>Enquiry Points</u> China has complied with its obligation to establish enquiry points.</p>
<p>Uniform Application of Laws Some problems with the uniform application of China's laws and regulations persist.</p>
<p>Judicial Review China has established courts to review administrative actions related to trade matters, but few U.S. or other foreign companies have had experience with these courts.</p>

INTRODUCTION

CHINA'S WTO ACCESSION NEGOTIATIONS

In July of 1986, China applied for admission to the WTO's predecessor, the General Agreement on Tariffs and Trade (GATT). The GATT formed a Working Party in March of 1987, composed of all interested GATT contracting parties, to examine China's application and negotiate terms for China's accession. For the next eight years, negotiations were conducted under the auspices of the GATT Working Party. Following the formation of the WTO on January 1, 1995, pursuant to the Marrakesh Agreement Establishing the World Trade Organization (WTO Agreement), a successor WTO Working Party, composed of all interested WTO members, took over the negotiations.

Like all WTO accession negotiations, the negotiations with China had three basic aspects. First, China provided information to the Working Party regarding its trade regime. China also updated this information periodically during the 15 years of negotiations to reflect changes in its trade regime. Second, each interested WTO member negotiated bilaterally with China regarding market access concessions and commitments in the goods and services areas, including, for example, the tariffs that would apply on industrial and agricultural goods and the commitments that China would make to open up its market to foreign services suppliers. The most trade liberalizing of the concessions and commitments obtained through these bilateral negotiations were consolidated into China's Goods and Services Schedules and apply to all WTO members. Third, overlapping in time with these bilateral negotiations, China engaged in multilateral negotiations with Working Party members on the rules that would govern trade with China. Throughout these multilateral negotiations, U.S. leadership in working with China was critical to removing obstacles to China's WTO accession and achieving a consensus on appropriate rules commitments. These commitments are set forth in

China's Protocol of Accession and an accompanying Report of the Working Party.

WTO members formally approved an agreement on the terms of accession for China on November 10, 2001, at the WTO's Fourth Ministerial Conference, held in Doha, Qatar. One day later, China signed the agreement and deposited its instrument of ratification with the Director-General of the WTO. China became the 143rd member of the WTO on December 11, 2001.

China's Protocol of Accession, accompanying Working Party Report and Goods and Services Schedules are available on the WTO's website (www.wto.org).

CHINA'S WTO COMMITMENTS

In order to accede to the WTO, China had to agree to take concrete steps to remove trade barriers and open its markets to foreign companies and their exports from the first day of accession in virtually every product sector and for a wide range of services. Supporting these steps, China also agreed to undertake important changes to its legal framework, designed to add transparency and predictability to business dealings.

Like all acceding WTO members, China also agreed to assume the obligations of more than 20 existing multilateral WTO agreements, covering all areas of trade. Areas of principal concern to the United States and China's other trading partners, as evidenced by the accession negotiations, included the core principles of the WTO, including most-favored nation treatment, national treatment, transparency and the availability of independent review of administrative decisions. Other key concerns arose in the areas of agriculture, SPS measures, technical barriers to trade, trade-related investment measures, customs valuation, rules of origin, import licensing, antidumping, subsidies and countervailing measures, trade-related aspects of

intellectual property rights and services. For some of its obligations in these areas, China was allowed minimal transition periods, where it was considered necessary.

Even though the terms of China's accession agreement are directed at the opening of China's market to WTO members, China's accession agreement also includes provisions establishing several mechanisms or other authority, independent of provisions applicable to all WTO members under the WTO Agreement, designed to prevent or remedy injury that U.S. or other WTO members' industries and workers might experience based on import surges or unfair trade practices. These mechanisms include (1) a special textile safeguard mechanism (which expired on December 11, 2008, 7 years after China's WTO accession), (2) a unique, China-specific safeguard mechanism allowing a WTO member to restrain increasing Chinese imports that disrupt its market (available for 12 years, running from the date of China's WTO accession), (3) the authority for WTO members whose national laws contain market

economy criteria as of the date of China's WTO accession to utilize a special non-market economy methodology for measuring dumping in anti-dumping cases against Chinese companies (this China-specific authority expires after 15 years, running from the date of China's WTO accession) and (4) the authority to use methodologies for identifying and measuring subsidy benefits to Chinese enterprises that are not based on terms and conditions prevailing in China (without expiration). The Administration is committed to maintaining the effectiveness of these mechanisms, to the extent that they remain available, for the benefit of affected U.S. businesses, workers and farmers.

With China's consent, the WTO also created a special multilateral mechanism for reviewing China's compliance on an annual basis. Known as the Transitional Review Mechanism, this mechanism operated annually for 8 years after China's accession. A final review, looking back over the first 10 years of China's WTO membership, took place in year 10, i.e., 2011.

OVERVIEW OF U.S. ENGAGEMENT

DIALOGUE

Bilateral Engagement

In 2012, the United States continued to pursue intensified, focused bilateral dialogue with China. Working together, the United States and China engaged in a set of formal and informal bilateral dialogues and meetings, including numerous working groups and meetings under the auspices of the U.S.-China Joint Commission on Commerce and Trade (see Box 1) and the U.S.-China Strategic and Economic Dialogue (see Box 2). Through the JCCT process, the United States sought resolutions to particular pressing trade issues while also encouraging China to accelerate its movement away from reliance on government intervention and toward full institutionalization of market mechanisms. At the same time, the United States used the S&ED's Economic Track to address cross-cutting and long-term economic issues.

Following several months of preparatory meetings, the JCCT met for the 23rd time in December 2012 (see Appendix 3). Chaired by Acting Commerce Secretary Blank and U.S. Trade Representative Kirk on the U.S. side and Vice Premier Wang on the Chinese side, the JCCT meets annually and focuses on seeking resolutions to discrete, pressing trade issues. This bilateral engagement produced meaningful progress in some key areas, including (1) confirmation that China requires state-owned enterprises and state-owned banks under the supervision of the central government to purchase and use legal software, (2) confirmation that China will correct in a timely manner any measures that are inconsistent with its prior bilateral commitment that technology transfer would be decided by businesses independently and would not be used by the Chinese government as a pre-condition for market access, (3) an announcement that China's Supreme People's Court will publish a Judicial

Interpretation on Internet Intermediary Liability before the end of 2012, (4) an agreement that China will not mandate any particular encryption standard for commercial 4G Long Term Evolution telecommunications equipment, (5) a commitment to work with the United States as China revises technical regulations that are impeding U.S. telecommunications equipment exports to China, (6) a commitment to delay finalization of a catalogue related to official use vehicles while China considers U.S. concerns, (7) a commitment to treat foreign and domestic manufacturers equally in any measures affecting the pricing of medical devices and (8) confirmation that eligible foreign-invested testing and certification entities registered in China can participate in China Compulsory Certification mark testing and certification. In addition, China agreed to hold serious discussions, beginning in the first half of 2013, regarding its VAT system, and China also agreed to engage seriously with the United States on outstanding core issues related to GPA accession. Despite the progress made at this year's JCCT meeting, the U.S. side made clear that much more work remains to be done to open China's market to trade and investment.

Box 1: JCCT

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

The fourth meeting of the S&ED, which included a Strategic Track and an Economic Track, took place in May 2012 (see Appendix 4). The Economic Track of the S&ED allows U.S. and Chinese officials at the highest levels to work together to address cross-cutting economic issues through candid and constructive engagement. The S&ED produced near-term results in the areas of trade and investment and financial services this year, including commitments by China to provide non-discriminatory treatment to all enterprises, regardless of whether state-owned or privately owned, in terms of credit, taxation, and regulatory policies, to submit a revised comprehensive offer to join the WTO Agreement on Government Procurement in 2012, to further simplify and enhance the transparency of its investment approval system, to focus its security review of foreign investment solely on national security concerns, to extend its efforts to promote the use of legal software by Chinese enterprises, to prioritize trade secrets in its IPR protection policies and to increase enforcement against trade secret misappropriation, to treat IPR owned or developed in other countries the same as IPR owned or developed in China, to allow foreign investors to take up to 49 percent equity stakes in domestic securities joint ventures and to allow foreign investors to take up to 49 percent equity stakes in joint venture brokerages to trade commodity and financial futures. The two sides also agreed to discussions in some important areas, including the commencement of negotiations for new rules on official export financing with the United States, China and other major exporters and intensified bilateral investment treaty negotiations. In addition, during the run-up to the May 2012 S&ED meeting, China issued regulations implementing its commitment to open mandatory third party auto insurance to foreign suppliers, consistent with

pledges made during the February 2012 U.S. visit of Vice President Xi and the May 2011 S&ED meeting.

Box 2: S&ED

The U.S.-China Strategic and Economic Dialogue was established by Presidents Obama and Hu in April 2009 and represents the highest-level bilateral forum between the United States and China. The S&ED is an essential step in advancing a positive, constructive and comprehensive relationship between the two countries. Treasury Secretary Geithner and Secretary of State Clinton, as special representatives of President Obama, and Vice Premier Wang and State Councilor Dai, as special representatives of President Hu, co-chair the S&ED, which includes Strategic and Economic tracks and takes place annually in alternating capitals. In the Economic Track, the two sides have focused on four pillars that have formed the basis of our economic engagement over the course of the Administration: (1) promoting a strong recovery and achieving more sustainable and balanced growth; (2) promoting more resilient, open and market-oriented financial systems; (3) strengthening trade and investment; and (4) strengthening the international financial architecture.

Multilateral Meetings

In 2012, as in prior years, the United States supplemented its bilateral engagement of China with robust participation in meetings at the WTO focusing on China and its adherence to the obligations that it assumed upon acceding to the WTO in December 2001. Throughout the year, the United States raised China-related issues at regular meetings of WTO committees and councils. The United States also played an active role in the WTO's third Trade Policy Review of China (see Box 3), held in June 2012, submitting approximately 135 written questions about various aspects of China's trade regime and presenting an evaluation of China's conduct as a WTO member.

Box 3: Trade Policy Review Mechanism

The Trade Policy Review Mechanism (TPRM) was created by the WTO Agreement to facilitate the smooth functioning of the multilateral trading system by enhancing the transparency of WTO members' trade policies. All WTO members are subject to review under the TPRM. The four WTO members with the largest shares of world trade (currently, the EC, the United States, Japan and China) are reviewed every two years, the next 16 largest are reviewed every four years, and all others are reviewed every six years (except that a longer period may be fixed for least-developed country members of the WTO). The reviews are conducted by the Trade Policy Review Body (TPRB) on the basis of a policy statement by the WTO member under review and a report prepared by economists in the Secretariat's Trade Policy Review Division. In preparing its report, the Secretariat seeks the cooperation of the Member, but has the sole responsibility for the facts presented and views expressed about the member's trade policies. During a meeting that takes place over two days, the TPRB's debate is stimulated by a discussant, selected beforehand for this purpose. Members also make their own observations, while the member under review is required to respond orally and in writing to written questions that have been submitted by other members. The Secretariat's report and the member's policy statement are published after the review meeting, along with the minutes of the meeting.

Agreement on Subsidies and Countervailing Measures (Subsidies Agreement) not to provide subsidies contingent upon export performance. In addition, it appeared that China failed to abide by various WTO transparency obligations requiring it to publish the measures at issue in an official journal, notify them to the WTO Committee on Subsidies and Countervailing Measures and make translations of them available in one or more WTO languages. Consultations took place in November 2012.

In another new WTO case, initiated in July 2012, the United States is challenging China's imposition of antidumping and countervailing duties on imports of certain U.S. automobiles. As in certain other recent antidumping (AD) and countervailing duty (CVD) investigations, China's regulatory authorities appear to have imposed the duties at issue without necessary legal and factual support and without observing certain transparency and procedural fairness requirements, in violation of various WTO obligations under the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (AD Agreement) and the Subsidies Agreement. Consultations took place in August 2012. A WTO panel was established to hear this case in October 2012, and eight other WTO members joined the case as third parties.

ENFORCEMENT

While engaging in intensified dialogue with China throughout the year, the United States also continued to hold China accountable for adherence to WTO rules when dialogue did not resolve U.S. concerns. The United States brought three new WTO cases against China during the past year, while it continued to pursue five other WTO cases against China, as set out in Table 2 below.

In the newest WTO case, initiated in September 2012, the United States is challenging numerous subsidies provided by the central government and various sub-central governments in China to automobile and automobile-parts enterprises located in regions in China known as "export bases." The challenged subsidies appear to be inconsistent with China's obligation under Article 3 of the

In March 2012, the United States, joined by the European Union (EU) and Japan, initiated a WTO case challenging export quotas, export duties and other restraints maintained by China on the export of rare earths, tungsten and molybdenum, which are key inputs in a multitude of U.S.-made products, including hybrid car batteries, wind turbines, energy-efficient lighting, steel, advanced electronics, automobiles, petroleum and chemicals. China is a leading world producer of these materials, and its export restraints can skew the playing field against the United States and other countries by creating substantial competitive benefits for downstream Chinese producers that use these materials as inputs in the production and export of further processed and finished products. The export restraints also can create substantial pressure on U.S. and other non-

Chinese downstream producers to move their operations, jobs and technologies to China. The export restraints appear to be inconsistent with China's obligations under various provisions of the GATT 1994 and China's accession agreement. Joint consultations took place in April 2012. A WTO panel was established to hear the case at the complaining parties' request in July 2012, and 18 other WTO members joined the case as third parties. The first panel meeting is scheduled to take place in February 2013.

In a WTO case initiated in September 2011, the United States is challenging China's imposition of antidumping and countervailing duties on imports of certain U.S. chicken products known as "broiler products." In the course of its AD and CVD investigations, China's regulatory authorities appear to have imposed the duties at issue without necessary legal and factual support and without observing certain transparency and procedural fairness requirements, in violation of various WTO obligations under the AD Agreement and the Subsidies Agreement. Consultations were held in October 2011. A WTO panel was established to hear this case at the United States' request in January 2012, and seven other WTO members joined the case as third parties. Hearings before the panel took place in September and December 2012, and the panel is expected to issue its decision in 2013.

In a WTO case initiated in September 2010, the United States challenged China's restrictions on foreign suppliers of electronic payment services. Suppliers like the major U.S. credit card companies provide these services in connection with the operation of electronic networks that process payment transactions involving credit, debit, prepaid and other payment cards. They also enable, facilitate and manage the flow of information and the transfer of funds from cardholders' banks to merchants' banks. China's regulatory regime places severe restrictions on foreign suppliers of electronic payment services. Among other things, China prohibits foreign suppliers from handling the typical payment card transaction in China, in which a

Chinese consumer is billed in and makes a payment in China's domestic currency, known as the renminbi, or RMB. Instead, China has created a national champion, allowing only one domestic entity, China UnionPay (CUP), to provide these services. Consultations were held in October 2010. A WTO panel was established to hear this case at the United States' request in March 2011, and six other WTO members joined the case as third parties. Hearings before the panel took place in October and December 2011, and the panel issued its decision in July 2012. The panel found the challenged restrictions to be inconsistent with China's commitments under the General Agreement on Trade in Services (GATS). China decided not to appeal the panel's decision and subsequently agreed to come into compliance with the WTO's rulings by July 2013.

In another WTO case initiated in September 2010, the United States challenged China's imposition of antidumping and countervailing duties on imports of grain-oriented electrical steel (GOES) – a soft magnetic material used by the power generating industry in transformers, rectifiers, reactors and large electric machines – from the United States. In the course of its AD and CVD investigations, China's regulatory authorities appear to have imposed the duties at issue without necessary legal and factual support and without observing certain transparency and procedural fairness requirements, in violation of various WTO obligations under the AD Agreement and the Subsidies Agreement. Consultations were held in November 2010. A WTO panel was established to hear this case at the United States' request in March 2011, and eight other WTO members joined the case as third parties. Hearings before the panel took place in September and December 2011, and the panel issued its decision in June 2012, finding in favor of the United States on all significant claims. China appealed the panel's decision in July 2012. The WTO's Appellate Body rejected China's appeal in October 2012.

In a WTO case initiated in June 2009, the United States, joined by the EU and Mexico, challenged

export quotas, export duties and other restraints maintained by China on the export of several key raw material inputs, including bauxite, coke, fluorspar, magnesium, manganese, silicon metal, silicon carbide, yellow phosphorus and zinc. Because China was a leading world producer of these inputs, the export restraints could skew the playing field against the United States and other countries by creating substantial competitive benefits for downstream Chinese producers that used the inputs in the production and export of numerous processed steel, aluminum and chemical products and a wide range of further processed products. The export restraints also could create substantial pressure on U.S. and other non-Chinese downstream producers to move their operations, jobs and technologies to China. The United States and its co-complainants alleged that the export restraints were inconsistent with China's obligations under various provisions of the GATT 1994 and China's accession agreement. Joint consultations were held in July and September 2009. A WTO panel was established to hear this case at the complaining parties' request in December 2009, and 13 other WTO members joined the case as third parties. Hearings before the panel took place in August and November 2010, and the panel issued its decision in July 2011. The panel rejected China's defenses, which had attempted to portray China's export restraints as conservation or environmental protection measures or measures taken to manage critical shortages of supply, and found in favor of the United States and its co-complainants on all significant claims, ruling that the export restraints at issue were inconsistent with China's WTO obligations. China appealed certain aspects of the panel's decision in August 2011, and the WTO's Appellate Body rejected China's appeal in January

2012, confirming that the export restraints at issue violate China's WTO obligations. China subsequently agreed to come into compliance with the WTO's rulings by the end of December 2012.

The one remaining WTO case that was active in 2012 involved U.S. challenges to market access restrictions maintained by China that restricted the importation and distribution of copyright-intensive products such as books, newspapers, journals, theatrical films, DVDs and music. In this case, proceedings before a WTO panel took place in 2008, and the panel issued its decision in August 2009, ruling in favor of the United States on every significant claim in the case. China appealed the panel's decision in September 2009. The WTO's Appellate Body rejected China's appeal on all counts in December 2009. China agreed to come into compliance with the WTO's rulings by March 2011. China subsequently issued several revised measures, and repealed other measures, relating to the market access restrictions on books, newspapers, journals, DVDs and music. As China acknowledged, however, it did not issue any measures addressing theatrical films. Instead, China proposed bilateral discussions with the United States in order to seek an alternative solution. After months of negotiations, which included discussions between the two sides' Vice Presidents, the United States and China reached agreement in February 2012 on a Memorandum of Understanding (MOU) providing for substantial increases in the number of foreign films imported and distributed in China each year and substantial additional revenue for foreign film producers. The MOU will be reviewed after five years in order to discuss issues of concern, including additional compensation for the U.S. side.

2012 USTR Report to Congress on China's WTO Compliance

Table 2

Active U.S. WTO Disputes against China in 2012

China – Market Access for Books, Movies and Music	
<u>Initiation:</u>	April 2007
<u>Dispute:</u>	The United States challenged China's barriers to importing and distributing books, newspapers, journals, theatrical films, DVDs and music in China.
<u>Third Parties:</u>	Australia, the EU, Japan, Korea and Chinese Taipei
<u>Status:</u>	A WTO panel issued its decision in August 2009, ruling in favor of the United States on all significant claims. China appealed the panel's decision in September 2009. The WTO's Appellate Body rejected China's appeal in December 2009. China agreed to come into compliance with the WTO's rulings by March 2011. Since then, China has taken compliance steps with regard to the market access barriers on books, newspapers, journals, DVDs and music. With regard to theatrical films, the United States and China concluded an MOU providing for substantial increases in the number of foreign films imported and distributed in China each year and substantial additional revenue for foreign film producers.
China – Export Restraints on Raw Materials I	
<u>Initiation:</u>	June 2009
<u>Dispute:</u>	The United States, the EU and Mexico challenged China's export restraints on several key raw material inputs used to produce downstream products in steel, aluminum and chemical sectors around the world.
<u>Third Parties:</u>	Argentina, Brazil, Canada, Chile, Colombia, Ecuador, India, Japan, Korea, Norway, Saudi Arabia, Chinese Taipei and Turkey
<u>Status:</u>	A WTO panel issued its decision in July 2011, rejecting China's defenses and finding in favor of the United States and its co-complainants on all significant claims. China appealed the panel's decision in August 2011. The WTO's Appellate Body rejected China's appeal in January 2012. China agreed to come into compliance with the WTO's rulings by December 2012.
China – Electronic Payment Services	
<u>Initiation:</u>	September 2010
<u>Dispute:</u>	The United States challenged China's restrictions on foreign suppliers of electronic payment services like the major U.S. credit card companies.
<u>Third Parties:</u>	Australia, Ecuador, the EU, India, Japan and Korea
<u>Status:</u>	Hearings before a WTO panel took place in October and December 2011. The panel issued its decision in July 2012, finding the challenged measures to be inconsistent with China's GATS commitments. China decided not to appeal the panel's decision. China agreed to come into compliance with the WTO's rulings by July 2013.
China – Antidumping and Countervailing Duties on Grain-Oriented Electrical Steel	
<u>Initiation:</u>	September 2010
<u>Dispute:</u>	The United States challenged China's imposition of antidumping and countervailing duties on imports of grain-oriented electrical steel from the United States.
<u>Third Parties:</u>	Argentina, the EU, Honduras, India, Japan, Korea, Saudi Arabia and Vietnam
<u>Status:</u>	Hearings before a WTO panel took place in September and December 2011. The panel issued its decision in June 2012, finding in favor of the United States on all significant claims. China appealed the panel's decision in July 2012. The WTO's Appellate Body rejected China's appeal in October 2012.
China – Antidumping and Countervailing Duties on Chicken Broiler Products	
<u>Initiation:</u>	September 2011
<u>Dispute:</u>	The United States is challenging China's imposition of antidumping and countervailing duties on imports of chicken broiler products from the United States.
<u>Third Parties:</u>	Chile, the EU, Japan, Mexico, Norway, Saudi Arabia and Thailand
<u>Status:</u>	Hearings before a WTO panel took place in September and December 2012. The panel is scheduled to issue its decision in 2013.

2012 USTR Report to Congress on China's WTO Compliance

Table 2 (cont'd)

Active U.S. WTO Disputes against China in 2012

China – Export Restraints on Raw Materials II	
<u>Initiation:</u>	March 2012
<u>Dispute:</u>	The United States, the EU and Japan are challenging China's export restraints on rare earths, tungsten and molybdenum.
<u>Third Parties:</u>	Argentina, Australia, Brazil, Canada, Colombia, India, Indonesia, Korea, Norway, Oman, Peru, Russian Federation, Saudi Arabia, Chinese Taipei, Turkey and Vietnam
<u>Status:</u>	A WTO panel was established to hear the case in July 2012.
China – Antidumping and Countervailing Duties on Automobiles	
<u>Initiation:</u>	July 2012
<u>Dispute:</u>	The United States is challenging China's imposition of antidumping and countervailing duties on imports of automobiles from the United States.
<u>Third Parties:</u>	Colombia, the EU, India, Japan, Korea, Oman, Saudi Arabia and Turkey
<u>Status:</u>	A WTO panel was established to hear the case in October 2012.
China – Subsidies for Automobile and Automobile-Parts Exporter Base Enterprises	
<u>Initiation:</u>	September 2012
<u>Dispute:</u>	The United States is challenging China's provision of what appear to be export subsidies to automobile and automobile-parts enterprises in China.
<u>Third Parties:</u>	It is not yet clear whether other WTO members will join in as third parties.
<u>Status:</u>	Consultations took place in November 2012.

CHINA'S WTO COMPLIANCE

Set forth below is a detailed analysis of the commitments that China made upon acceding to the WTO on December 11, 2001, the progress that China has made in complying with those commitments and the United States' efforts to address compliance concerns that have arisen as of December 2012. As noted above, a summary of China's WTO compliance efforts is reproduced in Table 1.

TRADING RIGHTS

China appears to be in compliance with its trading rights commitments in most areas. One significant exception has involved restrictions on the right to import copyright-intensive products such as books, newspapers, journals, theatrical films, DVDs and music, which China reserved for state trading. China agreed to remove those restrictions in 2011 in order to comply with the rulings in a WTO case brought by the United States. To date, China has taken steps to comply with those rulings to the extent that they apply to books, newspapers, journals, DVDs and music. With regard to theatrical films, the two sides entered into an MOU in 2012 providing for substantial increases in the number of U.S. films imported and distributed in China each year and substantial additional revenue for foreign film producers.

Within the context of China's WTO commitments, the concept of "trading rights" includes two elements, i.e., the right to import goods (into China) and the right to export goods (from China). It does not include the right to sell goods within China, as that right is governed by separate commitments principally relating to "distribution services" set forth in China's Services Schedule (see the Distribution Services section below). Nevertheless, together with China's distribution services commitments, China's trading rights commitments call for the elimination of significant barriers to a wide range of U.S. and other foreign industries doing business, or seeking to do business, in China.

Until shortly before its WTO accession, China severely restricted the number and types of enterprises that could import or export goods, and it also restricted the goods that a particular enterprise could import or export. For the most part, China confined trading rights to certain state-owned manufacturing and trading enterprises, which could import or export goods falling within their approved scopes of business. China also granted trading rights to certain foreign-invested enterprises, allowing them to import inputs for their production purposes and export their finished products.

In its accession agreement, China committed to substantial liberalization in the area of trading rights. Most importantly, China agreed to eliminate its system of examination and approval of trading rights and make full trading rights automatically available for all Chinese enterprises, Chinese-foreign joint ventures, wholly foreign-owned enterprises and foreign individuals, including sole proprietorships, within three years of its accession, or by December 11, 2004, the same deadline for China to eliminate most restrictions in the area of distribution services. The only exceptions applied to products listed in an annex to China's accession agreement, such as grains, cotton and tobacco, for which China reserved the right to engage in state trading.

As previously reported, the NPC issued a revised *Foreign Trade Law*, which provided for trading rights to be automatically available through a registration process for all domestic and foreign entities and individuals, effective July 2004, while MOFCOM issued implementing rules setting out the procedures for registering as a foreign trade operator. U.S. companies have reported few problems with this trading rights registration process.

Books, Movies and Music

Under the terms of China's accession agreement, trading rights for copyright-intensive products such as books, newspapers, journals, theatrical films,

DVDs and music should have been automatically available to all Chinese enterprises, Chinese-foreign joint ventures, wholly foreign-owned enterprises and foreign individuals as of December 11, 2004. These products are not included in the list of products for which China reserved the right to engage in state trading. Nevertheless, China did not liberalize trading rights for these products. China continued to reserve the right to import these products to state trading enterprises, as reflected in a complex web of measures issued by numerous agencies, including the State Council, the State Administration of Radio, Film and Television (SARFT), MOFCOM, the National Development and Reform Commission (NDRC), the Ministry of Culture, the General Administration of Press and Publication (GAPP) and the General Administration of Customs.

As previously reported, the United States initiated a WTO dispute settlement case against China in April 2007, challenging China's restrictions on the importation and distribution of copyright-intensive products such as books, newspapers, journals, theatrical films, DVDs and music. The WTO panel established to hear this case issued its decision in August 2009, ruling in favor of the United States on all significant claims. China appealed the panel's decision in September 2009, and the WTO's Appellate Body rejected China's appeal on all counts in December 2009. China agreed to comply with these rulings by March 2011. China subsequently issued several revised measures, and repealed other measures, relating to the importation restrictions on books, newspapers, journals, DVDs and music. However, China did not issue any measures addressing theatrical films and instead proposed bilateral discussions with the United States in order to seek an alternative solution. After months of negotiations, which included discussions between the two sides' Vice Presidents, the United States and China reached agreement in February 2012 on an MOU providing for substantial increases in the number of foreign films imported and distributed in China each year and substantial additional revenue for foreign film producers. The MOU will be reviewed after five years in order to discuss issues of

concern, including additional compensation for the U.S. side.

DISTRIBUTION SERVICES

China has made substantial progress in implementing its distribution services commitments, although significant concerns remain in some areas.

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

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

Overall, China has made substantial progress in implementing its distribution services commitments. As discussed below, however, significant concerns remain in some areas.

Wholesaling Services

China has issued regulations generally implementing its commitments in the area of wholesaling and commission agents' services. One significant exception has involved restrictions on the distribution of copyright-intensive products such as books, newspapers, journals, DVDs, music and theatrical films. China agreed to remove those restrictions in 2011 in order to comply with the rulings in a WTO

case brought by the United States. To date, China has taken steps to comply with those rulings to the extent that they apply to books, newspapers, journals, DVDs and music, although more steps are needed. With regard to theatrical films, the two sides entered into an MOU in 2012 providing for substantial increases in the number of U.S. films imported and distributed in China each year and substantial additional revenue for foreign film producers. Meanwhile, U.S. companies continue to have concerns about restrictions on the distribution of other products, such as pharmaceuticals, crude oil and processed oil.

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

As previously reported, MOFCOM issued the *Measures on the Management of Foreign Investment in the Commercial Sector* in April 2004 following sustained engagement by the United States, including through the JCCT process. Among other things, these regulations lifted market access and national treatment restrictions on wholly foreign-owned enterprises and removed product exceptions for books, newspapers, magazines, pesticides and mulching films as of the scheduled phase-in date of December 11, 2004. The regulations also required

enterprises to obtain central or provincial-level MOFCOM approval before providing wholesale services, and they appeared to set relatively low qualifying requirements, as enterprises needed only to satisfy the relatively modest capital requirements of the *Company Law* rather than the high capital requirements found in many other services sectors. Since the issuance of the regulations, U.S. companies have been able to improve the efficiency of their China supply chain management. In addition, many of them have been able to restructure their legal entities to integrate their China operations into their global business more fully and efficiently, although problems remain in certain areas.

Books, Movies and Music

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

As previously reported, the United States initiated a WTO dispute settlement case against China in April 2007 challenging the importation and distribution restrictions applicable to copyright-intensive products such as books, newspapers, journals, theatrical films, DVDs and music. As discussed above in the Trading Rights section, a WTO panel issued its decision in August 2009, ruling in favor of the United States on all significant claims, and China appealed. The WTO's Appellate Body rejected China's appeal on all counts in December 2009, and China agreed to come into compliance with these rulings by March 2011. China subsequently issued several revised measures, and repealed other measures, relating to its distribution restrictions on imported books, newspapers, journals, DVDs and music, although

these steps have not yet brought China into full compliance with the WTO's rulings, particularly with regard to the online distribution of music. With regard to theatrical films, China proposed bilateral discussions with the United States in order to seek an alternative solution, and these discussions culminated in the two sides' agreement in February 2012 on an MOU providing for substantial increases in the number of foreign films imported and distributed in China each year and substantial additional revenue for foreign film producers.

Pharmaceuticals

China committed to allow foreign suppliers to distribute pharmaceuticals by December 11, 2004, and it began accepting applications from and issuing wholesale licenses to foreign pharmaceutical companies about six months after that deadline. At the same time, despite overall progress in this area, many other restrictions affecting the pharmaceuticals sector continue to make it difficult for foreign pharmaceutical companies to realize the full benefits of China's distribution commitments. The United States is continuing to engage the Chinese regulatory authorities in these areas as part of a broader effort to promote comprehensive reform and to reduce the unnecessary trade barriers that foreign companies face.

Crude Oil and Processed Oil

China committed to permit foreign enterprises to engage in wholesale distribution of crude oil and processed oil, e.g., gasoline, by December 11, 2006. Shortly before this deadline, as previously reported, China issued regulations that prevent U.S. and other foreign enterprises from realizing the full benefits of this important commitment. In particular, China's regulations impose high thresholds and other potential impediments on foreign enterprises seeking to enter the wholesale distribution sector, such as requirements relating to levels of storage capacity, pipelines, rail lines, docks and supply contracts. The United States has raised concerns about these regulations in connection with past

transitional reviews before the Council for Trade in Services, while U.S. industry has attempted to compete under difficult circumstances. In consultation with U.S. industry, the United States will continue to assess the effects of China's restrictive regulations in 2013 while urging China to remove unwarranted impediments to market entry.

Automobiles

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

Retailing Services

China has issued regulations generally implementing its commitments in the area of retailing services, although some concerns remain with regard to licensing discrimination. China continues to maintain restrictions on the retailing of processed oil.

China committed that, immediately upon its accession to the WTO, it would begin to eliminate national treatment and market access limitations on foreign enterprises providing retailing services through a local presence pursuant to an agreed schedule of liberalization. Within three years after accession (or by December 11, 2004), almost all of the required liberalization should have been

implemented. By this time, China agreed to permit foreign enterprises to supply retailing services through wholly foreign-owned enterprises. In addition, by this time, exceptions that China had been allowed to maintain for pharmaceutical products, pesticides, mulching films and processed oil were to be eliminated. An exception for chemical fertilizers was to be eliminated within five years after accession (or by December 11, 2006).

As previously reported, the April 2004 distribution regulations issued by MOFCOM lifted market access and national treatment limitations on wholly foreign-owned enterprises and removed the product exceptions for pesticides and mulching films as of the scheduled phase-in date of December 11, 2004. These regulations also removed the product exception for chemical fertilizer as of the scheduled phase-in date of December 11, 2006. In addition, in the revised *Catalogue Guiding Foreign Investment in Industry* (Foreign Investment Catalogue), issued in December 2011, China removed the retailing of over-the-counter medicines from the "restricted" category of foreign investments.

Licensing Process

The 2004 regulations required enterprises to obtain central and provincial-level MOFCOM approval before providing retail services, and initially foreign retailers encountered various problems when seeking licenses. Changes subsequently made by MOFCOM helped to remedy these problems, although in practice foreign retailers reportedly still had to meet higher capital requirements than domestic retailers.

In 2007, as previously reported, the U.S. retail industry became increasingly concerned about extra burdens that it faced, in comparison to domestic retailers, when attempting to expand their operations in China. Following U.S. engagement of China both bilaterally and in WTO meetings, China delegated authority for foreign retail outlet license approvals to the provincial government level. Since

then, U.S. retailers have welcomed this change as a very positive step in streamlining and facilitating approvals for foreign retail outlets. In 2013, the United States will continue to monitor how this new licensing process works in practice while also continuing to monitor whether China is imposing additional capital requirements on foreign retailers.

Processed Oil

China committed to allow wholly foreign-owned enterprises to sell processed oil, e.g., gasoline, at the retail level by December 11, 2004, without any market access or national treatment limitations. However, to date, China has treated retail gas stations as falling under the chain store provision in its Services Schedule, which permits only joint ventures with minority foreign ownership for "those chain stores which sell products of different types and brands from multiple suppliers with more than 30 outlets." This treatment has severely restricted foreign suppliers' access to China's retail gas market, a situation that has since been exacerbated by China's restrictions on foreign enterprises that seek to engage in wholesale distribution of crude oil and processed oil. As in prior years, the United States is working with U.S. industry to assess the effects of China's unwarranted restrictions on wholesale and retail distribution in this sector and will continue to engage the Chinese government in 2013 in an effort to ensure that U.S. industry realizes the full benefits to which it is entitled in this sector.

Franchising Services

China has issued regulations generally implementing its commitments in the area of franchising services.

As part of its distribution commitments, China committed to permit the cross-border supply of franchising services immediately upon its accession to the WTO. It also committed to permit foreign enterprises to provide franchising services in China, without any market access or national treatment limitations, by December 11, 2004.

In December 2004, as previously reported, MOFCOM issued new rules governing the supply of franchising services in China, which included a requirement that a franchiser own and operate at least two units in China for one year before being eligible to offer franchises in China. In 2007, following U.S. engagement, China eased the requirement that a franchiser own and operate at least two units in China by allowing a franchiser to offer franchise services in China if it owns and operates two units anywhere in the world. The United States welcomed this action and has been monitoring developments in this area closely since then.

Direct Selling Services

China has issued regulations generally implementing its commitments in the area of direct selling services, although regulatory restrictions including service center requirements, imposed on the operations of direct sellers continue to generate concern.

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

As previously reported, the Chinese regulatory authorities issued implementing measures in 2005 and 2006, which contained several problematic provisions. For example, one provision requires a direct seller to establish a service center in each urban district in which it intends to do business – which translates into many thousands of service centers to carry out direct selling throughout China. Another provision essentially outlaws multi-level marketing practices allowed in every country in which the U.S. industry operates – reportedly 170 countries in all – by refusing to allow direct selling enterprises to pay compensation based on team sales, where upstream personnel are compensated based on downstream sales. Other problematic

provisions include a three-year experience requirement that only applies to foreign enterprises, not domestic enterprises, a cap on single-level compensation, restrictions on the cross-border supply of direct selling services and high capital requirements that may limit smaller direct sellers' access to the market. To date, extensive U.S. engagement has failed to persuade China to reconsider the various problematic provisions in these measures.

Meanwhile, MOFCOM's application and review process initially proved to be opaque and slow, although a number of companies, including several foreign companies, obtained direct selling licenses. However, beginning in May 2007, it appeared that MOFCOM was not issuing any new licenses even though several companies had applied for them. In 2009, following extensive U.S. engagement, China issued a direct selling license to one additional U.S. direct selling company, although no further licenses have been issued to foreign companies. The United States is continuing to closely monitor MOFCOM's progress in issuing new direct selling licenses.

IMPORT REGULATION

Tariffs

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

During its bilateral negotiations with interested WTO members leading up to its accession, China agreed to greatly increase market access for U.S. and other foreign companies by reducing tariff rates on industrial goods over a period of years running from 2002 through 2010. The agreed reductions are set forth as tariff "bindings" in China's Goods Schedule, meaning that while China cannot exceed the bound tariff rates, it can decide to apply them at a lower rate, as many members do when trying to attract particular imports. As previously reported, each year, China implemented its scheduled tariff reductions on January 1 as required.

The annual tariff changes that China made following its WTO accession significantly increased market access for U.S. exporters in a range of industries, as China reduced tariffs on goods of greatest importance to U.S. industry from a base average of 25 percent (in 1997) to approximately 7 percent, while it made similar reductions throughout the agricultural sector (see the Agriculture section below). In addition, U.S. exports have benefited from China's ongoing participation in the Information Technology Agreement (ITA), which requires the elimination of tariffs on computers, semiconductors and other information technology products. U.S. exports also have continued to benefit from China's ongoing adherence to another significant tariff initiative, the WTO's Chemical Tariff Harmonization Agreement, completed in 2005. Overall, U.S. exports to China continued to increase significantly in 2012, rising approximately 6 percent from January through October 2012, when compared to the same time period in 2011.

Customs and Trade Administration

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

CUSTOMS VALUATION

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

The WTO Agreement on the Implementation of GATT Article VII (Agreement on Customs Valuation) is designed to ensure that determinations of the customs value for the application of duty rates to imported goods are conducted in a neutral and

uniform manner, precluding the use of arbitrary or fictitious customs values. Adherence to the Agreement on Customs Valuation is important for U.S. exporters, particularly to ensure that market access opportunities provided through tariff reductions are not negated by unwarranted and unreasonable "uplifts" in the customs value of goods to which tariffs are applied. China agreed to implement its obligations under the Agreement on Customs Valuation upon accession, without any transition period. In addition, China's accession agreement reinforces China's obligation not to use minimum or reference prices as a means for determining customs value. It also called on China to implement the *Decision on Valuation of Carrier Media Bearing Software for Data Processing Equipment* and the *Decision on Treatment of Interest Charges in Customs Value of Imported Goods* by December 11, 2003.

As previously reported, in 2002, shortly after China acceded to the WTO, China issued regulations addressing the inconsistencies that had existed between China's customs valuation methodologies and the Agreement on Customs Valuation. China's Customs Administration subsequently issued rules that were intended to clarify provisions of the regulations addressing the valuation of royalties and license fees. In addition, China issued a measure on interest charges and a measure requiring duties on software to be assessed on the basis of the value of the underlying carrier medium, meaning, for example, the CD-ROM or floppy disk itself, rather than based on the imputed value of the content, which includes, for example, the data recorded on a CD-ROM or floppy disk.

Customs Clearance Procedures

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

Customs Valuation Determinations

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

According to U.S. exporters, even though the Customs Administration's measures provide that imported goods normally should be valued on the basis of their transaction price, meaning the price the importer actually paid, many Chinese customs officials are still improperly using "reference pricing," which usually results in a higher dutiable value. Indeed, it appears that the practice of using reference prices is increasing. Imports of information technology products are often subjected to reference pricing, as are other imported products, such as wood products.

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. Rather, following their pre-WTO accession practice, these officials are still automatically adding royalties and license fees to the dutiable value (for example, when an imported personal computer includes pre-installed software), even though the rules expressly direct them to add those fees only if they are import-related and a condition of sale for the goods being valued.

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

When the United States first presented its concerns about the customs valuation problems being encountered by U.S. companies several years ago,

China indicated that it was working to establish more uniformity in its adherence to WTO customs valuation rules. Since then, the United States has sought to assist in this effort in part by conducting technical assistance programs for Chinese government officials on WTO compliance in the customs area. In addition, the United States raised its concerns about particular customs valuation problems during the annual transitional reviews before the WTO's Committee on Customs Valuation, including the final review that took place in 2011. At present, China still needs to improve its adherence to applicable customs valuation measures.

RULES OF ORIGIN

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

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

As previously reported, it took China nearly three years after its accession to the WTO for China's State Council to issue the regulations intended to bring

China's rules of origin into conformity with WTO rules for import and export purposes. Shortly thereafter, the Customs Administration issued implementing rules addressing the issue of substantial transformation. U.S. exporters have not raised concerns with China's implementation of these measures.

IMPORT LICENSING

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

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

technology transfer or research and development, or on whether competing domestic suppliers exist.

Shortly after China acceded to the WTO, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) issued regulations revising China's automatic import licensing regime, and it later supplemented these regulations with implementing rules. MOFTEC also issued regulations revising China's non-automatic licensing regime. In 2012, as in prior years, the United States continued to monitor MOFCOM's implementation of these regulations.

Iron Ore

In 2005, China began imposing new import licensing procedures for iron ore, a key steel input, for which Chinese steel producers are dependent on foreign suppliers. China restricted the number of licensed importers, but did not make public a list of the qualified enterprises or the qualifying criteria used.

The WTO's Import Licensing Agreement calls for import licensing procedures that do not have a restrictive effect on trade. However, procedures that direct iron ore imports toward certain producers significantly distort trade, particularly because China is by far the largest iron ore importer in the world, and global prices for iron ore have reached historically high levels, led by Chinese demand. China's procedures also set a troubling precedent for the handling of imports of other raw materials. Indeed, when viewed in light of Chinese measures to restrict exports of other steelmaking raw materials and Chinese government involvement in iron ore contract negotiations, the licensing system for iron ore appears to be part of a program to control raw material prices to provide an unfair advantage to Chinese steel producers.

In the years after 2005, China further reduced the number of licensed importers. China also issued a stimulus plan to revitalize its steel industry which provided that the Chinese government would regulate iron ore imports to ensure market order

and that Chinese steel producers and iron ore suppliers would establish a mutually beneficial import pricing mechanism and long-term cooperation relationship. In addition, China reportedly temporarily suspended the issuance of licenses to importers of Australian iron ore in 2008 in an effort to limit price increases being negotiated between foreign exporters of iron ore and Chinese steelmakers.

The United States has raised its concerns about China's restrictive iron ore licensing procedures bilaterally, such as through Steel Dialogue meetings. The United States has also raised its concerns in meetings before the WTO's Committee on Import Licensing and Council for Trade in Goods, including during the final transitional reviews conducted in 2011. In 2012, the United States continued to monitor closely China's iron ore import licensing system as well as other Chinese government actions seeking to influence iron ore prices.

Other Issues

The United States has focused considerable attention on import licensing issues that have arisen in a variety of other specific contexts since China's WTO accession. In 2012, these included the administration of tariff-rate quota systems for fertilizer and cotton (discussed below in the sections on Tariff-rate Quotas on Industrial Goods and Tariff-rate Quotas on Bulk Agricultural Commodities), various SPS measures (discussed below in the section on Sanitary and Phytosanitary Issues) and inspection-related requirements for soybeans, meat, poultry, pork and dairy products (discussed below in the section on Inspection-Related Requirements).

Non-tariff Measures

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

In its WTO accession agreement, China agreed that it would eliminate numerous trade-distortive non-tariff measures (NTMs), including import quotas,

licenses and tendering requirements covering hundreds of products. Most of these NTMs, including, for example, the NTMs covering chemicals, agricultural equipment, medical and scientific equipment and civil aircraft, had to be eliminated by the time that China acceded to the WTO. China committed to phase out other NTMs, listed in an annex to the accession agreement, over a transition period ending on January 1, 2005. These other NTMs included import quotas on industrial goods such as air conditioners, sound and video recording apparatuses, color TVs, cameras, watches, crane lorries and chassis, and motorcycles as well as licensing and tendering requirements applicable to a few types of industrial goods, such as machine tools and aerials.

As previously reported, China's import quota system was beset with problems, despite consistent bilateral engagement by the United States. Some of the more difficult problems were encountered with the auto import quota system, resulting at times in significant disruption of wholesale and retail operations for imported autos. However, China did fully adhere to the agreed schedule for the elimination of all of its import quotas as well as all of its other NTMs, the last of which China eliminated in January 2005. In some cases, China even eliminated NTMs ahead of schedule, as it did with the import quotas on crane lorries and chassis, and motorcycles.

Tariff-rate Quotas on Industrial Products

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

In its WTO accession agreement, China agreed to implement a system of tariff-rate quotas (TRQs) designed to provide significant market access for three industrial products, including fertilizer, a major U.S. export. Under this TRQ system, a set quantity of imports is allowed at a low tariff rate, while imports above that level are subject to a higher tariff rate. In

addition, the quantity of imports allowed at the low tariff rate increases annually by an agreed amount. China's accession agreement specifies detailed rules, requiring China to operate its fertilizer TRQ system in a transparent manner and dictating precisely how and when China is obligated to accept quota applications, allocate quotas and reallocate unused quotas.

As previously reported, since China began implementing its TRQ system for fertilizer in 2002, it has not functioned smoothly. Despite repeated bilateral engagement and multilateral engagement at the WTO, including formal consultations with China in Geneva under the headnotes in China's Goods Schedule, concerns about inadequate transparency and administrative guidance have persisted. Meanwhile, U.S. fertilizer exports to China have declined sharply since China acceded to the WTO, as separate Chinese government policies promoting domestic fertilizer – including export duties (discussed below in the Export Regulation section) and discriminatory internal taxes (discussed below in the Taxation section) – appear to have made it difficult for foreign producers to compete in China's market.

Other Import Regulation

ANTIDUMPING

China has issued laws and regulations bringing its legal regime in the AD area largely into compliance with WTO rules, although China still needs to issue additional procedural guidance such as rules governing expiry reviews. More significantly, China needs to improve its commitment to the transparency and procedural fairness requirements embodied in WTO rules, as the WTO found in a WTO case brought by the United States. In addition, China needs to eliminate its apparent use of trade remedy investigations as a retaliatory tool.

By the time of its accession to the WTO, China agreed to revise its regulations and procedures for AD proceedings, in order to make them consistent

with the AD Agreement. That agreement sets forth detailed rules prescribing the manner and basis on which a WTO member may take action to offset the injurious dumping of products imported from another WTO member. China also agreed to provide for judicial review of determinations made in its AD investigations and reviews.

China has become a leading user of AD measures since its accession to the WTO. Currently, China has in place 107 AD measures, some of which pre-date China's membership in the WTO, affecting imports from 17 countries or regions. China also has 12 AD investigations in progress. The greatest systemic shortcomings in China's AD practice continue to be in the areas of transparency and procedural fairness. In addition, as discussed below, in recent years, China has invoked AD and CVD remedies under troubling circumstances. In response, the United States has pressed China both bilaterally and in WTO meetings to adhere strictly to WTO rules in the conduct of its AD investigations, and the United States has consistently pursued WTO litigation where necessary.

Legal Regime

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

China continues to add new regulations and rules to its AD legal framework, although not all of these

measures have been notified to the WTO in a timely manner. Most recently, in July 2009, MOFCOM solicited public comment on draft revisions of its rules on new shipper reviews, AD duty refunds and price undertakings. To date, however, China still has not finalized revisions to any of these rules. Once finalized, China is obligated to notify these revised rules to the WTO so that all Members have an opportunity to review the rules for compliance with the AD Agreement and seek any needed clarifications. Meanwhile, another area generating concern involves expiry reviews. China has still not issued any regulations specifically establishing the rules and procedures governing expiry reviews.

Conduct of Antidumping Investigations

In practice, it appears that China's conduct of AD investigations in many respects continues to fall short of full commitment to the fundamental tenets of transparency and procedural fairness embodied in the AD Agreement. In 2012, 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. All of these aspects of China's AD practice have been challenged by the United States in the WTO cases involving GOES, chicken broiler products and automobiles.

The United States and other WTO members have also expressed serious concerns about China's evolving practice of launching AD and CVD investigations that appear designed to discourage the United States or other trading partners from the legitimate exercise of their rights under WTO AD and CVD rules and the trade remedy provisions of

China's accession agreement. This type of retaliatory conduct is not typical of WTO members, and it may have its roots in China's *Foreign Trade Law* and AD and CVD implementing regulations, which authorize "corresponding countermeasures" when China believes that a trading partner has discriminatorily imposed antidumping or countervailing duties against imports from China. Further, when China has pursued investigations under these circumstances, it appears that its regulatory authorities have tended to move forward with the imposition of duties regardless of the strength of the underlying legal and factual support. The United States' successful WTO case challenging the duties imposed by China on imports of U.S. GOES offers a telling example of this problem.

The United States initiated the GOES WTO case in September 2010, claiming that China's regulatory authorities appeared to have imposed the duties at issue without necessary legal and factual support and without observing certain transparency and procedural fairness requirements, in violation of various WTO obligations under the AD Agreement and the Subsidies Agreement. Consultations were held in November 2010. A WTO panel was established to hear this case at the United States' request in March 2011, and eight other WTO members joined the case as third parties. Hearings before the panel took place in September and December 2011. The panel issued its decision in June 2012, finding in favor of the United States on all significant claims. China appealed the panel's decision in July 2012. The WTO's Appellate Body rejected China's appeal in October 2012.

In September 2011, the United States initiated a WTO case challenging the antidumping and countervailing duties that China imposed on imports of certain U.S. chicken products known as "broiler products." Once again, in the course of its AD and CVD investigations, China's regulatory authorities appeared to have imposed the duties at issue without necessary legal and factual support and without observing certain transparency and procedural fairness requirements, in violation of

various WTO obligations under the AD Agreement and the Subsidies Agreement. Consultations were held in October 2011. A WTO panel was established to hear this case at the United States' request in January 2012, and seven other WTO members joined the case as third parties. Hearings before the panel took place in September and December 2012, and the panel is scheduled to issue its decision in 2013.

Earlier this year, in July 2012, the United States initiated a WTO case challenging to China's imposition of antidumping and countervailing duties on imports of certain U.S. automobiles. Again, China's regulatory authorities appeared to have imposed the duties at issue without necessary legal and factual support and without observing certain transparency and procedural fairness requirements, in violation of various WTO obligations under AD Agreement and the Subsidies Agreement. Consultations took place in August 2012. A WTO panel was established to hear this case in October 2012, and eight other WTO members joined the case as third parties.

Throughout 2012, as in prior years, the United States continued to work closely with U.S. companies subject to Chinese AD investigations in an effort to help them better understand the Chinese system. The United States also advocated on their behalf in connection with ongoing AD investigations, with the goal of obtaining fair and objective treatment for them, consistent with the AD Agreement.

In addition, the United States continued to engage China vigorously on the various concerns generated by China's AD practices, including systemic concerns in the areas of transparency and procedural fairness. The United States also raised concerns about China's apparent decisions to use AD and CVD remedies against U.S. imports as a means to discourage the United States from the legitimate exercise of its rights under WTO AD and CVD rules and the trade remedy provisions of China's accession agreement. In addition to pursuing WTO litigation, as discussed above, the United States engaged China on these matters during meetings before the WTO's AD

Committee, as in past years. The United States also engaged China through the Trade Remedies Working Group, which was established under the auspices of the JCCT in 2004. This working group has given U.S. AD experts a dedicated forum to speak with China's AD authorities directly and in detail on issues facing U.S. exporters subject to Chinese AD investigations. The working group has held several meetings since its creation in April 2004, including a meeting in November 2012. In between meetings, U.S. experts also have frequent informal exchanges with China's AD authorities, which are intended to promote greater accountability in China's AD regime.

Meanwhile, as China's AD regime has matured, many of the AD orders put in place have reached the five-year mark, warranting expiry reviews. MOFCOM is currently conducting eight expiry reviews. While none of these reviews involves products from the United States, every expiry review involving U.S. products to date has resulted in the measure at issue 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 repeatedly pressed China to issue regulations governing expiry reviews and will continue to do so.

Finally, it appears that no interested party from the United States or any other WTO member to date has filed for judicial review of a Chinese AD proceeding. However, as China continues to launch AD investigations and apply AD measures against imports, the opportunity for interested parties to seek judicial review will become more critical.

COUNTERVAILING DUTIES

China has issued laws and regulations bringing its legal regime in the CVD area largely into compliance with WTO rules, although China still needs to issue additional procedural guidance such as rules governing expiry reviews. More significantly, China needs to improve its commitment to the

transparency and procedural fairness requirements embodied in WTO rules, as the WTO has found in a WTO case brought by the United States. In addition, In addition, China needs to eliminate its apparent use of trade remedy investigations as a retaliatory tool.

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

China initiated its first three CVD investigations in 2009. Each of these investigations involved imports of products from the United States – GOES, chicken broiler products and automobiles. China also initiated a CVD investigation involving imports of polysilicon from the United States in 2012. Many of the concerns generated by China's AD practice with regard to transparency and procedural fairness also apply to these CVD investigations. China also appears to have committed significant methodological errors that raise concerns, in light of Subsidies Agreement rules. In addition, as discussed above in the Antidumping section, in recent years, China has invoked AD and CVD remedies under troubling circumstances. In response, the United States has pressed China both bilaterally and in WTO meetings to adhere strictly to WTO rules in the conduct of its CVD investigations, and the United States has consistently pursued WTO litigation where necessary.

Legal Regime

As previously reported, China has put in place much of the legal framework for its CVD regime. Under this regime, like in the AD area, MOFCOM's BOFT is

charged with making subsidies determinations, and MOFCOM's IBII is charged with making injury determinations.

It appears that China has attempted to conform its CVD regulations and procedural rules to the provisions and requirements of the Subsidies Agreement and the commitments in its WTO accession agreement. China's regulations and procedural rules generally track those found in the Subsidies Agreement, although there are certain areas where key provisions are omitted or are vaguely worded. In addition, China has not yet issued regulations specifically establishing the rules and procedures governing expiry reviews.

Since China's accession, the United States and other WTO members have sought clarifications on a variety of issues concerning China's regulatory framework and have pressed China for greater transparency both during regular meetings and the annual transitional reviews before the WTO's Subsidies Committee. The United States will continue to seek clarifications as needed in 2013.

Conduct of Countervailing Duty Investigations

In June 2009, acting on a petition from China's state-owned steel industry, MOFCOM initiated China's first CVD investigation. The petition alleged that subsidies were being provided to the U.S. GOES industry. Later that year, MOFCOM initiated two additional CVD investigations involving imports of chicken broiler products and automobiles from the United States. In July 2012, China initiated a CVD investigation involving imports of U.S. polysilicon.

These CVD investigations make clear that, as in the AD area, China needs to improve its transparency and procedural fairness when conducting these investigations. In addition, the United States has noted procedural concerns specific to China's conduct of CVD investigations. For example, China initiated investigations of alleged subsidies that raised concerns, given the requirements regarding "sufficient evidence" in Article 11.2 of the Subsidies

Agreement. The United States is also concerned about China's application of facts available under Article 12.7 of the Subsidies Agreement. In addition, as in the AD area, the United States has expressed serious concerns about China's pursuit of AD and CVD remedies that appear intended to discourage the United States and other trading partners from the legitimate exercise of their rights under WTO AD and CVD rules and the trade remedy provisions of China's accession agreement.

As discussed above in the Antidumping section, in September 2010, the United States initiated – and later won – a WTO case challenging the final AD and CVD determinations in China's GOES investigations because China's regulatory authorities appeared to have imposed the duties at issue without necessary legal and factual support and without observing certain transparency and procedural fairness requirements, in violation of various WTO obligations under the AD Agreement and the Subsidies Agreement. For similar reasons, the United States initiated a second WTO case in September 2011 challenging the final AD and CVD determinations in China's chicken broiler products investigations and a third WTO case in July 2012 challenging the final AD and CVD determinations in China's automobiles investigations. These two cases are still pending.

In addition to pursuing WTO dispute settlement, the United States has raised its concerns bilaterally with MOFCOM, principally through the JCCT Trade Remedies Working Group, as well as at the WTO in meetings before the Subsidies Committee. The United States has also actively participated in MOFCOM's ongoing CVD investigations, and will continue to do so as envisioned by WTO rules, in order to safeguard the interests of U.S. industry. Going forward, the United States will continue to impress upon China the importance of strictly adhering to WTO rules when conducting CVD investigations and imposing countervailing duties.

SAFEGUARDS

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

In its WTO accession agreement, China committed to revising its regulations and procedures for conducting safeguard investigations by the time of its WTO accession in order to make them consistent with the WTO Agreement on Safeguards (Safeguards Agreement). That agreement articulates rules and procedures governing WTO members' use of safeguard measures.

Legal Regime

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

Conduct of Safeguards Investigations

To date, as previously reported, China has conducted only one safeguard proceeding, which resulted in the

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

EXPORT REGULATION

China maintains numerous export restraints that raise serious concerns under WTO rules, including specific commitments that China made in its WTO accession agreement. In the one WTO case decided to date in this area, the WTO found that exports restraints maintained by China on several raw material inputs violated China's WTO obligations.

Upon acceding to the WTO, China took on the obligations of Article XI of the GATT 1994, which generally prohibits WTO members from maintaining export restraints (other than duties, taxes or other charges), although certain limited exceptions are allowed. China also agreed to eliminate all taxes and charges on exports, including export duties, except as included in Annex 6 to its WTO accession agreement or applied in conformity with Article VIII of GATT 1994. Article VIII of GATT 1994 only permits fees and charges limited to the approximate cost of services rendered and makes clear that any such fees and charges shall not represent an indirect protection to domestic products or a taxation of exports for fiscal purposes.

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

Export Restraints on Raw Materials

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

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

China's export restraints affect U.S. and other foreign producers of a wide range of downstream products, such as steel, chemicals, hybrid and electric cars, energy efficient light bulbs, wind turbines, hard-disk drives, magnets, lasers, ceramics, semiconductor chips, refrigerants, medical imagery, aircraft, refined petroleum products, fiber optic cables and catalytic converters, among numerous others. The export restraints can create serious disadvantages for these foreign producers by artificially increasing China's export prices for their raw material inputs, which also drives up world prices. At the same time, the export restraints appear to artificially lower China's domestic prices for the raw materials due to significant increases in domestic supply, enabling China's domestic downstream producers to produce lower-priced products from the raw materials and thereby

creating significant advantages for China's domestic downstream producers when competing against foreign downstream producers both in the China market and in other countries' markets. The export restraints can also create incentives for foreign downstream producers to move their operations, technologies and jobs to China.

As previously reported, the United States began raising its concerns about China's continued use of export restraints shortly after China's WTO accession, while also working with other WTO members with an interest in this issue, including the EU and Japan. In response to these efforts, China refused to modify its policies in this area. In fact, over time, China's economic planners expanded their use of export restraints and also made them increasingly restrictive, particularly on raw materials.

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. Mexico subsequently became a co-complainant in August 2009.

At the time of the initiation of this case, China's treatment of coke, a key steel input, provided a clear example of the trade distortions engineered by China's export restraints. In 2008, China produced 336 million metric tons (MT) of coke, but it limited exports of coke to 12 million MT and additionally imposed 40 percent duties on coke exports. With these export restraints in place, the effects of the export restraints on pricing were dramatic. In August 2008, the world price for coke reached \$740 per MT at the same time that China's domestic price was \$472 per MT. This \$268 per MT price difference created a huge competitive advantage for China's downstream steel producers over their foreign counterparts, as coke represents about one-third of the input costs for integrated steel producers.

The WTO panel established to hear the export restraints case issued its decision in July 2011. The panel rejected China's defenses, which had attempted to portray China's export restraints as conservation or environmental protection measures or measures taken to manage critical shortages of supply, and found in favor of the United States and its co-complainants on all significant claims, ruling that the export restraints at issue were inconsistent with China's WTO obligations. China appealed certain aspects of the panel's decision in August 2011, and the WTO's Appellate Body rejected China's appeal in January 2012, confirming that the export restraints at issue were inconsistent with China's WTO obligations. China subsequently agreed to come into compliance with the WTO's rulings by the end of December 2012.

In 2010, China's export restraints on rare earths – a collection of 17 different chemical elements used in a variety of green technology products, among other products – began to generate significant concern among China's trading partners. China controls about 97 percent of the global rare earths market and has been imposing increasingly restrictive export quotas and export duties on rare earth ores, oxides and metals. In July 2010, China sharply reduced its export quotas, causing world prices for some of the rare earths to rise dramatically higher than China's domestic prices and further hindering efforts in other countries to develop expertise in the increasingly important downstream manufacturing of green technology products. Then, in September 2010, China reportedly imposed a de facto ban on all exports of rare earths to Japan, causing even more concern among China's trading partners.

The United States pressed China during the run-up to the December 2010 JCCT meeting to eliminate its export restraints on rare earths and also used the November 2010 G-20 meeting, as did Japan, the EU and other trading partners, to try to persuade China to pursue more responsible policies on raw materials. However, China refused to abandon its use of export restraints.

In 2011, China expanded the scope of products covered by the rare earths export quota to include more processed rare earths products, making the quota even more restrictive than it had been in 2010. In addition, according to several reports, China's customs authorities began imposing minimum export prices on rare earth exports. It appeared that this practice disrupted the export quota process and contributed to rapidly increasing prices outside China.

The United States continued to press China and seek its agreement to eliminate its export restraints on rare earths, using both bilateral engagement through the JCCT process and multilateral engagement at the WTO during the final transitional reviews before the Market Access Committee, the Council for Trade in Goods and the General Council. Japan, the EU and other trading partners made similar efforts. However, China continued to refuse to abandon its use of export restraints.

In March 2012, the United States, joined by the EU and Japan, initiated a WTO case challenging export quotas, export duties and other restraints maintained by China on the export of rare earths, tungsten and molybdenum. These materials are key inputs in a multitude of U.S.-made products, including not only a variety of green technology products, such as hybrid car batteries, wind turbines and energy-efficient lighting, but also steel, advanced electronics, automobiles, petroleum and chemicals. The export restraints appear to be inconsistent with China's obligations under various provisions of the GATT 1994 and China's accession agreement. Joint consultations took place in April 2012. A WTO panel was established to hear the case at the complaining parties' request in July 2012, and 18 other WTO members joined the case as third parties. The first panel meeting is scheduled to take place in February 2013.

Border Tax Policies

China's economic planners attempt to manage the export of many primary, intermediate and

downstream products by raising or lowering the value-added tax (VAT) rebate available upon export and sometimes by imposing or retracting export duties. With VAT rebates ranging from zero to 17 percent and export duties typically ranging from zero to 40 percent, these border tax practices have caused tremendous disruption, uncertainty and unfairness in the global markets for the affected products – particularly when these practices operate to incentivize the export of downstream products for which China is a leading world producer or exporter such as steel, aluminum and soda ash.

Typically, the objective of China's border tax adjustments is to make larger quantities of primary and intermediate products in a particular sector available domestically at lower prices than the rest of the world, giving China's downstream producers of finished products using these inputs a competitive advantage over foreign downstream producers. To accomplish this objective, China discourages the export of the relevant primary and intermediate products by reducing or eliminating VAT rebates and perhaps also imposing export duties on them, resulting in increased domestic supply and lower domestic prices. China's downstream producers, in turn, benefit not only from these lower input prices but also from full VAT rebates when they export their finished products.

In some situations, China has also used its border taxes to encourage the export of certain finished products over other finished products within a particular sector. For example, in the past, China has targeted value-added steel products, particularly wire products and steel pipe and tube products, causing a surge in exports of these products, many of which ended up in the U.S. market.

For several years, the United States and other WTO members have raised broad concerns about the trade-distortive effects of China's VAT export rebate and export duty practices using the Trade Policy Reviews of China at the WTO, held in April 2006, May 2008, May 2010 and June 2012, and the annual transitional reviews before the Committee on

Market Access and the Council for Trade in Goods. The United States has also raised broad concerns about the trade-distortive effects of China's variable VAT export rebate practices in connection with the July 2009, May 2010 and May 2011 S&ED meetings and the October 2009, December 2010, November 2011 and December 2012 JCCT meetings. In addition, the United States has highlighted the harm being caused to specific U.S. industries, including steel, aluminum and soda ash, using the JCCT process and bilateral meetings such as the Steel Dialogue.

To date, however, China has been unwilling to commit to any disciplines on its use of VAT export rebates, although it has acknowledged that its eventual goal is to provide full VAT rebates for all exports like other WTO members with VAT systems. In addition, at the December 2012 JCCT meeting, China agreed to hold serious discussions with the United States, beginning in the first half of 2013, in order to work toward a mutual understanding of China's VAT system and the concepts on which a trade-neutral VAT system is based.

INTERNAL POLICIES AFFECTING TRADE

Non-discrimination

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

In its WTO accession agreement, China agreed to assume the obligations of GATT 1994, the WTO agreement that establishes the core principles that constrain and guide WTO members' policies relating to trade in goods. The two most fundamental of these core principles are the Most-Favored Nation (MFN), or non-discrimination, rule – referred to in the United States as “normal trade relations” – and the rule of national treatment.

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

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

In its WTO accession agreement, China agreed to repeal or revise all laws, regulations and other measures that were inconsistent with the MFN rule upon accession. China also confirmed that it would observe this rule with regard to all WTO members, including separate customs territories, such as Hong Kong, Macau and Taiwan. In addition, China undertook to observe this rule when providing preferential arrangements to foreign-invested enterprises within special economic areas. With regard to the national treatment rule, China similarly agreed to repeal or revise all inconsistent laws, regulations and other measures. China also

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

As previously reported, China reviewed its pre-WTO accession laws and regulations and revised many of those which conflicted with its WTO MFN and national treatment obligations in 2002 and 2003. However, concerns remain regarding China's observation of MFN and national treatment requirements in some areas.

U.S. industries report that China continues to apply the value-added tax in a manner that unfairly discriminates between imported and domestic goods, both through official measures and on an *ad hoc* basis, as discussed below in the Taxation section. In addition, China's industrial policies on automobiles and steel call for discrimination against foreign producers and imported goods, as discussed below in the Investment section. It also appears that China has applied sanitary and phytosanitary measures in a discriminatory manner since it acceded to the WTO, as discussed below in the Agriculture section, while concerns about discriminatory treatment also remain prevalent in a variety of services sectors, as discussed below in the Services section. The United States continued to address these and other MFN and national treatment issues with China in 2012, both bilaterally

and in WTO meetings. The United States will continue to pursue these issues vigorously in 2013.

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. By the end of 2009, ACFTU statistics indicated that 79 percent of foreign-invested enterprises had set up trade unions. The ACFTU also announced in 2010 that its current goal was to establish trade unions in 90 percent of foreign-invested enterprises by 2012.

The ACFTU campaign may be discriminatory, both because it does not appear to be directed at private Chinese companies and because it appears to specifically target Fortune 500 companies, to the disproportionate impact of U.S.-invested companies. The United States continues to monitor this situation

and is attempting to assess its effects on U.S.-invested companies and their workers.

Taxation

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

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

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

Fertilizer VAT

China has used VAT policies to benefit domestic fertilizer production. In July 2001, the Ministry of Finance (MOF) and the State Administration of Taxation (SAT) issued a circular exempting all phosphate fertilizers except diammonium phosphate (DAP) from a 13 percent VAT. DAP, a product that the United States exports to China, competes with similar phosphate fertilizers produced in China, particularly monoammonium phosphate.

The United States raised this issue bilaterally with China soon after it acceded to the WTO and in many subsequent bilateral meetings, including high-level meetings. The United States has also raised this issue at the WTO, both in regular meetings of the Committee on Market Access and during the annual transitional reviews, including the final transitional

review held in October 2011. To date, China has not eliminated its discriminatory treatment of DAP.

Meanwhile, a larger concern for U.S. fertilizer exporters remains the rapid expansion of China's domestic fertilizer production. This expanded production, which appears to have been brought on in part by China's export duties on phosphate rock, a key fertilizer input, has saturated China's market with low-priced fertilizer and greatly reduced demand for imported fertilizer.

VAT Irregularities

Several U.S. industries have continued to express concerns more generally about the unfair operation of China's VAT system. They report that Chinese producers are often able to avoid payment of the VAT on their products, either as a result of poor collection procedures, special deals or even fraud, while the full VAT still must be paid on competing imports. In discussions with Chinese government officials on this issue, the United States has raised its serious concerns about the *de facto* discriminatory treatment accorded to foreign products, while also continuing to emphasize the value to China of a properly functioning VAT system as a revenue source.

Border Trade

China's border trade policy also continues to generate MFN and other concerns. China provides preferential import duty and VAT treatment to certain products, often from Russia, apparently even when those products are not confined to frontier traffic as envisioned by Article XXIV of GATT 1994. In 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.

Subsidies

China continues to provide injurious subsidies to its domestic industries, and some of these subsidies appear to be prohibited under WTO rules. Although China filed a long-overdue WTO subsidies notification in 2011, its notification was far from complete.

Upon its accession to the WTO, China agreed to assume the obligations of the WTO Subsidies Agreement, which addresses not only the use of CVD measures by individual WTO members (see the section above on Import Regulation, under the heading of Countervailing Duties), but also a government's use of subsidies and the application of remedies through enforcement proceedings at the WTO. As part of its accession agreement, China committed that it would eliminate, by the time of its accession, all subsidies prohibited under Article 3 of the Subsidies Agreement, which includes subsidies contingent on export performance (export subsidies) and subsidies contingent on the use of domestic over imported goods (import substitution subsidies). This commitment expressly extends throughout China's customs territory, including in special economic zones and other special economic areas.

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

Subsidies Notification

As previously reported, following repeated pressure from the United States and other WTO members, China submitted its first subsidies notification to the WTO's Subsidies Committee in April 2006, nearly five years late. Although the notification reported on more than 70 subsidy programs, it was also notably incomplete, as it failed to notify any subsidies provided by provincial and local government authorities or any subsidies provided by state-owned banks, whether in the form of preferential loans, debt forgiveness or otherwise. In addition, while China notified several subsidies that appear to be prohibited, it did so without making any commitment to withdraw them, and it failed to notify other subsidies that appear to be prohibited.

Following the submission of China's 2006 subsidies notification, the United States devoted significant time and resources to monitoring and analyzing China's subsidy practices, and these efforts helped to identify significant omissions in China's subsidies notification. These efforts also made clear that provincial and local governments play an important role in implementing China's industrial policies, including through subsidization of enterprises. Recent academic literature, for example, indicates that provincial and local governments are responsible for nearly 20 percent of China's investment in industry, much of which is misdirected into sectors with excess capacity, such as steel.

Over the past six years, the United States repeatedly raised concerns about China's incomplete subsidies notification and identified numerous unreported subsidies in meetings before the Subsidies Committee as well as during the WTO's Trade Policy Reviews of China. At the October 2009 meeting of the Subsidies Committee, China indicated that it would finalize a second subsidies notification in the coming months while noting that this notification would again not include any subsidies provided by provincial and local government authorities. China reiterated this same pledge a year later at the October 2010 meeting of the Subsidies Committee.

In response to these unfulfilled promises from China, the United States sought to make progress on this issue through the filing of a counter notification under Article 25.10 of the Subsidies Agreement in October 2011. In its counter notification, the United States identified 200 unreported subsidy programs that China has maintained since 2004, including many provided by provincial and local government authorities. Shortly after the United States filed its counter notification, China finally submitted the new subsidies notification that it had been promising. Unfortunately, China's new notification covered only the period from 2005 to 2008, and it again failed to notify a single subsidy administered by provincial or local governments. In addition, the central government subsidies included in the new notification were largely the same partial listing of subsidies as those notified in China's 2006 notification, and only included approximately ten of the more than 200 subsidy programs identified in the U.S. counter notification. As a result, China's new notification was again far from complete.

China still remains behind on its subsidies notification obligations. It should have submitted its subsidies notification for the period 2009-2010 in July 2011.

In 2012, the United States continued to highlight China's failure to abide by its important transparency obligations under the Subsidies Agreement. For example, in connection with the October 2012 meeting of the Subsidies Committee, the United States submitted a written request for information pursuant to Article 25.8 of the Subsidies Agreement in which it provided more evidence of central government and sub-central government subsidies that China has not yet notified. To date, China has not responded to this latest U.S. request for information, nor has China submitted an updated subsidy notification.

In 2013, the United States will continue to research and analyze the various forms of financial support that the Chinese government provides to manufacturers and exporters in China, including in

the green technology sector, and assess whether this support is consistent with WTO rules. The United States will also continue to raise its concerns with China's subsidies practices in bilateral meetings with China, including through future meetings of the Structural Issues Working Group and the Steel Dialogue. In addition, before the WTO's Subsidies Committee, the United States will continue to press China to submit a complete and up-to-date subsidies notification, along with a response to the United States' recent written request for information under Article 25.8 of the Subsidies Agreement.

Prohibited Subsidies

Immediately after China submitted its first subsidies notification in April 2006, the United States began seeking changes to China's subsidies practices. As previously reported, after bilateral dialogue failed to resolve the matter, the United States, together with Mexico, initiated WTO dispute settlement proceedings against China in February 2007, challenging tax-related subsidies that took the form of both export subsidies, which make it more difficult for U.S. manufacturers to compete against Chinese manufacturers in the U.S. market and third-country markets, and import substitution subsidies, which make it more difficult for U.S. manufacturers to export their products to China. China subsequently agreed to and did eliminate all of the subsidies at issue by January 2008.

After bringing the WTO case challenging China's tax-related prohibited subsidies, the United States developed information that appeared to show that China may have been attempting to use prohibited subsidies outside its taxation system in an effort to increase the market share of numerous Chinese brands in markets around the world. Many of these subsidies appeared to be provided by provincial and local governments seeking to implement central government directives found in umbrella programs, such as the "Famous Export Brand" program and the "World Top Brand" program. These subsidies appeared to offer significant payments and other benefits tied to qualifying Chinese companies'

exports. The United States also developed information about several other export subsidies apparently provided by sub-central governments independent of the two brand programs.

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

In December 2010, following an investigation in response to a petition filed under section 301 of the Tariff Act of 1974, as amended, USTR announced the filing of a WTO case challenging what appeared to be prohibited import substitution subsidies being provided by the Chinese government to support the production of wind turbine systems in China. Specifically, the United States challenged subsidies being provided by the Chinese government to manufacturers of wind turbine systems that appeared to be contingent on the use of domestic over imported components and parts. Consultations were held in February 2011. Following consultations, China issued a notice invalidating the measures that had created the subsidy program at issue.

In September 2012, the United States initiated a WTO case challenging numerous subsidies provided by the central government and various sub-central governments in China to automobile and automobile-parts enterprises located in regions in China known as "export bases." The challenged subsidies appear to be inconsistent with China's obligation under Article 3 of the Subsidies Agreement not to provide subsidies contingent upon export performance. In addition, it appears that China failed to abide by various WTO transparency obligations, including the requirement to notify the

subsidies at issue to the WTO Committee on Subsidies and Countervailing Measures pursuant to Article 25 of the Subsidies Agreement. Consultations were held in November 2012.

U.S. CVD Investigations

Concerns about China's subsidies practices led the U.S. paper industry to file a petition with the Commerce Department in October 2006 requesting the initiation of a CVD investigation based on allegations of subsidized imports of coated free sheet paper from China causing injury in the U.S. market. As previously reported, in the ensuing investigation, the Commerce Department changed its longstanding policy of not applying U.S. CVD law to China or any other country considered a "non-market economy" for AD purposes. The Commerce Department began applying U.S. CVD law to China after finding that reforms to China's economy in recent years had removed the obstacles to applying the CVD law that were present in the "Soviet-era economies" at issue when the Commerce Department first declined to apply the CVD law to non-market economies in the 1980s.

Since then, many other U.S. industries, including the steel, textiles, chemicals, tires and paper industries, among others, have expressed concern about the injurious effects of various Chinese subsidies in the U.S. market as well as in China and third-country markets, leading to the filing of additional CVD petitions, together with companion AD petitions. In response, the Commerce Department has initiated CVD investigations of imports of Chinese off-road tires, oil country tubular goods and various other types of steel pipe, laminated woven sacks, magnets, thermal paper, citric acid, kitchen racks and shelves, lawn groomers, pre-stressed concrete wire strand, steel grating, wire decking, narrow woven ribbons, carbon bricks, coated paper for high-quality print graphics, steel fasteners, phosphate salts, drill pipe, aluminum extrusions, multilayered wood flooring, steel wheels, galvanized steel wire, high pressure steel cylinders, photovoltaic cells and modules, wind towers, drawn stainless steel sinks and plywood.

The subsidy allegations investigated have involved preferential loans, income tax and VAT exemptions and reductions, the provision of goods and services on non-commercial terms, among other subsidies provided by the central government, along with a variety of provincial and local government subsidies.

In September 2008, China requested WTO consultations with the United States regarding the Commerce Department's final determinations in the AD and CVD investigations on Chinese imports of steel pipe, off-road tires and laminated woven sacks. China challenged the imposition of anti-dumping duties calculated using a "non-market economy" measurement methodology while also imposing countervailing duties to address subsidization of the same imports (known as the "double remedies" issue). In addition, China challenged Commerce Department findings that certain state-owned enterprises and state-owned commercial banks are government actors (known as the "public bodies" issue), along with a number of other case-specific CVD issues. Consultations were held in November 2008, and proceedings before a WTO panel took place in July and November 2009. The panel issued a decision in October 2010, finding in favor of the United States on all systemic issues as well as the vast majority of the case-specific issues. China filed an appeal with the WTO's Appellate Body in December 2010. In March 2011, the Appellate Body issued its decision, which overturned the panel's findings on double remedies and modified the panel's interpretation of the term "public body." The United States subsequently agreed to come into compliance with the WTO's rulings, which required the Commerce Department to revisit its double remedies approach and its public body determinations relating to state-owned enterprises. The Commerce Department accordingly undertook so-called "Section 129" proceedings pursuant to U.S. law and issued final determinations in August 2012 that complied with the WTO's rulings on the double remedies and public bodies issues.

In May 2012, China initiated a new WTO case challenging how the Commerce Department handled

the public bodies issue in final determinations from 21 past CVD investigations of various Chinese imports. China also is challenging various case-specific issues from these CVD investigations. Consultations were held in June and July 2012. At China's request, a WTO panel was established to hear this case in October 2012.

Separately, in September 2012, China initiated a WTO case challenging Public Law 112-99, new U.S. legislation enacted in March 2012 that expressly confirms the applicability of the U.S. CVD law to countries that have been determined to be non-market economies for purposes of the U.S. AD law and that grants the Commerce Department authority to adjust for the possibility of "double remedies" when AD duties and CVD duties are applied concurrently to the same imports. China also is challenging the Commerce Department's application of the U.S. CVD law in 34 sets of past AD and CVD investigations and administrative reviews of various Chinese imports. Consultations were held in November 2012.

Price Controls

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

In its WTO accession agreement, China agreed that it would not use price controls to restrict the level of imports of goods or services. In addition, in an annex to the agreement, China listed the limited number of products and services remaining subject to price control or government guidance pricing, and it provided detailed information on the procedures used for establishing prices. China agreed that it would try to reduce the number of products and services on this list and that it would not add any products or services to the list, except in extraordinary circumstances.

In 2012, China continued to maintain price controls on several products and services provided by both state-owned enterprises and private enterprises.

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

The United States obtained additional information about China's use of price controls in connection with the Trade Policy Reviews of China at the WTO, held in April 2006, May 2008, May 2010 and May 2012. The next Trade Policy Review will take place in 2014, and the United States will use that mechanism to continue to monitor China's progress in eliminating price controls.

Medical Devices

Beginning in 2006, NDRC released proposals for managing the prices of medical devices, with the stated objectives of avoiding excessive mark-ups by distributors and reducing health care costs. Among other things, the proposals would impose limits on the allowable mark-ups on medical devices. The proposals also would require manufacturers to provide sensitive pricing information. The United States and U.S. industry have been concerned about the proposals' limits on price mark-ups, which would reduce competition as well as patient and physician choice, and the proposals' collection of sensitive pricing data, the publication of which could be very damaging to U.S. companies' operations in China.

Since 2006, the United States and U.S. industry have repeatedly raised their concerns about NDRC's proposals. In particular, U.S. industry has been able to engage in an informal dialogue with NDRC, and the United States has pressed China in this area

using the JCCT process. While acknowledging China's legitimate concerns regarding the need to provide effective and affordable medical devices to patients and the need to address inefficiency, excessive mark-ups and irregular business practices among wholesalers and distributors of medical devices, the United States and U.S. industry have urged China to develop an approach that will not inhibit increased imports of the same innovative and effective health care products that China is seeking to encourage.

In 2012, NDRC released an updated draft of a pricing proposal, which would impose price mark-up controls on six major categories of implantable medical devices. U.S. industry has expressed concern that NDRC's proposal would significantly discriminate against foreign manufacturers. Similar pricing proposals have appeared at the provincial government level. For example, in September 2010, Guangdong Province published a medical device pricing system for public comment that is similar to the one proposed by NDRC. Going forward, the United States will continue to work to ensure that NDRC and provincial government authorities seek its input and input from U.S. industry stakeholders in a transparent and meaningful way as China develops new policies and measures.

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

and that the quality and innovation of medical devices are given adequate consideration in purchasing decisions. MOH subsequently entered into discussions directly with U.S. industry. During the run-up to the December 2010 JCCT, U.S. industry presented a risk-based approach to medical device classification based on Global Harmonization Task Force principles. Since then, the United States has continued to work closely with U.S. industry and to promote a cooperative resolution of U.S. concerns.

At the December 2012 JCCT meeting, China committed that any measures affecting the pricing of medical devices will treat foreign and domestic manufacturers equally. China further committed that it will take into account comments that it receives from the United States, including on the issue of how to improve transparency.

Standards, Technical Regulations and Conformity Assessment Procedures

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

With its accession to the WTO, China assumed obligations under the Agreement on Technical Barriers to Trade (TBT Agreement), which establishes rules and procedures regarding the development, adoption and application of standards, technical regulations and the conformity assessment procedures (such as testing or certification) used to determine whether a particular product meets such standards or regulations. Its aim is to prevent the use of technical requirements as unnecessary barriers to trade. The TBT Agreement applies to all products, including industrial and agricultural products. It establishes rules that help to distinguish legitimate standards and technical regulations from protectionist measures. Among other things, standards, technical regulations and conformity

assessment procedures are to be developed and applied transparently and on a non-discriminatory basis by WTO members and should be based on relevant international standards and guidelines, when appropriate.

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

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

RESTRUCTURING OF REGULATORS

China has restructured its regulators for standards, technical regulations and conformity assessment procedures in order to eliminate discriminatory

treatment of imports, although in practice China's regulators sometimes do not appear to enforce regulatory requirements as strictly against domestic products as imports.

As previously reported, in anticipation of its WTO accession, China made significant progress in the areas of standards and technical regulations. China addressed problems that foreign companies had encountered in locating relevant regulations and how they would be implemented, and it took steps to overcome poor coordination among the numerous regulators in China. In October 2001, China announced the creation of the Standardization Administration of China (SAC) under the State Administration of Quality Supervision, Inspection and Quarantine (AQSIQ). SAC is charged with unifying China's administration of product standards and aligning its standards and technical regulations with international practices and China's commitments under the TBT Agreement. SAC is the Chinese member of the International Organization for Standardization and the International Electro-technical Commission.

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

Despite these changes, U.S. industry still has concerns about significant conformity assessment

and testing-related issues in China. For example, U.S. exporters representing several sectors continue to report that China's regulatory requirements are not enforced as strictly or uniformly against domestic producers as compared to foreign producers. In addition, in some cases, China's regulations provide only that products will be inspected or tested upon entry into China's customs territory, without any indication as to whether or how the regulations will be applied to domestic producers. The United States will continue to monitor these issues in 2013 to determine if U.S. industry is being adversely affected.

STANDARDS AND TECHNICAL REGULATIONS

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

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

The United States continues to make efforts to assist China through bilateral exchanges and training, as China works to improve its standards regime. For example, in May 2005, a new U.S. private sector standards office, using funding from the U.S. Department of Commerce, opened in Beijing. Its goals are to strengthen ties with Chinese

government regulatory authorities, Chinese industry associations and Chinese standards developers and, in particular, to ensure that close communication exists between U.S. and Chinese standards developers. The United States also continued to provide technical assistance to China. Since 2004, this technical assistance has focused on broad standards-development issues, such as the relationship between intellectual property rights and standards, and specific standards in a number of industries, including petroleum, information and telecommunications technology, chemicals, steel, water conservation, energy efficiency, hydrogen infrastructure, elevators, electrical safety, gas appliances, distilled spirits, heating, ventilation and air conditioning, and building fire safety. The United States has also conducted programs addressing China's regulation of hazardous substances and China's new chemical management system.

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

At the same time, concern has grown over the past few years that China seems to be actively pursuing the development of unique requirements, despite the existence of well-established international standards, as a means for protecting domestic companies from competing foreign standards and technologies. Indeed, China has already adopted unique standards for digital televisions, and it is trying to develop unique standards and technical

regulations in a number of other sectors, including, for example, autos, telecommunications equipment, Internet protocols, wireless local area networks, radio frequency identification tag technology, audio and video coding and fertilizer as well as software encryption and mobile phone batteries. This strategy has the potential to create significant barriers to entry into China's market, as the cost of compliance will be high for foreign companies, while China will also be placing its own companies at a disadvantage in its export markets, where international standards prevail.

WAPI Encryption Standards

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

Focusing on the WTO compatibility of China's implementation of the standards, the United States repeatedly raised its concerns with China throughout the remainder of 2003 and made WAPI one of the United States' priority issues during the run-up to the April 2004 JCCT meeting. The United States was particularly concerned about the precedent that

could be established if China were allowed to enforce unique mandatory standards in the fast-developing information technology sector. The United States and China were ultimately able to resolve the issue at the April 2004 JCCT meeting, as China agreed to an indefinite delay in the implementation of the WAPI standards.

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

In 2009, China moved forward with plans to mandate the use of the WAPI standard in mobile handsets, despite the growing commercial success of computer products in China complying with the internationally recognized ISO/IEC 8802-11 WLAN standard, otherwise known as "WiFi." In this regard, over the past several years, global mobile handset makers have increasingly added WLAN/Internet capability into their mobile handsets, expanding the interest in WLAN equipment from laptop computers and home computers to mobile handsets. The operative standard for this expansion of WLAN/Internet capability has been the WiFi ISO/IEC 8802-11 standard. No other competing standard is in commercial-scale use anywhere in the world. However, China has never issued type approvals for handsets that connect to the Internet through WLANs, and instead has only issued type approvals for handsets that connect to the Internet through cellular networks. This practice has required foreign equipment makers to disable WLAN/Internet capability before their handsets can be marketed in China. Recently, however, in concert with its plan for encouraging an aggressive roll out of 3G mobile handsets by Chinese telecommunications operators, many of which are Internet-enabled via WLAN networks, China's Ministry of Industry and Information Technology (MIIT) established a process for approving hand-held wireless devices such as cell phones and smart phones that are Internet-enabled.

During bilateral discussions in September 2009, MIIT officials indicated to U.S. government officials that MIIT will approve devices that use the WiFi ISO/IEC 8802-11 standard only if those devices are also enabled with the WAPI standard. MIIT officials acknowledged that there is no published or written measure setting out this requirement, and that China has not notified this requirement to the WTO. The United States subsequently elevated this issue to the level of the JCCT in October 2009, expressing serious concerns about MIIT's WAPI mandate for Internet-enabled mobile handsets as well as the lack of transparency and fairness in the regulatory process associated with MIIT's development of this policy.

In 2011, MIIT remained unwilling to approve any Internet-enabled mobile handsets or similar hand-held wireless devices unless the devices were WAPI-enabled, indicating that China's unpublished requirement continues to be in force. The United States continued to raise concerns with this requirement, both bilaterally and in meetings of the TBT Committee.

A new issue related to WiFi standards arose in 2011, after China published a proposed voluntary wireless LAN industry standard known as the "UHT/EUHT standard." China's UHT/EUHT standard appears to be an alternative to the international standard IEEE 802.11n, which is the wireless LAN industry standard currently used throughout the world in Wi-Fi networks. The Chinese UHT/EUHT standard was released for only a 15-day public comment period on September 20, 2011. U.S. industry groups submitted comments, arguing, among other things, that there are technical compatibility concerns regarding the interoperability of the UHT/EUHT standard with the existing Chinese national standard (WAPI) and with the most widely used and recognized WLAN industry standard (IEEE 802.11). Separately, the United States expressed concerns to China that, if China integrates standards such as the UHT/EUHT standard into its certification or accreditation schemes, these standards would become *de facto* mandatory and therefore would raise questions in light of China's

obligations under the WTO TBT Agreement. In February 2012, MIIT approved the UHT/EUHT standard as a voluntary standard, but U.S. industry has expressed concern that the unusual approval process for UHT/EUHT may reflect a desire within the Chinese Government to promote this indigenous standard, despite technical concerns raised by industry participants in the technical committee relating to its compatibility and co-existence with 802.11 products. Since then, the United States has raised its concerns about the *de facto* mandating of voluntary standards like UHT/EUHT via certification or accreditation schemes, and the United States will continue to do so in 2013.

3G Telecommunications Standards

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

By the end of 2004, it had become evident that there was still pressure from within the Chinese government to ensure a place for China's home-grown 3G telecommunications standard, known as TD-SCDMA. In 2005, China continued to take steps

to promote the TD-SCDMA standard. It also became evident that they had not ceased their attempts to influence negotiations on royalty payments. Then, in February 2006, China declared TD-SCDMA to be a "national standard" for 3G telecommunications, heightening concerns among U.S. and other foreign telecommunications service providers that Chinese mobile telecommunications operators would face Chinese government pressure when deciding what technology to employ in their networks.

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

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

In March 2010, U.S. concerns over China's preferential treatment of TD-SCDMA were exacerbated by the inclusion of products based on this technology in the *Opinions on Advancing Third-*

Generation Communications Network Construction, issued by MIIT, NDRC, the Ministry of Science and Technology (MOST), MOF, the Ministry of Land and Resources, the Ministry of Housing and Urban-Rural Development and SAT. Specifically, the United States was concerned that this measure would lead to these products being entitled to government procurement preferences.

Meanwhile, China's insistence on promoting TD-SCDMA discouraged further innovation. For example, China was reluctant to permit operators to deploy alternative technologies, including 4G technologies.

Throughout 2010, the United States continued to press China to reaffirm the principle of technology neutrality for current and future services and technologies. In an important development at the December 2010 JCCT meeting, China agreed to technology neutrality for 3G networks and future networks based on new technologies, allowing operators to choose freely among those technologies and without the Chinese government providing any preferential treatment based on the standard or technology used by an operator.

In 2012, the United States carefully monitored developments in this area, stressing to China in bilateral meetings the importance of a continuing commitment to technology neutrality in line with China's JCCT commitments, both for 3G standards and for emerging 4G standards issues, such as the ZUC standard described below. The United States will continue to work in 2013 to ensure that China's regulators adhere to China's JCCT commitments.

4G Telecommunications ZUC Encryption Algorithm Standard

At the end of 2011 and into 2012, China moved ahead with the rollout of a Chinese government-developed 4G Long-Term Evolution (LTE) encryption algorithm known as the ZUC standard. The European Telecommunication Standards Institute

(ETSI) 3rd Generation Partnership Project (3GPP) had approved ZUC as a voluntary standard in September 2011. According to U.S. industry reports, MIIT, in concert with the State Encryption Management Bureau (SEMB), informally announced in early 2012 that only domestically developed encryption algorithms, such as ZUC, would be allowed for 4G TD-LTE networks in China, and it appeared that burdensome and invasive testing procedures threatening companies' sensitive intellectual property could be required.

In response to U.S. industry concerns, the United States urged China not to mandate any particular encryption standard for 4G LTE telecommunications equipment, in line with its bilateral commitments and the global practice of allowing commercial telecommunications services providers to work with equipment vendors to determine which security standards to incorporate into their networks. Any mandate of a particular encryption standard such as ZUC would contravene a commitment that China made to its trading partners in 2000, which clarified that foreign encryption standards were permitted in the broad commercial marketplace and that strict "Chinese-only" encryption requirements would only be imposed on specialized IT products whose "core function" is encryption. Additionally, a ZUC mandate would contravene China's 2010 JCCT commitment on technology neutrality, in which China had agreed to take an open and transparent approach with regard to operators' choices and not to provide preferential treatment based on the standard or technology used in 3G or successor networks, so that operators could choose freely among whatever existing or new technologies might emerge to provide upgraded or advanced services.

The United States pressed China on this issue throughout the run-up to the December 2012 JCCT meeting. At that meeting, China agreed that it will not mandate any particular encryption standard for commercial 4G LTE telecommunications equipment. In 2013, the United States will continue to closely monitor developments in this area.

Mobile Smart Device

In 2012, MIIT began to develop a new draft regulatory framework for the mobile smart device market. MIIT's stated objective is to help protect consumer interests relating to the privacy of users and the security of their personal information in connection with the operation of their mobile smart devices.

In April 2012, MIIT shared a draft *Notice Regarding Strengthening Management of the Network Access for Mobile Smart Devices* with select foreign companies for informal comments. It appears that the draft measure would impose numerous new obligations and technical mandates on information technology and telecommunications hardware, operating systems, applications, application stores and other related services. The draft measure also may impose, by reference, mandatory technical regulations and testing requirements on these same goods and services, as well as on the mobile smart devices themselves. In addition, the China Communications Standardization Association is in the process developing numerous "industry standards" relating to smart terminal requirements, which appear to be linked to the development of the draft measure.

The United States expressed its concerns to MIIT and requested that China notify the measure to the WTO TBT Committee. The United States also offered to work with MIIT on best practices for addressing privacy and security associated with mobile smart devices. In response, in June 2012, MIIT published the draft measure on the MIIT website and asked for public comments within 30 days. In addition, in November 2012, China notified the draft measure to the WTO TBT Committee and indicated that it would accept comments for a 60-day period.

The United States and U.S. industry are concerned because the far-reaching regulatory approach embodied in the draft measure – which is exclusively oriented toward government mandates rather than voluntary private sector-developed global standards

and public-private cooperation – is unprecedented among the leading markets for mobile smart devices and could create significant trade barriers. Furthermore, the potential inclusion of numerous voluntary standards relating to smart terminal requirements could create further trade barriers, as it could readily lead to these voluntary standards becoming mandatory standards within MIIT's testing and certification process. In 2013, the United States will continue to closely monitor this issue.

Patents Used in Chinese National Standards

China has prioritized the development of Chinese national standards in documents such as the *Outline for the National Medium to Long-Term Science and Technology Development Plan (2006-2020)*, issued by the State Council in February 2006, and amplified shortly thereafter in the *11th Five Year Plan (2006-2010) for Standardization Development*, issued by the Standardization Administration of China. More recently, China has also publicly expressed its resolve to rely on either non-patented technology or patented technology made available at prices lower than those that patent owners would otherwise seek to charge when developing standards. As a result, China's treatment of patents in the standard setting process has garnered increasing attention and concern around the world, including in the United States.

In November 2009, SAC circulated a draft of the *Provisional Rules regarding Administration of the Establishment and Revision of National Standards Involving Patents* for public comment. This draft measure would implement China's vision for a standards development process that uses government power to deny or lower the royalty rates owed to owners of patents incorporated into Chinese national standards. The draft measure would establish the general principle that mandatory national standards should not incorporate patented technologies. However, when they do incorporate patented technologies, the draft measure provides for the possibility of a compulsory license if a patent

holder does not grant a royalty-free license. In 2004, SAC circulated a similar draft measure – the *Interim Regulations for National Standards Relating to Patents* – for public comment, although it was never finalized. SAC's 2009 draft measure appears to incorporate many of the problematic aspects of the 2004 draft measure.

The United States provided comments to SAC on the 2009 draft measure in December 2009, requesting that SAC not move forward with it and instead consult with stakeholders. SAC reportedly received comments from 300 other interested parties as well. A draft measure with similar provisions was issued by the China National Institute for Standards (CNIS) in February 2010, and the United States provided comments to CNIS in March 2010. Throughout 2010, the United States also raised its concerns in meetings with China's regulators, and as of December 2010 neither SAC nor CNIS had moved forward to finalize their draft measures.

At the December 2010 JCCT meeting, the United States and China agreed that patent issues related to standards raise complex issues that require standard setting organizations to take into account the appropriate balance among the interests of patentees, standard users and the public when developing and adopting their rules on patent issues. The two sides also agreed to have further discussions on patent issues related to standards, including in the JCCT IPR Working Group, involving participants from all relevant U.S. and Chinese agencies. Going forward, the United States will continue to emphasize that, in contrast to China's proposed approach, standards organizations around the world normally require enterprises that contribute patented technology to a standard to license their patents on "reasonable and non-discriminatory" terms, which entitles them to set reasonable limits on the use of their technology and to receive reasonable compensation.

Meanwhile, in June 2009, China's Supreme People's Court (SPC) published a draft *Interpretation on Several Issues regarding Legal Application in the*

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

Information Security Standards

In August 2007, China notified to the TBT Committee a series of 13 proposed technical regulations relating to information security for various information technology products, including routers, smart cards and secure databases and operating systems. China requested that comments be provided within 60 days, but did not specify implementation dates for the proposed regulations. Subsequently, in March 2008, CNCA issued an announcement indicating that the final regulations would be published in May 2008, and would become mandatory one year later.

In part because of past actions that China has taken in this area, including China's issuance of mandatory encryption standards for Wi-Fi technologies in 2003 and regulations that China had issued in 1999 requiring the registration of a wide range of hardware and software products containing encryption technology, these proposed regulations generated immediate concerns for the United States and U.S. industry. In particular, the proposed regulations go substantially beyond global norms by mandating testing and certification of information

security in commercial information technology products, not just products for government use in national security applications. In other countries, mandatory testing and certification for information security is only required for products used in sensitive government and national security applications.

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

In April 2009, CNCA, AQSIQ and MOF announced that the implementation of compulsory certification for thirteen types of information security products would be delayed until May 2010, and would only be applied when products are sold to the government, representing a significant reduction in the scope of the requirements from China's original plan. In September 2009, during the run-up to the October 2009 JCCT meeting, China confirmed that the compulsory certification requirement only applies when products are sold to government agencies, and not to state-owned enterprises or other sectors of China's economy.

In 2010, the United States continued to meet with China's regulators to discuss their regulation of information security products. China's State Encryption Management Commission, in bilateral meetings, confirmed that it was considering revisions to its 1999 encryption regulations. The United States noted the earlier widespread concerns about these regulations and asked China to ensure that any revisions to these regulations would be published in draft form with opportunity for comment by interested parties.

Additionally, beginning in 2010 and continuing through 2012, both bilaterally and during meetings of the WTO's TBT Committee, the United States raised its concerns with China about framework regulations for information security in critical infrastructure known as the Multi-Level Protection Scheme (MLPS), first issued in June 2007 by the Ministry of Public Security and MIIT. The MLPS regulations put in place guidelines to categorize information systems according to the extent of damage a breach in the system could pose to social order, public interest and national security. The MLPS regulations also appear to require, by reference, purchasers' compliance with certain information security technical regulations and encryption regulations that are referenced within the MLPS regulations.

Among other things, the MLPS regulations bar foreign products from information systems graded level 3 and above, because all products deployed must be developed by Chinese information security companies and must bear Chinese intellectual property in their key components. Additional troubling product testing provisions for level 3 and above require companies to disclose product source code, encryption keys and other confidential business information. To date, hundreds of request for proposals (RFPs) incorporating MLPS requirements have come from government agencies, the financial sector, telecommunications companies, the power grid, educational institutions and hospitals in China. These RFPs cover a wide range of information security software and hardware, and many of them exclude the purchase of foreign products by incorporating level-3 requirements.

If implementing rules for the MLPS regulations are issued and apply broadly to commercial sector networks and IT infrastructure, they could have a significant impact on sales by U.S. information security technology providers in China. The United States has therefore urged China to notify any MLPS implementing rules laying down equipment-related requirements in accordance with China's obligations under the TBT Agreement.

At the December 2012 JCCT meeting, China indicated that it would begin the process of revising the MLPS regulations. It also agreed that, during that process, it would enter into discussions with the United States regarding its concerns.

The United States has also grown increasingly concerned that China may finalize several proposed voluntary standards related to information security and integrate them into certification or accreditation schemes, making the voluntary standards *de facto* mandatory. These proposed voluntary standards include the UHT/EUHT standard discussed above as well as a series of six information security voluntary standards released for public comment in July 2011 by the China National Information Security Technical Standards Committee. Another one, relating to information security requirements for office equipment, was released in September 2011 for a public comment period of 30 days by a standardization institute under MIIT's jurisdiction, known as the China Electronics Standardization Institute, in conjunction with the China National Information Security Technical Standards Committee. It appears to be an office equipment information security standard designed as an alternative to IEEE 2600, an international information security standard. As in the case of the UHT/EUHT standard, the United States has made clear to China that, if voluntary standards such as its proposed office equipment standard are integrated into its certification or accreditation schemes, these standards would become *de facto* mandatory and therefore would raise questions in light of China's obligations under the WTO TBT Agreement.

CONFORMITY ASSESSMENT PROCEDURES

China appears to be turning more and more to in-country testing for a broader range of products, which does not conform with international practices that generally accept foreign test results and conformity assessment certifications.

China's regulatory authorities appear to be turning more and more to in-country testing for a broader

range of products. This policy direction is troubling, as it is inconsistent with common international conformity assessment practices, which favor processes that accept test results from internationally recognized laboratories, the concept of a "supplier's declaration of conformity" and other similar trade-facilitating conformity assessment mechanisms.

The United States is unaware of any meaningful efforts by China to move toward a system that recognizes test results or conformity assessment certifications from bodies other than Chinese government-run testing, certification, or accreditation entities. Instead, China has developed plans to expand the CCC mark scheme and its mandatory testing requirements to information security, an area in which most countries do not engage in government certification. China also continues to prepare to implement in-country government testing for compliance with its new regulations on hazardous substances in electronic information products. In addition, China issued a measure, which it subsequently suspended, establishing a burdensome new regime for government inspection of imported medical devices that have already satisfied applicable Chinese certification requirements before being exported to China. Working with U.S. industry, the United States will continue to urge China in 2012 to reverse this trend and move in the direction of more globally recognized conformity assessment practices.

CCC Mark System

As previously reported, CNCA regulations establishing a new Compulsory Product Certification System, issued in December 2001, took full effect in August 2003. Under this system, there is now one safety mark – the CCC mark – issued to both Chinese and foreign products. Under the old system, domestic products were only required to obtain the "Great Wall" mark, while imported products needed both the "Great Wall" mark and the "CCIB" mark. In 2012, as in prior years, U.S. companies continued to express concerns that the regulations lack clarity

regarding the products that require a CCC mark. They have also reported that China is applying the CCC mark requirements inconsistently and that many domestic products required by CNCA's regulations to have the CCC mark are still being sold without the mark. In addition, despite the changes made by the regulations, U.S. companies in some sectors continued to express concerns in 2012 about duplication in certification requirements, particularly for radio and telecommunications equipment, medical equipment and automobiles.

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

In 2012, as in prior years, the United States raised its concerns about the CCC mark system and China's

limitations on foreign-invested conformity assessment bodies with China both bilaterally and during meetings of the WTO's TBT Committee. At the December 2012 JCCT meeting, China confirmed that eligible foreign-invested testing and certification entities registered in China can participate in CCC mark-related work and that China's review of applications from foreign-invested entities will use the same conditions as those applicable to Chinese domestic entities.

Telecommunications Equipment

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

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

in some cases, testing requirements for products can change on an almost monthly basis.

In bilateral meetings in 2010, the United States and China discussed testing and certification redundancies in the area of telecommunications equipment. As a result of these meetings, China's MIIT and U.S. regulatory officials, together with global industry stakeholders, conducted a one-day workshop in May 2010 to discuss prevalent concerns about telecommunications testing and certification requirements from a technical perspective. China also committed, at the December 2010 JCCT meeting, that it would develop a one-stop shopping mechanism for telecommunications network access license and radio type approval. At the November 2011 JCCT meeting, China agreed to publish the procedures for this new mechanism by the end of 2011. In December 2011, MIIT announced the implementation of its December 2010 JCCT commitment through the establishment of a single application window for both RTA and NAL testing and certification. In February 2012, a one-stop-shopping mechanism became operational on MIIT's website, with MIIT's Telecommunications Equipment Certification Center being appointed to process applications for both testing and certification processes. Based on industry's experience to date, it does not appear that MIIT's new approach is meaningful in terms of streamlining the MIIT processes. The United States remains concerned that it does not actually eliminate any redundancies or unnecessary elements of the testing and certification processes. It also does not appear to address a fundamental concern that unnecessary functionality testing is a major cause of the burdensome nature of these processes. In addition, the lack of transparency in the NAL testing and certification process remains a concern, as NAL requirements are not readily available to the public.

In 2013, the United States will monitor developments in this area closely and will continue to pursue progress in enhancing transparency and streamlining China's telecommunications testing and certification requirements.

Medical Devices

Since the creation of China's CCC Mark system, one of the more significant problem areas has been duplicative certification requirements for imported medical equipment. At the April 2006 JCCT meeting, as previously reported, the United States was able to obtain China's commitment to eliminate the redundancies to which imported medical equipment has been subjected. However, China only took steps to address duplicative product testing. China did not address the more burdensome duplicative factory inspection, certification and registration requirements applicable to imported electro-medical equipment or additional product-specific concerns, such as redundancies on border inspections for imported pacemakers.

The United States raised its continuing concerns in this area through various bilateral meetings in 2006, 2007 and 2008, including the JCCT meetings held in December 2007 and September 2008, as well as during the transitional reviews before the TBT Committee in November 2006 and November 2007. In September 2008, CNCA and China's State Food and Drug Administration (SFDA) jointly issued an announcement eliminating redundant testing, fees and factory inspections.

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

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

Despite apparent agreement at the October 2009 JCCT meeting that China would reconsider its requirement that a medical device be registered in the country of export before it can obtain approval in China, SFDA has not revised this requirement. Most recently, in 2012, China issued the third draft of the *Regulations on Supervision and Administration of Medical Devices*, where China continues to require prior marketing approval by the country of origin or country of legal manufacture. The United States is continuing to raise its concerns about China's inaction with SFDA and other Chinese regulatory authorities.

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

not reported problems with the medical device recall system. In 2013, the United States will continue to monitor developments in this area to ensure that China's regulatory approach is consistent with China's JCCT commitment.

China RoHS

The United States continues to be concerned by China's *Administrative Measures for Controlling Pollution Caused by Electronic Information Products*, issued by MIIT and several other Chinese agencies effective March 2007. This measure is modeled after existing EU regulations that restrict hazardous substances in electronic products and is known as "China RoHS." While both the EU regulations and China's regulations seek to ban lead and other hazardous substances from a wide range of electronic products, there are significant differences between the two regulatory approaches.

Throughout the process of developing the China RoHS regulations, there was no formal process for interested parties to provide comments or consult with MIIT, and as a result foreign stakeholders had only limited opportunity to comment on proposals or to clarify MIIT's implementation intentions. China did eventually notify the regulations to the TBT Committee, but the regulations did not provide basic information such as the specific products for which mandatory testing will be required or any details on the applicable testing and certification protocols, generating concern among U.S. and other foreign companies that they would have insufficient time to adapt their products to China's requirements and that in-country testing requirements would be burdensome and costly.

In October 2009, China issued for public comment its first draft catalogue, covering electronic information products that will be subject to hazardous substance restrictions and mandatory testing and conformity assessment under the China RoHS regulations. The draft catalogue, which was subsequently finalized and issued in final form, included mobile phones,

other phone handsets and computer printers and was supposed to come into force ten months after its adoption. However, information on the applicable testing, certification and conformity assessment regime was not included in either the draft or final catalogue.

China subsequently proposed revisions to the original China RoHS regulations. Specifically, in October 2010, China notified the draft *Measures for the Administration of the Pollution Control of Electronic or Electrical Products* to the WTO's TBT Committee and also solicited public comment on it. China has not yet finalized this measure.

In May 2010, MIIT and CNCA jointly issued the *Opinions on the Implementation of the National Voluntary Certification Program for Electronic Information Products Subject to Pollution Control*, which announced a voluntary program to certify electronic information products to the China RoHS limits established for six substances. More recently, MIIT and CNCA indicated that they intend to encourage electronic information product manufacturers, sellers and importers to take advantage of the program's financial and tax incentives and priority in government procurement. MIIT and CNCA began implementing this voluntary program in November 2011.

In July 2012, MIIT posted on its website another draft revision of the China RoHS regulations for public comment. U.S. industry submitted comments on this draft revision, and the United States will carefully monitor developments in this area in 2013.

TRANSPARENCY

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

In the area of transparency, AQSIQ's TBT inquiry point, established shortly after China acceded to the

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

However, in 2012, as in prior years, almost all of the notified measures have emanated from AQSIQ, SAC or CNCA and have rarely included measures from other agencies that appear to require notification, such as MOH, MIIT, the State Environmental Protection Administration and SFDA. Several years ago, in part to address this problem, China had reportedly formed a new inter-agency committee, with representatives from approximately 20 ministries and agencies and chaired by AQSIQ, to achieve better coordination on TBT (and SPS) matters, but progress has been inconsistent in this area.

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

Other Internal Policies

STATE-OWNED AND STATE-INVESTED ENTERPRISES

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

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

In the first few years after China's accession to the WTO, U.S. officials did not hear many complaints from U.S. companies regarding WTO compliance problems in this area, although a lack of available information made it a difficult area to assess. However, after China's establishment of SASAC in 2003, it became evident that the Chinese government was intent on heavily intervening in a broad range of decisions related to the strategies, management and investments of state-owned enterprises. SASAC was specifically created to represent the state's shareholder interests in state-owned enterprises, and its basic functions include guiding the reform of state-owned enterprises, taking daily charge of supervisory panels assigned to large state-owned enterprises, appointing and removing chief executives and other top management officials of state-owned enterprises,

supervising the preservation and appreciation of value of state-owned assets, reinvesting profits and drafting laws, regulations and departmental rules relating to the management of state-owned assets.

According to 2010 Chinese government statistics, the assets of state-owned enterprises account for 42 percent of the total assets of Chinese industrial enterprises, representing a significant decrease from the 1978 figure of 92 percent. Nevertheless, the continuing concentration of state-owned enterprises in key sectors has meant that their economic influence has not decreased correspondingly. For example, while the number of central-level state-owned enterprises has declined over time, in some cases the market position of the remaining state-owned enterprises has been strengthened through administrative mergers that may not have been subject to review under the *Anti-monopoly Law*.

Government Guidance in Key Sectors

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

Particularly since the start of the global economic downturn in late 2008, state-owned enterprises at the central government level have been aggressively acquiring and merging with other central state-owned enterprises as well as provincial and local state-owned enterprises and private enterprises. According to one recent Chinese government statement, 82 percent of central state-owned enterprises' assets are concentrated in the petrochemicals, electric power and grid, defense, telecommunications, transport, mining, metallurgy and machinery sectors. Central state-owned enterprises also supply almost all of the crude oil, natural gas, ethylene and basis telecommunication services for China's economy.

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

In March 2010, SASAC issued a potentially far-reaching measure, the *Interim Provisions on Guarding Central State-Owned Enterprises' Commercial Secrets*, effective as of the date of its issuance. This measure appears to implement the *Law on Guarding State Secrets*, which the National People's Congress amended in 2009. It is unclear why the commercial secrets of state-owned enterprises need to be protected through a measure

applicable only to state-owned enterprises, when the commercial secrets of all enterprises in China are already subject to protection.

In July 2010, the Central Committee of the Communist Party and the State Council issued the *Opinions on Further Promoting the Implementation of the "Three-Major One-Large" Decision-making System*. This measure requires state-owned enterprises to establish a collective decision-making system in which the Communist Party plays a significant role in major business decisions, major personnel changes and major project arrangements (known as the "three majors"). It also requires the movement of large amounts of funds (the "one large") to be decided collectively by the leadership team, which includes representatives from the Communist Party.

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

Particularly in recent years, the United States has sought to engage China on these and a variety of other issues related to state-owned enterprises. The United States has used bilateral avenues such as the economic track of the S&ED and the JCCT process as well as meetings at the WTO, principally through the Subsidies Committee and the Committee on Government Procurement.

This year, at the May 2012 S&ED meeting, the United States obtained commitments from China that should help to create a more level playing field for U.S. enterprises competing against China's state-owned enterprises. China committed to providing non-discriminatory treatment to all enterprises, regardless of type of ownership, in terms of credit, taxation, and regulatory policies. China also agreed to increase the number of state-owned enterprises

that pay dividends as well as to increase the amount of dividends actually paid. In addition, China agreed that it would encourage listed state-owned enterprises – which include China's largest and most profitable state-owned enterprises – to increase the portion of profits that they pay out in dividends so as to be in line with market levels.

In 2013, the United States will continue to address the growing number of issues relating to state-owned enterprises in China in order to ensure that China fully adheres to its WTO obligations and that the actions of the Communist Party, the Chinese government and China's SOEs do not impede the ability of U.S. firms to compete and invest in China.

Anti-monopoly Law

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

After the *Anti-monopoly Law* was issued, MOFCOM, NDRC, SAIC and other Chinese government ministries and agencies began to formulate implementing regulations, departmental rules and other measures. Throughout this process, the United States has urged China to implement the *Anti-monopoly Law* in a manner consistent with global best practices and with a focus on consumer welfare and the protection of the competitive process, rather than consideration of industrial policy or other non-competition objectives. The United States has also specifically pressed China to

ensure that its implementation of the *Anti-monopoly Law* does not create disguised or unreasonable barriers to trade and does not provide less favorable treatment to foreign goods and services or foreign investors and their investments.

The United States also launched an *Anti-monopoly Law* technical assistance program in 2008, funded by the U.S. Trade and Development Agency and led by a multi-agency team of U.S. experts. Since then, several workshops have taken place under this program in China on important substantive issues, such as merger review, unilateral conduct by firms with a dominant market position, cartel enforcement, non-discrimination in interstate commerce and the interface between intellectual property, antitrust and trade laws and policies. Chinese government officials from MOFCOM, SAIC, NDRC, SCLAO and the NPC have also come to Washington as part of this program.

The *Anti-monopoly Law* does contain provisions that have generated concerns. For example, it remains unclear how the Chinese government will implement one provision that requires protection for the lawful operations of state-owned enterprises and government monopolies in industries deemed nationally important, although MOFCOM has imposed conditions on at least one state-owned company forming a joint venture, and NDRC has conducted an investigation into anti-competitive price discrimination by two large state-owned telecommunications companies. 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 implementing regulations, could be important instruments for promoting the establishment and maintenance of increasingly competitive markets in China. In addition, because trade associations in China frequently appear to have strong government ties, the United States has encouraged the Chinese agencies charged with enforcing the *Anti-monopoly Law* to work with Chinese regulatory agencies with sectoral responsibilities to emphasize the

importance of trade associations refraining from engaging in conduct that would violate the *Anti-monopoly Law*.

Since the *Anti-monopoly Law* went into effect in 2008, China's administrative enforcement of it has been most active in the merger area overseen by MOFCOM, largely due to the requirement to pre-notify merger transactions. Some U.S. enterprises have expressed concern about delays by MOFCOM, for example, in accepting merger filings. In addition, although MOFCOM's initial merger decisions were brief, MOFCOM has begun to release more detailed explanations of its merger decisions, some of which have been criticized by U.S. industry observers for lack of adequate bases to find that a merger has or may have the effect of eliminating or restricting competition. In addition, MOFCOM's enforcement seems to have focused more on mergers involving foreign enterprises than those involving China's enterprises. More than 90 percent of the transactions notified to MOFCOM since the *Anti-monopoly Law* went into effect in 2008 have involved at least one multinational corporation, and none of the 15 transactions that MOFCOM approved with conditions has been between Chinese enterprises. MOFCOM has imposed conditions in several transactions in which one party was a Chinese enterprise, including one instance involving a state-owned enterprise. In addition, MOFCOM has formally blocked only one transaction, and that transaction involved a foreign enterprise's attempt to acquire a well-known Chinese enterprise.

STATE TRADING ENTERPRISES

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

In its WTO accession agreement, China agreed to disciplines on the importing and exporting activities of state trading enterprises. China committed to provide full information on the pricing mechanisms of state trading enterprises and to ensure that their import purchasing procedures are transparent and fully in compliance with WTO rules. China also

agreed that state trading enterprises would limit the mark-up on goods that they import in order to avoid trade distortions. Since China's WTO accession, the United States and other WTO members have sought information from China on the pricing and purchasing practices of state trading enterprises, principally through the transitional reviews at the WTO. So far, however, China has only provided general information, which does not allow a meaningful assessment of China's compliance efforts.

GOVERNMENT PROCUREMENT

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

The WTO Agreement on Government Procurement or GPA, is a plurilateral agreement that currently covers the United States and 41 other WTO members. The GPA applies to the procurement of goods and services by central and sub-central government agencies and government enterprises specified by each party, subject to specified thresholds and certain exceptions. It requires GPA parties to provide MFN and national treatment to the goods, services and suppliers of other GPA parties and to conduct their procurement in accordance with procedures designed to ensure transparency, fairness and predictability in the procurement process.

China is not yet a party to the GPA. It committed, in its WTO accession agreement, to initiate negotiations for accession to the GPA "as soon as possible." Until it completes its accession to the GPA, China has committed in its WTO accession agreement that all of its central and local government entities will conduct their procurements in a transparent manner. China also agreed that, where it opens a procurement to foreign suppliers, it will provide MFN treatment by allowing all foreign suppliers an equal opportunity to participate in the bidding process.

GPA Accession

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

At the April 2006 JCCT meeting, China agreed to initiate GPA negotiations no later than December 2007. China subsequently initiated negotiations on its accession to the GPA in December 2007 with the submission of its application for accession and its initial offer of coverage, known as its Appendix I Offer. In May 2008, the United States submitted its Initial Request for improvements in China's Initial Appendix I Offer, and other GPA parties submitted similar requests. In September 2008, China submitted its responses to the Checklist of Lists for Provision of Information Relating to Accession.

In 2009, the United States held three rounds of negotiations with China on the terms and conditions of China's GPA accession. In addition, at the July 2009 S&ED meeting, China agreed to submit a report to the WTO's Government Procurement Committee, before its October 2009 meeting, setting out the improvements that China would make in its revised offer. In October 2009, China submitted the report, which indicated that improvements to its offer would provide for the coverage of more entities, goods and services and lower thresholds. Subsequently, following further bilateral engagement by the United States, China committed during the October 2009 JCCT meeting to submit a revised offer as early as possible in 2010.

In 2010, the United States held three more rounds of negotiations with China on the terms and conditions of China's GPA accession and the development of its government procurement system. In addition, the United States submitted questions to China on its responses to the Checklist of Lists for Provision of Information Relating to Accession. At the May 2010

S&ED meeting, China committed to submit its first Revised Offer in July 2010, as it later did. The United States then submitted its Second Request for improvements in China's proposed coverage of government procurement in September 2010.

At the December 2010 JCCT meeting, the United States obtained China's commitment to accelerate its accession to the GPA, as China agreed to work with provincial and local governments and to submit a robust revised offer of coverage in 2011. During President Hu's January 2011 visit to Washington, China expressly committed that its next revised offer would include sub-central entities. Subsequently, China reiterated that it would submit a second revised offer in 2011, which it did in November 2011.

In 2011, the United States held three rounds of negotiations with China on its accession to the GPA. The negotiations included U.S. experts who explained the U.S. government procurement system and the implementation of U.S. commitments under the GPA. The negotiations also focused on the coverage of government enterprises under the GPA, with the United States requesting that China add state-owned enterprises to its GPA coverage.

At the May 2012 S&ED meeting, China committed to submit "a new comprehensive revised offer that responds to the requests of the GPA parties . . . before the [GPA] committee's final meeting in 2012." China subsequently submitted its third revised offer in November 2012. This revised offer falls short of the coverage provided by the United States and other GPA parties, as China responded to few requests made by GPA parties. These requests had sought to extend coverage to state-owned enterprises, include additional services coverage, eliminate broad exclusions and significantly expand coverage of sub-central entities. The United States, the EU and other GPA parties described the revised offer as highly disappointing, both in terms of scope and coverage. At the December 2012 JCCT meeting, China agreed to engage seriously with the United States on outstanding core issues relating to the scope of projects that qualify as government

procurement and the extent to which state-owned enterprises in China engage in government procurement activities.

Going forward, the United States will continue to work with China and other interested GPA parties in an effort to ensure that China's accession to the GPA takes place expeditiously and on robust terms that are comparable to the coverage of the United States and other GPA Parties.

China's Government Procurement Regime

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

It is notable, however, that the *Government Procurement Law* does not cover most public works projects, which represent at least one-half of China's government procurement market. Those projects are subject to a different regulatory regime,

established by China's *Tendering and Bidding Law*, which entered into force in January 2000. In September 2009, the State Council circulated NDRC's draft regulations implementing the *Tendering and Bidding Law* for public comment. In October 2009, the United States submitted written comments on these draft regulations in which it emphasized, among other things, the need for greater clarification of the relationship between the *Tendering and Bidding Law* and China's *Government Procurement Law*, and the need to define "domestic products." In December 2011, the State Council issued the final implementing regulations for the *Tendering and Bidding Law*, which entered into force in February 2012.

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

Subsequently, in 2007 and 2008, the United States grew concerned with statements and announcements being made by some Chinese government officials indicating that state-owned enterprises should give priority to the purchase of domestic software. In response, at the September 2008 JCCT meeting, China clarified that its formal

and informal policies relating to software purchases by Chinese enterprises, whether state-owned or private, will be based solely on market terms without government direction.

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

In 2009, China reinforced its existing "Buy China" measures at the central, provincial and local government levels. For example, in May 2009, MIIT issued a circular entitled *Government Procurement Administration Measures*, which applies to MIIT and its direct subsidiaries. The measure required entities engaging in government procurement to give priority to domestic products, projects and services as well as to indigenous innovation products, except where the products or services cannot be produced or provided in China or are for use outside of China. Similarly, 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.

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

In 2010, China circulated two draft measures intended to implement its *Government Procurement Law*. The first draft measure, the *Regulations to Implement the Government Procurement Law*, was issued by MOF in January 2010. The United States submitted comments in February, in which, among other things, it expressed concern that the draft measure did not provide a GPA-consistent regime. The United States also expressed concern that the draft measure did not provide more specificity about the conduct of government procurement. The second draft measure, the *Administrative Measures for Government Procurement of Domestic Products*, was issued for public comment in May 2010 by MOF, MOFCOM, NDRC and the General Administration of Customs. In accordance with China's October 2009 JCCT commitment, this draft measure set out the requirements for a product to qualify as a "domestic product." The United States submitted comments on this draft measure in June, in which it expressed

concerns about the lack of details regarding how the draft measure would be implemented as well as its broad application. As of December 2012, neither one of the draft measures had been issued in final form.

Separately, in November 2009, MOST, NDRC and MOF issued the *Circular on Launching the 2009 National Indigenous Innovation Product Accreditation Work*, requiring companies to file applications by December 2009 for their products to be considered for accreditation as "indigenous innovation products." This measure provides for preferential treatment in government procurement to any products that are granted this accreditation. Subsequently, the United States and U.S. industry, along with the governments and industries of many of China's other trading partners, expressed serious concerns to China about this measure, as it appears to establish a system designed to provide preferential treatment in government procurement to products developed by Chinese enterprises.

In April 2010, MOST, NDRC and MOF issued a draft measure for public comment, the *Circular on Launching 2010 National Innovation Product Accreditation Work*. The draft measure would amend certain of the product accreditation criteria set forth in the November 2009 measure, but would leave other problematic criteria intact, along with the accreditation principles, application form and link to government procurement. In addition, the draft measure originally was to become effective the day after comments were due. The United States submitted comments in May 2010, in which it asked China to suspend the implementation of the indigenous innovation accreditation system and to engage in consultations with the United States to address U.S. concerns with the system. To date, the draft measure has not been finalized, and the Chinese authorities have not requested or accepted applications for accreditation.

At the December 2010 JCCT meeting, China took important steps to address some of the U.S.

concerns about China's indigenous innovation policies. Specifically, China agreed not to maintain any measures that provide government procurement preferences for goods or services based on the location where the intellectual property is owned or was developed. One month later, during President Hu's visit to Washington in January 2011, China went further by agreeing that it would "not link its innovation policies to the provision of government procurement preferences." Subsequently, at the May 2011 S&ED meeting, China also agreed to "eliminate all of its government procurement indigenous innovation products catalogues" when implementing the agreement reached during President Hu's visit. Finally, at the November 2011 JCCT meeting, China announced that the State Council had issued a measure requiring provincial and local governments to eliminate all links between China's innovation policies and government procurement preferences by December 1, 2011.

At the December 2010 JCCT meeting, China also agreed that, in 2011, it would revise a major MIIT catalogue, which covers heavy equipment and other industrial machinery, and that it would not use the revised catalogue for import substitution or the provision of export subsidies or otherwise to discriminate against foreign suppliers. MIIT issued a draft of the revised catalogue for public comment shortly before the November 2011 JCCT meeting, but it has not yet issued a final revised catalogue.

In 2013, the United States will continue to work with China to move forward on its GPA accession and to address a range of other government procurement issues. In addition, the United States will continue to monitor the treatment accorded to U.S. suppliers under China's government procurement regime and will continue to urge China to apply its regulations and implementing rules in a transparent, non-discriminatory manner. The United States will also continue to encourage China to develop its government procurement system in a manner that will facilitate its expeditious accession to the GPA.

INVESTMENT

China has revised many laws, regulations and other measures on foreign investment to eliminate WTO-inconsistent requirements relating to export performance, local content, foreign exchange balancing and technology transfer. However, some of the revised measures continue to “encourage” these requirements, and it appears that Chinese government officials at times continue to use the foreign investment approval process to pressure foreign companies to accept one or more of these requirements or other conditions. China has also issued industrial plans covering the auto and steel sectors that include guidelines that appear to conflict with its WTO obligations. In addition, China has added a variety of restrictions on investment that appear designed to shield inefficient or monopolistic Chinese enterprises from foreign competition.

Upon its accession to the WTO, China assumed the obligations of the Agreement on Trade-Related Investment Measures (TRIMS Agreement), which prohibits investment measures that violate GATT Article III obligations to treat imports no less favorably than domestic products or the GATT Article XI obligation not to impose quantitative restrictions on imports. The TRIMS Agreement thus expressly requires elimination of measures such as those that require or provide benefits for the incorporation of local inputs (known as local content requirements) in the manufacturing process, or measures that restrict a firm's imports to an amount related to its exports or related to the amount of foreign exchange a firm earns (known as trade balancing requirements). In its WTO accession agreement, China also agreed to eliminate export performance, local content and foreign exchange balancing requirements from its laws, regulations and other measures, and not to enforce the terms of any contracts imposing these requirements. In addition, China agreed that it would no longer condition importation or investment approvals on these requirements or on requirements such as technology transfer and offsets.

Foreign Investment Approval Process

Since China's accession to the WTO in December 2001, U.S. and other foreign companies have expressed serious concerns about China's foreign investment approval process, which lacks transparency and is governed by vaguely written and apparently unpublished rules. In particular, as set forth in an extensive study conducted for a U.S. industry association in 2012, confidential accounts from foreign companies indicate that Chinese government officials at times use the foreign investment approval process on an ad hoc basis to restrict or unreasonably delay market entry for foreign companies, to require the foreign company to take on a Chinese partner, or to extract valuable, deal-specific commercial concessions as a price for market entry. These same accounts also indicate that the Chinese government officials at times tell the foreign company that it will have to transfer technology, conduct research and development in China or satisfy performance requirements relating to exportation or the use of local content if it wants its investment approved, even though none of these requirements is set forth in Chinese law and China committed in its WTO accession agreement not to impose these requirements.

This situation has been able to persist in part because of the absence of the rule of law in China, which fosters the use of vague and unwritten policies and does not provide for meaningful administrative or judicial review of Chinese regulatory actions, thereby enabling government officials to take unilateral actions without fear of legal challenge. Exacerbating this situation is the fact that foreign companies are hesitant to speak out publicly, or to be perceived as working with their governments to challenge China's foreign investment approval practices, because they fear retaliation from Chinese government officials. The 2012 U.S. industry association study notes that foreign companies have confidentially reported receiving explicit or implicit threats from Chinese government officials – typically made orally rather

than in writing – about possible retaliatory actions that could have severe repercussions for a company's business prospects in China.

In many cases, it appears that Chinese government officials are motivated by China's industrial policy objectives when they use their unchecked power to dictate or influence foreign investment outcomes. With China's state-led economic development model, the government issues five-year plans that set objectives for virtually every sector of the economy. While these plans in broad terms seek to foster national champions, protect state-owned enterprises, promote indigenous innovation and guide the development of Chinese domestic industry up the value chain, they also include specific guidelines addressing matters such as technology transfer and the use of local content, as well as decisions about industry consolidation, production capacity, product lines and similar decisions normally made by the marketplace.

Even though China has revised a number of laws, regulations and other measures on foreign investment to eliminate requirements relating to export performance, local content, foreign exchange balancing and technology transfer, as China committed to do in its accession agreement, some of the revised measures, for example, continue to encourage technology transfer or the use of local content, without formally requiring it. From the beginning, U.S. companies were concerned that this "encouragement" in practice could amount to a "requirement" in many cases, in light of the high degree of discretion provided to Chinese government officials when reviewing foreign investment applications. Moreover, according to U.S. companies, even without formal encouragement, some Chinese government officials still consider factors such as technology transfer and the use of local content when deciding whether to approve an investment or to take some other action, such as recommend approval of a loan from a Chinese policy bank, which is often essential to the success of a project.

In 2012, as in prior years, the United States and other WTO members, including the EU and Japan, raised concerns in this area during meetings of the WTO TRIMS Committee. The United States and several other WTO members also highlighted this area during China's fourth Trade Policy Review, which took place in June 2012.

On the bilateral front, the United States has pressed its concerns with the foreign investment approval process through the JCCT and S&ED processes and other avenues. During the February 2012 visit of Vice President Xi to the United States, China affirmed that technology transfer and technological cooperation shall be decided by businesses independently and will not be used by the Chinese government as a pre-condition for market access. At the December 2012 JCCT meeting, China also confirmed that it would correct in a timely manner any measures that were inconsistent with this commitment.

Foreign Investment Catalogue

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

In 2007, as previously reported, the State Council issued a revised Foreign Investment Catalogue

without having provided an opportunity for public comment. The revised Foreign Investment Catalogue placed 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 and genetically modified plant seeds remained in place. From a positive standpoint, the revised Foreign Investment Catalogue encouraged foreign investment in highway cargo transport and modern logistics, while it removed from the "encouraged" category projects of foreign-invested enterprises that export all of their production.

Using both the JCCT process and the S&ED process, the United States pressed China to increase the transparency of its revisions to the Catalogue. At the May 2010 S&ED meeting, China committed to publish proposed future revisions of the Foreign Investment Catalogue in advance for public comment.

This commitment was fulfilled in April 2011, when NDRC and MOFCOM jointly issued a draft of the newly revised Foreign Investment Catalogue for a 30-day public comment period. The United States submitted comments on the draft revised Foreign Investment Catalogue, noting that the proposed revisions fail to make substantial progress in opening China's market to greater foreign investment, and in some cases impose new limitations on foreign investment in sectors that previously had been more open. The draft revised Foreign Investment Catalogue places new sectors into the restricted and prohibited categories, including the processing of certain types of edible oil seeds, the mining of certain minerals, and the research and production of genetically modified seeds, among others. Even some sectors listed in the encouraged category are subject to new investment limitations, including, for example, the manufacture of new energy vehicle components, which is now subject to a 50 percent equity cap for foreign investment. The United States also noted that the draft revised Foreign Investment Catalogue fails to provide foreign investors with

clear and consistent guidance about their ability to invest in China's market.

In December 2011, China published the final version of the revised Catalogue, which entered into force in January 2012. Although the revised Foreign Investment Catalogue makes minor improvements, including by allowing wholly foreign-owned medical establishments and by removing the retailing of over-the-counter medicines from the "restricted" category, it is generally not responsive to the requests that the United States has made to lift investment restrictions in particular sectors.

In 2012, the United States continued to engage China vigorously through the S&ED process, the JCCT process and other bilateral channels in order to encourage China to make further on-the-ground improvements in its investment regime. At the May 2012 S&ED meeting, China committed to implement a more proactive opening-up strategy and to expand the areas open to foreign investment, and the degree of openness, during the 12th Five-year Plan period. The United States continues to press China for a concrete implementation plan for this commitment.

Other Restrictions on Investment

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

In August 2006, China made a further move toward a more restrictive investment regime when it issued new regulations on mergers and acquisitions (M&A) involving foreign investors. These regulations strengthened MOFCOM's supervisory role over foreign investment, in part by requiring MOFCOM's approval of M&A transactions that it believes impact "national economic security" or involve traditional

Chinese brands or well-known Chinese trademarks. Three years later, in July 2009, China issued revised regulations addressing M&A involving foreign investors, without having provided a notice-and-comment period. The revised regulations retain the review criteria from the 2006 regulations.

In November 2006, NDRC released a five-year plan on foreign investment, which promises greater scrutiny over foreign capital utilization. This plan calls for the realization of a “fundamental shift” from “quantity” to “quality” in foreign investment from 2006 to 2010, with the state’s focus changing from shoring up domestic capital and foreign exchange shortfalls to introducing advanced technology, management expertise and talent. The plan seeks to restrict foreign enterprises’ acquisition of “dragon head” enterprises, prevent the “emergence or expansion of foreign capital monopolies,” protect national economic security, particularly “industry security,” and prevent “abuse of intellectual property.” The plan also directs that more attention be paid to ecology, the environment and energy efficiency and demands tighter tax supervision of foreign enterprises. In April 2010, the State Council issued the *Several Opinions on Further Improving the Work of Utilizing Foreign Investment*, which appears to be a step toward implementing part of the five-year plan. This measure includes guidelines to encourage foreign investment in certain sectors of the economy, such as high-end manufacturing, high-tech businesses, advanced services businesses and eco-friendly industries, and in the central and western regions of China. It also calls for raising the threshold for central government approval for foreign investments falling in the “permitted” and “encouraged” categories from \$100 million to \$300 million. While the stated purpose of the measure is to create a better environment for foreign investors in China, it remains to be seen how it will be implemented in practice.

In December 2006, as discussed above in the State-owned and State-Invested Enterprises section, SASAC, the government entity charged with overseeing China’s interests in state-owned

enterprises, published a list of key sectors that it deemed critical to the national economy. SASAC committed to restrict foreign participation in these sectors by limiting further foreign investment in state-owned enterprises operating in these sectors.

In August 2007, as discussed above in the State-owned and State-Invested Enterprises section, China enacted its *Anti-monopoly Law*. Among other things, this law calls for China to establish a review process to screen inward investment for national security implications. In February 2011, the State Council issued a notice establishing a “security review system” for mergers and acquisitions of Chinese domestic enterprises by foreign investors. Shortly thereafter, in March 2011, MOFCOM issued interim implementing rules for this system. Final rules were issued in August 2011.

The new security review system allows the central government to review transactions where a foreign company invests in any company involved in China’s defense industry, or where a foreign company invests in, and obtains actual control over, any Chinese enterprise that is related to national security or is involved in important agriculture products, important energy and resource products, critical infrastructure, critical transportation systems or key technology or equipment. Under the rules, “national security” could include the impact on national defense, economic stability, social stability or the research and development capabilities of key national security technologies. Transactions found to have a significant impact on national security will be denied or approved only subject to conditions.

Although it appears that the new security review system has yet to be applied, the United States continues to have a broad range of concerns about this system and how it will be enforced. These concerns relate to China’s application of the broad scope of review allowed for under the system, the determination of “actual control” under the system, the criteria for determining risks to national security, the relationship between this review process and other existing reviews of foreign investment, and the

ability of non-government entities, including competitors, to call for reviews of transactions in which they are not directly involved.

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

In August 2012, NDRC circulated for public comment draft *Administrative Measures for the Examination and Approval of Foreign and Overseas Investment Projects*. This draft measure seems to consolidate many of NDRC's existing policies and practices relating to foreign investment approvals, but also appears to introduce new ones. The United States is concerned that any new or expanded investment approval process would lack transparency and could be used by government officials to block, hinder or condition market access for foreign investors.

In 2012, as in prior years, the United States raised its concerns about China's investment restrictions on multiple occasions, using bilateral mechanisms such as the JCCT process, the economic track of the S&ED and the Investment Forum as well as meetings at the WTO. The United States and China also continue to pursue bilateral investment treaty (BIT) negotiations. Most recently, at the May 2012 S&ED meeting, the two sides committed to schedule additional negotiating rounds and to intensify their negotiations. Successful BIT negotiations would

secure important legal protections for U.S. investors in China, including the right to non-discriminatory treatment and the right to submit investment disputes with the Chinese Government to independent international arbitral tribunals.

Auto Policy

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

In 2005, as previously reported, China began to issue measures implementing the new auto policy. One measure that generated strong criticism from the United States, the EU, Japan and Canada was the *Measures on the Importation of Parts for Entire Automobiles*, issued by NDRC in February 2005. This measure imposed charges that unfairly discriminated against imported automobile parts and discouraged automobile manufacturers in China from using imported automobile parts in the assembly of vehicles. This treatment appeared to be inconsistent with several WTO provisions, including Article III of GATT 1994 and Article 2 of the TRIMS Agreement, as well as the commitment in China's accession agreement to eliminate all local content requirements relating to importation. In 2006, the United States, the EU and Canada initiated WTO

cases challenging China's treatment of automobile parts, once it had become clear that dialogue would not lead to a satisfactory resolution. A WTO panel and the WTO's Appellate Body both issued decisions in 2008 in favor of the United States and the other complaining parties, finding that China's treatment of automobile parts was WTO-inconsistent. China repealed its discriminatory rules on automobile parts in 2009.

Over the last few years, additional problems began to arise after China's economic planners decided that the Chinese auto industry should focus on developing expertise in manufacturing so-called New Energy Vehicles (NEVs), which include alternative fuel vehicles such as electric, fuel cell and bio-diesel vehicles. With that decision, China began devoting substantial resources – and creating new policies – to assist Chinese automobile enterprises in developing cutting-edge NEV technologies and building domestic brands that could succeed in global markets.

The most significant policies pursued by China can be traced to regulations issued by NDRC in 2007 and by MIIT in 2009 requiring manufacturers of NEVs in China to “demonstrate mastery” over, and hold intellectual property rights in, core NEV technologies. Because China only allows foreign automobile manufacturers to operate in China through joint ventures with Chinese enterprises, and none of these joint ventures can be majority foreign-owned, this requirement effectively requires foreign automobile manufacturers to transfer their core NEV technologies to their Chinese joint venture partners. The NDRC and MIIT regulations also require NEV manufacturers to establish research and development centers in China. Reportedly, China also was considering additional regulations that would require all NEVs manufactured in China to be sold under Chinese, rather than foreign, brands by 2015. These same reports indicated that China's regulators had already informed foreign automobile manufacturers that their joint ventures must commit to launch Chinese NEV brands in order to get approval for new or expanded production facilities.

All of these requirements appeared to be inconsistent with commitments that China made in its WTO accession agreement, where China agreed not to tie investment approvals to the transfer of technology, the conduct of research or the use of local content, and China also agreed to eliminate all restrictions on the types of cars foreign enterprises could produce or sell in China.

China has also pursued related policies similarly designed to promote the development of a Chinese NEV industry at the expense of foreign enterprises. For example, in March 2011, NDRC issued a draft Foreign Investment Catalogue that proposes a new limitation on foreign ownership in NEV parts manufacturing facilities in China to no more than 50 percent. Previously, foreign automobile parts manufacturers could establish in China as wholly foreign-owned enterprises. Ultimately, in the final Foreign Investment Catalogue that went into effect in January 2012, China narrowed the scope of these proposed investment restrictions, and it applied the 50-percent investment cap only to NEV battery manufacturing facilities. In addition, China has used a catalogue of approved NEV models to determine eligibility for consumer subsidies and other incentive programs maintained by the Chinese government, and it appears that to date domestic but not imported NEVs are included in this catalogue, raising national treatment concerns.

In 2011, the United States repeatedly raised serious concerns about China's NEV policies during the run-up to the November 2011 JCCT meeting, including during the Industries and Competitiveness Dialogue held under the auspices of the JCCT. The United States also highlighted its concerns about China's NEV policies during the final transitional review before the WTO's TRIMS Committee in October 2011. At the November 2011 JCCT meeting, China committed that it will not require foreign automobile manufacturers to transfer technology to Chinese enterprises or to establish Chinese brands in order to invest in China's market for NEVs. China also committed that foreign-invested enterprises would have equal access to subsidies and other

preferential policies for NEVs and that these policies would conform to WTO rules.

To date, it has been difficult to assess to what degree China has been implementing its November 2011 JCCT commitments. Public announcements by several foreign automobile manufacturers indicate that their joint ventures with Chinese enterprises have been approved by NDRC and MIIT to establish new production facilities in China, and these approvals have coincided with public commitments by the foreign automobile manufacturers to launch new Chinese NEV brands and to establish or expand research and development in China. This pattern of investment approvals is troubling, as it suggests that Chinese regulators may be pressuring foreign automobile manufacturers to establish Chinese brands and to make additional research and development investments in China as conditions for approving new production facilities. A number of other foreign automobile manufacturers have announced plans to manufacture NEVs in China, and therefore the United States will closely monitor developments related to China's commitment not to require technology transfer, as these automobile manufacturers seek regulatory approval for the launch of their NEV models.

Recently, in October 2012, MOF, MIIT and MOST issued two new measures establishing a fiscal support fund for manufacturers of NEVs and NEV batteries. Because these ministries issued the measures in final form without having first circulated them in proposed form for public comment, the United States and U.S. industry did not have an opportunity to comment on them before they were finalized. It appears that, in order to qualify for funding under these measures, an enterprise must demonstrate ownership of intellectual property and "mastery" of core NEV technologies and also meet a minimum level of investment in China-based research and development. As foreign automobile manufacturers are required to form 50-percent joint ventures with Chinese partners, these requirements could effectively require them to transfer core NEV technology to their Chinese joint-venture partners in

order to receive the available government funding. These measures therefore raise serious questions in light of China's 2011 JCCT commitment not to mandate technology transfer and China's 2012 S&ED commitment to treat intellectual property owned or developed in other countries the same as Chinese-owned or -developed intellectual property.

During the run-up to the December 2012 JCCT meeting, the United States pressed its concerns about China's progress in implementing its November 2011 JCCT commitments in numerous bilateral meetings, including the JCCT Industries and Competitiveness Dialogue. The United States also raised concerns about the October 2012 fiscal support measures and in particular the conditions that must be satisfied to receive the funds available to manufacturers of NEVs and NEV batteries.

Steel Policy

In July 2005, five years into its WTO membership, China issued a Steel and Iron Industry Development Policy. As previously reported, this policy restricts foreign investment in a number of ways. For example, it requires that foreign investors possess proprietary technology or intellectual property in the processing of steel. Given that foreign investors are not allowed to have a controlling share in steel and iron enterprises in China, this requirement would seem to constitute a *de facto* technology transfer requirement, in conflict with the commitment in China's accession agreement not to condition investment on the transfer of technology. This policy also appears to discriminate against foreign equipment and technology imports. Like other measures, this policy encourages the use of local content by calling for a variety of government financial support for steel and iron projects utilizing newly developed domestic equipment. It also calls for the use of domestically produced steel-manufacturing equipment and domestic technologies whenever domestic suppliers exist, apparently in contravention of the commitment in China's WTO accession agreement not to condition

the right of investment or importation on whether competing domestic suppliers exist.

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

While China's 2005 steel policy remains in effect, China also issued a stimulus plan to revitalize its steel industry in March 2009. This plan represented the first major adjustment to the 2005 steel policy. The plan sought to control steel output volume and to eliminate outdated and inefficient capacity while emphasizing technological improvement. The plan also sought to stimulate exports, a significant difference from the 2005 steel policy. In addition, the plan called for further industry consolidation and the creation of large steel enterprises with capacity exceeding 50 million MT.

In June 2010, the State Council published the *Opinions on Strengthening Energy Saving and Emission Reduction and Accelerating Structural Adjustment in the Iron and Steel Sector*. This measure reiterated existing steel policies, specifically identifying a number of well-known objectives for the sector, such as controlling steel industry growth, strengthening efforts to eliminate outdated capacity, promoting energy savings and emissions reduction, technical innovation, accelerating mergers,

disciplining access to iron ore imports and promoting domestic iron ore mining, and encouraging domestic steel producers to explore mining and steel investments abroad.

In July 2010, MIIT released the *Regulations and Conditions of Production and Operation of the Iron and Steel Industry*. These regulations are intended to support the objectives laid out in the State Council's June 2010 measure. They also indicate that small steel mills will be shut down, establish operating standards for larger steelmakers and address issues such as product quality and environmental protection. At the time, steel analysts viewed these regulations as a prelude to China's next five-year steel plan.

In October 2011, MIIT published China's twelfth five-year plan for the steel industry, covering the period from 2011 to 2015. As the plan itself notes, China's steel production grew from 350 million MT in 2005 to 684 million MT in 2011, with the steel industry accounting for ten percent of national industrial output. The steel industry's rate of growth during this period exceeded the growth rates of the Chinese economy as a whole as well as the global steel industry, and China shifted from being a net importer of steel to being a large net exporter of steel. China's exports of steel products reached 47 million MT in 2011, more than the total production of Brazil. Indeed, despite China's goal of eliminating inefficient steel capacity, and despite slowing growth in domestic steel demand, stagnant demand in export markets and significant Chinese steel company losses, steel production in China continued to grow in 2012 and was on track to reach a record 723 million MT. At the same time, net steel exports from China increased by 24 percent in the first 10 months of 2012, when compared to 2011, according to the Chinese Iron and Steel Association. In addition, the OECD projected Chinese steelmaking capacity to reach 865 million MT in 2012 and to continue growing significantly through 2013, reaching 900 million MT, even in the face of a very weak domestic and global demand outlook.

There are a number of concerns raised by China's twelfth five-year plan for the steel industry. In particular, the plan continues to place the government in the role of closely managing the development of the steel industry. The plan specifies where to build, close or relocate steelmaking capacity, how much to spend on research and development, and even what products Chinese steel producers are to make. In addition, the plan continues to emphasize "self-sufficiency" in steel production and states that continued reliance on imports of certain steel products is a problem to be addressed. For example, the plan appears to set specific targets for Chinese producers' share of the domestic market in high-grade steel products that are currently supplied primarily by foreign steelmakers, including U.S. steelmakers. In the case of automotive steel and silicon steel sheets, the plan sets a goal of Chinese producers supplying 90 percent of the domestic market by 2015. The plan also provides no indication that China's current restrictions on foreign investment are to be liberalized. At the same time, the plan lays out objectives for overseas investment by China's steel producers and explains that incentives will be provided to support investment in foreign iron ore mines and steel plants to create groups with "powerful international competitive strength." Additionally, it appears that China is continuing to support the largest steel companies through subsidies, raw materials export restrictions and other preferential government policies.

The United States has focused its engagement of China on steel issues in a dialogue (known as the Steel Dialogue) established under the auspices of the JCCT shortly after China issued its 2005 steel policy. The two sides have held four Steel Dialogue meetings since then, with the next one envisioned to take place in early 2013. The objectives of these meetings, which have included participation from U.S. and Chinese steel industry officials, are to increase mutual understanding of the challenges faced by each industry and to discuss strategies for addressing trade imbalances and overcapacity in the

steel industry, including the benefits of increased reliance on market mechanisms.

At the WTO, the United States has also pressed its concerns regarding China's steel policy, in regular meetings and through the transitional reviews before the Committee on Import Licensing, the TRIMS Committee, the Subsidies Committee and the Council for Trade in Goods, with support from other WTO members, including Canada, Mexico, the EU and Japan. The United States also focused on China's steel policy in connection with China's first four Trade Policy Reviews at the WTO, held in 2006, 2008, 2010 and 2012, and in plurilateral fora such as meetings of the Organization for Economic Cooperation and Development (OECD) Steel Committee.

In particular, the United States and other WTO members, including Canada and Mexico, called for China to eliminate subsidies to its steel industry, except for those designed to facilitate capacity elimination or to address worker dislocation, to implement steel industry stimulus policies in a manner that encourages domestic consumption rather than exports and does not discriminate against imports, to eliminate the use of differential VAT rebates and duties on steel exports as a tool of industrial policy, to allow market forces rather than restraints on imports and exports to determine steelmaking raw material input supply and to eliminate restrictions on foreign investment in China's steel industry. Several steel industry associations from North and South America and Europe have pressed similar concerns.

At present, the United States is working with Canada, Mexico and the EU to monitor and support concrete steps by China to rein in its steelmaking capacity. Going forward, the United States will continue to closely scrutinize the development of the new five-year steel plan and the implementation of China's 2010 steel measures to reduce excess capacity and improve energy efficiency. The United States will also continue to engage China, through

the Steel Dialogue, at the WTO and in plurilateral fora such as the OECD.

AGRICULTURE

While China has timely implemented its tariff commitments for agricultural goods, a variety of non-tariff barriers continue to impede market access, particularly in the areas of SPS measures and inspection-related requirements.

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

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

In the area of domestic support, the basic objective is to encourage a shift in policy to the use of measures that minimize the distortion of production and trade. Essentially, WTO members committed to reduce over time the types of domestic subsidies and other support measures that distort production

and trade, while remaining free to maintain or even increase support measures that have little or no distorting effect, such as agricultural research or training by the government. China committed to a cap for trade- and production-distorting domestic subsidies that is lower than the cap permitted for developing countries and that includes the same elements that developed countries use in determining whether the cap has been reached.

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

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

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

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

While tariff reductions have certainly encouraged U.S. exports to China, which reached record highs for many agricultural products in 2008 before declining as a result of the global economic downturn in 2009, the increases have continued to be largely the result of greater demand. China's administration of TRQs on bulk agricultural commodities still has not appeared to be functioning entirely as envisioned in China's WTO accession agreement, as it continued to be impaired by inadequate transparency. At the same time, a variety of non-tariff barriers have continued to impede U.S. agricultural trade with China, particularly in the area of sanitary and phytosanitary measures, where China's actions often have not appeared to be guided by scientific principles. The United States and China have only been able to resolve some of these issues, and those resolutions have required protracted negotiations.

In 2012, serious problems have remained for U.S. exporters, who are faced with non-transparent application of sanitary and phytosanitary measures, many of which have appeared to lack scientific bases and have impeded market access for many U.S. agricultural products. China's seemingly unnecessary and arbitrary inspection-related import requirements also continued to impose burdens and regulatory uncertainty on U.S. agricultural producers

exporting to China in 2012, as did China's AD and CVD investigations of imports of poultry from the United States. Products most affected in 2012 included poultry, pork and beef.

On the positive side, U.S. agricultural products continued to experience strong sales to China. China is now the United States' largest agricultural export market, as U.S. exports to China exceeded \$18 billion in 2011, more than nine times the level in 2002. Moreover, through the first ten months of 2012, U.S. exports increased by 42 percent, when compared to the same period in 2011.

In 2013, as in prior years, the United States will continue to pursue vigorous engagement with China in order to obtain progress on outstanding concerns. As part of this effort, the United States will continue to use the high-level U.S.-China agricultural working group, created at the April 2004 JCCT meeting, as well as JCCT plenary meetings to make progress on the range of issues in the agriculture area. In addition, the United States will not hesitate to take further actions, including WTO dispute settlement, if appropriate, to address U.S. concerns.

Tariffs

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

Tariffs on agricultural goods of greatest importance to U.S. farmers and ranchers were lowered from a 1997 average of 31 percent to 14 percent, in almost all cases over a period of five years running from January 1, 2002, or by January 1, 2006. China did not have to implement any new tariff reductions in 2012, as the last few required tariff reductions on agricultural goods took place in 2008.

The accumulated tariff reductions made by China, coupled with increased demand, contributed to continued healthy exports of certain U.S. exports to China in 2012. Exports of some bulk agricultural commodities have increased dramatically in recent years, and continue to perform strongly, including

soybeans and cotton, as discussed below in the sections on China's Biotechnology Regulations and Tariff-rate Quotas for Bulk Agricultural Commodities. Exports of forest products such as lumber, after increasing by 65 percent in 2011, in comparison to 2010, decreased by 20 percent during the first ten months of 2012. Fish and seafood exports, after growing by 54 percent in 2011, in comparison to 2010, remained steady during the first ten months of 2012. Meanwhile, exports of consumer-oriented agricultural products grew by 25 percent during the first ten months of 2012.

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

Tariff-rate Quotas on Bulk Agricultural Commodities

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

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

As previously reported, in 2002, the first year of this TRQ system, it appeared that SDPC had decided to allocate TRQs in a manner that would protect

domestic farm interests and maintain the monopoly enjoyed by state trading enterprises. SDPC operated with only limited transparency, refusing to provide specific details on the amounts and the recipients of the allocations. At the same time, SDPC reserved a significant portion of the TRQs for the processing and re-export trade, despite China's commitment to provide market access and national treatment for imported products. SDPC also allocated a portion of the TRQs for some commodities in smaller than commercially viable quantities, and it employed burdensome licensing requirements.

In 2003, NDRC issued new regulations for shipments beginning January 2004. Key changes included the elimination of separate allocations for general trade and processing trade, the elimination of certain unnecessary licensing requirements, and the creation of a new mechanism for identifying allocation recipients. At the same time, transparency continued to be problematic, although some improvement did take place for some of the commodities subject to TRQs.

While these systemic changes were taking place, spurred on by sustained U.S. engagement, including consultations with China under the headnotes contained in China's WTO goods schedule, exports of some bulk agricultural commodities from the United States continued to show substantial increases, largely due to market conditions. In particular, despite some continuing problems with NDRC's handling of the cotton TRQs, U.S. cotton exports to China totaled a then-record \$1.4 billion in 2004, and subsequently rose to \$2.6 billion in 2011. Moreover, in the first ten months of 2012, U.S. cotton exports to China increased 43 percent. In contrast, while U.S. exports of wheat to China totaled an unusually high amount of \$495 million in 2004, as the TRQ allocations for wheat did not appear to act as a limiting factor, in subsequent years they declined dramatically. Beginning in 2011, U.S. exports of wheat to China started to climb again, increasing 295 percent in comparison to 2010, reaching \$160 million. This trend continued in 2012, as U.S. wheat exports increased 87 percent during the first ten

months of 2012, compared to the same period in 2011, reaching \$213 million.

In 2012, the United States continued to raise transparency and other concerns about NDRC's TRQ administration, both bilaterally and at the WTO. In 2013, the United States will continue to work to ensure that NDRC administers TRQs transparently and in a manner that is consistent with China's commitments and that does not impede market access or commercial decisions.

China's Biotechnology Regulations

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

As previously reported, one of the most contentious agriculture trade issues that arose during China's first year of WTO membership involved new rules implementing June 2001 regulations relating to biotechnology safety, testing and labeling. The implementing rules, issued by China's Ministry of Agriculture (MOA) shortly before China's WTO accession, did not provide adequate time for scientific assessment and the issuance of formal safety certificates for biotechnology products. The U.S. products most affected were soybeans, which had seen exports to China grow to more than \$1 billion in 2001, while corn and other products, such as consumer products made from biotech commodities, remained at risk. Following concerted, high-level pressure from the United States, China agreed to issue temporary safety certificates until formal safety certificates could be issued. China subsequently issued a formal safety certificate for a U.S. biotechnology soybean variety known as Roundup Ready soybeans in February 2004. By the time of the April 2004 JCCT meeting, China had also issued formal safety certificates for six corn events, seven canola events and two cotton events. China issued a formal safety certificate for another corn event a few months later, leaving only one corn event still awaiting formal approval. China issued a

formal safety certificate for this last corn event at the time of the July 2005 JCCT meeting.

With some stability added to China's market through the issuance of temporary safety certificates, trade disruptions were minimized, and U.S. exports performed strongly. In 2003, U.S. soybean exports reached a then-record level of \$2.9 billion, representing an increase of 190 percent over 2002. In subsequent years, U.S. soybean exports continued to increase dramatically, reaching as high as \$10.8 billion in 2010, as China remained the leading export destination for U.S. soybeans. In 2011, U.S. soybean exports totaled \$10.5 billion.

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

Meanwhile, other U.S. concerns with China's biotechnology regulations and implementing rules remain. For example, China requires a product to be approved in the country of origin before it can be submitted in China for approval, and China's National Biosafety Committee normally reviews new product applications only during three meetings each year. These practices present significant and unnecessary delays for bringing U.S. goods into the China market. China's lack of clarity on the requirements applicable to products stacked with multiple traits is a cause for additional concern, as are China's sometimes duplicative and unprecedented testing requirements.

In 2007, MOA developed, issued and implemented some troubling new regulations without circulating them for public comment in advance or even consulting with relevant stakeholders such as the United States and U.S. industry. For example, in January 2007, MOA added a new requirement that

biotechnology seed companies turn over key intellectual property as part of the application process when seeking safety certificates. MOA later dropped this requirement, although it still unnecessarily requires the submission of other intellectual property. In another example, in March 2007, MOA halted a pilot program, which had been developed over two years of bilateral discussions, aimed at allowing MOA to review products under development in the United States prior to completion of the U.S. approval process. As a result, the MOA approval process can still only begin after the completion of the U.S. approval process. Even if the MOA approval process proceeds quickly, trade may still be disrupted, as importers need time to apply for vessel based safety certificates and Quarantine Inspection Permits, both of which require valid safety certificates for biotechnology products and can take up to 30 working days.

In 2007, 2008 and 2009, the United States raised its concerns about these developments in several bilateral meetings, including JCCT working group meetings and other bilateral meetings focused on biotechnology issues. At the December 2007 JCCT meeting, China addressed one of the U.S. concerns that had arisen in 2007 when it agreed to eliminate a requirement to submit viable biotechnology seeds for testing during the approval process, which will reduce the possibility of illegal copying of patented agricultural materials.

In 2012 meetings, the United States continued to raise concerns about China's regulatory system for biotechnology products. Potential disruptions to trade continue to be a concern due to China's asynchronous approval process, excessive data requests, duplicative requirements, an onerous process for extension of existing certificates and the potential for low-level presence of an unapproved event. An apparent slow-down in issuing approvals has also generated concern. In May 2012, approvals for five products were granted, and 12 renewals were approved in December 2012. However, a number of new events still await approval. Meanwhile, investment restrictions constrain foreign

companies' ability to increase product development in China and maintain control over important genetic resources. In 2013, the United States will continue to work to ensure that MOA's approval process does not create barriers for U.S. agricultural interests.

Sanitary and Phytosanitary Issues

In 2012, China's regulatory authorities continued to impose SPS measures in a non-transparent manner and without clear scientific bases, including BSE-related bans on U.S. beef and beef products, pathogen standards and residue standards for raw meat and poultry products, and Avian Influenza bans on poultry. Meanwhile, China has made progress but still does not appear to have notified all proposed SPS measures as required by WTO rules.

In 2012, China's SPS measures continued to pose increasingly serious problems for U.S. agricultural producers exporting to China. As in prior years, the United States repeatedly engaged China on a number of SPS issues, in high-level bilateral meetings and technical discussions as well as during meetings of the WTO's SPS Committee. In addition, the United States continued to provide extensive training to China's regulatory authorities while also urging them to ensure China's full compliance with SPS Agreement transparency obligations.

In 2012, market access for U.S. soybeans and grain has continued. However, little progress was made in addressing SPS barriers for beef and poultry products, while concerns about SPS barriers for some pork products remain and market entry requirements for processed foods and horticultural products continue to be burdensome. In 2012, China's market continued to be closed to U.S. beef and beef products because of China's BSE-related ban. China also continued to maintain several state-level Avian Influenza (AI) bans on poultry. Additionally, even though China had committed in October 2009 to lift its bans on imports of U.S. pork and pork products and live swine, which had been put in place in April 2009, ostensibly because of

China's concern about the transmission of the H1N1 influenza A virus, it was not until March 2010 that China actually took the necessary steps to allow a resumption of imports of U.S. pork and pork products. Market access for live swine was restored in March 2011.

In many instances, progress was made difficult by China's inability to provide relevant risk assessments or its science-based rationale for maintaining its import restrictions against U.S.-origin products. For example, China has been unable to provide a science-based rationale for import restrictions on U.S. beef products and some U.S. poultry and pork products, as described below. In addition, China's regulatory authorities continued to issue significant new SPS measures without first notifying them to the SPS Committee and providing WTO members with an opportunity to comment. The United States will continue to press for resolution of these and other outstanding issues in 2013.

BSE-related Bans

In December 2003, China and other countries imposed a ban on imports of U.S. cattle, beef and processed beef products in response to a case of BSE found in the United States. Since that time, the United States has repeatedly provided China with extensive technical information on all aspects of its BSE-related surveillance and mitigation measures, internationally recognized by the World Organization for Animal Health (known by its historical acronym OIE) as effective and appropriate, for both food safety and animal health. China still has not provided any scientific justification for continuing to maintain its ban.

At the April 2006 JCCT meeting, China agreed to conditionally reopen the Chinese market to U.S. beef, subject to the negotiation and finalization of a protocol by technical experts. Jointly negotiated protocols, and accompanying export certificates, are normal measures necessary for the export of any livestock products from the United States to any trading partner. However, subsequent negotiations

made it clear that China was only contemplating a limited market opening, still without any science-based support. In July 2006, China's food safety regulators unilaterally announced a limited market opening, restricted to the entry of U.S. deboned beef thirty months of age or less, accompanied by 22 onerous entry conditions. Several of these conditions were not commercially feasible, and others did not even relate to BSE.

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

Subsequent to May 2007, U.S. and Chinese officials met repeatedly at all levels. However, China did not indicate any willingness to begin accepting U.S. beef and beef products into its market in a manner consistent with the OIE's classification, and negotiations stalled.

At the same time that it banned U.S. cattle, beef and processed beef products, China also banned bovine-origin products (i.e., bovine semen, bovine embryos, and protein-free tallow) that are listed in OIE guidelines as safe to trade regardless of a country's BSE status. Additionally, China banned imports of U.S.-origin non-ruminant feeds and fats (such as pet food, rendered products and porcine proteins and skins) even though these products were of non-bovine-origin and presented absolutely no BSE-related risk. As previously reported, after numerous bilateral meetings, technical discussions and facility certifications, China allowed the resumption of trade in bovine semen and bovine embryos in early 2006. In addition, by early 2006, trade in the full range U.S.-origin non-ruminant feed and fat products had

also resumed, after negotiation and resolution of a series of onerous, detailed and unnecessary non-BSE related information requirements proposed by China that appear to be inconsistent with OIE guidelines and contrast sharply with U.S. requirements. To date, however, U.S. and Chinese officials continue to be unable to reach agreement on provisions of a protocol for protein-free tallow, a product listed by the OIE as safe to trade regardless of a country's BSE status. As a result, trade in protein-free tallow has still not resumed.

At the December 2010 JCCT meeting, the United States and China agreed to resume talks on U.S. beef market access. The two sides held a series of meetings in January 2011. The meetings did not produce agreement on market access terms, but did help to clarify the conditions both sides seek for trade to resume. In October 2011 meetings of the JCCT Agricultural Trade and SPS Working Groups, the United States continued to press for a science-based beef market opening by China. Subsequently, at the November 2011 JCCT meeting, the two sides endorsed a commitment to increased technical engagement on this issue. Subsequently, technical meetings between the two sides took place in September and December 2012. Further discussions took place at the December 2012 JCCT meeting, where the United States expressed disappointment with the lack of progress on this issue. The United States will continue to press for a science-based market opening in China in 2013.

H1N1-Related Bans

In April 2009, China imposed import bans on U.S. pork and pork products and live swine, ostensibly related to its concern about the transmission of the H1N1 influenza A virus. Import bans based on this type of concern are not consistent with international guidelines to control the spread of the H1N1 influenza A virus. International scientific bodies, including the Food and Agricultural Organization of the United Nations, the World Health Organization and the OIE, have repeatedly explained that the H1N1 influenza A virus is not transmitted by food

products. Furthermore, the OIE has stated that "the imposition of ban measures related to the import of pigs and pig products does not comply with international standards published by the OIE and all other competent standard setting international bodies for animal health and food safety." However, China still banned imports of pork, pork products and live swine from any states in which human cases of the H1N1 influenza A virus are present, and further imposed overly restrictive disinfection requirements, effectively blocking all imports from the United States because the virus is present in all 50 states.

Throughout 2009, the United States pressed China to remove its H1N1-related bans on imports of U.S. pork, pork products and live swine, using high-level bilateral meetings as well as JCCT working group meetings and the transitional review before the WTO's SPS Committee. At the October 2009 JCCT meeting, China announced its intent to reopen the China market to U.S. pork, pork products and live swine. In December 2009, MOA and AQSIQ issued a measure removing the bans on imports of U.S. pork and pork products, but not live swine. However, this measure required the negotiation of a mutually agreed export certificate, and China insisted that certain H1N1-related statements be included in the export certificate. Several months later, in May 2010, China and the United States reached agreement on export certificate language referencing the H1N1 influenza A virus. Nevertheless, the United States continues to believe that specific H1N1 references in a U.S. export certificate are unacceptable and inappropriate for inclusion in export certificates, given the international consensus that the H1N1 influenza A virus is not transmitted by food products.

Pathogen Standards and Residue Standards

Since 2002, as previously reported, China has applied SPS-related requirements on imported raw meat and poultry that are not based on sound science or current scientific testing practices. One requirement establishes a zero tolerance limit for the presence of

Salmonella bacteria. Similar zero tolerance standards exist for Listeria and other pathogens. Meanwhile, the complete elimination of these bacteria is generally considered unachievable. Moreover, China apparently does not apply this same standard to domestic raw poultry and meat, raising national treatment concerns.

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

In December 2008, the United States hosted a team of Chinese government officials and academic experts to observe how the U.S. government and U.S. industry regulate the use of veterinary drugs related to animal health. This visit was intended to address China's continuing ban on ractopamine residue in pork. China maintains that it has serious concerns about the safety of ractopamine, but to date it has not provided any evidence that it has conducted a risk assessment despite repeated U.S. requests.

During JCCT working group meetings in 2009, 2010 and 2011, the United States requested that China adopt an interim maximum residue level (MRL) for ractopamine in order to address the problems presented by China's current zero-tolerance policy, while China awaited the results of deliberations at the Codex Commission regarding the finalization of international MRLs for ractopamine. However, China has not yet agreed to take any steps to address its current zero-tolerance policy.

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

In 2013, the United States will continue to press China to revise its problematic pathogen and residue standards.

Avian Influenza Bans

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

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

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

China also banned poultry and poultry products from West Virginia, Virginia and Nebraska because of low-pathogenic AI.

Following the eradication of AI in Connecticut, Rhode Island, New York, Pennsylvania, West Virginia, Virginia and Nebraska, the United States asked China to re-open trade in poultry and poultry products from these states, consistent with OIE guidelines. In response to U.S. engagement, at the September 2008 JCCT meeting, China announced the lifting of the state-level bans covering Connecticut, Rhode Island, New York, Pennsylvania, West Virginia and Nebraska. However, China's state-level ban on Virginia remained in place, and China imposed new state-level bans on poultry from the state of Arkansas in August 2008, the state of Idaho in September 2008 and the state of Kentucky in April 2009. China also re-imposed a state-level ban on Pennsylvania and imposed a new state-level ban on Texas in January 2010. The Texas ban was especially egregious, given that no AI was actually detected.

In bilateral meetings in 2009 and 2010, including JCCT working group meetings, the United States pressed for removal of the current state-level bans and for China's adoption of OIE-consistent policies governing the import of poultry and poultry products. At the December 2010 JCCT meeting, China announced the lifting of the state-level bans covering Idaho and Kentucky, but not Virginia, Arkansas, Pennsylvania or Texas.

The Virginia ban, which dates from 2007, is also extremely problematic. Even though it is based on a single detection of low-pathogenic AI, China has been attempting to draw parallels between this one incident and a broad outbreak of high-pathogenic AI in Virginia more than 25 years earlier. At the same time, China has repeatedly refused the invitation of U.S. regulatory officials to visit their laboratory and jointly sequence the low-pathogenic AI virus isolated from the one Virginia incident.

In 2011, in addition to maintaining its state-level bans covering Pennsylvania, Texas, Arkansas and

Virginia, China imposed a new import ban on poultry and poultry products originating from the state of Minnesota based on detections of low-pathogenic AI. In bilateral meetings throughout the year, including at the November 2011 JCCT meeting, the United States pressed China to remove these bans. In December 2011, China lifted its AI-related trade import bans on poultry and poultry products originating from Pennsylvania and Texas. Throughout 2012, the United States pressed China to lift its remaining AI-related import bans, which applied to the states of Arkansas, Minnesota and Virginia. The United States also continued to express its broader concerns about China's misinterpretation of the OIE's guidelines on Avian Influenza.

During the December 2012 JCCT meeting, the United States reiterated the need for China to follow OIE guidelines and lift the import bans applicable to Arkansas, Minnesota and Virginia. China indicated that additional information was needed to lift the three bans.

Dairy Certification Requirements

In April 2010, China's AQSIQ notified the United States that it would begin imposing new conditions on the import of dairy products under a December 2009 measure, which was to become effective on May 1, 2010. Of specific concern were requirements that the United States certify that it is free of many diseases that are not of concern in pasteurized milk products. Responding to requests from the United States, China delayed the effective date to June 1, 2010, and subsequently allowed the United States to continue to ship products to China after that date, so long as technical discussions were ongoing. However, this situation was still creating a heightened level of uncertainty for U.S. exporters and their potential Chinese buyers. In December 2012, the United States and China provisionally agreed upon a bilateral certificate, pending translation approvals and receipt of sample certificates for distribution to Chinese port officials. The United States expects that the certificate will be finalized and fully implemented in early 2013.

Transparency

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

In 2012, as in prior years, the United States urged China's regulatory authorities to improve the transparency of their SPS regime by notifying more measures. The United States also highlighted this concern during meetings before the WTO's SPS Committee. The United States will continue to seek improvements from China in this area in 2013.

Inspection-related Requirements

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

Through two measures issued in 2002, the *Administrative Measures for the Entry-Exit Inspection and Quarantine for Grains and Feed Stuff* and the *Administrative Measures for Entry Animal and Plant Quarantine*, AQSIQ requires importers to obtain a Quarantine Inspection Permit (QIP), prior to signing purchase contracts for nearly all traded agricultural commodities. QIPs are one of the most important trade policy issues affecting the United States and China's other agricultural trading partners.

After AQSIQ began implementing these measures, traders complained that AQSIQ sometimes slows down or even suspends issuance of QIPs at its discretion, without notifying traders in advance or explaining its reasons, resulting in significant commercial uncertainty. Because of the commercial necessity to contract for commodity shipments when prices are low, combined with the inherent delays in having QIPs issued, many cargoes of products such as soybeans, meat and poultry arrive in Chinese ports without QIPs, creating delays in discharge and resulting in demurrage bills for Chinese purchasers. In addition, traders report that shipment quantities are often closely scrutinized and are at risk for disapproval if considered too large.

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

Traders continue to be hesitant to press AQSIQ for change because they would risk falling out of favor. Many traders would at least like AQSIQ to eliminate the quantity requirements that it unofficially places on QIPs. These quantity requirements have been used often by AQSIQ during peak harvest periods to limit the flow of commodity imports. In 2006, traders reported that MOFCOM not only limited QIP

quantities, but also required some companies to use up the majority of a QIP before being issued another one and required other companies to use up their QIPs or risk being “de-listed.” Eliminating these requirements would make the QIP system more dependent on market forecast.

Little improvement in the QIP system has taken place since 2004, despite U.S. engagement. AQSIQ officials continue to insist that the QIP system ensures that an adequate number of examiners are on duty at ports when shipments arrive to certify and inspect them for quality and quantity, while the United States and other WTO members argue that there does not appear to be any scientific basis for the QIP system and that it serves as an unjust and overly restrictive barrier to trade. The United States will continue to press China on this issue in 2013.

Meanwhile, MOFCOM administers an additional import permit system for poultry products. Through its issuance of Automatic Registration Forms (ARFs) to importers, MOFCOM allocates a volume amount to an importer for imports of particular commodities each year. However, problems periodically arise with MOFCOM's ARF administration. In July 2009, for example, U.S. poultry industry representatives reported that MOFCOM's issuance of ARFs to importers of U.S. but not other foreign poultry products slowed dramatically for a short period of time. Subsequently, in January 2010, MOFCOM expanded the ARF system to include imports of soybeans, pork and dairy. The United States continues to urge MOFCOM to eliminate the ARF system entirely.

Domestic Support

In recent years, China has been significantly increasing domestic subsidies and other support measures for its agricultural sector.

In recent years, China has been significantly increasing domestic subsidies and other support measures for its agricultural sector. Since 2004, China has established a direct payment program,

instituted minimum support prices for basic commodities and sharply increased input subsidies. More recently, China began several new support schemes for hogs and pork, and in 2011 it implemented a new cotton reserve system, based on minimum purchase prices.

In October 2011, China submitted its overdue notification concerning domestic support measures for the period 2005-2008. This notification documents an increase in China's support levels, but the United States is concerned that the methodologies used by China to calculate support levels, particularly with regard to its price support policies and direct payments, result in underestimates. The United States is also concerned about the effects of domestic support measures that China has adopted since 2008, such as the cotton reserves purchasing system.

In 2013, the United States will continue to monitor China's use of domestic subsidies and other support measures in the agricultural sector. The United States will also press China to provide an up-to-date notification.

Export Subsidies

It is difficult to determine whether China maintains export subsidies in the agricultural sector, in part because China has not notified all of its subsidies to the WTO.

Shortly after China's WTO accession, U.S. industry became concerned that China was providing export subsidies on corn, despite China's commitment to eliminate all export subsidies upon accession. It appeared that significant quantities of corn had been exported from China, including corn from Chinese government stocks, at prices that may have been 15 to 20 percent below China's domestic prices. As a result, U.S. corn exporters were losing market share for corn in their traditional Asian markets, such as South Korea and Malaysia, while China was exporting record amounts of corn.

Since 2002, the United States has pressed its concerns about possible export subsidies on corn with China in bilateral meetings. The United States has also raised its concerns and sought additional information about China's corn policies – including the use of potentially excessive VAT export rebates – during meetings before the Committee on Agriculture, including the transitional reviews.

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

The United States will continue to investigate the Chinese government's subsidization practices and VAT rebate system for the agricultural sector in 2013, although China's incomplete subsidy notifications hinder those efforts. The United States will make every effort to ensure that any use of export subsidies is eliminated.

INTELLECTUAL PROPERTY RIGHTS

While China has undertaken a wide-ranging revision of its legal regime aimed at protecting the intellectual property rights of domestic and foreign entities, key weaknesses remain, and enforcement of China's IP-related laws and regulations remains a challenge in the face of widespread counterfeiting, piracy and other forms of infringement.

With its acceptance of the TRIPS Agreement, China took on obligations to adhere to generally accepted international norms to protect and enforce the intellectual property rights held by U.S. and other foreign companies and individuals. Specifically, the TRIPS Agreement sets minimum standards of protection for copyrights and related rights, trademarks, geographical indications, industrial designs, patents, integrated circuit layout designs

and undisclosed information. Minimum standards are also established by the TRIPS Agreement for IPR enforcement in administrative and civil actions and, in regard to copyright piracy and trademark counterfeiting, in criminal actions and actions at the border. The TRIPS Agreement requires as well that, with very limited exceptions, WTO members provide national and most favored nation treatment to the nationals of other WTO members with regard to the protection and enforcement of intellectual property rights.

China is in the process of revising its legal regime and updating a comprehensive set of laws and regulations aimed at protecting the intellectual property rights of domestic and foreign entities in China. Some key improvements in China's legal framework are still needed. In addition, serious concerns remain about effective enforcement of these laws and regulations, whether looking at the impact of actions by the Government of China or by private parties seeking redress, given the continued widespread counterfeiting, piracy and other forms of infringement. As a result, in 2012, the United States aggressively pursued bilateral engagement with China, focusing on obtaining improvements to multiple aspects of China's system of IPR protection and enforcement, so that significant reductions in IPR infringement in China could be realized and sustained over time.

Several weaknesses in all aspects of China's enforcement system – criminal, civil and administrative – contribute to China's poor IPR enforcement record. One major weakness is China's chronic underutilization of deterrent criminal remedies. In particular, the thresholds established by China for criminal investigation, prosecution and conviction preclude criminal remedies in many instances of commercial-scale counterfeiting and piracy, creating a "safe harbor" for infringers and raising concerns that China may not be complying with its obligations under the TRIPS Agreement. The United States sought to address this concern, along with other concerns regarding border enforcement and copyright protection for works that have not

obtained approval from China's censorship authorities, in a WTO case filed in April 2007 focusing on deficiencies in China's legal regime for protecting and enforcing copyrights and trademarks on a wide range of products. Proceedings before the WTO panel took place in 2008, and the panel issued its decision in January 2009. The panel ruled in favor of the United States on two of its three claims, finding WTO-inconsistent China's denial of copyright protection to works that do not meet China's content review standards, as well as China's handling of border enforcement seizures of counterfeit goods. On the third issue, the panel clarified important legal standards relating to the criminal enforcement of copyrights and trademarks, but determined that it did not have sufficient factual information to find WTO-inconsistent China's quantitative thresholds for criminal prosecution and liability. Neither party appealed the panel's decision, and China agreed to come into compliance with that decision by March 2010. China subsequently modified the measures at issue, effective March 2010.

A factor that exacerbates the weaknesses in China's IPR enforcement regime has been China's continued maintenance of import and distribution restrictions for certain types of legitimate copyright-intensive products, such as books, newspapers, journals, theatrical films, DVDs and music, as these restrictions inadvertently have helped to ensure that infringing products continue to dominate those sectors within China. As discussed above in the sections on Trading Rights and Distribution Services, the United States mounted a successful challenge at the WTO to these restrictions, and China subsequently issued several revised measures, and repealed other measures, relating to its restrictions on books, newspapers, journals, DVDs and music. As China acknowledged, however, it did not issue any measures addressing theatrical films. Instead, China proposed bilateral discussions with the United States in order to seek an alternative solution. After months of negotiations, which included discussions between the two sides' Vice Presidents, the United States and China reached agreement in February 2012 on an MOU providing for substantial increases

in the number of foreign films imported and distributed in China each year and substantial additional revenue for foreign film producers. The MOU will be reviewed after five years in order to discuss issues of concern, including additional compensation for the U.S. side.

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

As previously reported, the United States elevated China to the Special 301 "Priority Watch List" in April 2005 and at the same time developed a comprehensive strategy for addressing China's ineffective IPR enforcement regime, which included the possible use of WTO mechanisms, as appropriate. Through this strategy, the United States sought China's agreement through the JCCT process to take a series of specific actions designed to (1) increase prosecutions of IPR violators, (2) improve enforcement at the border, (3) counter piracy of movies, audio visual products and software, (4) address Internet-related infringement, (5) ensure that all levels of China's government and Chinese enterprises use only legally authorized software and (6) assist small and medium-sized U.S. companies experiencing China-related IPR problems, among other things.

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

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

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

Shortly thereafter, in April 2007, USTR issued its annual Special 301 report, which continued to place China on the Priority Watch List. Notably, this report also discussed a special review conducted in 2006 and 2007 to examine the adequacy and effectiveness of IPR protection and enforcement in

China at the provincial government level. As the report explains, the provincial review revealed strengths, weaknesses and inconsistencies in and among China's provinces.

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

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

The United States again kept China on the Priority Watch List in 2009. At the JCCT meeting held in October 2009, China made commitments to impose maximum administrative penalties, including the revocation of business licenses, for Internet piracy, and to work with the United States to ensure that the Ministry of Culture's prescreening requirements do not hamper the distribution of legitimate sound recordings online. China also announced that it had issued a notice conveying the importance of compliance with all copyright laws, especially with respect to electronic journals, in state-run and academic libraries.

In 2010, the United States announced that China would remain on the Priority Watch List. At the same time, the United States and China continued to engage in bilateral efforts to address a variety of IPR issues. JCCT IPR Working Group meetings held in April and November 2010 allowed for constructive dialogue on the intellectual property regimes of both countries. Subsequently, at the December 2010 JCCT meeting, the United States secured a series of commitments from China that will have systemic consequences for the protection of IPR in China. As previously reported, in addition to announcing a special six-month campaign to step up enforcement against a range of IPR infringements, China agreed to expand and enhance its software legalization program, to take steps to eradicate the piracy of electronic journals, to adopt more effective rules for addressing Internet piracy and to crack down on landlords who rent space to counterfeiters. In addition, with regard to its problematic innovation policies, China committed that it would not provide government procurement preferences for goods or services based on the location where the intellectual property is owned or was developed is an important outcome for U.S. innovators and entrepreneurs (as discussed above in the section on Government Procurement).

In 2011, USTR's annual Special 301 report again placed China on the Priority Watch List. In addition, USTR's first Out-of-Cycle Review of Notorious Markets, which identifies Internet and physical markets that exemplify key challenges in the global struggle against piracy and counterfeiting, featured Chinese markets prominently. Following publication of the Notorious Markets list, one important market in China, the website Baidu, reached a precedent-setting licensing agreement with U.S. and international rights holders in the recording industry to curtail illegal music downloads. As a result, Baidu was subsequently removed from the Notorious Markets list.

In 2012, USTR's annual Special 301 report again placed China on the Priority Watch List, and USTR's Out-of-Cycle Review of Notorious Markets continued

to feature Chinese markets prominently. This year's Notorious Markets list also highlighted positive developments. For example, Chinese website Taobao was removed from the list due to its work with rights holders to significantly decrease the listing of infringing products for sale through its website, and due to its commitment to continue working to streamline its complaint procedures to further reduce listings of counterfeit products. Similarly, Chinese website Sogou was removed from the list based on reports that it had also made notable efforts to work with rights holders to address the availability of infringing content on its website.

The United States and China also continued to engage in bilateral efforts to address a variety of IPR issues in 2011. JCCT IPR Working Group meetings held in April and November 2011 allowed for constructive dialogue on the intellectual property regimes of both countries and led to some important new commitments from China.

At the November 2011 JCCT meeting, China announced the establishment of a State Council-level enforcement structure, which essentially makes permanent China's 2010 special IPR enforcement campaign. That campaign, among other things, had called for the investigation and prosecution of infringements of copyrights, trademarks, patents and new plant varieties. The campaign had focused on the press and publication industry, the cultural and recreational industry, the high-tech industry and agriculture as key fields for rectification, and on books, software, audio-visual products, seeds, bulk export commodities, automobile fittings, mobile phones and medicines as key products for rectification.

Building on commitments that it had made at the December 2010 JCCT meeting and during President Hu's January 2011 visit to Washington, China also agreed to make specific further progress in the area of software legalization under the leadership of Vice Premier Wang. China specifically committed to complete its software legalization efforts at the

provincial government level by the middle of 2012 and at the local and municipal government levels by the end of 2013. In addition, China committed to increase resources for audits and inspections of government agencies, and to pursue further efforts to improve the efficiency and accuracy of these audits and inspections. China also committed to increase its efforts to promote the use of licensed software in enterprises and to conduct and publish progress reports on software management pilot projects involving enterprises. China further agreed to expand its legalization efforts to cover all types of software, rather than only the three specified types of software that previously had been the subject of its legalization efforts. Piracy rates remain high, however, in China's important SOE sector, which accounts for 27 percent of China's industrial output.

At the November 2011 JCCT meeting, the United States also sought further progress from China in addressing China's innovation policies, which provide a variety of government preferences – not just preferences in government procurement – based on the location where the intellectual property is owned or was developed. China agreed to ensure that, by December 1, 2011, provincial and local governments would eliminate any policies that are not consistent with China's prior commitments to sever the link between China's innovation policies and government procurement preferences. However, China was not yet prepared to systematically address preferences outside of the government procurement context. It did confirm that it would not undertake specific problematic policies regarding NEVs. It also agreed to study investment, tax and other measures outside of the government procurement context to determine whether the receipt of government benefits is linked to where intellectual property is owned or developed or to the licensing of technology by foreign investors to Chinese enterprises. China further agreed to actively discuss the elimination of any links that affected trade and investment.

In February of 2012, during the visit of Vice President Xi, and building on President Hu's state visit in

January 2011, China agreed that technology transfer and technological cooperation shall be decided by businesses independently and will not be used by the Chinese government as a pre-condition for market access. China subsequently confirmed, at the December 2012 JCCT meeting, that it would correct in a timely manner any measures that were inconsistent with this commitment.

Through months of dialogue and negotiations leading up to the May 2012 S&ED meeting and the December 2012 JCCT meeting, the United States pressed China on a range of other IPR issues. As discussed below, the two sides were able to make some additional progress in the areas of software legalization and Internet intermediary liability.

Legal Framework

China has established a framework of laws, regulations and departmental rules that largely satisfies its WTO commitment. However, reforms are needed in a few key areas, such as further improvement of China's measures for copyright protection on the Internet following China's accession to the WIPO Internet treaties, deficiencies in China's criminal IPR enforcement measures and measures relating to technology transfer.

In most respects, China's framework of IPR laws, regulations and departmental rules remains largely satisfactory. However, reforms are still needed in a few key areas, such as criminal enforcement, where U.S. right holders have pointed to a number of continuing deficiencies in China's criminal IPR enforcement measures, online infringement and measures conditioning government procurement or government benefits and preferences on intellectual property being developed, owned or licensed to a Chinese party.

As previously reported, at the time of its accession to the WTO, China was in the process of modifying the full range of IPR laws, regulations and departmental rules, including those relating to

patents, trademarks and copyrights. Within several months after its accession, China had completed amendments to its *Patent Law*, *Trademark Law* and *Copyright Law*, along with regulations and departmental rules to implement them. China had also issued regulations and departmental rules covering specific subject areas, such as integrated circuits, computer software and pharmaceuticals. U.S. experts carefully reviewed these measures after their issuance and, together with other WTO members, participated in a comprehensive review of them as part of the first transitional review before the TRIPS Council in 2002.

Since then, China has periodically issued new IPR measures. The United States has reviewed these measures through bilateral discussions and subsequent TRIPS Council reviews. Encouragingly, China became more willing to circulate proposed measures for public comment and to discuss proposed measures with interested trading partners and stakeholders. Taking advantage of this openness, the United States and U.S. right holders provided written comments to China on several drafts of regulations for the protection of copyrights on information networks and on drafts of *Patent Law* amendments and regulations, among other draft measures.

In 2011, China announced an updated Action Plan for revising its laws and regulations in order to better protect intellectual property rights. Among other things, this Action Plan sets out China's intentions for revising various laws and other measures, including rules to implement the revised *Patent Law*, revisions to the *Trademark Law*, the *Copyright Law* and related measures. These efforts are ongoing, and the United States has been assessing the potential ramifications of the contemplated revisions for U.S. right holders.

China has also been working on other proposed legal measures that could have significant implications for the intellectual property rights of foreign right holders. In particular, China enacted its *Anti-monopoly Law* in August 2007, which became

effective in August 2008, and issued draft regulations and guidelines relating to standards that incorporate patents in 2009 and 2010. The United States has been carefully monitoring these efforts and raised concerns with particular aspects of the draft regulations and guidelines, both in bilateral meetings and at the WTO before the TRIPS Council and the TBT Committee.

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

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

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

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

At the December 2010 JCCT meeting, as discussed above, China committed that its judiciary would issue a Judicial Interpretation clarifying that those who facilitate the commission of copyright infringement by others will be equally liable for that

infringement. In April 2012, after more than a year of study, China's Supreme People's Court issued a draft Judicial Interpretation on this type of liability. At the December 2012 JCT meeting, China announced that it would issue the Judicial Interpretation in final form by the end of 2012.

With respect to software piracy, China issued new rules during the run-up to the April 2006 JCCT meeting that require computers to be pre installed with licensed operating system software and government agencies to purchase only computers satisfying this requirement. Combined with ongoing implementation of previous JCCT commitments on software piracy, it was hoped that these rules would contribute to significant reductions in industry losses due to software piracy. According to the U.S. software industry, China's PC software piracy rate has remained relatively flat during the past five years, dropping from 86 percent in 2005 to 77 percent in 2011. During the same period, the U.S. software industry reports that the commercial value of this unlicensed PC software doubled from \$3.9 billion in 2005 to \$8.9 billion in 2011, due to the rapid growth of China's PC market. Achieving sustained reductions in end user software piracy will therefore require more enforcement by China's authorities, followed by high profile publicity of fines and other remedies imposed. Another necessary tool is the use of Software Asset Management audits, not only by Chinese government agencies but also by enterprises, including state-owned and state-invested enterprises, to ensure that these agencies and enterprises are not using illegal software.

The United States is concerned about a growing number of cases in which important trade secrets of U.S. companies have been stolen by, or for the benefit of, Chinese competitors. It has been difficult for some U.S. companies to obtain legal relief through China's legal system against those who have benefitted from this theft or misappropriation, despite compelling evidence demonstrating guilt. The United States is also concerned that many more trade secrets cases involving U.S. companies and Chinese competitors go unreported, because U.S.

companies want to avoid the costs of pursuing legal relief, when weighed against the likelihood of obtaining no redress through Chinese legal channels and the possible commercial repercussions for them if they shine light on the conduct at issue. The United States and China have increased their bilateral exchanges on this important issue, including in the JCCT IPR Working Group and through engagement between senior-level government officials. Ensuring that companies are able to effectively protect and enforce their IPR in China, including trade secrets, is essential to promoting successful commercial relationships between U.S. and Chinese companies.

The United States is also concerned about the range of Chinese policies that link the receipt of government benefits or preferences to relevant intellectual property being owned or developed in China. As discussed above in the Government Procurement section, at the December 2010 JCCT meeting, China agreed not to maintain any measures that provide government procurement preferences for goods or services based on where the intellectual property is owned or was developed. Additionally, China agreed not to “adopt or maintain measures that make the location of the development or ownership of intellectual property a direct or indirect condition for eligibility for government procurement preferences for products and services.

During the 2011 JCCT meeting, the United States sought to build on China's 2010 JCCT commitment and the innovation principles agreed to in the Asia-Pacific Economic Cooperation (APEC) 2011 Leaders' Declaration. At that meeting, the United States and China agreed to study other measures, including investment and tax-related measures in 2012, in order to determine whether the receipt of government benefits is linked to where intellectual property is owned or developed, or to the licensing of technology by foreign investors to host country entities.

The United States used the 2012 JCCT process to press China to revise or eliminate specific measures

that appeared to be inconsistent with this commitment. One example raised by the United States was a draft 2012 catalogue for vehicles eligible for purchase for official use. The catalogue, and its applicable vehicle selection rules, triggered serious U.S. concerns because they contain a number of troubling eligibility criteria, including a requirement that auto manufacturers invest at least three percent of operating revenue on research and development in China and hold the right to modify, improve or transfer relevant intellectual property. Given that foreign automobile manufacturers must establish joint ventures with Chinese partners, and are not permitted to have controlling shares, in order to operate in China, these provisions effectively require foreign automobile manufacturers to transfer research and development activities to China and share the resulting technology with their Chinese partners. These provisions also require foreign automobile manufacturers to transfer the rights to existing core intellectual property to their Chinese partners. During the December 2012 JCCT meeting, China committed to delay issuance of a final catalogue and to engage with the United States on these concerns. The United States also raised similar concerns about other Chinese measures at the December 2012 JCCT meeting. China agreed to intensify discussions with the United States on these measures in 2013.

The United States is encouraged by the Customs Administration's increased efforts to provide effective enforcement against counterfeit and pirated goods destined for export and the Customs Administration's agreement in 2007 to cooperate with U.S. customs authorities to fight exports of counterfeit and pirated goods. Nevertheless, the United States remains concerned about various aspects of the *Regulations on the Customs Protection of Intellectual Property Rights*, issued by the State Council in December 2003, and the Customs Administration's May 2004 implementing rules, which had been intended to improve border enforcement, make it easier for right holders to secure effective enforcement at the border and strengthen fines and punishments.

The United States also remains concerned about a variety of weaknesses in China's legal framework that do not effectively deter, and that may even encourage, certain types of infringing activity, such as the "squatting" of foreign company names, designs, trademarks and domain names, the registration of other companies' trademarks as design patents and vice versa, the use of falsified or misleading license documents or company documentation to create the appearance of legitimacy in counterfeiting operations, and false indications of geographic origin of products.

In the pharmaceuticals sector, the United States continues to have a range of concerns. The United States continues to encourage China to provide an effective system to expeditiously address patent issues in connection with applications to market pharmaceutical products. In addition, the United States continues to be concerned about the extent to which China provides effective protection against unfair commercial use of, and unauthorized disclosure of, undisclosed test or other data generated to obtain marketing approval for pharmaceutical products. China's law, and a commitment that it made in its WTO accession agreement, require China to ensure that no subsequent applicant may rely on the undisclosed test or other data submitted in support of an application for marketing approval of new pharmaceutical products for a period of at least six years from the date of marketing approval in China. However, there is evidence that generic manufacturers have been granted marketing approvals by SFDA prior to the expiration of this six-year period and, in some cases, even before the originator's product has been approved. The United States looks forward to working with SFDA and other relevant agencies to address this important concern.

At the December 2012 JCCT meeting, China took a step toward establishing effective regulatory data protection. China agreed to define "new chemical entity" in a manner consistent with international research and development practices in order to ensure regulatory data of pharmaceutical products

are protected against unfair commercial use and unauthorized disclosure. In 2013, the United States will continue to work with SFDA and other relevant agencies to address these concerns.

Enforcement

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

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

Despite repeated anti-piracy campaigns in China and an increasing number of civil IPR cases in Chinese courts, overall piracy and counterfeiting levels in China remained unacceptably high in 2012. IPR infringement continued to affect products, brands and technologies from a wide range of industries, including films, music and sound recordings, publishing, business and entertainment software, pharmaceuticals, chemicals, information technology, apparel, athletic footwear, textile fabrics and floor coverings, consumer goods, food and beverages,

electrical equipment, automotive parts and industrial products, among many others.

U.S. industry estimates that levels of piracy in China across most lines of copyright products, except business software, ranged between 90 and 95 percent, while business software piracy rates were approximately 77 percent. Trade in pirated optical discs continues to thrive, supplied by both licensed and unlicensed factories and by smugglers. Small retail shops continue to be major commercial outlets for hard copies of pirated movies and music (and a variety of counterfeit goods). Piracy of books and journals also remains a key concern. However, the rapid growth in the number of Internet users in China, including the explosive growth in broadband connectivity, has led to rampant piracy online, which is increasingly becoming the predominant mechanism for both copyright piracy and the sale and distribution of counterfeit hard goods through web-based vendors.

In 2011, China reportedly imposed sanctions on 14 websites for providing illegal music downloads, requiring those websites to remove links to offending files identified by government regulators. Nevertheless, illegal downloads account for an estimated 99 percent of all music downloads in China, and piracy of copyrighted material over the Internet continues to be a major problem. In addition, China's Internet users are increasingly turning to streaming media to watch foreign television shows and movies. While it appears that a number of user-generated content sites have eliminated most of their pirated content, these streaming sites have become the preferred method in China to watch illegal content. The United States has urged China to focus on these streaming sites, and to prevent illegal transmission and rebroadcast of motion pictures and television and sports programming.

Despite many special campaigns in China over the years to combat IPR infringement, and despite repeated bilateral commitments by China to increase IPR enforcement, the United States is

concerned that sales of U.S. copyright-intensive goods and services in the China market remain substantially below levels in other markets, measured in a variety of ways, ranging from spending on legitimate music as a percentage of GDP to software sales per personal computer. The United States accordingly has urged China to continue its efforts to improve IPR protection and enforcement and to ensure that it results in an increase of sales of legitimate goods and services from all sources, including imports.

In October 2009, the NCA, the Ministry of Education, the Ministry of Culture and the National Anti-Pornography Office issued the *Notice on Strengthening Library Protection of Copyright*, which directs libraries to strictly adhere to the disciplines of the *Copyright Law*. The United States welcomed this directive and encouraged China to take steps to enforce this notice, including through unannounced spot checks of libraries and promptly investigating and taking action against web-based enterprises that provide pirated journal articles. Subsequently, at the December 2010 JCCT meeting, China committed to take steps to eradicate piracy of online academic journals, including actions against web-based enterprises. At the 2011 JCCT meeting, the United States and China agreed to hold government-industry roundtables in 2012 to discuss online copyright protection and enforcement, including in relation to libraries.

Meanwhile, the relatively modest progress made by China over the last several years in reducing the rate of end-user business software piracy rates is of increasing concern to the United States and to a variety of software developers. The United States looks forward to timely, meaningful and verifiable implementation of China's JCCT commitments to eliminate the use of unauthorized software at all levels of government and to discourage the use of unauthorized software by enterprises, including major state-owned and state-invested enterprises, beginning with pilot projects encouraging automated software asset management and increased deterrent penalties for violators.

At the May 2012 S&ED meeting and the December 2012 JCCT meeting, the United States sought to build on China's past commitments to eliminate the use of unauthorized software at all levels of government and to discourage the use of unauthorized software by enterprises, including major state-owned and state-invested enterprises. China committed to intensify its use of software audits and inspections within the government and to expand its software legalization efforts in the enterprise sector. China also confirmed that it requires state-owned enterprises and state-owned banks under the supervision of the central government to purchase and use legal software.

Despite China's commitment at the July 2005 JCCT meeting to take aggressive action against movie piracy, enhanced enforcement against the piracy of pre-release movie titles, including those not yet authorized for distribution, has not meaningfully improved over the last several years. It is not yet clear what impact the legal changes made by China in 2010 to comply with the WTO panel's ruling in the United States' WTO case challenging deficiencies in China's IPR enforcement regime will have in this area.

China's widespread counterfeiting not only harms the business interests of right holders, both foreign and domestic, but also includes many products that pose a direct threat to the health and safety of consumers in the United States, China and elsewhere, such as pharmaceuticals, food and beverages, batteries, auto parts, industrial equipment and toys, among many other products. At the same time, the harm from counterfeiting is not limited to right holders and consumers. China estimated its own annual tax losses due to counterfeiting at more than \$3.2 billion back in 2002, and this figure could only have grown in the ensuing years.

In 2012, there were reports concerning the impact that counterfeiting was having on U.S. agricultural industries, including the fruit and vegetable industries and the wine industry. Of particular

concern were counterfeit semiconductors entering the supply chain, creating the risk of the installation of fake and shoddy semiconductor components in electronic equipment, including in equipment used for critical functions related to agricultural safety and security.

With regard to counterfeit manufacturing and sales, attitudes regarding IPR infringement vary greatly by province and locality in China. For example, administrative authorities in Shenzhen, a city in southern Guangdong Province, have lowered the thresholds for bringing criminal prosecutions against optical disk pirates, and Shenzhen authorities regularly transfer cases for investigation to the Public Security Bureau. By contrast, U.S. rights holders have expressed concerns that local Administrations for Industry and Commerce (AICs) in other parts of Guangdong Province and in Fujian Province have refused to refer cases for criminal prosecution even when the relevant thresholds are met. The United States is encouraged that State Council Order No. 37, issued in November 2011, provides that provincial and local government officials will be rated on their ability to enforce against IPR infringement in their provinces and localities. The United States will be watching to see if this rating system helps to motivate provincial and local government officials to shut down infringing operations.

The United States places the highest priority on addressing the IPR protection and enforcement problems in China, and since 2004 it has devoted significant additional staff and resources, both in Washington and in Beijing, to address these problems. A domestic Chinese business constituency is also increasingly active in promoting IPR protection and enforcement. In fact, Chinese right holders own the vast majority of design patents, utility models, trademarks and plant varieties in China and have become the principal filers of invention patents. In addition, most of the IPR enforcement efforts in China are now undertaken at the behest of Chinese right holders seeking to protect their interests. Nevertheless, it is

clear that there will continue to be a need for sustained efforts from the United States and other WTO members and their industries, along with the devotion of considerable resources and political will to IPR protection and enforcement by the Chinese government, if significant improvements are to be achieved.

As in prior years, the United States worked with central, provincial and local government officials in China in 2012 in a sustained effort to improve China's IPR enforcement, with a particular emphasis on the need for dramatically increased utilization of criminal remedies as well as the need to improve the effectiveness of civil and administrative enforcement mechanisms. In addition, a variety of U.S. agencies held regular bilateral discussions with their Chinese counterparts, which have been periodically supplemented by technical assistance programs.

Trademark rights holders are beginning to report a noticeable reduction in the visibility of counterfeit goods for sale in some of the notorious physical markets in China. This development appears to be the result of intensified criminal enforcement, and more proactive intervention by landlords. It also may be attributable to steps taken by national and local AICs to target landlords of physical markets as part of a wider effort to promote enforcement of intellectual property rights, as well as court decisions that have found landlords liable for infringement that they knew or should have known was taking place on their premises. However, guidelines regarding landlord liability are not legally binding, and court decisions in China's civil law system are not precedential. As a result, many markets in China continue to trade in counterfeit and pirated merchandise. The United States therefore continues to urge the China to include explicit provisions on landlord liability in the new amendments to the *Trademark Law* that are currently under consideration by the SCLAO.

The United States' efforts have also benefited from cooperation with other WTO members in seeking improvements in China's IPR enforcement, both on

the ground in China and at the WTO during meetings of the TRIPS Council. For example, several WTO members participated as supportive third parties in the United States' two IPR-related WTO cases against China. Previously, Japan and Switzerland had joined the United States in making coordinated requests under Article 63.3 of the TRIPS Agreement in order to obtain more information about IPR infringement levels and enforcement activities in China. In addition, since then, the United States and the EU have increased coordination and information sharing on a range of China IPR issues. China's membership in the APEC forum also brings increased importance to APEC's work to develop regional IPR best practices.

The United States has continued to pursue a comprehensive initiative to combat the enormous global trade in counterfeit and pirated goods, including exports of infringing goods from China to the United States and the rest of the world. The Intellectual Property Enforcement Coordinator, a White House position created by the 2008 Pro-IP Act and established in 2009, coordinates these and other efforts. China's share of infringing goods seized at the U.S. border was 62 percent in 2011, a decrease from 2009 that was mostly due to a decline in footwear seizures, according to U.S. customs data.

At the same time, China is making genuine efforts to improve IPR enforcement, and cooperation between the United States and China has produced some successful enforcement actions. U.S. industry has confirmed that some of China's special campaigns, such as the "Mountain Eagle" campaign against trademark infringement crimes that ended in 2006, in fact resulted in increased arrests and seizures of infringing materials, although the disposition of seized goods and the outcomes of criminal cases remain largely obscured by lack of transparency.

In October 2010, the State Council announced a six-month campaign, the *Program for Special Campaign on Combating IPR Infringement and Manufacture and Sales of Counterfeit and Shoddy Commodities*, calling for, among other things, the investigation and

prosecution of infringements of copyrights, trademarks, patents and new plant varieties. This special campaign was extended by three months. The campaign's enforcement efforts were focused on the manufacturing and sales of counterfeit and inferior commodities in certain key industries, including the press and publication industry, the cultural and recreational industry, the high-tech industry and agriculture, and with regard to certain key products, including books, software, audio-visual products, seeds, bulk export commodities, automobile fittings, mobile phones and medicines. The United States monitored the special campaign's implementation and encouraged China to translate this increased attention to IPR enforcement into permanent, systemic improvements in the legal protections of, and resources and capacity to enforce, IPR in a sustained and effective manner. In 2011, China committed to take stock of the results of the special campaign and to make improvements. At the November 2011 JCCT meeting, China committed to establish a State Council-level leadership structure, headed by a Vice Premier, to lead and coordinate IPR enforcement across China in order to enhance China's ability to crack down on IPR infringement, thereby making permanent the leadership structure under the special campaign.

In 2013, the United States will continue to closely monitor the implementation and effectiveness of this new leadership structure. The United States will also urge China to use it as an opportunity to tackle emerging enforcement challenges, particularly the sale of pirated and counterfeit goods on the Internet, and to ensure that these efforts lead to sustained and systemic improvements in enforcement and deterrence of intellectual property crimes in China.

Despite its many positive efforts to improve IPR enforcement, China has pursued other policies that continue to impede effective enforcement. These policies led the United States to resort to the WTO dispute settlement mechanism in April 2007, where it sought needed changes to China's legal framework that would facilitate the utilization of criminal

remedies against piracy and counterfeiting, enhance border enforcement against counterfeit goods and provide copyright protection for works that have not obtained approval from China's censorship authorities. These changes should be an important objective for China, given the lack of deterrence clearly evident in China's current enforcement regime. As discussed above, China did not appeal WTO panel rulings in favor of the United States and subsequently modified the measures at issue, effective March 2010.

At the same time, other changes were needed on the market access side. As the WTO ruled in 2009, China maintains market access barriers, such as import and distribution restrictions, which discourage and delay the introduction of numerous types of legitimate foreign products into China's market. These barriers have created additional incentives for infringement of copyrighted products like books, newspapers, journals, theatrical films, DVDs and music and inevitably lead consumers to the black market, again compounding the severe problems already faced by China's enforcement authorities. The United States welcomed the steps that China took in 2011 to comply with the WTO rulings in this case with regard to books, newspapers, journals, DVDs and music, as discussed above. The United States also welcomed the U.S.-China MOU covering theatrical films, which should provide for substantial increases in the number of foreign films imported and distributed in China each year and substantial additional revenue for foreign film producers.

SERVICES

While China has implemented most of its services commitments, concerns remain in some service sectors. In addition, challenges still remain in ensuring the benefits of many of the commitments that China has nominally implemented are available in practice, as China has continued to maintain or erect restrictive or cumbersome terms of entry in some sectors. These entry barriers prevent or discourage foreign suppliers from gaining market

access through informal bans on new entry, high capital requirements, branching restrictions or restrictions taking away previously acquired market access rights. In addition, the licensing process in some sectors has generated national treatment concerns or inordinate delays.

The commitments that China made in the services area begin with the General Agreement on Trade in Services. The GATS provides a legal framework for addressing market access and national treatment limitations affecting trade and investment in services. It includes specific commitments by WTO members to restrict their use of those limitations and provides a forum for further negotiations to open services markets around the world. These commitments are contained in national services schedules, similar to the national schedules for tariffs.

In its Services Schedule, China committed to the substantial opening of a broad range of services sectors over time through the elimination of many existing limitations on market access, at all levels of government, particularly in sectors of importance to the United States, such as banking, insurance, telecommunications, distribution and professional services. At the time, these commitments were viewed as a good start toward opening up China's services sectors, particularly when compared to the services commitments of many other WTO members.

China also made certain "horizontal" commitments, which are commitments that apply to all sectors listed in its Services Schedule. The two most important of these cross-cutting commitments involve acquired rights and the licensing process. Under the acquired rights commitment, China agreed that the conditions of ownership, operation and scope of activities for a foreign company, as set out in the respective contractual or shareholder agreement or in a license establishing or authorizing the operation or supply of services by an existing foreign service supplier, will not be made more restrictive than they were on the date of China's

accession to the WTO. In other words, if a foreign company had pre-WTO accession rights that went beyond the commitments made by China in its Services Schedule, the company could continue to operate with those rights.

In the licensing area, prior to China's WTO accession, foreign companies in many services sectors did not have an unqualified right to apply for a license to establish or otherwise provide services in China. They could only apply for a license if they first received an invitation from the relevant Chinese regulatory authorities, and even then the decision-making process lacked transparency and was subject to inordinate delay and discretion. In its accession agreement, China committed to licensing procedures that were streamlined, transparent and more predictable.

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

At present, ten years after China's accession to the WTO, significant challenges still seem to remain in securing the benefits of many of China's services commitments. Through WTO dispute settlement, the United States was able to fully open China's financial information services sector in 2009, as China followed through on the terms of a settlement agreement requiring China to create an independent regulator and remove restrictions that had been placed on foreign financial information service suppliers. However, concerns remain with regard to the implementation of other important services commitments, such as in the area of electronic payment services, where China has not yet fully opened up its market to foreign companies that supply electronic payment and related services to banks and other companies that issue credit and debit cards. In September 2010, the United States initiated dispute settlement against China, after it had become clear that the Chinese regulator, the People's Bank of China (PBOC), would not take steps

to remove the restrictions that prevented foreign companies from providing electronic payment services for domestic currency credit card transactions. Earlier this year, a WTO panel found those restrictions to be inconsistent with China's commitments under the GATS.

In 2012, China also continued to maintain or erect restrictive or cumbersome terms of entry in some sectors that prevent or discourage foreign suppliers from gaining market access. Many of these actions raise questions about commitments made by China in its Services Schedule. For example, China maintains an informal ban on entry in the basic telecommunications sector, and despite its commitments to open this sector China has not granted any new licenses since acceding to the WTO on December 11, 2001. The requirement that any joint venture partners for basic services be majority government-owned provides a direct, non-transparent mechanism for enforcing this ban, and shuts off foreign suppliers from private Chinese enterprises that may be more attractive partners. In addition, excessive and sometimes discriminatory capital requirements continued to prove unduly burdensome for foreign suppliers in many sectors, such as telecommunications and construction services, among others. Moreover, in sectors such as banking, insurance and legal services, uneven and sometimes discriminatory application of branching regulations limit or delay market access for foreign suppliers. In other sectors, particularly construction services, problematic measures appear to be taking away previously acquired market access rights.

In 2013, the United States will continue its efforts to resolve the many concerns that have arisen in the area of services.

Financial Services

BANKING

China has taken a number of steps to implement its banking services commitments, although some of these efforts have generated concerns, and there are

some instances in which China still does not seem to have fully implemented particular commitments, such as with regard to Chinese-foreign joint banks and bank branches.

Prior to its accession to the WTO, China had allowed foreign banks to conduct foreign currency business in selected cities. Although China had also permitted foreign banks, on an experimental basis, to conduct domestic currency business, the experiment was limited to foreign customers in two cities.

In its WTO accession agreement, China committed to a five-year phase-in for banking services by foreign banks. Specifically, China agreed that, immediately upon its accession, it would allow U.S. and other foreign banks to conduct foreign currency business without any market access or national treatment limitations and conduct domestic currency business with foreign-invested enterprises and foreign individuals, subject to certain geographic restrictions. The ability of U.S. and other foreign banks to conduct domestic currency business with Chinese enterprises and individuals was to be phased in. Within two years after accession, foreign banks were also to be able to conduct domestic currency business with Chinese enterprises, subject to certain geographic restrictions. Within five years after accession, foreign banks were to be able to conduct domestic currency business with Chinese enterprises and individuals, and all geographic restrictions were to be lifted. Foreign banks were also to be permitted to provide financial leasing services at the same time that Chinese banks are permitted to do so.

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

As previously reported, shortly after China's accession to the WTO, the PBOC issued regulations

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

For example, China appears to have fallen behind in implementing its commitments regarding the establishment of Chinese-foreign joint banks. In its Services Schedule, China agreed that qualified foreign financial institutions would be permitted to establish Chinese-foreign joint banks immediately after China acceded, and it did not schedule any limitation on the percentage of foreign ownership in these banks. To date, however, China has limited the sale of equity stakes in existing state-owned banks to a single foreign investor to 20 percent, while the total equity share of all foreign investors is limited to 25 percent. For several years, the United States and other WTO members have urged China to relax these limitations, although no progress has yet been achieved.

Another problematic area involves the ability of U.S. and other foreign banks to participate in the domestic currency business in China, the business that foreign banks were most eager to pursue in China, particularly with regard to Chinese individuals. As previously reported, despite high capital requirements and other continuing impediments to entry into the domestic currency business, participation of U.S. and other foreign banks in the domestic currency business expanded tremendously after China acceded to the WTO on December 11, 2001, first with regard to foreign-

invested enterprises and foreign individuals and later with regard to Chinese enterprises, subject to geographic restrictions allowed by China's WTO commitments. China had committed to allow foreign banks to conduct domestic currency business with Chinese individuals by December 11, 2006, but it was only willing to do so subject to a number of problematic restrictions.

In November 2006, the State Council issued the *Regulations for the Administration of Foreign-Funded Banks*. Among other things, these regulations mandated that only foreign-funded banks that have had a representative office in China for two years and that have total assets exceeding \$10 billion can apply to incorporate in China. After incorporating, moreover, these banks only become eligible to offer full domestic currency services to Chinese individuals if they can demonstrate that they have operated in China for three years and have had two consecutive years of profits. The regulations also restricted the scope of activities that can be conducted by foreign banks seeking to operate in China through branches instead of through subsidiaries. In particular, the regulations restricted the domestic currency business of foreign bank branches. While foreign bank branches can continue to take deposits from and make loans to Chinese enterprises in domestic currency, they can only take domestic currency deposits of RMB 1 million (\$146,000) or more from Chinese individuals and cannot make any domestic currency loans to Chinese individuals. In addition, unlike foreign banks incorporated in China, foreign bank branches cannot issue domestic currency credit and debit cards to Chinese enterprises or Chinese individuals.

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

In 2007 and 2008, working closely with U.S. banks, the United States was able to use the SED process and meetings of the U.S.-China Joint Economic Committee to improve the access of U.S. banks to the domestic currency business. For example, China committed to act on the applications of foreign banks incorporated in China seeking to issue their own domestic currency credit and debit cards. However, the PBOC insists as a condition of its approval that the banks move the data processing for these credit and debit cards onshore, a costly step that has limited foreign participation in the market to date. In addition, China agreed to reduce its limitations on foreign bank issuance of local currency denominated subordinated debt in order to be able to raise capital to expand operations. China also agreed to allow foreign incorporated banks to trade bonds in the interbank market on the same basis as Chinese banks and to allow foreign banks to increase liquidity on an exceptional basis through guarantees or loans from affiliates abroad.

At the July 2009, May 2010 and May 2011 S&ED meetings, China reiterated its commitment to deepen financial system reform. In addition, China 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 corporate bonds in the interbank market. Subsequently, in April 2011, China's corporate bond market oversight body issued qualifying criteria for underwriters and opened up a window for applications. Many U.S. and other foreign institutions applied, and one foreign bank was approved to offer underwriting services in China's market.

At the May 2011 S&ED meeting, China took additional steps to deepen financial market opening. Specifically, China committed to allow locally incorporated U.S. and other foreign banks in China to distribute mutual funds, act as custodians for mutual funds, and serve as margin depository banks for qualified foreign institutional investors engaging in financial futures transactions.

In 2013, the United States will continue to make every effort to ensure that China fully implements its WTO commitments and that U.S. banks realize the full benefits to which they are entitled.

MOTOR VEHICLE FINANCING

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

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

At the May 2012 S&ED meeting, China committed to approve applications by qualified auto financing companies (AFCs), including foreign-invested entities, to issue financial bonds in China. This commitment should give AFCs regular access to financing in the interbank bond market.

INSURANCE

China has issued measures implementing most of its insurance commitments, but these measures have also created problems in the areas of licensing, branching and transparency.

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

In its WTO accession agreement, China agreed to phase out existing geographic restrictions on all types of insurance operations during the first three years after accession. It also agreed to expand the ownership rights of foreign companies over time. Specifically, China committed to allow foreign life insurers to hold a 50-percent equity share in a joint venture upon accession. China also committed to allow foreign property, casualty and other non-life insurers to establish as a branch or as a joint venture with a 51-percent equity share upon accession and to establish as a wholly foreign-owned subsidiary two years after accession. In addition, foreign insurers handling large scale commercial risks, marine, aviation and transport insurance, and reinsurance were to be permitted to establish as a wholly foreign-owned subsidiary five years after accession. China further agreed to permit all foreign insurers to expand the scope of their activities to include health, group and pension/annuities lines of insurance within three years after accession.

China also made additional significant commitments relating specifically to branching. China committed to allow non-life insurance firms to establish as a branch in China upon accession and to permit internal branching in accordance with the lifting of China's geographic restrictions. China further agreed that foreign insurers already established in China that were seeking authorization to establish branches or sub-branches would not have to satisfy the requirements applicable to foreign insurers seeking a license to enter China's market.

As previously reported, CIRC issued several new insurance regulations and implementing rules after China acceded to the WTO. These measures implemented many of China's commitments, but they also created problems in the critical areas of capitalization requirements, branching and transparency, and foreign insurers have often faced restrictions or obstacles that hinder them from expanding their presence in China's market.

Since China's accession to the WTO, the United States has used all available opportunities to engage

China and its insurance regulator, CIRC, on needed improvements to China's insurance regime. On the bilateral front, this engagement has included the JCCT process, the S&ED process and an Insurance Dialogue with CIRC, while multilateral engagement has included transitional review meetings before the WTO's Committee on Trade in Financial Services and the Trade Policy Reviews for China. As previously reported, U.S. engagement has led to improvements with regard to capital requirements and licensing, although many needed improvements remain, particularly in the area of branching.

For example, the United States has continued to press China regarding the need for CIRC to follow non-discriminatory procedures to approve U.S. companies for internal branches and sub-branches, following established regulatory time frames and recognizing the right to obtain approval for multiple, concurrent branches. The United States has also addressed new measures that could further restrict branching, such as the *Administrative Measures on Insurance Companies*, a draft measure circulated by CIRC in August 2009 that included new application procedures for branches and sub-branches. The United States used an Insurance Dialogue meeting in September 2009 and additional engagement during the run-up to the October 2009 JCCT meeting to persuade CIRC to modify the draft measure to avoid over-penalizing companies for minor violations of regulations, which would have inordinately delayed them from seeking new branches. The United States is continuing to work with CIRC to advocate for non-discrimination in its application of the final measure, which entered into force in October 2009.

In 2008, a new problem arose when the United States became aware of a draft CIRC regulation, the *Administrative Method of the Equity Interest in Insurance Companies*, which would have unfairly shut out foreign insurance companies from holding multiple investments in Chinese domestic insurance companies. The United States pressed its concerns during the run-up to the June 2008 SED meeting, and CIRC agreed to take U.S. and industry comments into account. The United States also obtained useful

clarifications from China regarding the procedures that insurance companies in China need to follow for overseas investment of their assets. Subsequently, in September 2009, CIRC circulated a revised draft of the regulation that is much narrower in scope and should avoid many of the adverse implications for foreign subsidiaries and joint ventures that would have resulted from the prior draft. To date, however, CIRC has not issued the regulation in final form.

In 2011 and 2012, using the U.S.-China Insurance Dialogue and related bilateral meetings, the United States continued to press CIRC to follow non-discriminatory procedures when approving new licensing requests and internal branching requests, with some limited success. The United States also sought the opening of China's mandatory third party liability auto insurance services sector to foreign-invested insurance companies. During the May 2011 S&ED meeting, China pledged to "actively study and push forward the opening of" mandatory third party liability auto insurance in China to foreign-invested insurance companies, even though China was not required to open this services sector by its GATS commitments. At the May 2012 S&ED meeting, China noted that it had amended its regulations to allow foreign-invested insurance companies to sell mandatory third party liability auto insurance in China.

Despite continuing challenges, a number of U.S. and other foreign insurers are currently operating in China, and they are continuing to work to broaden their presence in China. In 2013, as in prior years, the United States will continue to use both bilateral and multilateral engagement to address issues of concern to these and other U.S. insurers. The United States is committed to seeking market access for U.S. insurers on a transparent, fair and equitable basis.

FINANCIAL INFORMATION

In response to a WTO case brought by the United States, China has established an independent

regulator for the financial information sector and has removed restrictions that had placed foreign suppliers at a serious competitive disadvantage.

In its WTO accession agreement, as noted above, China committed that, for the services included in its Services Schedule, the relevant regulatory authorities would be separate from, and not accountable to, any service suppliers they regulated, with two specified exceptions. One of the services included in China's Services Schedule – and not listed as an exception – is the "provision and transfer of financial information, and financial data processing and related software by suppliers of other financial services."

As previously reported, following its accession to the WTO, China did not establish an independent regulator in the financial information services sector. Xinhua, the Chinese state news agency, remained the regulator of, and became a major market competitor of, foreign financial information service providers in China. In addition, in 2006, a major problem developed when Xinhua issued a measure that precluded foreign providers of financial information services from contracting directly with or providing financial information services directly to domestic Chinese clients. Instead, foreign financial information service providers were required to operate through a Xinhua-designated agent, and the only agent designated was a Xinhua affiliate. These new restrictions did not apply to domestic financial information service providers and, in addition, contrasted with the rights previously enjoyed by foreign information service providers since the issuance of the 1996 rules, well before China's accession to the WTO in December 2001.

In March 2008, after it had become clear that sustained bilateral engagement of China would not resolve the serious WTO concerns generated by Xinhua's restrictions, the United States and the EU initiated WTO dispute settlement proceedings against China. Canada later joined in as a co-complainant in September 2008. 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 2009, effective no later than June 2009. Subsequently, China timely issued the measures necessary to comply with the terms of the MOU.

ELECTRONIC PAYMENT SERVICES

China has not yet implemented electronic payment services commitments that were scheduled to have been phased in no later than December 11, 2006. However, China has agreed to implement these commitments by July 2013 in order to comply with the WTO's rulings in a WTO case brought by the United States.

In the Services Schedule accompanying its Protocol of Accession, China committed to remove market access limitations and provide national treatment for foreign suppliers providing payment and money transmission services, including credit, charge, and debit cards. This commitment was to be implemented by no later than December 11, 2006.

In the years leading up to 2006, China's regulator, the PBOC, placed severe restrictions on foreign suppliers of electronic payment services, like the major U.S. credit card companies, which typically provide electronic payment services in connection with the operation of electronic networks that process payment transactions involving credit, debit, prepaid and other payment cards. Through these services, they enable, facilitate and manage the flow of information and the transfer of funds from cardholders' banks to merchants' banks. However, the PBOC prohibited foreign suppliers from handling the typical payment card transaction in China, in which a Chinese consumer makes a payment in China's domestic currency, known as the renminbi, or RMB. Instead, through a variety of measures, the PBOC created a national champion, allowing only

one domestic entity, CUP, an entity created by the PBOC and owned by participating Chinese banks, to provide these services.

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

After China's deadline of December 11, 2006, which passed without any action having been taken by China, the United States again pressed China. The United States raised its concerns in connection with SED meetings and other bilateral meetings in 2007 and 2008 as well as at the WTO during the transitional reviews before the Committee for Trade in Financial Services in 2007, 2008 and 2009 and China's second and third Trade Policy Reviews, held in 2008 and 2010, without making progress.

In September 2010, the United States brought a WTO case challenging China's various restrictions on foreign suppliers of electronic payment services in an effort to ensure that U.S. suppliers would enjoy the full benefits of the market-opening commitments that China made in its Services Schedule. Consultations were held in October 2010. At the United States' request, a WTO panel was established to hear this case in March 2011, and six

other WTO members joined the case as third parties. Hearings before the panel took place in October and December 2011, and the panel issued its decision in July 2012. The panel found the challenged restrictions to be inconsistent with China's commitments under the GATS. China decided not to appeal the panel's decision and subsequently agreed to come into compliance with the WTO's rulings by July 2013.

Legal Services

China has issued measures intended to implement its legal services commitments, although these measures give rise to WTO compliance concerns because they impose an economic needs test, restrictions on the types of legal services that can be provided and lengthy delays for the establishment of new offices.

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

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

representative offices were to have been phased out within one year of China's accession to the WTO, which means that foreign law firms should have been able to open more than one office anywhere in China beginning on December 11, 2002.

As previously reported, the State Council issued the *Regulations on the Administration of Foreign Law Firm Representative Offices* in December 2001, and the Ministry of Justice issued implementing rules in July 2002. While these measures removed some market access barriers, they also generated concern among foreign law firms doing business in China. In many areas, these measures were ambiguous. Among other things, these measures could be interpreted as imposing an economic needs test for foreign law firms that want to establish offices in China, which raises WTO concerns. In addition, the procedures for establishing a new office or an additional office seem unnecessarily time-consuming. For example, a foreign law firm may not establish an additional representative office until its most recently established representative office has been in practice for three consecutive years. Furthermore, new foreign attorneys must go through a lengthy approval process that can take more than one year.

These measures also include other restrictions that make it difficult for foreign law firms to take advantage of the market access rights granted by China's WTO accession agreement. For example, foreign attorneys may not take China's bar examination, and foreign law firms may not hire registered members of the Chinese bar as attorneys to provide advice on Chinese law, nor may foreign attorneys working in China otherwise provide advice on Chinese law to clients. Foreign law firms have also reported that they are not given the uniform right to attend or provide consultancy services to clients during regulatory proceedings administered by Chinese government agencies. In addition, foreign law firms are subject to taxes at both the firm and individual levels, while domestic law firms are only taxed as partnerships.

The United States has raised its concerns in this area both bilaterally and at the WTO during meetings before the Council for Trade in Services and China's Trade Policy Reviews, with support from other WTO members. To date, although a number of U.S. and other foreign law firms have been able to open additional offices in China, little progress has been made on the other issues affecting access to China's legal services market. The United States will continue to engage China in 2013 in an attempt to resolve these outstanding concerns.

Telecommunications

It appears that China has nominally kept to the agreed schedule for phasing in its WTO commitments in the telecommunications sector, but restrictions maintained by China on basic services, such as informal bans on new entry, a requirement that foreign suppliers can only enter into joint ventures with state-owned enterprises and exceedingly high capital requirements, and additional restrictions on value-added services, have created serious barriers to market entry.

In the Services Schedule accompanying its WTO accession agreement, China committed to permit foreign suppliers to provide a broad range of telecommunications services through joint ventures with Chinese companies, including domestic and international wired services, mobile voice and data services, value-added services (such as electronic mail, voice mail and on-line information and database retrieval) and paging services. The foreign equity stake permitted in the joint ventures was to increase over time, reaching a maximum of 49 percent for basic telecommunications services and 50 percent for value-added services. In addition, all geographical restrictions were to be eliminated within two to six years after China's WTO accession, depending on the particular services sector.

Importantly, China also accepted key principles from the WTO Reference Paper on regulatory principles. As a result, China became obligated to separate the regulatory and operating functions of MII (known as

MIIT since 2008), which had been both the telecommunications regulatory agency in China and the operator of China Telecom, upon China's accession to the WTO. China also became obligated to adopt pro-competitive regulatory principles, such as cost-based pricing and the right of interconnection, which are necessary for foreign-invested joint ventures to compete with incumbent suppliers such as China Telecom, China Unicom and China Mobile.

Even though China appears to have nominally implemented its WTO commitments on schedule, no meaningful market-opening progress has taken place in the telecommunications services sector through 2012. As previously reported, with regard to basic services, MIIT's imposition of informal bans on new entry, limitations on foreign suppliers' selection of Chinese joint venture partners and high capital requirements, have continued to present formidable barriers to market entry for foreign suppliers. In addition, the approach that China has taken to regulating value-added services, including its insistence on classifying certain value-added services as basic services when provided by foreign suppliers, and other uncertainties presented by China's classification of value-added services, have presented similarly formidable barriers to foreign entry. The United States also is concerned by the fact that China is seeking to classify certain computer and related services, such as the provision of Internet data centers, as telecommunications services and thereby impose additional foreign equity restrictions on foreign suppliers of these services.

As China nears the end of its eleventh year of WTO membership, the United States is unaware of any domestic or foreign application for a new stand-alone license to provide basic telecommunications services that has completed the MIIT licensing process, even in commercially attractive areas such as the re-sale of basic telecommunications services, leased line services or corporate data services. In fact, at present, the number of suppliers of basic telecommunications services appears to be frozen at

three Chinese state-owned enterprises, limiting the opportunities for new joint ventures and reflecting a level of competition that is extraordinarily low given the size of China's market.

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

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

If China takes the initiative, its planned new *Telecommunications Law* could be a vehicle for addressing existing market access barriers and other problematic aspects of China's current telecommunications regime. A draft of this long-awaited law has been under consideration for at least eleven years, although, to date, the Chinese government has not made a draft available for public comment, despite repeated requests from the United States and other WTO members. Information obtained through informal channels indicates that although some proposed provisions are helpful, others, including a possible codification of China's foreign equity caps for basic and value-added telecommunications services, appear to conflict with China's commitment in its GATS Schedule to negotiate further liberalization.

Over the years, the United States raised its many telecommunications concerns with China, using bilateral engagement, particularly the JCCT process, and WTO meetings, including the annual transitional reviews before the Council for Trade in Services and China's Trade Policy Reviews, where the United States has received support from other WTO members. These efforts, however, achieved little progress.

In 2011, the United States engaged China throughout the run-up to the November JCCT meeting. While continuing to urge China to pursue further market liberalization, the United States also sought to influence China's plans for allowing telecommunications sector convergence and urged China to provide an opportunity for public comment on the next draft of its value-added services catalogue. At the November 2011 JCCT meeting, China agreed to the United States' request for a public comment period.

Throughout 2012, the United States again vigorously engaged China on the range of telecommunications services issues. In 2013, the United States will continue to engage China vigorously on these and other issues that contribute to the absence of meaningful market-opening in China's telecommunications sector.

Construction and Related Engineering Services

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

Upon its WTO accession, China committed to permit foreign enterprises to supply construction and related engineering services through joint ventures with foreign majority ownership, subject to the requirement that those services only be undertaken in connection with foreign-invested construction

projects and subject to registered capital requirements that were slightly different from those of Chinese enterprises. Within three years of accession, China agreed to remove those conditions, and it also agreed to allow wholly foreign-owned enterprises to supply construction and related engineering services for four specified types of construction projects, including construction projects wholly financed by foreign investment.

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

Decrees 113 and 114 created concerns for U.S. firms by imposing new and more restrictive conditions than existed prior to China's accession to the WTO, when U.S. firms were permitted to work in China on a project-by-project basis pursuant to MOC rules. In particular, these decrees for the first time require foreign firms to obtain qualification certificates. In addition, the decrees for the first time require foreign-invested enterprises to incorporate in China. The decrees also impose high minimum registered capital requirements as well as technical personnel staff requirements that are difficult for many foreign-invested enterprises to satisfy.

With regard to the Decree 113 regulatory regime for construction enterprises, the United States has actively engaged China, both bilaterally and at the annual transitional reviews before the Council for Trade in Services, in an effort to obtain needed improvements. In particular, the United States has

urged China to maintain non-discriminatory procedures under Decree 113 to enable foreign-invested enterprises to carry out the same kinds of projects that domestic companies can provide. The United States also has sought a reduction in the registered minimum capital requirements under Decree 113 or the use of other arrangements, such as bonds or guarantees in lieu of the capital requirements.

With regard to the Decree 114 regulatory regime for construction engineering design enterprises, the United States generally welcomed the implementing rules issued by MOC in 2007, as they temporarily lifted foreign personnel residency and staffing requirements imposed by Decree 114, and recognized the foreign qualifications of technical experts when considering initial licensing. The United States has since continued to press China to make these improvements permanent, using both the March 2008 U.S.-China Best Practices Exchange on Architecture, Construction and Engineering and the transitional reviews before the Council for Trade in Services in 2007, 2008 and 2009. Separately, the United States has also urged China to give foreign construction engineering design companies the right to immediately apply for a comprehensive, "Grade A" license, like domestic design companies can do. Under existing rules, set forth in Circular 202, the *Implementation of the Administrative Provisions on the Qualification of Construction and Engineering Supervision and Design*, issued by MOC in August 2007, foreign companies are subjected to more restrictive licensing procedures than domestic companies, although foreign companies have begun to have more success with regard to their licensing requests in 2009.

Meanwhile, in the area of project management services, inconsistent regulations have allowed market entry barriers for foreign-invested enterprises to persist. In 2004, MOC issued the *Provisional Measures for Construction Project Management*. Known as Decree 200, this measure requires, among other things, local establishment and the possession of separate qualifications in the

area of construction, engineering or design. In contrast, a measure issued by MOC and MOFCOM in 2007 – the *Regulations on the Administration of Foreign-Invested Construction and Engineering Service Enterprises* – appears to allow foreign-invested enterprises to provide project management services without possessing separate construction, engineering or design qualifications, but the absence of implementing rules has resulted in inconsistent interpretations of this measure. The United States and U.S. industry has been urging China to clarify this situation and ease the entry barriers currently facing foreign-invested enterprises.

In 2013, as in prior years, the United States will continue to engage China through bilateral channels in an attempt to achieve improved market access for U.S. firms.

Express Delivery Services

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

The specific commitments that China made in the area of express delivery services did not require China to take implementation action upon its accession to the WTO. Basically, China agreed to increase the stake allowed by foreign express delivery companies in joint ventures over a period of years, with wholly foreign-owned subsidiaries allowed within four years of accession.

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

to undermine market access for foreign companies and have raised questions in light of China's WTO obligations. As previously reported, through sustained and high-level engagement, the United States was able to persuade China to forego a series of restrictive measures.

Nevertheless, in August 2008, the draft of a problematic new *Postal Law* went before the National People's Congress. Among other things, this draft excluded foreign suppliers from the document segment of China's domestic express delivery market. At the September 2008 JCCT meeting, the United States urged China to revise the draft *Postal Law* to remove the discriminatory exclusion of foreign suppliers from a major segment of China's domestic express delivery market, while noting that the draft *Postal Law* also contains other troubling elements. The United States also raised its concerns in bilateral meetings with MOFCOM, the State Postal Bureau, the SCLAO and the National People's Congress as well as during the September 2008 convocation of the U.S.-China Symposium on Postal Reform and Express Delivery and the December 2008 transitional review before the WTO's Council for Trade in Services. The United States continued these efforts in 2009. However, the *Postal Law*, as approved by the National People's Congress, effective October 2009, continued to exclude foreign suppliers from the document segment of China's domestic express delivery market.

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

During the run-up to the November 2011 JCCT meeting, the United States and China held a Fifth Postal Express Delivery Symposium, during which important issues, such as China's review of foreign companies' domestic permit applications and customs issues related to express delivery services, were discussed. At the Symposium, SPB agreed to formally accept for review foreign companies' applications for business permits (submitted more than one year earlier) to provide domestic express package delivery services in China. Regrettably, despite intensive U.S. engagement, SPB did not respond formally to the applications until well into 2012, and SPB's response did not appear to ensure the full protection of U.S. companies' existing operations and other key components of their access to the domestic express package delivery market. Since then, the United States has used every opportunity, including high-level engagement, to press China to clarify that the domestic express package delivery services operations of U.S. companies will not face new restrictions. The United States will continue to engage vigorously with China on this issue in 2013.

In other ways, SPB's regulation of the express delivery sector in China seems to be overly burdensome and restrictive. China's new *Postal Law*, along with related regulatory measures, such as express business permitting measures and various standards that China has developed and imposed relating to services, labor and packaging, seem to impose undue burdens on an industry that would normally not be subject to such intrusive regulation. The United States has been monitoring developments in this area and has urged China to move toward international norms. In 2013, the United States will continue to seek improvements in this area.

Aviation Services

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

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

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

However, China's interpretation of cargo hub provisions in the agreement has resulted in U.S. cargo carriers experiencing difficulties in getting their operating schedules approved by the General Administration of Civil Aviation in China. U.S. and

Chinese negotiators are currently involved in a series of technical discussions to resolve this issue.

Maritime Services

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

As previously reported, even though China made only limited WTO commitments relating to its maritime services sector, it took a significant step in December 2003 to increase market access for U.S. service providers. The United States and China signed a far-reaching, five-year bilateral agreement, with automatic one-year extensions, which gives U.S.-registered companies the legal flexibility to perform an extensive range of additional shipping and logistics activities in China. U.S. shipping and container transport services companies, along with their subsidiaries, affiliates and joint ventures, are also able to establish branch offices in China without geographic limitation.

Other Services

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

In its accession agreement, China also agreed to give foreign suppliers increased access in other sectors, including several types of professional services, tourism and travel-related services, educational services and environmental services. In each sector, China agreed to the phased elimination or reduction of various market access and national treatment limitations. To date, the United States has not identified significant concerns related to China's implementation of the commitments made in these sectors, and U.S. companies confirm that the relevant laws and regulations are generally in compliance with China's WTO commitments, with one exception. U.S. and European companies have

expressed GATS and other concerns regarding China's regulation of foreign suppliers of global distribution system services. Although China issued new regulations addressing global distribution system services dated August 2012, these regulations provide only a modest opening to foreign suppliers, as they allow foreign suppliers to handle domestic segments of an international flight but not the most lucrative part of China's market, which is purely domestic travel within China.

LEGAL FRAMEWORK

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

Transparency

OFFICIAL JOURNAL

China has re-committed to use a single official journal for the publication of all trade-related laws, regulations and other measures. To date, it appears that most but not all government entities publish trade-related measures in this journal, although they take a narrow view of the types of trade-related measures that need to be published.

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

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

As previously reported, following sustained U.S. engagement, the State Council issued a notice in March 2006 directing all central, provincial and local government entities to begin sending copies of all of their trade-related measures to MOFCOM for immediate publication in the *MOFCOM Gazette*. The United States subsequently monitored the effectiveness of this notice, both to assess whether all government entities regularly publish their trade-related measures in the *MOFCOM Gazette* and whether all types of measures are being published. It appeared that adherence to the State Council's notice was far from complete. As a result, the United States continued to engage China bilaterally on the need for a fully compliant single official journal, and at the December 2007 SED meeting China re-confirmed its WTO commitment to publish all final trade-related measures in a designated official journal before implementation.

The United States has been closely monitoring the effectiveness of China's official journal commitment since the December 2007 SED meeting. To date, it appears that most but not all government entities publish trade-related measures in this journal. At the same time, these government entities tend to take a narrow view of the types of trade-related measures that need to be published in the official journal. As a result, while trade-related regulations and departmental rules are often published in the journal, it is less common for other measures such as opinions, circulars, orders, directives and notices to be published, even though they are all binding legal measures.

In the September 2012 WTO case challenging numerous subsidies provided by the central government and various sub-central governments in China to automobile and automobile-parts enterprises located in regions in China known as

"export bases," the United States included claims alleging that China had failed to abide by various WTO transparency obligations, including China's obligation to publish the measures at issue in an official journal. Consultations in this case took place in November 2012.

TRANSLATIONS

China has not yet established an infrastructure to undertake the agreed upon translations of its trade-related measures into one or more of the WTO languages.

Another important transparency commitment that China made in its WTO accession agreement involves translations. China agreed to make available translations of all of its laws, regulations and other measures affecting trade in goods, services, TRIPS or the control of foreign exchange into one or more of the WTO languages (English, French and Spanish). China further agreed that, to the maximum extent possible, it would make translations of these laws, regulations and other measures available before implementation or enforcement, but in no case later than 90 days afterwards.

China has a poor record of compliance with its translation commitment. Indeed, after ten years of WTO membership, China still has not established an infrastructure to undertake the agreed-upon translations of its trade-related measures. Although China has complained that it is too difficult for it to live up to this commitment, this excuse lacks credulity. As the United States has pointed out, other WTO members translate all of their legal measures, and one of these members – the EU – translates its measures into 23 official languages.

The United States has raised this issue at the WTO during the annual transitional reviews, including during final transitional reviews before several committees and councils that took place in 2011. In addition, in the December 2010 WTO case challenging what appeared to be prohibited import substitution subsidies being provided by the Chinese

government to support the production of wind turbine systems in China, the United States included a claim alleging that China had violated its WTO accession agreement by not translating the measures at issue into a WTO language. China repealed those measures following consultations. More recently, in the September 2012 WTO case challenging export base subsidies, discussed in the Official Journal section above, the United States included a claim alleging that China had failed to make available translations of the measures at issue into one or more WTO languages.

PUBLIC COMMENT

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

One of the most important of the transparency commitments that China made in its WTO accession agreement concerned the procedures for adopting or revising laws, regulations and other measures affecting trade in goods, services, TRIPS or the control of foreign exchange. China agreed to provide a reasonable period for public comment on these new or modified laws, regulations and other measures before implementing them, except in certain specific instances, enumerated in China's accession agreement.

As previously reported, in the first few years after China acceded to the WTO, China's ministries and agencies had a poor record of providing an opportunity for public comment *before* new or modified laws, regulations and other measures were implemented. Although the State Council issued regulations in December 2001 addressing the procedures for the formulation of administrative regulations and rules and expressly allowing public comment, many of China's ministries and agencies in 2002 continued to follow the practice prior to China's WTO accession, and no notable progress took place in 2003. Typically, the ministry or agency

drafting a new or revised measure consulted with and submitted drafts to other ministries and agencies as well as Chinese experts and affected Chinese companies. At times, it also consulted with select foreign companies, although it would not necessarily share drafts with them. As a result, only a small proportion of new or revised measures were issued after a period for public comment, and even in those cases the amount of time provided for public comment was generally too short.

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

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

At the SED meeting in December 2006, the United States and China agreed to make transparency, including notice-and-comment procedures and other rulemaking issues, a topic for discussion in future SED meetings. These discussions began at the May 2007 SED meeting, while the United States continued to provide technical assistance to facilitate Chinese government officials' understanding of the workings, and benefits, of an

open and transparent rulemaking process. At the December 2007 SED meeting, China specifically committed to publish, when possible, proposed trade-related measures and provide interested parties a reasonable opportunity for comment. China also agreed that it would publish these proposed measures either in its designated official journal or on an official website. At the June 2008 SED meeting, China then committed to publish all proposed trade- and economic-related regulations and departmental rules for public comment, subject to specified exceptions, and to provide a comment period of no less than 30 days. China indicated that it would publish these proposed measures on the Legislative Information Website maintained by the SCLAO.

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

The United States has been monitoring the effectiveness of these changes. While the NPC has been regularly publishing draft laws for public comment, and the State Council has been regularly publishing draft regulations for public comment, it appears that China has had more difficulty implementing China's new policy regarding trade- and economic-related departmental rules. Since 2008, China has increased the number of proposed departmental rules published for public comment on the SCLAO website. However, a significant number of departmental rules are still issued without first having been published for public comment on the SCLAO website. While some ministries publish departmental rules on their own websites, they often allow less than 30 days for public comment, making it difficult for foreign interested parties to submit timely and complete comments.

In October 2010, the State Council issued the *Opinions on Strengthening the Building of a*

Government Ruling by Law. This measure directs ministries and agencies at the central and provincial levels of government to solicit public comment when developing their rules, subject to certain exceptions. However, the measure does not dictate the procedures or time periods to be used.

At the May 2011 S&ED meeting, the United States was able to persuade China to commit that it would issue a measure in 2011 to implement the requirement to publish all proposed trade- and economic-related administrative regulations and departmental rules on the SCLAO website for a public comment period of not less than 30 days from the date of publication, subject to certain exceptions. In April 2012, shortly before the May 2012 S&ED meeting, the SCLAO published two measures, the *Interim Measures on Solicitation of Public Comment on Draft Laws and Regulations* and the *Notice on Related Issues Regarding Solicitation of Public Comments on Draft Departmental Rules*, on its website. These two measures provide that administrative regulations and departmental rules have to be posted on the Legislative Information Website of the SCLAO.

ENQUIRY POINTS

China has complied with its obligation to establish enquiry points.

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

have created websites to provide answers to frequently asked questions as well as further guidance and information.

Uniform Application of Laws

Some problems with the uniform application of China's laws and regulations persist.

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

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

During 2012, as in prior years, some problems with uniformity persisted. These problems are discussed above in the sections on Customs and Trade Administration, Taxation, Investment and Intellectual Property Rights.

Judicial Review

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

In its WTO accession agreement, China agreed to establish tribunals for the review of all administrative actions relating to the implementation of laws, regulations, judicial decisions and administrative rulings on trade-related matters. These tribunals must be impartial and independent of the government authorities entrusted with the administrative enforcement in question, and their review procedures must include the right of appeal.

Beginning before China's accession to the WTO, China had taken steps to improve the quality of its judges. For example, in 1999, the Supreme People's Court began requiring judges to be appointed based on merit, educational background and experience, rather than as a result of politics or favoritism. However, existing judges, many of whom had no legal training, were grandfathered in. In part because of this situation, many U.S. companies in 2012 continued to express serious concern about the independence of China's judiciary. In their experience and observation, Chinese judges continue to be influenced by political, government or business pressures, particularly outside of China's big cities.

Meanwhile, in 2012, the United States continued to monitor how the courts designated by the Supreme People's Court's *Rules on Certain Issues Related to Hearings of International Trade Administrative Cases*, which went into effect in October 2002, have handled cases involving administrative agency decisions relating to trade in goods or services. So far, however, there continues to be little data, as few U.S. or other foreign companies have had experience with these courts.

APPENDICES

- Appendix 1* List of Written Submissions Commenting on China's WTO Compliance
September 24, 2012
- Appendix 2* List of Witnesses Testifying at Hearing on China's WTO Compliance
October 3, 2012
- Appendix 3* U.S. Fact Sheet for 23rd U.S.-China Joint Commission on Commerce and Trade Meeting
December 19, 2012
- Appendix 4* U.S. Fact Sheet for 4th U.S.-China Strategic and Economic Dialogue
May 4, 2012
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2012 USTR Report to Congress on China's WTO Compliance

Appendix 1

List of Written Submissions Commenting on China's WTO Compliance September 24, 2012

1. U.S. Chamber of Commerce
 2. U.S.-China Business Council
 3. International Intellectual Property Alliance
 4. American Iron and Steel Institute
 5. American Bar Association
 6. Electron Energy Corporation
 7. United States Information Technology Office
 8. U.S. Council for International Business
 9. U.S. Wheat Associates
 10. National Milk Producers Federation
 11. U.S. Dairy Export Council
 12. American Dehydrated Onion and Garlic Association
 13. U.S. Meat Export Federation
 14. National Cattlemen's Beef Association
 15. American Meat Institute
 16. National Pork Producers Council
 17. North American Meat Association
 18. American Society of Composers, Authors and Publishers
 19. American Wire Producers Association
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2012 USTR Report to Congress on China's WTO Compliance

Appendix 2

List of Witnesses Testifying at Public Hearing on China's WTO Compliance October 3, 2012

1. Erin Ennis
U.S.-China Business Council
 2. Michael Schlesinger
International Intellectual Property Alliance
 3. Jeremie Waterman
U.S. Chamber of Commerce
 4. Paul Williams
American Society of Composers, Authors and Publishers
 5. Peter Dent
Electron Energy Corporation
 6. Kevin Dempsey
American Iron and Steel Institute
 7. Mark MacCarthy
Software & Information Industry Association
 8. David Isaacs
Semiconductor Industry Association
 9. Jimmy Goodrich
Information Technology Industry Council
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2012 USTR Report to Congress on China's WTO Compliance

Appendix 3

23rd U.S.-China Joint Commission on Commerce and Trade Meeting December 19, 2012 U.S. Fact Sheet

INTELLECTUAL PROPERTY RIGHTS, LOCALIZATION OF IPR & TECHNOLOGY

Copyright – State-Owned Enterprise Software Legalization

- China confirmed that it requires state-owned enterprises under the authority of the China Banking Regulatory Commission and central state-owned enterprises directly supervised by the State-Owned Assets Supervision and Administration Commission of the State Council to purchase and use legitimate software, including but not limited to operating system and office suite software.

Judicial Interpretation on Intermediary Liability

- Building on an existing JCCT commitment to develop a Judicial Interpretation making clear that those who facilitate online infringement will be jointly liable for such infringement, China announced that its Supreme People's Court will publish a Judicial Interpretation on Internet Intermediary Liability before the end of 2012.

Localization of Intellectual Property and Technology

- China reaffirmed that technology transfer and technology cooperation are the autonomous decisions of enterprises. China will not make this a precondition for market access. If departmental or local documents contain language inconsistent with the above commitment, China will correct them in a timely manner.

Multi-level Protection Scheme (MLPS)

Article 21 of China's 2007 MLPS Administrative Measures specifies an indigenous intellectual property requirement for the selection of information security products for level three and above with the objective of protecting national information security. China will conduct a process to revise this measure and seek the views of all parties, including through dialogue with the United States.

Official Use Vehicles

China's central, provincial, and local level governments procure more than \$16 billion in official use vehicles per year. China committed to delay issuing the 2012 Party and Government Organ Official Use Vehicle Selection Catalogue and to discuss U.S. concerns with regard to the draft catalogue and applicable vehicle selection rules with the United States.

High and New Technology Enterprises

The United States and China will maintain communication on U.S. concerns regarding whether China's High and New Technology Enterprise Certification Administration Measures and related rules apply equally to Chinese and foreign invested enterprises or contain technology transfer or intellectual property localization requirements, including through the U.S.-China Innovation Dialogue.

GOVERNMENT PROCUREMENT

- China's definition of government procurement in its Government Procurement Law is narrower than the definition in the WTO Government Procurement Agreement (GPA). Accordingly, China recognized that some Chinese government procurement projects are for public service and that some enterprises, including some state-owned enterprises, procure in the public interest. Understanding that many enterprises are for profit with diversification of ownership, including being publicly listed, China and the United States will conduct consultations, under the GPA framework and through bilateral dialogues, focused on projects for public service and on the entities that procure in the public interest.

REGULATORY OBSTACLES

Testing and Certification for the China Compulsory Certification (CCC) Mark

- China confirmed that eligible foreign-invested testing and certification entities registered in China can participate in CCC mark-related work and China's review of applications from foreign-invested entities will use the same conditions as are applicable to Chinese domestic entities.
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2012 USTR Report to Congress on China's WTO Compliance

Appendix 3 (cont'd)

23rd U.S.-China Joint Commission on Commerce and Trade Meeting December 19, 2012 U.S. Fact Sheet

REGULATORY OBSTACLES (cont'd)

ZUC Encryption Algorithm

- China agreed it will not mandate any particular encryption standard for commercial 4G Long Term Evolution telecommunications equipment.

Civil Aviation

- China committed to engage in discussions with the United States on measures related to fleet planning associated with the civil aviation industry.

TRADE, AGRICULTURAL AND INVESTMENT ISSUES

Strategic Emerging Industries (SEIs)

- The Chinese Government clarified that it will provide foreign enterprises fair and equitable participation in the development of SEIs, including the 20 major projects announced on May 30, 2012 by Premier Wen.
- China committed that policies supporting SEI development comply with the World Trade Organization's national treatment rules and that such policies are equally applicable to qualified domestic and foreign enterprises.
- Relevant Chinese Government ministries will engage in dialogue and exchange with relevant U.S. departments on the development of SEIs.

Medical Device Pricing

- China committed that any measures affecting pricing of medical devices will treat foreign and domestic manufacturers equally, and that China will take into account comments from the United States on this issue, including how to improve transparency.

Value-Added Tax (VAT)

- China confirmed that a Ministry of Finance-led delegation would hold discussions with the United States, beginning in the first half of 2013, in order to work toward a mutual understanding of China's VAT system and the concepts on which a trade-neutral VAT system is based.

Draft Smart Terminal Regulations

- China confirmed that it will take the views of all stakeholders into full consideration in regard to the regulation of information technology and telecommunications hardware, operating systems, applications, app stores, and other related services. The United States and China will continue to discuss this issue at the working level as China works to revise and improve the current draft.

Agriculture

- The U.S. Department of Agriculture (USDA) affirmed new access for pears in the Chinese marketplace through a commitment to allow reciprocal trade between the two countries beginning in 2013. Additionally, USDA and China's Ministry of Agriculture made a commitment to a biotechnology pilot program, which could provide greater cooperation in the approval process for new products.

Regulatory Data Protection

- To promote scientific advancement and to establish effective regulatory data protection, China agreed to define new chemical entity in a manner consistent with international research and development practices in order to ensure regulatory data of pharmaceutical products are protected against unfair commercial use and unauthorized disclosure.
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2012 USTR Report to Congress on China's WTO Compliance

Appendix 4

4th U.S.-China Strategic and Economic Dialogue May 4, 2012 U.S. Fact Sheet

Creating New Opportunities for U.S. Workers and Firms: China is the fastest growing major economy and the third largest destination for U.S. goods and services exports. Reducing Chinese barriers to U.S. exports will help the United States take full advantage of the opportunities in this growing market, creating more jobs for U.S. workers.

Creating a level playing field for U.S. firms and workers

- China agreed to participate in negotiations for new rules on official export financing with the United States and other major exporters, with the first meeting to take place this summer in Washington, DC. China is one of the world's largest providers of export financing today, and China's participation in negotiated rules governing the terms and conditions of official export financing is critical to making sure that competitive U.S. exports are not undercut by subsidized foreign government financing.
- In order to create a more level playing field for U.S. firms competing against Chinese state-owned enterprises (SOEs), China committed to providing non-discriminatory treatment to all enterprises, regardless of type of ownership, in terms of credit, taxation, and regulatory policies.
- China agreed to increase the number of SOEs that pay dividends as well as to increase the amount of dividends actually paid. China will further encourage listed SOEs – which include China's largest and most profitable SOEs – to increase the portion of profits they pay out in dividends so as to be in line with market levels. SOE profits, as a share of China's GDP, rose from 1.7 percent in 2001 to a peak of 3.7 percent in 2007, just prior to the global financial crisis, contributing to China's imbalanced growth pattern. Unlocking the profits maintained in the corporate sector will help boost China's domestic consumption, creating new opportunities for U.S. producers.
- China committed to submit this year a revised comprehensive offer to join the WTO Agreement on Government Procurement (GPA) – one that responds to the requests of the United States and other GPA parties. The United States is focused on ensuring that China's offer is commensurate with other WTO GPA parties. Opening one of the largest and fastest growing procurement markets would provide substantial opportunities for U.S. exports.
- To help level the playing field and increase protections for U.S. investors, the United States and China agreed to intensify negotiations for a U.S.-China Bilateral Investment Treaty.
- China committed to open up further, including new sectors, to foreign investment. China also committed to further simplify and enhance the transparency of its investment approval system, and to focus its security review of foreign investment solely on national security concerns and adhere to specific timelines and review standards.
- Following its commitment from last year's S&ED, China issued measures providing that departmental rules and administrative regulations have to be posted for public comment on an official government website for a period of no less than 30 days, except under special circumstances. This is intended to give all interested parties, including U.S. companies, a better opportunity to learn about and comment on rules and regulations that affect their business.

Ensuring greater protection of intellectual property rights (IPR)

Innovation is fundamental to America's core competitiveness and future growth, and preventing theft of our inventors' and researchers' intellectual property remains a top priority. China recognized the importance of increasing sales in China of legitimate IP-intensive products and services in line with China's status as a globally significant consumer of these goods.

- China committed to extend its efforts to promote the use of legal software by Chinese enterprises, in addition to more regular audits of software on government computers.
 - China agreed to prioritize trade secrets in its IPR protection policies and to increase enforcement against trade secret misappropriation.
 - China agreed to treat IPR owned or developed in other countries the same as IPR owned or developed in China.
 - China agreed to intensive discussions on the implementation of its commitment that technology transfer is to be decided by firms independently and not to be used by the Chinese government as a pre-condition for market access.
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2012 USTR Report to Congress on China's WTO Compliance

Appendix 4 (cont'd)

4th U.S.-China Strategic and Economic Dialogue May 4, 2012 U.S. Fact Sheet

Shifting China Toward Consumption-based Domestic Demand-led Growth: China has committed to greatly increase its reliance on domestic demand – particularly household consumption – for growth, and to reduce China's dependence on exports and investment. For American exporters, this means a much more rapidly growing Chinese market for U.S. goods and services, as well as a pattern of Chinese growth that supports stronger and more sustained growth of the global market.

China's commitment to continued exchange rate reform is a critical part of this effort. While important progress has been achieved, more remains to be done.

- China's exchange rate has appreciated and is up about 13 percent against the U.S. dollar when accounting for differences in inflation since June 2010, and 40 percent since 2005. China also recently announced that it is widening its trading band to allow market forces to play a greater role in setting the exchange rate.
- China committed to enhancing exchange rate flexibility, letting supply and demand play a bigger role, and reiterated its determination to implement fully its G-20 commitments to move more rapidly to a more market-determined exchange rate system.

China also is taking a number of steps to raise household income and to lower the prices of consumer goods and services that ordinary Chinese purchase, including from the United States.

- China cut import tariffs on certain consumer goods in the run up to the S&ED this year and has committed to another round of tariff cuts before the end of 2012.
- China agreed to expand its pilot program to reduce taxes on services to other regions and sectors. U.S. services firms are among the most competitive in the world and stand to benefit as China's services market grows.

Expanding Opportunities for U.S. Firms Through Promoting More Resilient, Open, and Market-Oriented Financial Systems: Financial sector reform is critical to our goals of leveling the playing field and promoting home-grown, consumption-led growth in China. China's current financial system provides low returns and few choices to consumers, leading them to save too much, and channels cheap financing to state-owned enterprises through large state-owned banks. Financial opening will support more competition and give Chinese households higher income on their savings and better access to a range of financial products so they can meet their financial goals and insure against life's risks.

Developing China's financial markets and promoting consumer financing

- China now has amended its regulations to implement last year's S&ED commitment to allow U.S. and other foreign insurance companies to sell mandatory auto liability insurance in what is the world's largest market for automobiles.
 - China committed that foreign and domestic auto financing companies – currently dependent on China's state-owned banks for funding – will be able to issue bonds regularly, including issuing securitized bonds. This will help boost the competitive edge in China of U.S. auto firms, which are global leaders in auto financing.
 - China committed to increase the total dollar amount that foreigners can invest in China's stock and bond markets under its Qualified Foreign Institutional Investor (QFII) program from \$30 to \$80 billion. This will reduce restrictions on the free flow of capital and increase opportunities for U.S. pension and mutual funds and other investment management firms.
 - China committed to allow foreign investors to take up to 49 percent equity stakes in domestic securities joint ventures, going beyond China's WTO commitment of 33 percent. This provides U.S. investors greater ability to control their operations and protect proprietary technology and know how. China also agreed to shorten the waiting period ("seasoning period") for securities joint ventures to apply to expand into brokerage, fund management, and trading activities that are essential to building competitive securities businesses.
 - China agreed to allow investors from the U.S. and other economies to establish joint venture brokerages to trade commodity and financial futures and hold up to 49 percent of the equity in those joint ventures.
 - China reaffirmed its intention to promote more market-based interest rates. Raising the ceiling on deposit rates also would allow Chinese households to earn a higher return on their savings, supporting greater household consumption. And it would make it more costly to continue exchange rate intervention.
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