



United States Council for International Business

1212 Avenue of the Americas, New York, NY 10036-1689
tel: 212-354-4480 ~ fax: 212-575-0327
e-mail: info@uscib.org ~ Internet: www.uscib.org

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ATA Carnet System

September 6, 2005

Ms. Gloria Blue
Office of the U.S. Trade Representative
1724 F Street, N.W.
Washington, D.C. 20508
FR0437@ustr.eop.gov

RE: China's WTO Obligations

Dear Ms. Blue:

The attached statement is in response to the United States Trade Representative's Federal Register notice of August 3, 2005, soliciting comments on China's compliance with the commitments it made in its accession to the World Trade Organization (WTO). The United States Council for International Business (USCIB) is pleased to offer its comments on this important subject. USCIB represents over 300 U.S. corporations, professional firms, and business associations, many with substantial trade and investment interests in China.

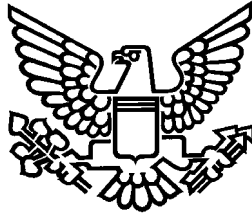
We recognize that this discussion is not exhaustive, and that there may be significant issues that our members have not raised with us for various reasons. Similarly, the differences in length and detail provided in the following statement of specific issues should not suggest that shorter entries are less important than longer entries with more details.

USCIB appreciates this opportunity to express its views on China's WTO obligations. We stand ready to meet with U.S. agencies to discuss our recommendations and concerns at greater length.

Yours truly,

Peter M. Robinson
President
United States Council for International
Business

Clarence T. Kwan
Chairman, China Subcommittee
United States Council for International
Business



STATEMENT
of the
UNITED STATES COUNCIL
FOR INTERNATIONAL BUSINESS

**Submission to the United States Trade Representative (USTR) on
China's Compliance with its World Trade Organization (WTO)
Commitments**

September 6, 2005

UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS
1212 Avenue of the Americas, New York, New York 10036. (212) 354-4480

Executive Summary

USCIB welcomes the opportunity to submit comments on China's compliance with its WTO Commitments. USCIB actively supported the granting of Permanent Normal Trade Relations status to China, and called for its entry into the WTO.

We appreciate the significant efforts China has made to meet its obligations under the terms of its accession agreement. There remain, of course, general compliance concerns. Among the factors cited by our members as affecting their investment decisions are lack of transparency in rulemaking, insufficient notice of proposed or new laws, non-national treatment, and lax enforcement of intellectual property rights.

In our submission to USTR on this subject last year, USCIB members called for the incorporation of transparency and procedural fairness into the anti-dumping process, for transparency in China's implementation of its WTO commitments, particularly with respect to trading and distribution rights, while also requesting the improvement of China's compliance with WTO commitments for customs valuations, particularly for digital products. USCIB members have also called on China to provide national treatment in government procurement, in the insurance industry, and to provide for competition in the postal sector, while also eliminating the discriminatory consumption tax, and market access restrictions in the area of audio visual services. Meaningful progress towards complying with WTO telecommunications commitments in these areas had so far been absent as well.

USCIB appreciates the opportunity to comment for the 2005 submission, and program staff are ready to meet with officials at U.S. agencies to discuss recommendations and concerns at greater length.

Progress Thus Far

We appreciate the resolutions that have been achieved over the last year to previous issues that we have raised regarding China's WTO commitments. We welcome the progress announced on July 11, 2005 at the recent U.S.-China Joint Commission on Commerce and Trade (JCCT) meeting in China that included several commitments on intellectual property right protection, discussed more fully below.

It is noted that China will delay issuing draft regulations on software procurement but failed to withdraw the regulations or to provide insight into areas of potential revision. Also announced was a willingness to accelerate efforts to join the WTO GPA initiative but there was no timeframe for specific actions identified that would achieve the agreed objective. We would like to see concrete plans for implementing that commitment.

On insurance, China agreed to convene another meeting of the U.S.-China Insurance Dialogue before the end of 2005 to discuss regulatory concerns and barriers to further liberalization of the sector. Regarding telecom market access, we are pleased to hear that the Chinese have agreed to a new dialogue under the JCCT Information Technology Working Group to discuss capitalization requirements, resale services and other issues, however, more descriptions of concrete actions plans would have been preferred, but USCIB recognizes the steps that have been taken.

China has made continued progress on extending trading and distribution rights to foreign investors, as mandated in China's WTO accession agreement. In addition to IPR, this was the most commonly cited complaint by USCIB members until new regulations that removed all equity and geographic restrictions on participation in the commercial sector were introduced in April 2004 to start December 11, 2004. There were problems with implementation, as a backlog of applications was created from inaction by the government due to concerns on tax status of applicants. In April 2005, the Ministry of Commerce of the People's Republic of China (MOFCOM) issued additional guidance clarifying that trading and distribution rights would also be extended to existing foreign-invested manufacturing enterprises, including trade in products they did not make themselves, provided these goods were related to their line of business and did not exceed 30% of their revenues. In July, more guidance was issued by MOFCOM and the General Administration of Customs to allow foreign-invested trading firms in China's 15 bonded zones to import and export goods and to engage in trade outside the zone themselves.

USCIB welcomes the progress achieved in extending trading and distribution rights to foreign invested enterprises thus far, but looks forward to movement on direct sales, allowing wholesale and retail trade away from a fixed location, which China decided to cover separately but for which it has yet to promulgate new regulations.

Finally, we are pleased to hear that the Chinese agreed to provide a detailed accounting of its subsidies to the WTO by the end of 2005.

Current Compliance Issues

The positive steps outlined above may be eclipsed by the new issues that continue to emerge with each step forward. For example, a major emerging concern relates to the possible interaction of the draft *Antimonopoly Law* with contemplated regulations on patent issues related to national standards, which may subject companies to compulsory licensing of intellectual property rights, with a resulting diminution of such rights' value. There will be more substantive submissions on this issue in due course.

In the meantime, members of USCIB have raised numerous compliance issues, specific issues which include the following:

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ANTI-DUMPING

USCIB urges the Chinese government to incorporate transparency and procedural fairness into the anti-dumping process. USCIB remains concerned that anti-dumping cases at times are being utilized as means of domestic protectionism. Appropriate opportunities for business to comment and provide input to the government's deliberative process are essential to continue to achieve one of the goals for all members of the WTO, transparency in the regulatory processes affecting trade among members.

Transparency remains a serious issue in anti-dumping cases, particularly as it pertains to the submissions by the Chinese petitioners. Chinese authorities, without disclosing actual data submitted, not even in a summarized form, proceed to accept incorrect and misleading statistics. This is especially true in the injury phase of the anti-dumping procedure.

Chinese custom authorities struggle with proper classification procedures, misclassifying products which results in erroneous conclusions based on inaccurate statistics. This applies to both the dumping and injury phases of anti-dumping cases.

AUDIO VISUAL SERVICES

In the area of audio visual services, China has, per its WTO accession agreement, allowed for minority foreign participation in cinema operations (subsequently revised to allow 75% foreign investment on an experimental basis in selected cities, although recent regulations rolled back this limited liberalization). It has also increased to 20 the number of foreign revenue-sharing films allowed into the market each year, a minimal market opening measure. However, the existence of any such quota, along with the lengthy approval process required for each film, only serves to promote the spread of illegal pirated content, as is discussed in greater detail below.

The publishing industry has also witnessed important regulatory reform, although control over content remains strict. In March 2003, China issued the *Measures on the Administration of Foreign-Invested Distribution Enterprises of Books, Newspapers and Periodicals*, which became effective on May 1, 2003, and which allow wholly foreign-owned enterprises in publication retailing. The Measures also allow all forms of foreign investment in wholesale distribution from December 1, 2004.

Finally, China has published guidelines permitting the injection of private equity into publishing enterprises, previously controlled exclusively by state entities. This liberalization is currently limited to domestic Chinese private investment. It had been hoped that this would be an indicator of a future move to allow foreign investment, but new regulations issued in August 2005 have put any such hopes on hold. China should allow foreign investment in publishing.

Intellectual property rights violations and the limitations on market access for providing legitimate product into the market constitute the greatest impediments to the development of a healthy Chinese media and entertainment industry. The situation has hurt not only foreign businesses, but has also left many areas of the domestic industry in a state of general crisis. Without a proper, functioning market where intellectual property rights are respected and laws

are enforced, investment will remain depressed, content quality will continue to suffer, and the general population will be left to turn to the black market.

According to the Motion Picture Association of America (MPAA), piracy is rampant in China, whose cities have become open markets for illicit DVDs, VCDs, music CDs, and video games. In addition, piracy of broadcast signals and the underlying content incorporated into broadcasts remains rampant in China. Although an inefficient enforcement system and low penalties for violators are significant contributing factors, these problems are partly the result of limits on market access for foreign products that place legitimate supply far below significant existing consumer demand and are compounded by deficiencies in statutory penalties and enforcement of intellectual property protection.

Internet piracy has recently emerged as another major challenge. Online infringers have used the Internet to distribute a wide range of illegal products that violate copyright protections, particularly those for films. Additionally, the MPAA reports that the emergence of China as an export country for pirated DVDS has resulted in thousands of illicit copies of the latest American movies being exported globally.

See “Intellectual Property Rights”, below at page 15, for further discussion of intellectual property rights enforcement.

Without a comprehensive approach to this problem, both domestic and foreign producers of media content will continue to perceive China as an unattractive place to make investments. The commitments given by Premier Wen Jiabao and Vice Premier Wu Yi in meetings in the spring of 2004 and 2005 to take a number of measures to address piracy in China are welcome, but real progress will depend on the successful implementation of these commitments by government agencies and the effectiveness of interagency coordinating mechanisms.

In addition to lax enforcement of intellectual property rights, market access restrictions inhibit the ability of content providers to build a legitimate market and satisfy consumer demand. And although these restrictions affect each sector differently, the situation is most acute in the sound recording, film and TV markets.

Present rules in the music sector prevent the establishment of wholly owned subsidiaries, or even equity joint ventures, for the production, advertising, promotion and distribution of sound recordings. As a consequence, the infrastructure for the production and distribution of legitimate recordings is severely underdeveloped, greatly exacerbating the piracy situation. While USCIB understands that the Chinese Government has concerns about content in the cultural arena, the current investment restrictions do little to secure control over content, and merely serve to allow wholly unregulated sources (the pirate market) to provide access to cultural materials outside of censorship channels. USCIB calls upon the Chinese Government to lift its investment restrictions in this area, allowing US companies to bring their expertise in production, promotion and advertising to the Chinese market, thus expanding opportunities for US and Chinese companies and creators alike.

Film import quotas and the tardy distribution of approved film and video products also serve to create a vacuum being filled by copyright violators. The failure of China to implement its WTO commitments with respect to customs valuation on entertainment products being shipped to

China (basing valuation on subjective criteria of projected revenues or others instead of on the basis of the value of the carrier medium) also increase the costs of getting legitimate product into the country. This has a negative impact on the entire value chain of the industry in China, from importation to distribution to exhibition. While total box office receipts in China have declined by 40 percent since the advent of VCD's and DVD's (from 1996 to 2003 with a slight uptick in 2004), the box office in countries with much smaller populations and numbers of screens is far more valuable on a per capita basis than China's, simply because there are few if any restrictions on the number of films that can be imported.

A number of actions are needed to build a viable market and to improve market access in the entertainment industry. Current investment/establishment restrictions in the music industry should be immediately lifted. The cap on the number of foreign-revenue-sharing films allowed for exhibition in China each year, which is set at a maximum of 20, should be eliminated, given that an unofficial exhibition quota of two Chinese films for each foreign film already exists. China's entertainment market is starved for content and this artificial limit simply drives consumers to the black market to satisfy their desire to see the latest films. In addition, market-distorting policies such as the imposition of "black-out" periods when releases of foreign films are suspended in order to give an artificial advantage to domestically produced films should be eliminated. These policies only further restrict legitimate access for foreign films and the delay in release dates further fuels demand for pirated product. China should also introduce competition into the film import and distribution sector by breaking the state controlled monopoly on imports and duopoly on distribution.

Limits on foreign content in television programming in China (25 percent of total dramatic programming, a de facto ban on foreign content during prime time, and restrictions on the availability of foreign channels) should be eased. Chinese broadcasters are working hard to develop a commercially viable industry free of state subsidies, and existing restrictions deprive broadcasters of access to content with which they could build their business. As China rolls out digital broadcasting and pay-TV channels, there will be a huge increase in the demand for content. Shortsighted policies that limit access to content, handicap the development of the local broadcasting industry. The very slow growth in digital subscriptions is largely a result of a lack of specialized, compelling content.

Censorship clearance procedures for films and optical media should be streamlined. These procedures severely restrict the ability to distribute timely and legitimate film, CD, VCD and DVD products in China, and provide yet another unfair and unnecessary advantage to pirate producers, who are able to bring their products to market long before legitimate film or DVDs are available for viewing or sale. This, combined with restrictive licensing policies on retail outlets, which at present require separate licenses in each jurisdiction rather than providing retail chain stores with a national license, severely inhibits the industry's ability to provide consumers with timely access to legitimate products, an important element in the fight against piracy.

With respect to sound recordings, the current investment regime greatly restricts the ability of foreign record companies to enter the Chinese market, and USCIB requests that the Chinese Government reforms its investment and censorship provisions in the music market to facilitate the growth of a healthy record industry in China. While current regulations permit foreign partners 49% ownership in certain joint ventures (JVs), these JVs do not have the right to publish recordings in China, greatly limiting their vitality and resulting in a number of releases that is

greatly limited compared to other markets around the world. This seriously inhibits the emergence of a prosperous retail environment and promotes the sale of pirated goods.

In addition, every release in China has to go through a complicated and time-consuming censorship process, which often is an operational nightmare. As with film and optical media, it effectively limits the number of releases and it gives a further unintentional advantage to the pirates, who are not subject to this process. As a result, the pirates can come to the marketplace before the legitimate industry can, and offer products that were partly or completely banned for distribution by the censorship authorities. If censorship is to be maintained, it must be made more efficient by, for example, the institution of a film rating system, so that it doesn't impair the marketing of legitimate materials and create unintended advantages for the distribution of pirated materials.

CHEMICALS

The U.S. business of chemistry is a \$516 billion enterprise and a key element of the nation's economy. It is the nation's largest exporter, with \$109 billion in exports in 2004, accounting for more than ten cents out of every dollar in U.S. exports. USCIB recognizes that China is a major growing world producer and market for chemicals and downstream manufacturers. However, we would like to highlight two areas of ongoing concern for the chemicals sector as well as businesses that use chemicals in the manufacture or formulation of their products: intellectual property rights protection and chemicals regulation.

- **Intellectual Property Rights Protection for Chemicals**

Concerns about IPR protection in China fall into three categories. First is the prevalence of IPR violations in China. US-based companies have been subjected to the counterfeiting of their products and the theft of their proprietary data, including not only product formulations but also patented production processes. Second, US companies are concerned about China's lack of efficient and timely IPR enforcement in chemicals. Finally, we are concerned that Chinese national and local regulatory and licensing regimes do not include adequate provisions for IPR and confidential business information protection.

- **Chemical Regulation**

USCIB supports chemical control legislation that protects humans and the environment. We also believe, however that it is critically important to strive for consistency with already-established national chemicals management programs when enacting new laws. Unfortunately, implementing regulations to accompany China's *Provisions on the Environmental Administration of New Chemical Substances*, which entered into force on October 15, 2003, have been either deficient or confounding to US businesses, the result of which has been a negative impact on exports of chemicals and chemical products into China. After nearly two years, US exporters still await meaningful guidance for complying with the Provisions and the resolution of a number of inconsistencies with other similar regulations worldwide.

COMPUTER AND RELATED SERVICES

China's accession protocol to the WTO included commitments to liberalize certain sub-sectors of computer and related services upon accession, namely:

1. Hardware consultancy - full commitments for this subsector;
2. Software implementation - mode 3 requires a joint venture for market access with foreign majority ownership permitted;
3. Data processing - full commitments for this subsector;

USCIB welcomed those commitments. However, there is confusion regarding their implementation. This confusion, which is not unique to China, is due largely to the overlap between the classification of certain sub-sectors of Computer and Related Services and Value-Added Services. In general USCIB believes flexibility on classification is necessary given rapid technological advances. In China, the confusion noted above has resulted in some Internet-delivered Computer and Related Services being defined as Value-added Telecom Services, which are subject to a higher level of control, which could have a negative impact on the growth of the IT industry in China. USCIB members seek full market access and national treatment commitments in both Computer and Related Services and Value-added Services so as to ensure that commitments and classification schemes, such as the GATS, are flexible enough to accommodate technological advances and the evolution in the delivery of services. It is important to note that USCIB does not support revisiting the existing w/120 classifications.

CUSTOMS VALUATION

China made commitments that Customs valuation would be consistent with GATT AD 4.1 for all products within two years of accession. With respect to digital products, in particular, Customs valuation is to be based on the value of carrier medium, and not on another standard. Unfortunately, Customs valuation in China continues to vary by Customs office for the same product, with duties for certain products (such as equipment used for CD and DVD production) being assessed based on arbitrary values for the product, or on its potential output, rather than being valued consistent with GATT AD 4.1 on the carrier medium. In fact, any attempt to assess tariffs based on a valuation, which includes intangible elements, such as intellectual property recorded on hardware or software, or presumptive values which are inconsistent with transaction value, represent a departure from the undertakings of the WTO Valuation Code. USCIB members urge China to set a timetable to bring consistency of implementation of customs practices across its various customs offices. We also believe that China should develop a plan of action and timetable to solve the problems identified in this section.

Several additional concerns about the practices of China Customs on the valuation of digital products include the following:

- China Customs in many localities maintains that the “right to produce” and the “right to use” are synonymous, despite the fact that the WTO Valuation Code states that the “right to use” is a dutiable charge and the “right to produce” is not.

- China Customs is attempting to charge royalties and license fees on imported software even though the WTO Commentaries say that they are not applicable to 4.1.
- China Customs has not adequately defined "condition of sale," leaving the door open to misuse and inconsistent interpretation at the borders.
- China Customs is struggling with inconsistencies between the Decision 4.1 for duty purposes and the requirement to present the customs declaration (with full declared value) in order to remit currency out of the country.
- We have received reports that China Customs is leaning towards excluding pc games from the 4.1 valuation ruling.

DISCRIMINATORY CONSUMPTION TAX

For certain product categories, the Chinese government engages in a taxation practice that reduces the value of that country's tariff concessions and puts imports from the United States at a marked disadvantage vis-à-vis their Chinese competition. The consumption tax calculation for certain imports and their locally produced competitive counterpart differs materially, resulting in importers paying twice as much as they would if the tax were assessed at the same rate as for China-produced products.

GOVERNMENT PROCUREMENT

Since 1996, China has been steadily working to reform its government procurement regime to bring it more strongly in line with global norms in areas such as transparency, fair competition, national treatment, accountability, and Value for Money (VFM). At the same time, when China joined the WTO, it simultaneously became an observer to the WTO's Government Procurement Agreement (GPA) and committed to begin accession negotiations "as soon as possible" thereafter. USCIB members welcome China's announcement at the JCCT meetings in July 2005 that it will accelerate its efforts to join the GPA and will initiate technical consultations with other WTO Members. USCIB welcomes an open, fair, and transparent procurement regime and encourages Chinese officials to see that such rules and practices are put in place at regional and local levels of government as well.

However, China's 2003 *Government Procurement Law* requires that China's government purchase only domestic goods, works and services, with limited exceptions. Although important questions as to the nature and extent of the requirement remain, and basic definitions (for example, "domestically produced") are still unclear, USCIB believes that measures of this kind represent a significant retreat from the progress China has made in the area of government procurement since the mid-1990s, as well as the spirit of openness China embraced when it joined the WTO.

China is presently developing sector specific regulations for software procurement, which could roll back market access for an important market that U.S. and other foreign software makers have enjoyed for some time. While we note that at the JCCT, it was announced that China

would delay issuing draft regulations on software procurement, we remain concerned about the negative precedent that this has set. We are disappointed that China did not agree to withdraw the proposed software purchase regulations, which were clearly contrary to the commitments made when joining the WTO.

At the JCCT meeting China also agreed to ensure that all central, provincial and local government offices are using only legally licensed software by the end of 2005, and will extend that program to enterprises, including state-owned enterprises in 2006. China should be encouraged to budget sufficient software procurement funding to make these commitments meaningful.

USCIB members are also concerned with reports that Chinese officials do not always recall that China agreed that state-owned enterprises would not be treated as government entities for the purpose of government procurement exceptions to national treatment obligations.

We urge USTR and other U.S. government officials to monitor the government procurement situation closely and to engage the Chinese on this issue to ensure transparent, non-discriminatory, merit-based, and technology-neutral market access to China's government procurement market

INSURANCE

USCIB welcomes the announcement from the JCCT meetings in July, that China has agreed to convene another meeting of the U.S.-China Insurance Dialogue by the end of 2005 to discuss regulatory concerns and barriers to further liberalization of the insurance sector.

- **Insurance Industry-Regulatory Dialogue**

We applaud industry and regulatory efforts to establish the U.S.-China Insurance Dialogue on important policy issues affecting the insurance industry in China. The first Dialogue took place in December 2002, and the second took place in April this year, and provided the opportunity for bilateral industry experts to join government and industry representatives for a discussion of a broad range of concerns. We encourage the China Insurance Regulatory Commission (CIRC) to increase the dialogue between Chinese regulators and industry, on the one hand, and U.S. regulators, government officials and industry on the other. While not limited to the following issues, key topics for such dialogue should include clarification on branching rights for non-life insurance companies, national treatment for branching and product approval, and greater transparency throughout the rule-making process. The issue of excessively high capitalization requirements should also be revisited in light of recent regulatory changes.

- **Branch and Sub-branch Licensing and Acquired Rights**

The issues outlined below which all relate to branch and sub-branch licensing and protection of acquired rights are perhaps the most significant issues that foreign insurance companies operating in China presently face.

- *Guaranteed Branching Rights for Non-life Companies*

Prior to China's WTO accession, a number of foreign insurance companies were allowed to establish operations in the PRC. All of these companies were requested by the Chinese government to register as operational branches, not as subsidiaries. However, in both of two new draft regulations (Draft Administrative Regulations and Draft Trial Implementing Rules), the only regulations governing branch operation, the maintenance, development and/or expansion of branch operation does not appear to be addressed., Instead, the CIRC has encouraged branch operations to convert to subsidiary operations.

The guaranteed branch/sub-branch structure (whereby the branch and sub-branch solvency is guaranteed by the total assets of the parent company) is a well-established international norm appropriate for application in China. While subsidiary operations suit some business models well, the branch structure offers advantages to other business models. Unlike a subsidiary company or investments in a joint venture or other host-country insurance company, a branch is one and the same legal entity as the parent. Therefore, in the case of a branch of a foreign insurer, the rights and obligations of the branch are those of the foreign parent, all policies and liabilities of the branch are backed by the full asset base of the parent corporation, and branch operations will have the same credit rating as the parent corporation. For this reason, branch operations need not be capitalized in the same manner as a locally incorporated subsidiary company. The parent corporation is usually required to make deposits in respect of the insurance liability assumed by the branch operation. What is more, contrary to what is often proposed, foreign branch operations are subject to local law for all aspects of their in-country business . Branch operations are not only licensed, registered and required to issue policies in accordance with local law, they also prepare financial statements and are audited in accordance with local law. In addition, they pay taxes to the host government.

Finally, if the host country's insurance supervisor bases prudential ratios on the foreign insurer's total assets, a branch may be less restricted than a subsidiary in supplying scarce and valuable insurance services (e.g., covering large and difficult risks) on a competitive basis in the host country economy.

Several U.S. insurers have indicated their intention to convert branch operations into subsidiary operations, but others would prefer the branching structure. USCIB recommends a flexible approach that would provide a choice of corporate form that would allow insurers to convert to subsidiary companies, create joint-venture enterprises with local partners or to continue and expand operations through a branch/sub-branch structure, whichever best suits their business model. For this reason, USCIB suggests that regulations should be developed to govern existing, future and expanded branch operations in China in accordance with the internationally accepted branch/sub-branch operating structure.

- *National Treatment for Branching*

Foreign companies should receive the same treatment as their domestic counterparts with regard to branch and product approvals. Relevant provisions in the December 12, 2001 *State Council Management Regulations on Foreign-Invested Insurance Companies* and the May 13 2004 *Implementing Measures for Management Regulations on Foreign-Invested Insurance Companies* are silent on how many branch licenses a company may apply for at one time and whether

licenses applied for will be granted consecutively or concurrently. Domestic companies routinely receive branch approvals on a concurrent basis, even when first establishing their businesses in China. In contrast, no foreign insurance company has received branch approvals on a concurrent basis. This practice is discriminatory and inconsistent with China's WTO national treatment obligations. It greatly disadvantages foreign companies' ability to develop their business, establish a nationwide network of branches and sub-branches, and build other distribution networks throughout China. Ultimately, it denies the Chinese consumer access to a broad range of products.

Access to provincial cities, prefectures and municipalities is essential to foreign insurers operating in China if they are to fairly compete with domestic companies. Existing regulations do not stipulate whether CIRC's approval to establish a branch operation will be sufficient to operate throughout a province. What is more, as mentioned in the preceding paragraph, it is unclear whether multiple branch licenses may be applied for and approved on a concurrent basis.

- *Capitalization Requirements*

The most notable, positive change in the recently released regulations has been a substantial lowering of capitalization requirements for initial establishment (minimum of RMB200 million up to RMB500 million; previously RMB200 million up to RMB 1.5 billion) and branching (RMB 20 million; previously RMB 50 million), putting them closer to international norms for some products and business models. Although still considered too high by many, the industry appreciates the CIRC's engagement on this issue as well as consideration of research on international best practices.

Nevertheless, we maintain that an initial requirement of RMB200 million, and RMB20 million for each additional branch up to a cap of RMB500 million (providing all solvency issues have been addressed in any subsequent efforts to expand), are too prescriptive in nature and still much higher than international norms for many lines of business. In fact, according to a study presented to the CIRC in 2003, the capitalization requirements for insurance operations in China – even under the new rules - appear excessive in relation to 11 Asian jurisdictions, the United States, and the European Union. Excessive reserve, deposit and capital requirements are not an efficient way of ensuring financial solvency and disproportionately impact new foreign and domestic investment, which could hinder the sound development of China's insurance market. The USCIB understands that China is considering adopting a risk based capital model. This is an excellent model, but the USCIB suggests that a comprehensive risk management scheme encouraging sound business management and prudential practice is the best assurance of solvency.

- **Group Insurance Business**

The phase-in period for China's WTO commitments with respect to group life, pension/annuity and health insurance ended in December 2004.

Group Life Coverage: A top issue is the publication of guidelines which will address group life insurance coverage, specifically what geographic area is covered by a master-contract.

It appears that domestic and foreign insurers who wish to write group life insurance may only issue master contracts to companies who have a “substantial presence” or are headquartered in the jurisdiction for which the insurer holds a group license. USCIB recommends that China consider following the international model that would permit any insurer with a group license to provide coverage to a principal policyholder under a master contract and to members of the group represented by the principal policyholder, wherever the principal policyholder or its group members may be located in China.

Supplementary Pensions: A first important step toward clarifying China’s supplementary pension system was taken when The Enterprise Annuity Regulations were issued in May 2004. Supplementary pensions play a very important role in any economy as they provide additional, employer-sponsored retirement income at no expense to the government. For this reason, USCIB favors private supplemental pension schemes and recommends that the Chinese government issue further regulations to explain how private pension schemes are to be established. USCIB would further recommend that fee caps be eliminated in favor of a market-driven approach and that tax incentives be provided to promote the purchase of supplementary pensions.

- **Transparency for the Insurance Industry**

Improving performance in this area is critical as new sets of regulations are released including provisions that will put many new entrants at a competitive disadvantage in the marketplace. One case in point is the recent issue of regulations that would permit companies who have been licensed for more than eight years to invest in a much broader range of assets than those licensed since China joined the WTO. This rule places new entrants, especially new foreign investment companies, at a competitive disadvantage. It appears to have no prudential base and to be inconsistent with China's national treatment obligations. A second case in point is China’s omission in early 2005 to solicit industry comment on a variety of regulations covering administration of insurance agencies, asset management, stock investment transactions, and investment in subordinated bonds. The USCIB does note however, that China invited insurers to comment on revisions to the Insurance Law in December 2004. Insurers responded positively and provided comments. To date no feedback from CIRC has been received.

USCIB urges CIRC and the Chinese government to make every possible effort to engage the industry in the legislative making process on a routine basis.

INTELLECTUAL PROPERTY RIGHTS

Since acceding to the WTO and taking on obligations in the area of intellectual property rights (IPR) protection, China has made some limited progress in combating copyright piracy and trademark counterfeiting, especially through legislation. However, despite these improvements, piracy and counterfeiting at the wholesale and retail level, and over the Internet, remain rampant due to inadequate penalties, uncoordinated enforcement among local, provincial and national authorities, and the lack of transparency in China’s administrative and criminal enforcement system. The patent law has also improved significantly over the past few years, but much work remains concerning implementation. Work is also needed to enhance cross-border cooperation

between Chinese enforcement agencies and their non-Chinese counterparts, as well as between the private and public sectors, including through greater voluntary information sharing. Moreover, right-holders would benefit by having access to large-scale infringers' banking information, to enable tracing of money flows for purposes of identifying laundered funds.

USCIB believes that the new IP laws and regulations issued recently are generally positive developments. These include the *Rules on the Determination and Protection of Well-Known Trademarks*, *Measures on the Implementation of the Madrid Agreement on Trademark International Registration*, *Measures on the Registration and Administration of Collective Trademarks and Certification Marks*, *Measures on the Implementation of Administrative Penalties in Copyright cases*, and *Regulations on the Customs Protection of IPR*. If implemented effectively, these measures will benefit the development of China's own IP dependent industries, not just those of its foreign trading partners.

USCIB also notes that at the Joint Commission on Commerce and Trade (JCCT) meetings in the spring of 2005, China made many commitments intended to address U.S. concerns with respect to IPR including: increasing criminal prosecution, reducing exports of infringing goods, improving national police coordination, enhancing cooperation between law enforcement authorities, expanding an initiative to address piracy of movies and audio-visual products, ensuring use of legal software in the state-owned sector, fighting software end-user piracy, establishing a Chinese embassy IPR ombudsman, ridding trade fairs of fake goods, promising to take steps to join global internet treaties in 2006, and clarifying the judicial interpretation regarding criteria for criminalization of IPR infringements issued at the end of 2004. While USCIB welcomed the issuance of the judicial interpretation as promised at the 2004 JCCT meetings, it does not uniformly resolve concerns regarding both substance and procedure, as explained more fully below. We urge USTR and other U.S. government officials to stay closely engaged with the Chinese government to ensure timely action on these important commitments.

- **Copyright Concerns**

Pirated optical media products, CD, VCD and DVD, and counterfeit goods continue to be a major problem, and the piracy rate for optical media products and business software is well in excess of 90 percent. While recent copyright law amendments and regulations made significant progress toward bringing Chinese law into statutory compliance with TRIPS, the law remains deficient in several important respects, including wholly inadequate criminal liability for copyright offenses and overly broad exceptions to protection for computer software, and enforcement in line with international standards is sorely lacking.

Moreover, in newspaper and magazine publishing, copyright (and trademark) protection remains lax. Content is still regularly pilfered from competing sources with impunity, making it both impractical and unprofitable for publications to invest in high-quality research and editorial content. This, in turn, yields many virtually identical publications, thereby depriving consumers of meaningful choice.

There is a great need for better coordination between agencies, as well as better coordination between administrative and criminal measures. There have been some successes in bringing civil actions, but deterrent sentencing in criminal courts continues to be ineffective. China's

criminal law has rarely been used to prosecute piracy because of the high thresholds for criminal liability established by the People's Supreme Court in its interpretations of the criminal copyright provisions, but USCIB notes that China promulgated a new judicial interpretation on Dec. 21 that lowered the criminal thresholds for IPR offense punishments. For example, if an individual brings in a minimum of RMB30,000 (USD3,600) in illegal gains [down from RMB50,000] or RMB50,000 (USD6,024) in illegal business volume [down from RMB200,000] from infringing on copyrighted works or reproduces more than 1,000 illegal copies, the individual is eligible for a prison term of no more than three years, while reproduction of more than 5,000 copies calls for a mandatory three-year minimum prison term. However, such thresholds still place a heavy burden on enforcers and, in a seeming oversight; sound recordings are not included in reproduction thresholds. Moreover, illegal business volume is calculated using the price of the infringing work instead of the price of the genuine work. It is unclear how to prosecute repeat offenders and how the thresholds apply to online piracy. Even with the lowering of the criminal thresholds, effective enforcement will not become a reality if there is inadequate attention, investment and training by the Public Security Bureaus (PSB). The PSB needs to treat criminal enforcement of IPR offenses as a top priority. Enforcement remains slow, cumbersome and rarely results in deterrent fines. Although Chinese authorities have undertaken some administrative enforcement actions against pirates, the government's refusal to share information about the activities of CD plants or the ultimate outcomes of these actions makes it very difficult for rightholders to assess the deterrent impact of China's enforcement efforts.

With respect to software, the Copyright Administration (CA) has administrative authority to do surprise audits of companies suspected of using illegal software, but CA offices are reluctant to exercise their authority and are plagued by inadequate manpower, training and resources. Moreover, when they do take action, most of the CA offices have been unwilling to issue a formal punishment with deterrent penalties. In the case of civil enforcement, courts are also reluctant to issue decisions in corporate end user infringement cases, instead urging the parties to settle. Civil enforcement is also far from predictable, due to an uncertain evidentiary standard to support an evidence preservation order. To date, there have been very few instances of an evidence preservation order executed against a corporate end user. Finally, organizational end user piracy should be clarified as a criminal offense to allow for prosecutions against software piracy on a commercial scale and penalties must be high enough to actually deter further infringement.

China urgently needs to update its *Copyright Law* by speeding up the drafting process of the Internet regulations by the State Council to bring China in adherence with the WIPO Internet treaties in order to effectively deal with online piracy and create a safe online environment for electronic commerce. With respect to online piracy, there need to be express limitations on liability protecting ISPs, including for network conduit functions, caching, hosting, storage and information location tools, consistent with the *Digital Millennium Copyright Act* of 1998. The manufacture and trade in circumvention devices, components, and service should be expressly prohibited and there should be effective remedies and adequate legal protection against unlawful circumvention of "copy controls" and "access controls." In updating its *Copyright Law*, China also needs to ensure that any clarification or addition of exceptions or limitations to the rights of authors and copyright owners comply with the so-called three-step-test set forth in Article 13 of TRIPS.

- **Trademark and Counterfeiting Concerns**

For branded products, trademark protection is crucial to maintaining high-quality goods and services in order to build and strengthen customer loyalty. Counterfeiting damages the reputation of companies; compromises the safety and quality of products (which affects Chinese as well as foreign consumers); results in the loss of tax revenue to the government; and harms China's reputation among foreign companies as a desirable place to do business.

Another challenge faced by major U.S. brand holders is that China only very rarely grants "Well Known" or "Famous Mark" status under Article 6bis of the *Paris Convention to non-Chinese trademarks/brands*. (This article provides that contracting countries agree to refuse or invalidate a trademark that creates confusion with a mark considered by the competent authority of the country of registration to be well known as a mark of a national of another contracting country.)

While USCIB welcomed the issuance in December 2004 of the promised judicial interpretation, the interpretation does not resolve all, and in some cases even introduces new, areas of concern, including: lack of clarity regarding valuation of seized goods and liability of accomplices; failure to define adequately key concepts; removal of provisions allowing for criminal prosecution based on repeated administrative offenses; use of numerical thresholds for criminal liability; and differing thresholds for liability of individuals and enterprises.

While recent implementing rules on bond requirements mark an improvement in transparency regarding bond amounts, IP owners may be required to file for an IP seizure in order for the published calculation methods to apply. In the context of storage costs, recent implementing rules still provide for U.S. corporations to be assessed fees for the storage and disposal of seized goods.

- *Seized Storage Costs*

U.S. corporations are unexpectedly assessed fees for the storage of seized counterfeit goods. As with the bond amounts, there are no clear guidelines on the circumstances under which such fees will be assessed, no prior arrangement for such assessments, and no indication of when payment of such fees will be required. The imposition of uncertain storage fees without prior notice or advance agreement undermines the ability of U.S. business to address the Chinese domestic market effectively. Uniform requirements in a clear, published form, are essential.

- **Patent Concerns**

Although China has put into place a legal and regulatory framework that is substantially in compliance with TRIPS, implementation of those regulations is inadequate. Local public officials evince a stronger interest in protecting their local economy than in policing IPRs and have been known to act uncooperatively in patent infringement suits. Moreover, attempts to enforce patent rights through patent administrative departments are largely ineffective because the administrative agencies only have the power to stop infringements in their local territories and because they act slowly, cannot collect damages and suffer from a lack of transparency. Enforcement actions through the court system are generally more effective, but damages are not calculated in such a way as to compensate all the actual expenses of a rightholder in stopping

infringing acts. Procedures for evidence exchange where trade secrets are alleged are not fully defined, and courts have referred matters to appraisal panels without input from parties involved, despite the clear TRIPS mandate that parties are entitled to see any evidence used to determine their rights. A 2003 Chinese Supreme Court case overturning a high court decision related to an appraisal conclusion based on evidence withheld from the opposing party and holding that parties must have an opportunity to review and challenge relevant underlying evidence, however, may herald improvements in this regard.

Further, while patent infringement is decided through the judicial process, patent validity is decided at the Patent Reexamination Board (PRB) of the State Intellectual Property Office (SIPO). While many countries separate the infringement and validity determinations in a similar way, the PRB has accepted challenges to validity based on arguments already decided during the original patent examination process, and has permitted multiple, simultaneous challenges by the same party, making enforcement and defense of valid patent rights difficult. Moreover, the PRB has improperly generated and applied its own patentability standards that are more restrictive than those in the Chinese Patent Law and Implementing Regulations.

USCIB member Pfizer Inc. has recently had its patent on the use of the active ingredient in Viagra invalidated in China. The decision appears to create and impose standards of patentability that are inconsistent with TRIPS Article 29.1. Moreover, this raises concerns that limiting patentability in such a way subsequent to WTO entry is violative of TRIPS Article 70.2.

The use of the patent system to thwart originator-proprietary companies is also troubling. Some companies, including USCIB member Baxter Healthcare, have faced the situation where a local manufacturer has obtained patents on a foreign company's commercial products in addition to knocking off the product. This has caused the originator-proprietary company to expend time and money to invalidate the pirate's patents. A great deal of effort is required by the administrative agency to prove beyond reasonable scope the invalidity of the patent.

As for design patents, some infringers obtain a design patent registration based on a copied product designed by utilizing the non-substantive examination system in China, and insist the legality of their infringing conduct based on the invalid design patent right, notwithstanding the existing procedures available to invalidate such design patents. In regulated product areas such as pharmaceuticals, there is no linkage between the regulatory agency and the enforcement of patents. Thus, the State Food and Drug Agency approves generic versions of patented medicines without regard to the patent protection that covers the product.

Moreover, the judicial enforcement system lacks transparency. All courts should follow the same rules and guidelines, and decisions should be published so that companies can learn how the rules and guidelines are implemented.

In addition to enforcement concerns, foreign companies face impediments to technology licensing. The *Regulations on Technology Import and Export Regulation* of January 1, 2002 define the procedures for technology licensing contracts between a Chinese company and a foreign company. There have been many criticisms, however, that these regulations impose unfair burdens on foreign licensors, requiring them to make excessive warranties.

Finally, USCIB members are tracking with concern the development of the draft *Provisions for Patent Issues Relating to National Standards* and the draft *Antimonopoly Law*, which could interact so as to pave the way for the compulsory licensing of technologies required for compliance with a national standard, in contravention of TRIPS limits on compulsory licensing. Additionally, concerns have been raised about the divergence from international competition principles of certain provisions of the *Antimonopoly Law*. The two drafts could be finalized as early as fall 2005, with final adoption in early 2006. We urge USTR and other U.S. officials to keep abreast of these developments and work with the Chinese government to ensure compliance with TRIPS and convergence with international competition principles.

- **Trade Secrets and Protection of Confidential Test Data**

Enforcement of trade secrets is very difficult because the evidentiary burden is very high, ability for discovery is minimal and local protectionism can be a serious obstacle. Foreign companies are often reluctant to transfer key trade secrets into China because of the serious threat of misappropriation by competitors and employees and the near impossibility of enforcement. The legal infrastructure for the enforcement of trade secrets (including breaches of contracts including confidentiality provisions) needs to be significantly strengthened. This would include requiring that Chinese government agencies and affiliated institutions establish protocols for protection of trade secrets and confidential test data submitted to them and that these protocols are recorded in writing and made publicly available. In addition, although China's State Drug Administration issued regulations to implement China's commitment to provide six years of data exclusivity pursuant to TRIPS Article 39.3, protection of such data provided to the government from 'unfair commercial use' is inconsistent.

POSTAL LAW

The most recent draft of China's proposed new *Postal Law* (July 2004) is more restrictive than previous drafts and would discourage competition in express delivery services. Although the Chinese government has adopted some recommendations from the express industry, the draft would add new licensing requirements, impose a new tax on express firms to support postal services, and expand the scope of the postal monopoly. Parts of the draft explicitly discriminate against foreign enterprises and would likely be in violation of the WTO's fundamental principle of national treatment.

USCIB urges USTR and other U.S. government officials to monitor this situation to ensure that any changes in the Postal Law are consistent with China's WTO commitments, including the horizontal commitments under GATS. The creation of a new monopoly, a new tax in the form of the universal service fund, and a new licensing requirement are all potential WTO violations.

USCIB also supports that China establish a regulatory authority for the Post so that there is a complete and transparent separation between the postal regulatory authority, the national postal operator, and other government authorities. The postal regulator must have jurisdiction only over the universal service obligation provided by the universal postal service provider. The general transportation and express industries, both domestic and international, should remain outside the authority of the postal regulator.

TRANSPARENCY AND NOTICE

There are positive signs that China is improving the transparency of the lawmaking process and related activities that affect USCIB members. For example, the Party's and State Council's General Offices issued *Opinions on Further Promoting the Transparency of Government Affairs* in March 2005. These Opinions require that government organizations at all levels expand the scope of transparency of their decision making processes. The Opinions specify that government organization transparency efforts should be focused on key project approvals, government procurement, mineral resource development, land use, and the development of permitting requirements/procedures. Further, the State Environmental Protection Administration (SEPA) promulgated Procedures and Methods on the Promulgation of Environmental Regulations in April 2005. The Procedures and Methods provide, among other things, that SEPA should seek public comment on proposed laws and notify the WTO concerning SEPA laws that may affect foreign investment and trade.

Despite these policy and regulatory developments, however, there is still not sufficient transparency with respect to China's implementation of its commitments. It is apparent that there is still significant work that must be done to put the policy and law commitments into practice in China and to ensure consistency in practice among various agencies on transparency and related issues. This lack of transparency is despite the fact that enquiry points have been established as required by the Protocol and Working Party Report. For example, MOFCOM continues to wage battles internally with other ministries as to the interpretations of China's commitments and the necessary implementation requirements. China needs, therefore, to ensure that MOFCOM or another State Council unit is given authority to make a final interpretation of WTO commitments and to ensure implementation consistent with this interpretation among China's myriad law-making entities.

China also agreed to allow for a reasonable period for public comment on most categories of new and revised laws and regulations relating to foreign trade and to regularly publish such measures in one or more of the WTO languages. This commitment strongly reflects the fact that transparency is a crucial element to creating a stable and predictable environment for foreign investment. Yet U.S. firms continue to be blindsided by new measures without notice and prior to any meaningful consultation with those most affected. In certain instances, Chinese agencies and ministries seem to view their obligations to comply in the most nominal of terms, allowing a hasty and poorly publicized comment period to go forward shortly before new rules are announced and go into effect. This situation is exacerbated by deficiencies in Chinese-agency capacity to support robust notice and comment practices. Experience elsewhere has shown that allowing for an adequate public comment period prior to final decisions on regulation tends to lead to better a regulatory framework and enforcement. If the views of business and other interests are solicited and taken into consideration during the drafting process, and if the Chinese government provides its agencies with the staffing and training to support this process, fewer problems will occur during implementation and the overall level of compliance will improve.

In China, it normally takes 1-2 years or more for an agency to promulgate a new regulation. USCIB applauds the fact that many Chinese agencies are providing opportunities for USCIB members to comment on proposed rules. Nonetheless, such opportunities are brief, are sometimes offered only by invitation, are often provided at only the early stages of the rulemaking process, and rarely involve agency feedback on submitted comments. Chinese

rulemaking agencies generally do not provide USCIB members with notification of a final draft rule before promulgation.

For instance, since the National Development and Reform Commission (NDRC) commenced drafting of the Management Regulations on Recycling and Disposal of Waste and Used Household Electronic Products in early 2004, the regulated community was provided with only two official opportunities to view and comment on the draft law. NDRC commenced the first comment period in late September 2004. This comment process was notified to the public via the NDRC web site. In December 2004, the State Council Legislative Office provided certain invitees with opportunity to comment on the second draft. The comment periods lasted roughly one month and it remains uncertain whether and how USCIB member comments on this law were incorporated into the draft. The State Council is still considering the draft law, which may be promulgated by the end of this year.

Common problems encountered in China stemming from the lack of transparency in rulemaking are illustrated by several examples attached as Annex 1 to this document.

TELECOMMUNICATIONS (BASIC AND VALUE-ADDED)

USCIB members welcomed China's commitments on basic and value-added telecommunications. Our members have identified several issues regarding China's compliance with its commitments. Please see the attached Annex 2 for more details.

CONCLUSION

We appreciate the opportunity to express our concerns about China's WTO obligations and trust they will be useful in the Administration's on-going efforts to encourage China's compliance. USCIB stands ready to meet with U.S. agencies to discuss our recommendations and concerns at greater length.

ANNEX 1: TRANSPARENCY IN RULEMAKING

Common problems encountered by USCIB members in China stemming from the lack of transparency in rulemaking are illustrated by the following examples from the area of environmental regulation.

1. Rulemaking practices in China still favor the use of government agency-approved academic and technical experts who are often unable to impart into the rulemaking process the full range of industry experience relevant to a particular issue. Thus, many rules present very challenging compliance situations to foreign investors.

- Example: China Compulsory Certification (CCC) product quality marking regime. Exemptions from the marking requirements are available for certain products. However, in many cases, companies must apply for these exemptions and the exemptions must be renewed *each* month.

2. Insufficient industry input into the rulemaking process also facilitates the creation of product standards that are based on Chinese or other national models. Two problems result; i.) Chinese industry is not designing for an international market and may eventually find itself hampered when it desires to find purchasers outside China, and ii.) the resulting standard may prohibit from import products that do not conform to these models.

- Example: The use of Chinese food products as the models for chemical content in certain standards included in the *Circular on Seeking Comments on the Hygiene Standard for Raw Milk*, [and other standards in a total of] *90 National Standards* (MOH) (pending).

3) Lacking insight into the realities of business, Chinese rulemakers often develop regulatory requirements that are aspirational in nature. This approach can serve as a barrier to compliance, especially for companies with U.S. and EU-type compliance cultures.

- Example: The *Regulation on Mercury Content Limitation for Batteries* (promulgated Dec. 31, 1997) sets 1 ppm mercury content restriction for certain battery chemistries. Chinese law drafters involved in the development of this Regulation indicated that one of their key goals in setting the very low mercury-content restriction was to spur local industry to reduce battery mercury content. However, the 1 ppm limit actually requires manufacturers to reduce the limit of mercury in batteries subject to the rule *below natural background levels*.

4) Often, a significant period of time passes before key implementing measures and documents are issued that enable compliance with a particular Chinese law.

- Example: October 18, 2002, the State Economic and Trade Commission (SETC) (now disbanded) issued *Regulations on the Registration of Dangerous Chemicals*, *Regulations on Licensing for Business and Sale of Dangerous Chemicals*, and *Regulations on the Manufacturing of Packaging and Containers for Dangerous Chemicals*. These regulations

entered into effect November 15, 2002. However, the implementing rules for these laws were not released until November 21, 2002, and the associated registration/license application forms were not published until January 2003.

ANNEX 2: TELECOMMUNICATIONS

China has made no meaningful progress towards complying with its WTO telecommunications commitments in the past year, so many of our comments will of necessity be repetitive. There are reports that a long-awaited Telecom Law is making its way through the Chinese bureaucracy, and that provides a modicum of hope that China may take such steps as overhauling its licensing regime and establishing an independent telecom regulator. Offsetting this apparent development, there has been regression in other areas such as the regulation of value-added services. In most other liberalizing countries, the concept of value added services was introduced as a way to open up the telecom market to competition. By contrast, China has become more conservative with the concept of basic versus value added services since WTO accession, shuffling some very important value-added services into the highly protected basic category. It would be an improvement if the pending law were to replace these conservatively applied vertical service classifications with more objective and transparent guidelines for Type I (facility-based) and Type II (non-facility based) services. China has the opportunity to demonstrate its commitment to both liberalization and to transparency by making the draft law available for public comment well in advance of adoption. Further, China should seize this opportunity to grant equivalent national treatment to both domestic and foreign investors, boldly taking advantage of the gains that an open telecom market can bring to the economy as a whole.

China's WTO commitments to liberalize telecommunications services became effective upon its accession to the WTO on December 11, 2001. These commitments include a six-year schedule for phasing in direct foreign participation in value-added network services and basic telecommunications. China also agreed to be bound by the obligations in the Reference Paper to establish an independent, impartial regulatory authority and a pro-competitive regulatory regime. USCIB recognizes and appreciates the positive steps China has taken to implement its WTO commitments. However, China's overly narrow interpretation of market access opportunities for foreign participants and a lack of an independent regulator have negatively impacted market opportunities for U.S. telecommunications companies, contrary to China's WTO commitments. We are especially concerned by China's unreasonably high capitalization requirements for basic services, and the prohibition on resale which greatly limit market access.

High Capitalization Requirements: In 2003, China's regulator, the Ministry of Information Industries (MII), reclassified several international value-added services as basic services. This action had the undesirable effect of delaying until December of 2004 the ability of foreign entrants to offer these services, thus subjecting any would-be entrant to the excessively high capitalization requirements placed on new basic services providers. This reclassification has had an unwelcome market constraining effect. A basic services license, when available for application by foreign invested joint ventures in late 2004, will be subject to a 2 billion RMB (US\$250 million) capitalization requirement, or 100 times the capital requirement for value added service licensees. USCIB considers the existing capitalization requirement in basic services an excessively burdensome and unjustified restriction that violates Article VI of the GATS. The requirement was effected by State Council Order No. 333 of December 11, 2001, the day of China's accession to the WTO, and "could not reasonably have been expected" when China made its commitments, as stipulated by Article VI 5 (a)(ii). A narrowly tailored performance bond would be sufficient to address any existing concerns. In addition, the

approval process for equity joint ventures is cumbersome and lengthy: four separate government authorities are required to approve such ventures pursuant to a long and complicated process.

Market Access: Presently, market entry is being delayed by the MII's extremely narrow views of what constitutes a value-added service for purposes of international value added network service licensing. The regulator has construed the meaning of value-added services in its WTO commitment schedule so narrowly that any meaningful offerings, such as IP-VPN services demanded by global enterprises, are excluded. The Catalogue of Telecommunication Services defines basic and value-added services in a manner that discourages and severely limits new providers from entering China's telecommunications market. The narrowing of the scope for value added services represents a counter-liberalization trend inconsistent with China's WTO commitments. For example, it limits virtual private networks to "domestic" services, and deletes "resale" services.

Most markets around the world including many with the Asia Pacific region have fully liberalized their VAS markets – along Type 1 (facilities-based) and Type 2 (service-based resale) classifications – and permit 100% foreign ownership of VAS enterprises. This approach would have the positive effects as outlined in the document tabled by the United States and other WTO member countries on the benefits of telecommunications liberalization. (Document TN/S/W/50) We urge USTR to encourage China to take the following steps to remove the bottlenecks to development of value added services in China:

- Expand the list of value-added services in the Catalogue to include such services as managed, IP VPN, in conformity with the international norm; and,
- Lift the prohibition on resale enabling incumbent carriers, as well as new entrants, to acquire capacity at wholesale rates and interconnect their networks to deliver services to a broader reach of the country.

Independent and Impartial Regulator: China is far from achieving its Reference Paper Section 5 commitment to establish an independent regulator. The Chinese Government owns and controls all of the major operators in the telecommunications industry, and the MII still occupies dual roles as protector of state enterprise operators and as industry regulator. The pending Telecom Law could improve this situation by mandating a regulatory body that is organizationally separate from government agencies that are focused on developing the state-owned telecommunications industry. Because this new law has been pending for a long time, finalizing and adopting it should be a top priority for the government. Interested parties must also be provided a reasonable period for review and comment on the Ministry's regulations and decisions as required by China's accession documents. Virtually no notice was given, and no comments invited, before the revised Telecom Catalog went into effect last year.

USCIB encourages USTR and others in the U.S. Government to place a high priority on working with China to establish a regulatory body that is separate from, and not accountable to, any basic telecoms supplier, and that is capable of issuing impartial decisions and regulations affecting the telecoms sector. In this context, it is important that the regulatory body adopts the following:

- transparent processes for drafting, finalizing, implementing and applying telecom regulations and decisions;
- appropriate measures, consistent with the Reference Paper, for the purpose of preventing major suppliers from engaging in or continuing anti-competitive practices;
- a defined procedure – as it has done for interconnection -- to resolve commercial disputes in an efficient and fair manner between public telecom suppliers that are not able to reach mutually acceptable agreements;
- an independent and objective process for administrative reconsideration of its decisions; and
- appropriate procedures and authority to enforce China's WTO telecom commitments, such as the ability to impose fines, order injunctive relief, and modify, suspend, or revoke a license.

At present the regulatory environment in China is discouraging new entrants from participating. This will continue until foreign investors have confidence that China has a clear intention and a demonstrated plan to implement its WTO commitments.

Geographic Restrictions: Notwithstanding the business model of the Internet, MII has at times suggested that a commercial presence must be established in each city where customers will be located, and that an inter-regional service, based in one city but serving customers in another, is not permitted. Such an interpretation is inconsistent with the global model of how value-added, non-facilities based Internet service providers are structured, and imposes geographical restrictions that make an inter-regional, or national scaled business model non-viable. The impact of this interpretation is to negate the benefits accorded to foreign value-added telecommunications providers under the WTO agreement. This interpretation, if implemented will also greatly impact the cost to local Chinese businesses adding an unnecessary burden to them as they wish to become more robust and increase their participation in a broader geographic market.